Submitted via email to:
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Re: CP 85: Loan originating Qualifying Investor AIF

The Irish Funds Industry Association (IFIA) is the industry association for the international investment fund community in Ireland, representing custodians, administrators, managers, transfer agents and professional advisory firms. Ireland is a leading centre for the domiciling and administration of collective investment schemes, including Alternative Investment Funds ("AIFs"). With net assets of Irish Qualifying Investor AIFs now in excess of €270 billion[1], developments in this area are of particular strategic interest and importance to the Irish industry.

Over more than 25 years, Ireland has developed a world-leading position as a jurisdiction for the administration and domiciling of internationally distributed investment funds. With more than 13,000 people employed in the administration, custody and servicing of funds, this is the single largest sector within Ireland's international financial services sector by employment.

The recent implementation of the Alternative Investment Fund Managers Directive ("AIFMD") has presented both challenges and opportunities for the industry, involving a great deal of legal, regulatory and business change. Ireland took a leading role early on in developing a regulatory framework for alternative investment funds and positioning itself as a centre of excellence for the servicing of regulated investment funds. With the introduction of a new EU-wide regulatory regime under AIFMD, it is now more critical than ever that Ireland remains at the forefront of regulatory developments relating to AIFs. The AIFMD has provided a highly regulated framework for Alternative Investment Fund Managers ("AIFMs") but also enables AIFMs to deliver a wide range of strategies subject to these robust rules encompassing risk management, liquidity management, valuation, the depositary, reporting/disclosure and conflicts of interest for example. We welcome the development of innovative fund structures under this highly regulated framework, which address market needs and also contribute to economic activity.

The IFIA is strongly supportive of the Central Bank's proposals on a loan originating Qualifying Investor AIF. We agree that there is a public good to be served in allowing pooled investment

[1] Source: Central Bank of Ireland CIS statistics, June 2014

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funds to directly lend to the corporate sector, which has witnessed a reduction in lending from traditional banking institutions in recent years.

Europe currently lags behind other jurisdictions in enabling corporations to access alternative channels to bank credit and we concur with evidence presented by the European Commission and other international bodies which suggest that non-bank financing options can contribute to the economic development of the European economy. With appropriate risk mitigants in place, loan origination can perform a valuable economic function through the promotion of beneficial long-term investment in infrastructure, technology and businesses generally.

We note the launch of the European Venture Capital Fund (EuVECA) in 2013 and European Commission's proposals to devise a European Long-term Investment Fund (ELTIF). The aim of these projects is closely aligned with the Central Bank's initiative on loan origination, i.e. the promotion of non-bank financing options for sustainable investment in viable businesses that can contribute to economic growth and employment.

We believe that the proposals outlined in CP 85 generally strike the right balance in allowing loan origination to take place within a fund product targeted at professional investors which is subject to appropriate risk mitigants and investor protection safeguards. As such, the proposals represent a carefully considered loan origination fund product reflective of international best practice and aligned with and supplementary to AIFMD.

In the following pages we have outlined our responses to the Central Bank's consultation and included our suggestions in that regard. Our response focusses mainly on a small number of proposed adjustments to the regime based on feedback we have received from specialist loan fund managers, their advisors and service providers in terms of addressing loan market practice and requirements. Central to our concerns are the ability for the loan originating QIAIF to also conduct loan participation on the secondary market in line with market practice and the need to allow for increased leverage in certain cases and subject to appropriate safeguards.

We welcome the opportunity to discuss any aspect of this submission with the Central Bank and look forward to the launch of the loan originating Qualifying Investor AIF in the near future.

Yours sincerely,

Patrick Lardner
Chief Executive

Annex I: Permitted activities of loan originating QIAIFs

We note that CP 85 refers to the proposed new regulatory regime which would apply to a type of fund whose *"sole strategy is loan origination"*. However, we note that the proposed new draft section 4, paragraph 2 of Chapter 2 of the AIF Rulebook provides as follows:

"*The 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"*.

