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Date | 25 August 2014

By Email fundspolicy@centralbank.ie



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CP85 - Loan Originating Qualifying Investor AIF

Dear Sir/Madam

We welcome the publication of CP85 – Consultation on Loan Originating Qualifying Investor AIF. We act for a number of parties which have expressed an interest in exploring the possibility of undertaking loan origination in regulated fund structures.

We have set out our responses below to the Consultation Paper. In addition, our Asset Management & Investment Fund team has been involved in the production of the Irish Funds Industry Association's response to the discussion paper.

Please do not hesitate to contact Michael Barr (mbarr@algoodbody.com or 01-649-2327) if you have any questions or would like any further detail in respect of our responses.

Yours faithfully

A&L Goodbody

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Activities of Loan Originating Qualifying Investor AIFs

Paragraph 2 of the proposed Section 4 provides that a loan originating qualifying investor AIF shall limit its operations **solely** to the business of issuing loans, participations in lending and to operations directly arising therefrom, to the exclusion of all other commercial business. A loan originating qualifying investor AIF should also be entitled to acquire loans on the secondary market, seek exposure to such loans by way of sub-participations and acquire debt securities and equity securities. Such funds should also be entitled to use derivative instruments with the leverage parameters set out in Section 4.

There is no reason why the management team that meets the requirements of Section 4 should not also be capable of buying other debt related assets. In addition, depending on market circumstances, it may be in the best interests of the fund to seek exposure to debt related assets by way of acquiring loans or debt securities. In addition, in some cases, it is of benefit to a fund to also acquire an equity position where a loan is being originated or acquired. The new Section should make it clear that the acquisition of equity securities in connection with the granting or acquisition of a loan or debt securities is permissible.

In addition, a fund may acquire equity securities as part of a reorganisation of a loan that it holds and, again, a loan originating qualifying investor AIF should not be precluded from opting to do so.

Credit Assessment, Granting and Monitoring

We agree with the approach being proposed. However, as a point of clarity, the proposed insert into the AIF Rulebook should provide that the qualifying investor AIF shall establish and implement the procedures etc or ensure that its authorised AIFM (or its relevant delegate) has such policies and procedures in place. A number of the policies and procedures called for are more appropriately housed in the AIFM (or its delegate) being the entity tasked with portfolio management.

Diversification

We agree with the proposal regarding diversification and, in particular, to allow a ramping-up period to achieve the diversification required. Likewise, a fund should be permitted to exceed the diversification limits during the run-off phase towards the end of its fixed term life. In such circumstances, a fund may be making distributions out to investors and end up holding a concentrated portfolio while it looks to sell down such loans or the fund is waiting for such loans to mature. Forcing it to hold back from distributing cash so that it would meet the diversification requirement in such circumstances would not be in the interests of investors.

Liquidity

We would recommend that the term "*closed-ended*" is not used as this has a variety of different meanings across AIFMD and the Prospectus Directive, for example. We have no difficulty that the fund has to be set up for a finite period. In addition, we have no difficulty with the fact that the fund must have discretion to refuse redemption requests so that investors have no right to redeem and hence there can be no run on the assets of the fund as a result of redemptions.

Accordingly, we would recommend that the section is reworded to state that the fund must be closed-ended or limited liquidity to the extent that any redemption requests made are entirely at the discretion of the fund or the AIFM, provided that if redemption requests are acceded to they are acceded to on a non-preferred basis.

In addition, the fund should be entitled to add specified dates upon which investors can request redemptions without having to set those out as at the authorisation date. Assets may pay off unexpectedly early and, therefore, it may be appropriate to offer a possibility to all investors to request some degree of redemptions at a later date. It may not be possible to predict this in advance of the authorisation date.



As regards the need for unitholder approval for a distribution or redemption in the event that the loan originating assets are not valued by a reference to prevailing market prices, we do not believe that this is a necessary requirement. The AIFM will be subject to the AIFMD valuation rules and any distribution or redemption must be offered on a non-preferred basis. Accordingly, even where model pricing is being used in a fund, all investors will have the possibility to partake in a distribution or redemption. Any such distribution or redemption would have to be met out of unencumbered cash or liquid assets. Finally, we do not believe it is appropriate that unitholders holding a majority of the units could block a distribution or redemption approved by the fund and the AIFM that could otherwise be made available to all unitholders. This would put minority unit holders at a distinct commercial disadvantage as they would be relying on the votes of other unit holders rather than the judgement of an AIFM and the fund that they have selected to invest in.

Finally we believe that open-ended qualifying investor AIFs should be entitled to engage in loan origination up to a very limited percentage of their NAV, for example 10%, provided that they met the other conditions set out in the proposed Section 4, particularly as regards have the necessary expertise, policies and procedures etc. This is no different than the current position whereby open-ended qualifying investor AIFs may acquire other types of illiquid assets (for example, property, closed-ended funds or funds with lock-ups) provided such purchase does not impact on the redemption provisions offered to investors. This would enable open-ended qualifying investor AIFs that can currently acquire loans on the secondary market to engage, to a very limited extent, in loan origination (again provided they met the other conditions of the proposed Section 4). Having a cap at 10% of NAV would mitigate against any run risk that could impact on the loan origination activity of the fund in question.

Due Diligence

We concur with the IFIA's submission on this point. We believe it is very important that the obligation on the AIFM should be to provide such information as is requested by an investor rather than leaving the AIFM to try and second guess as to what the investor may look for.

Separately, a loan originating qualifying investor AIF would have the same obligations as any other qualifying investor AIF to ensure that its prospectus meets the requirements of Section 3 of Chapter 2 of the AIF Rulebook and, in particular, contains sufficient information from investors to make an informed judgement of the investment proposed to them.

Valuation

We agree that the AIFMD rules are sufficient to deal with valuation issues in respect of loan originating qualifying investor AIFs. Please also refer to our comments under the section headed "Liquidity" above regarding unitholder approval distributions and redemptions where non-market prices are used.

Leverage

We concur with the IFIA's proposal in respect of leverage limits that should apply to loan originating qualifying investor AIFs.

Disclosure

There is no difficulty in having specific disclosure requirements for loan originating qualifying investor AIFs. However, some of the matters provided for in the draft Section 4 – specifically paragraph 24(iii) and (iv) may well include information that would otherwise be confidential, proprietary or price sensitive, particularly in respect of the underlying borrower. Accordingly, the loan originating qualifying investor AIF should be obliged to provide aggregate details of loans that are non performing without being required to identify the specific loans in question.



Finally, under paragraph 20 of the draft AIF Rulebook amendments, we suggest that the term "all sales material" is clarified. Much of the sales material will come from the AIFM and will relate to its team rather than specifically any AIF in question. We would therefore recommend changing "by a loan originating QIAIF" to "in respect of a loan originating QIAIF" to exclude general sales material regarding the AIFM itself that does not reference the fund.

Interconnectedness with the Banking Sector

We concur with the IFIA's response in respect of this area.

Reporting and Stress Testing

We concur with the IFIA's response in respect of this area.