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Central Bank of Ireland

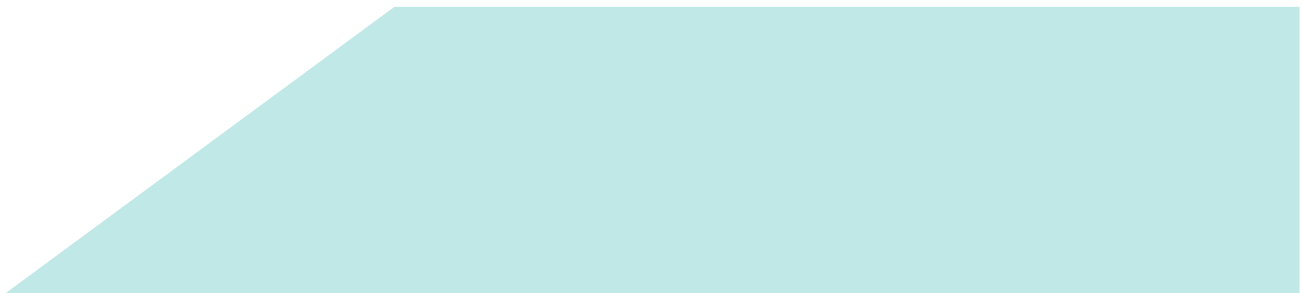
Eurosystem

Consultation Paper 132 - Guidance on share class features of closed-ended QIAIFs

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Introduction

The AIF Rulebook was introduced with effect from 22 July 2013 to coincide with implementation of the Alternative Investment Fund Managers Directive (“AIFMD”). It sets out in a single rulebook format the conditions which the Central Bank imposes on authorised Alternative Investment Funds (AIFs),¹ AIF management companies, Alternative Investment Fund Manager (AIFMs) and depositaries appointed to authorised AIFs. The provisions of the AIF Rulebook are supplemented by Guidance issued by the Central Bank of Ireland (“Central Bank”)

In keeping with the commitment made by the Central Bank when the AIF Rulebook was published, these requirements have been kept under review in order to ensure they remain appropriate particularly given the evolving nature of strategies and operational features of authorised AIFs. As part of its usual review process, the Central Bank has considered the manner in which certain rules are applied in the context of the share class structure for closed-ended AIFs.

Closed-ended AIFs can be expected to deliver exposure to less liquid assets and often have complex investment strategies (for example, private equity, infrastructure and venture capital). Subscription arrangements for such AIFs is also often on the basis of a capital commitment over a period of time. This commitment may be drawn down by the closed-ended AIF upon identification of suitable investment.

The Central Bank is consulting on the establishment of regulatory guidance in relation to the scope of permissible features for share classes of closed-ended AIFs. In summary, the key features of the proposed guidance include:

- **Scope** – the Central Bank is proposing to limit availability of these features to closed-ended AIFs authorised as Qualifying Investor AIFs (“CE QIAIFs”) with strategies which are generally described as relating to private equity, venture capital and real estate and which generally do not invest in assets that must be held in custody in accordance with the AIFMD or which generally invest in issuers or non-listed companies in order potentially to acquire control over such companies in accordance with the AIFMD. This takes account of the nature of closed-ended AIFs, in particular the commitment made by investors in terms of capital drawdowns.

¹ AIFs are authorised by the Central Bank under: the Unit Trusts Act, 1990; the Investment Limited Partnerships Act 1994; the Investment Funds, Companies and Miscellaneous Provisions Act 2005; the Companies Act 2014; and the Irish Collective Asset-management Vehicles Act 2015.

- **Investor protections** – The Central Bank considers that the availability of the share class features outlined in this Consultation should be subject to certain investor protections. These are described in detail in the draft Guidance.
- **Share class features** – the consultation proposes to permit a CE QIAIF to issue share classes which permit (i) the profit, loss and capital of certain assets to be allocated to certain share classes, (ii) subject to certain conditions, investors to participate in some, but not all the assets of the CE QIAIF and (iii) management share classes to participate in the CE QIAIF and receive returns which are greater than, but subordinate to the returns to which other share classes are entitled.

Format of consultation

This Consultation Paper comprises draft Guidance and a series of key questions on the proposals set out therein.

The Central Bank offers all interested parties an opportunity to consider the matters presented in this paper and to offer their views. Following the closing of the consultation period, the Central Bank will consider responses received in order to prepare related requirements and guidance. Such requirements and guidance will be subject to further consultation as appropriate.

Anyone considering responding to this Consultation should do so by 22 December, 2020 by emailing a response in Word format to fundspolicy@centralbank.ie clearly labelled “Consultation Paper 132: Guidance on share class features of closed-ended QIAIFs”.

The Central Bank’s intention is to publish all written contributions submitted with a feedback statement to follow in the normal course of events.

Draft proposed guidance

This Guidance addresses operational matters for closed-ended QIAIFs (“CE QIAIFs”) and the application of certain provisions of the AIF Rulebook to those CE QIAIFs.

Scope

1. This Guidance applies only to closed-ended Qualifying Investor AIFs (“CE QIAIF”) which generally use private equity type strategies or invest in illiquid assets.

Share classes in a CE QIAIF

2. The AIF Rulebook generally requires that capital gains/losses and income arising from the assets of a QIAIF must be distributed and/or must accrue equally to each unitholder relative to their participation in the QIAIF. Certain exceptions arise in the case of share classes which may be differentiated on the basis of subscription/redemption procedures, distribution policies or charging structure, hedging policies, asset exposure or other criteria as clearly disclosed in the prospectus and permitted by the QIAIF’s constitutional document.
3. Where a QIAIF allocates assets to individual share classes in accordance with AIF Rulebook criteria this is generally effected either through the use of financial derivative instruments to generate the differentiated exposure or through establishment of side-pocket share classes for the purpose of acquiring illiquid assets.