The ability for investment funds to pursue a combined strategy of loan origination, loan participation and the acquisition of debt securities is of fundamental importance to asset managers in this sector based on the feedback we have received to date for various reasons including, but not limited to, the following:

- based on our dealings with asset managers in this sector, both the domestically and internationally, it is market standard for funds which engage in loan origination to also engage in loan participation and the acquisition of debt securities more generally;

- Any of the relevant credit and risk analysis can be easily transferred and applied when acquiring a loan on the secondary market or acquiring a debt security. Any manager complying with the additional requirements for loan origination will be able to apply this skillset to include loans acquired on the secondary market;

- market practice necessitates loan originating funds investing in the secondary loan and debt securities market while the credit analysis and borrower assessment processes are finalised (in practice, such processes are typically lengthy in nature). By allowing managers to also acquire loans on the secondary market during such periods, managers may utilise the cash that comes into the structure while the credit analysis and borrower assessment processes are taking place, thus instilling investor confidence in the structure. If a fund is restricted to a sole strategy of loan origination, the ramp-up phase of the transaction is likely to be significantly longer; and

- when the fund is not wholly invested in loans (as it could take some time to ramp-up, or the fund could be holding the proceeds of a loan sale prior to reinvestment/payment of redemptions etc.), it should be able to invest in cash and other liquid assets. We would view this ability as essential, as otherwise the fund cannot operate and manage its liquidity effectively;

- in circumstances where a fund wishes to gain exposure to loans in a particular jurisdiction and it is restricted from engaging in loan origination due to local regulatory constraints (for example, we understand that loan origination may not be permitted by collective investment schemes in France, Spain and Italy), it is important that such a fund would not be prohibited, from an Irish regulatory perspective, from engaging in loan participation on the secondary market and the acquisition of debt securities in such jurisdictions.

Given the reference in CP 85 that the *"sole strategy"* of the fund should be loan origination, it would be helpful if the revised AIF Rulebook unambiguously confirmed that a loan originating fund could (i) acquire an interest in a loan by way of assignment in the secondary market, (ii) participate in a loan by way of sub-participation, (iii) acquire debt securities (whether to a prescribed level of NAV or more generally) and (iv) hold cash and other liquid assets, use FDI and, where the QIAIF enforces a loan, acquire the assets that are pledged as collateral. We note that the current draft of the AIF Rulebook refers to the business of 'participations in lending', in addition to the business of 'issuing loans' – however, it is not entirely clear to us that this would be broad enough, in practice, to extend to the activities mentioned in points (i) to (iv) above. It is also worth noting that paragraphs 13 and 14 of the proposed revised AIF Rulebook contemplates circumstances where a loan originating fund might acquire a loan from a credit institution – therefore, it would appear that certain parts of the AIF Rulebook envisage circumstances where a fund might acquire a loan on the secondary market. It would be helpful, however, for the AIF Rulebook to explicitly confirm this point to avoid any confusion.

Furthermore, we note that the proposed wording in the AIF Rulebook *"…shall limit its operation solely to…"* and *"…to the exclusion of all other commercial business…"* reflects the language contained in Regulation 7(2)(a) of the European Communities (Non-Life Insurance) Framework Regulations 1994 (which reflects EU Directives). The difficulty with using this language is that Regulation 7(2)(a) causes many practical difficulties in practice for insurance undertakings. In particular, significant consideration would need to be given as to whether or not a particular activity is indeed the *"business"* of the fund or whether such an activity would constitute *"operations directly arising therefrom"*. We are concerned that the proposed inclusion of this restrictive wording in the AIF Rulebook could have unintended practical consequences. For example, if the AIF issued a loan in return for a charge over shares in company B, would it be unambiguously the case that, upon enforcement, the exercise of the security and consequential ownership by the AIF of the company B shares could be regarded as constituting *"operations directly arising"* from the business of issuing loans or participation in lending?

In summary, we are of the view that the activities of a loan originating fund should not be restricted solely to originating its own loans for the reasons highlighted above and we would hope that the relevant provisions of the AIF Rulebook would be tailored accordingly to unambiguously confirm this.

Annex II: IFIA responses to individual questions raised under CP 85

1.

