Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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

2 February 2021

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Introduction

1. The AIF Rulebook was introduced with effect from 22 July 2013 to coincide with implementation of AIFMD. It sets out in a single rulebook format the conditions imposed by the Central Bank of Ireland (the "Central Bank") on authorised AIF, AIF management companies and depositaries.

2. 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.

3. Stakeholders were invited to provide observations and comments on the proposed amendments. The closing date for comments was 22 December 2020 and three responses were received.

4. This document sets out Central Bank feedback on responses received to CP132.

Markets Policy Division
Central Bank of Ireland
2 February 2021

General feedback

1. In general, respondents to the Consultation Paper welcomed the draft Guidance. Feedback received was that the proposed share class structures were consistent with the requirements of funds which pursued long term investment in illiquid assets. They also met the expectations of the professional investors who would subscribe in such funds.

2. Respondents in general considered the proposals set out in the draft Guidance to be proportionate and consistent with share class features available for professional investor closed-ended funds in other regulated jurisdictions.

Specific feedback to questions posed

Question 1: ***Do you have views on the Central Bank's approach to limit the availability of these features to certain types of CE QIAIFs?***

3. Respondents generally agreed with the proposal to limit the proposed share class features to closed-ended qualifying investor AIFs ("CE QIAIFs").

4. Respondents raised concern that the Guidance might be interpreted as excluding the availability of features currently used by open-ended or limited liquidity QIAIFs. In this regard, respondents referred to arrangements whereby the management of the QIAIF receives carried interest-type fee arrangements through participating in the QIAIF, side pocket arrangements, subscriptions by way of capital commitments or different offering arrangements[1]. They noted there was an overlap between these features and what is being provided for in the draft Guidance.

5. Respondents noted that while the Guidance referred to CE QIAIFs which invested in illiquid assets, there was a suggestion that only CE QIAIFs investing in illiquid assets <u>and</u> following a private equity-type strategy could avail of the Guidance. In this regard, respondents observed that CE QIAIFs could utilise other strategies for which the features

[1] The AIF Rulebook provides for subscription at net asset value, except where prior approval has been granted by the Central Bank. Except as set out therein, the Guidance does not affect these approvals or the availability of them in the future, in respect of circumstances falling outside of the scope of the Guidance.

of the Guidance would be important (for example sustainable investment or infrastructure-related strategies).

6. Respondents noted that the capital commitment subscription mechanism as well as the mechanism for incentive allocation fee arrangements were internationally available features of closed-ended funds and not those solely involved in private equity type strategies.

7. One respondent commented on the difficulty in defining "private equity like" strategies, noting that they could encompass a broad set of investment methodologies and techniques. In this regard the respondent noted that there was no singular definition of private equity and that a common defining feature would be relative illiquidity of underlying assets. The same respondent suggested that the share class features be made

Central Bank Response: The Central Bank has considered the feedback received from industry. The Central Bank considers that the features provided for in the draft Guidance remains appropriate for CE QIAIFs and so does not propose any amendment in that regard. The Central Bank also does not currently propose extending the availability of these features to QIAIFs with limited liquidity.

The proposal for share class features, represented by the draft Guidance is additional to the currently available structures available to a QIAIF irrespective of whether it is open-ended, closed-ended or has limited liquidity. In this regard, respondents referred to current arrangements to implement management incentive allocations, side pockets, the ability to subscribe by way of capital commitments and to have different offering arrangements. Where these features have previously been implemented they would have been (a) subject to the AIF Rulebook provision that generally requires capital gains/losses and income arising from the assets of a QIAIF to be distributed and/or accrued equally to each unitholder relative to their participation in the QIAIF (b) permitted following a specific submission to the Central Bank on that point, or (c) permitted by the Central Bank in recognition of the prevailing market practice.

The Guidance proposed is intended to provide additional features for CE QIAIFs and is not intended to affect the availability of arrangements currently available to a QIAIF irrespective of whether it is open-ended, closed-ended or has limited liquidity.

The Central Bank acknowledges the evolving nature of investment strategies and considers that over time certain strategies may fall to be considered, or cease to be considered as "private equity like". Arising from this definitional question and the fact there is no generally accepted definition of strategies which are "private equity like", the Central Bank considers greater certainty can be achieved by limiting the availability of share classes of the type now envisaged in the Guidance to CE QIAIFs.

available to funds established with limited liquidity. This respondent noted that some limited liquidity funds would have need of the features proposed in the draft Guidance.

Question 2: ***Are there other aspects or requirements of the Central Bank AIF Rulebook that require clarification or consideration in operationalising these arrangements?***

8. Respondents considered that the draft Guidance should clarify the nature of participation in a CE QIAIF. In this regard they requested clarification that reference to "share classes" in the draft Guidance could also include other manners of participating in a CE QIAIF It was noted, for example, that investment limited partnerships did not issue share classes.

Central Bank Response: The proposed Guidance will apply generally to CE QIAIFs regardless of the form it takes. The Central Bank is aware that investment in investment limited partnerships is represented in a manner which is different to other "unitised" fund structures and that investment is represented by participations rather than share classes. For the avoidance of doubt the Guidance will clarify that reference to "share classes" can be read as reference to any other form of interest granted in a CE QIAIF.

Question 3: ***Are the safeguards proposed sufficient? Are there other features which may be desirable or of benefit from an investor protection perspective?***

9. Respondents considered that the funds which would utilise these share class features would require investment obligations over the longer term. The duration of such a commitment both in terms of the nature of capital drawdowns and the illiquid nature of investment in the fund is consistent with limiting availability of these share classes to professional investor funds. Respondents therefore considered the restrictions on availability of these share class features to be proportionate and appropriate.

10. One respondent queried the requirement for a formal legal opinion in the event an investor sought to invoke an excuse or exclude provision. It observed that this might result in directors being required to obtain an independent legal opinion to disagree with the opinion received from the investor. The respondent envisaged difficulty in enforcing participation in the QIAIF.

Central Bank Response: Where a CE QIAIF decides to provide for excuse and exclude provisions then it should be live to the circumstances and possible difficulties associated with it. The requirement of the Board of a CE QIAIF or AIFM to obtain a legal opinion to corroborate or disagree with the legal opinion provided by the investor is a matter for the CE QIAIF in question.

The Central Bank, in proposing the investor safeguards set out in the Guidance sought to strike a balance between share class features commonly available elsewhere for closed-ended professional investor funds and the need to provide for investor protection safeguards. The Central Bank considers that the complexity associated with these share class features means that the important investor protection safeguards proposed in the Guidance should be retained.

T: +353 (0)1 224 6000
E: xxx@centralbank.ie
www.centralbank.ie

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