BNY MELLON

Loan Originating Qualifying Investor AIF
Markets Policy Division
Central Bank of Ireland
Block D
Iveagh Court
Harcourt Road
Dublin 2
By Email: fundspolicy@centralbank.ie

25 August 2014

Re: Consultation Paper 85 "Consultation on loan originating Qualifying Investor AIF"

Dear Sirs,

BNY Mellon welcomes the opportunity to comment on the Consultation Paper issued by the Central Bank of Ireland ("CBI") on loan originating Qualifying Investor AIFs ("QIAIFs").

BNY Mellon is strongly supportive of the CBI's proposal to allow for loan origination within a regulated Irish-domiciled fund structure.

We believe that the proposals enabling QIAIFs to originate loans will allow Ireland to become a jurisdiction of choice for sophisticated investment managers seeking to do business in a regulated environment.

We further support, in general, the CBI proposals for the creation of a robust framework of controls, risk mitigants and safeguards which we believe strikes the right balance between promoting Ireland as jurisdiction of choice for funds while ensuring stability of the financial system.

However, we would submit that in its current form, certain elements of the framework, such as the restrictive leverage limit and strict diversification rules, may result in limiting the attractiveness of Ireland to the extent to which these funds will be established in this jurisdiction. We therefore have focused our response on a number of slight modifications, outlined below, which we believe will enhance the regime.

LEVERAGE

We note the CBI's intention to mitigate potential risks associated with loan originating QIAIFs and to curtail pro-cyclicality by imposing a leverage limit of 1:1 on loan originating QIAIFs.

We believe that the imposition of a 1:1 leverage ratio is overly restrictive and submit that an increase of the limit to 2:1, or above, would be more appropriate. We believe this would allow the AIFM sufficient flexibility, within a highly regulated and controlled framework, to structure the QIAIF in a manner consistent with the risk appetite of investors.

We refer to Article 111 Regulation 231/2013 in respect of the use of leverage on a "substantial basis" which states *"Leverage shall be considered to be employed on a substantial basis for the purposes of Article 24(4) of Directive 2011/61/EU when the exposure of an AIF is calculated according to the commitment method under Article 8 of this Regulation exceeds three times its net asset value".*
This potential 3:1 leverage ratio, as envisaged under AIFMD, is proposed without significantly increasing disclosure and reporting requirements and therefore we would submit that an increase of the CBI proposed ratio to 2:1 or above is in line with current regulatory standards in the funds industry.

We have seen significant market and investor demand and appetite for higher leveraged products and we believe that, within this regulated environment, allowing loan originating QIAIFs an increased leverage limit would be beneficial to market participants and the wider economy.

We believe the framework proposed in the amended AIF Rulebook, together with the requirements arising from AIFMD, particularly with regards to transparency and investor disclosures, ensures that any potential risks in respect of leverage limit can be very effectively mitigated. We believe the proposed rules create sufficient and strong safeguards for both investors and financial stability.

DIVERSIFICATION

BNY Mellon agrees that diversification requirements provide an important risk mitigant tool for funds and considers the proposal for a 25% diversification limit to be reasonable.

However, we feel a higher threshold should be permitted in relation to sovereign debt exposure, allowing for a more flexible limit in respect of debt issued or guaranteed by sovereign governments.

We would submit that this is appropriate given the inherent stability of sovereign debt, particularly in comparison with other debt classes and note that policy makers typically allow for greater investment and concentration in sovereign debt than non-sovereign classes. We make specific reference to Article 54 of the UCITS Directive (Directive 2009/65/EC) which states *"By way of derogation from Article 52, Member States may authorise UCITS to invest in accordance with the principle of risk-spreading up to 100 % of their assets in different transferable securities and money market instruments issued or guaranteed by a Member State, one or more of its local authorities, a third country, or a public international body to which one or more Member States belong".*

ELIGIBLE INVESTMENTS

We refer to the proposed text of the AIF Rulebook which states *"the loan originating Qualifying Investor AIF shall limit its operations solely to the business of issuing loans, participants in lending and to operations directly arising therefrom, to the exclusion of all other commercial business".*

We believe that allowing the loan originating QIAIF the flexibility to purchase other assets in the secondary market, while originating loans in the primary, will maximise the return to the investor and that any associated risks are effectively mitigated in the framework proposed in the draft AIF Rulebook.

We believe that, in a regulated, controlled and secure framework such as that proposed by the CBI, loan origination and participation would be consistent with preferred participant practice in both domestic and international markets. We believe that restricting these QIAIFs to loan origination could prove prejudicial to the successful operation of this fund type in Ireland.

We note the proposed rule outlined in Paragraph 14(b)(i) in the draft AIF Rulebook which requires vendor warranty of retention of a material net economic interest of at least 5% of the nominal value of the loan.

We believe this requirement could result in Ireland being at a competitive disadvantage to other jurisdictions where such loan-partner continued participation is not mandated.

We make specific reference to Articles 404-410 of CRD IV which requires this continued participation only in circumstances where a loan is intended to be securitised.

We believe comfort as to quality and performance of investment strategy, and thus investor protection, can be effectively and sufficiently derived through the supervision of the AIFM together with other controls and safeguards contained in the proposed framework including, but not limited to, reporting and disclosure requirements.

DEPOSITARY DUTIES

We note that the proposal to allow loan origination for QIAIFs does not discuss the role of the Depositary in these transactions.

BNY Mellon believes that it would be helpful for the CBI to confirm that a Depositary's responsibility in respect of loan originating funds will be aligned for those of funds investing in any other asset class, i.e. as outlined in AIFMD and its accompanying measures, including the AIF Rulebook.

For example, the Central Bank might confirm that it does not propose that a depositary's role would be combined with that of 'security trustee', which may exist in certain loan arrangements, and which is a wholly separate function from that of a 'depositary' (although such a function might be performed by a depositary, beyond its depositary duties, where it contracts or otherwise undertakes to do so). We raise this issue because we understand that some (non-common law) jurisdictions require the appointment of a security trustee, and if no entity is appointed to fulfil that function, may seek to impose the obligation on a depositary in the absence of any other relevant party, though we do not consider that such a function is relevant in the context of Irish loan originating funds.

REPORTING

We refer to Section 4 Paragraph 24 of the proposed addition to the AIF Rulebook which sets out extensive reporting information which must be provided to unit holders of the QIAIF at each NAV point. The manner in which these requirements are drafted may result in investor expectation of receiving detailed portfolio data and analytics on a monthly basis. We believe this would be quite cumbersome and would not result in any additional benefit to investors to provide this level of detail to the unit holders at each NAV point.

We would submit that a more pragmatic approach would be to supply this level of detail in the annual financial statements or, alternatively, in the interim financial statements if a decision is taken by the QIAIF to provide such interim statements.

We hope that you will find this submission of benefit in your determination of CP85.

Should you have any queries in relation to our submission, or wish to discuss same further, please do not hesitate to contact us.

Yours sincerely,

BNY MELLON