

Irish Loan Origination Investment Funds

Ireland was the first European Union (“EU”) member state to introduce a specific regulatory framework for loan originating investment funds. Matheson advised on the establishment of one of the first loan originating qualifying alternative investment funds (“L-QIAIFs”) in Ireland. Following the conclusion of a public consultation process, in 2014 the Central Bank of Ireland (“Central Bank”) published its requirements for L-QIAIFs in its AIF Rulebook, allowing L-QIAIFs with an authorised alternative investment fund manager (“AIFM”) to be authorised by the Central Bank and marketed throughout the EU pursuant to the Alternative Investment Fund Managers Directive (“AIFMD”). This briefing note sets out the key features of L-QIAIFs.

Key Features of L-QIAIFs

The Central Bank’s AIF Rulebook sets out a number of requirements applicable to L-QIAIFs over and above the general requirements imposed on all L-QIAIFs. The additional requirements are principally designed to combat the regulatory and systemic risks which the Central Bank considers to be associated with loan originating investment funds.

Authorised AIFM

An L-QIAIF must have an authorised AIFM in order to avail of the AIFMD marketing passport. The Central Bank will not authorise an L-QIAIF with a registered AIFM that is, an AIFM managing AIFs with assets under management below the thresholds specified in the AIFMD (under €100 million or €500 million where the AIFM does not use leverage and have a five year lock-in period for their investors) that has not opted into the full AIFMD regime.

The L-QIAIF may itself be the AIFM (in effect, a self-managed fund) and delegate functions such as portfolio management to third parties, including non-EU entities. In this scenario, the self-managed L-QIAIF would be able to avail of the AIFMD passport.

Closed-ended

An L-QIAIF must be closed-ended. This requirement is designed to mitigate many of the financial stability risks considered to be associated with loan originating investment funds (including mismatches between the maturity or liquidity of assets and liabilities).

Despite being closed-ended, an L-QIAIF may invite requests for redemption of holdings from unitholders either at dates determined at the authorisation date, or at dates approved by the AIFM. However, redemptions may only be made with the approval of unitholders unless the assets of the L-QIAIF are valued by reference to prevailing market prices.

Permitted Activities

An L-QIAIF may engage in loan origination and participation in loans and lending. Enhancements introduced by the Central Bank in January 2017 permitted L-QIAIFs to invest 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*”. In a welcome development, on 7 February 2018, the Central Bank announced that it intended to further amend the requirements for L-QIAIFs by permitting the investment in debt or credit instruments. This change will come into effect from **7 March 2018** when the Central Bank will publish a revised AIF Rulebook.

Eligible Borrowers

An L-QIAIF is restricted as regards the persons to whom it may originate loans and, in particular may not originate loans to:

- natural persons;

- the AIFM, management company, general partner (if applicable), its depositary, or to delegates or group companies of these;
- other investment funds;
- financial institutions unless there is a bona fide treasury management purpose which is ancillary to the L-QIAIF's primary objective; or
- persons intending to invest in equities or other traded investments or commodities.

Diversification

Diversification requirements are principally designed to reduce investor risk within the L-QIAIF. It is the Central Bank's view that diversification requirements are particularly important in the context of L-QIAIFs, which are likely to have an inherent tendency for sectoral concentration and large exposures.

An L-QIAIF must set out a risk diversification strategy in its prospectus that achieves a portfolio of loans which is diversified and that will limit exposure to any one issuer or group to 25% of net assets within a specified time limit. The AIF Rulebook imposes a number of requirements which apply if the diversification strategy is breached.

Leverage

An L-QIAIF must not have gross assets of more than 200% of net asset value and this leverage limit must be managed to ensure compliance in changing market circumstances.

Credit Granting, Monitoring and Management

L-QIAIFs must establish and implement documented and regularly updated procedures, policies and processes in respect of a number of credit granting, monitoring and management activities, including:

- a risk appetite statement;
- assessment, pricing and granting of credit;
- credit monitoring, renewal and refinancing;
- collateral management;
- concentration risk management;
- valuation, including collateral valuation and impairment;
- credit monitoring;
- identification of problem debt management; and
- forbearance.

Stress Testing

An L-QIAIF is required to maintain a comprehensive stress testing programme to identify possible events or future changes in economic conditions that could have unfavourable effects on the L-QIAIF's credit exposure. The programme must: (i) provide for at least monthly exposure stress testing of the principal market risk factors; and (ii) apply at least quarterly multifactor stress testing scenarios.

Due Diligence by Investors

Where the L-QIAIF's AIFM intends to provide access to its records / staff to any investor for the purposes of a due diligence process, it must ensure that such access has been made available on a non-discriminatory basis to all unitholders.

Disclosure to Investors

Certain information must be included in the L-QIAIF's prospectus including information on the risk and reward profile, information on the concentration levels as regards individual entities, geographical location and sectors as well as the risks arising from the proposed concentration. The prospectus must also include details of the credit assessment monitoring process and information on whether the L-QIAIF's AIFM will provide unitholders with access to records and staff for the purpose of due diligence.

Conclusion

The Irish regulatory framework for L-QIAIFs provides an important opportunity for European funds to engage in new investment strategies under a clear and transparent regulatory framework. L-QIAIFs also benefit from the fast-track authorisation procedure available to all types of QIAIF, which means that they are capable of being authorised within 24 hours of a single filing of documentation with the Central Bank. As mentioned, once authorised a L-QIAIF with an EU AIFM may be marketed throughout the EU pursuant to the AIFMD marketing passport.

While the Central Bank was the first European regulator to create a specific regulatory regime for direct lending funds, it is possible that an EU-wide regulatory framework for loan originating funds will be introduced in the future. In April 2016, the European Securities and Markets Authority ("ESMA") published an opinion addressed to the EU law-making institutions on loan origination by investment funds. The opinion forms part of ESMA's ongoing work on the Capital Markets Union and was issued in response to a request for input from the European Commission which intends to consult on establishing a common European framework for loan originating investment funds. The opinion sets out ESMA's views on matters such as the authorisation of loan-originating funds and their managers, eligible investors, organisational requirements and leverage. Many of the features of the EU-wide regime recommended by ESMA are already features of the Irish regulatory framework. The ESMA opinion may be accessed [here](#).

We are seeing increased interest from promoters and managers in the establishment of regulated direct lending vehicles and our Asset Management and Investment Funds Department would be delighted to discuss the L-QIAIF regime with you in more detail.

Full details of the Asset Management and Investment Funds Department, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team can be accessed at www.matheson.com.

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