Establishment of differentiated share classes in a CE QIAIF

4. Share classes in a CE QIAIF may be used to operationalise either the capital commitment made by an investor or the participation of the investment management function in the QIAIF. These share classes may, subject to requirements further set out below, provide for the (i) allocation of the returns of specific assets to the share class and / or (ii) participation by a share class in the CE QIAIF other than on a pro rata basis. Establishment of share classes which provide for such differentiated participation will be permissible to reflect:
 - a. issue of shares at a price other than net asset value without prior approval of the Central Bank;
 - b. excuse and exclude provisions;
 - c. stage investing; and
 - d. management participation.

5. In order for a CE QIAIF to provide for share classes to reflect 4(a)-(d) and to allocate the returns of a specific asset to that share class¹ the following general conditions apply:
- a. the ability to establish share classes providing for the features outlined at paragraph 4(a)-(d) has been provided for in the CE QIAIF's constitutional document and has been disclosed to unitholders in advance;
 - b. the CE QIAIF's prospectus permits establishment of share classes which provide for different levels of participation in the CE QIAIF;
 - c. the unitholder's interest in a CE QIAIF is proportionate to:
 - i. the capital it has paid into the CE QIAIF at a particular point in time; and / or
 - ii. the pre-determined flow of capital returns to the share class; and / or
 - iii. the extent to which the share class held by the unitholder participates in the assets of the CE QIAIF.
 - d. where the investor has subscribed in the CE QIAIF is on the basis of a capital commitment and periodic drawdowns from the investor the CE QIAIF maintains records on a per-investor basis to enable it to clearly identify commitments paid and commitments outstanding for each investor¹ ("capital accounting"), and
 - e. the capital accounting methodology is consistent with the requirements of Commission Delegated Regulation (EU) 231/2013 which require the AIFM to establish, implement and maintain accounting policies and procedures to ensure that the calculation of the net asset value is carried out as required by that Delegated Regulation and the AIFM Regulations.¹

Additional conditions for establishment of differentiated share classes in a CE QIAIF

6. The following additional conditions apply:
- 7.
- a. A CE QIAIF may provide for the issue of shares at a price other than net asset value without prior approval of the Central Bank. This may be necessary, for example, to recognise the capital commitment made by an investor to the CE QIAIF and the fact that portions of this fixed amount will be periodically drawn down from the investor (as is the case in private equity AIFs).
 - b. **Share classes enabling the exercise of excuse or exclude provisions**

A CE QIAIF may facilitate excuse provisions (which enable an investor to be excused from an investment that the CE QIAIF proposes to make) and / or exclude provisions (which permits the CE QIAIF to exclude an investor from a proposed investment that the CE QIAIF proposes to make provided that:

 - i. the excuse and / or exclude provisions are predetermined and documented by the CE QIAIF (in respect of excuse provisions by way of a written document between the CE QIAIF and the investor prior to an investment being made in the CE QIAIF and, in respect of exclude provisions, by

providing for the circumstances in which this may occur in the prospectus and / or constitutional document of the CE QIAIF);

- ii. a formal legal opinion must be provided by the unitholder or CE QIAIF (depending on the party invoking the provision) outlining the basis on which the excuse or exclude provision is being invoked;
- iii. the board of the CE QIAIF and AIFM must document
 - whether or not it accepts the formal legal opinion so provided, and
 - the consequences of accepting or disagreeing with such opinion (for example, enforcing the investor's participation in the CE QIAIF in accordance with subscription terms or the resultant share class structure).

c. **Stage investing**

To facilitate new investors in the CE QIAIF the CE QIAIF may, at a later stage in the life cycle of the CE QIAIF, permit new investors to acquire shares in the CE QIAIF. The purchase of shares by way of transfer from an existing unitholder or the subscription for new shares in the CE QIAIF may be facilitated by the CE QIAIF by way of establishment of a new share class which provides for participation in existing and future investments of the CE QIAIF or in future investments only and provided that:

- i. upon acquisition by way of transfer of shares, the terms of investment by the new investor is clearly documented,
- ii. upon the issue of new shares, a new share class is established for the investor, and
- iii. the commitments paid and commitments outstanding for each investor are accounted for using a capital accounting methodology.

d. **Share classes providing for management participation**

A CE QIAIF may establish management share classes which permit portfolio managers of a CE QIAIF to participate in investments of the CE QIAIF. Such share classes may participate in the CE QIAIF on the basis of conditions which differentiate the share class from other share classes in the CE QIAIF (for example, to reflect a pre-determined fee arrangement or capital payout which is not pro-rata). This is subject to:

- i. the conditions applicable to management share classes being provided for in the prospectus, and
- ii. capital payments (both committed capital and preferred returns) being allocated to relevant investor share classes in priority to management share classes.

Questions to Stakeholders

1. Do you have views on the Central Bank's approach to limit the availability of these features to certain types of CE QIAIFs?
2. Are there other aspects or requirements of the Central Bank AIF Rulebook that require clarification or consideration in operationalising these arrangements?
3. Are the safeguards proposed sufficient? Are there other features which may be desirable or of benefit from an investor protection perspective?

Next Steps

Stakeholders are requested to provide responses to the questions posed throughout this Consultation Paper. They are also invited to provide any general observations on the matters discussed or issues raised herein. Following the closing of the consultation period, the Central Bank will consider responses received in order to prepare guidance.



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