Credit assessment granting and monitoring: *The draft rules require that the loan originating Qualifying Investor AIF must have an effective credit assessment and management process with established policies in a number of key areas in line with the requirements for credit institutions. Do you agree with this approach?*

In addition it should be noted that

- *Loan originating Qualifying Investor AIF will, in relation to relevant lending, be subject to the Central Bank's Code of Conduct for Business Lending to Small and Medium Enterprises.*
- *The Central Bank has the ability to tighten the lending standards, including in cases where this is deemed necessary for financial stability and macro prudential purposes.*

We welcome the proposals in relation to credit assessment granting and monitoring, which we recognise are aligned with CRD and practices in the banking sector. Many large managers will have similar procedures in place already to ensure that a detailed due diligence is carried out prior to the granting of loans. We would see the application of the proposed credit assessment rules as largely reflective of best practice and have no further comment on these.

We note that the Central Bank's Code of Conduct for Business Lending to Small and Medium Enterprises ("SME Code") would apply only where loans are issued to SMEs operating within the State. However, it should be noted that the SME Code covers many of the same general principles which an AIFM must adhere to under Article 12 of the AIFMD, for example. Application of the SME Code would therefore need to take that into account and provide for a hierarchy of laws in the event of a conflict. This could be addressed by providing that the Central Bank's SME Code applies in relation to relevant lending *"except where the requirements of that Code are covered by AIFMD or inconsistent with an obligation the AIFM has under AIFMD*." We note that the SME Code was written at the time when investment funds were not within its scope and is written from the perspective of a bank acting as the lender. We suggest that consideration should be given to how the SME Code will work in an investment funds context.

2.	***Diversification:*** *While, unlike other Qualifying Investor AIF, we propose that a loan originating Qualifying Investor AIF must aim to achieve a diversified portfolio of loans, we also propose that the period of time necessary to achieve the minimum diversification can be established by the AIF in the prospectus. We believe this is a proportionate control because of the particular dangers of an overly concentrated strategy. We also recognise that because of the nature of this asset class it may subsequently, for reasons beyond the control of the AIF, be impossible to reach the target diversification. Accordingly, we have devised a solution which would require the AIF to seek approval from unit holders to either continue with a revised diversification strategy or terminate. Do you think this is the right approach?*

We agree with the principle of diversifying the portfolio of loans as part of a sound risk management practice and consider the proposed 25% diversification limit to be a reasonable approach. We also agree that it is appropriate and in line with market standards to allow a ramping-up period of time to be specified in the prospectus to achieve the minimum diversification. Inversely, we would infer from this that when ramping-down, a specified period of time to rebalance the portfolio would also apply to allow for closing out a position.

We also accept the Central Bank's proposal to seek unitholder approval to either continue with a revised diversification strategy or terminate in the event that it has not been possible to reach the target diversification level.

In the event that a fund meets its target diversification level but then subsequently falls back from this as a result of loan repayments or a revaluing of the portfolio, we propose that the situation be addressed in a similar way to which the Central Bank proposes addressing a breach of the leverage limit. The fund would within 30 days or such longer period as the Central Bank may specify, secure the approval of the Central Bank for a formal plan to bring the fund into compliance with the diversification limit.

3.	***Liquidity:*** *We propose to require that a loan originating Qualifying Investor AIF must be closed ended. This is to avoid the situation which may arise in an open ended fund where sudden losses of investor confidence lead to investor runs which in turn leads to a situation where loans may have to be recalled or sold on. Our research indicates that investment funds which engage in loan origination elsewhere tend to establish as closed funds in any event.* *We also recognise that the requirement for a closed fund should not prevent an AIF following the maturity of certain of the assets, to distribute the return from the realised assets to unit-holders. Accordingly we have developed an approach which will allow redemptions or distributions at the discretion of the loan originating Qualifying Investor AIF. This discretion must be exercised on a non-prejudicial basis. Moreover, if assets of the AIF are not valued by reference to market prices, each redemption or distribution can only be made with the approval of unitholders.*

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 absolute 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 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.

Regarding 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 AIMFD 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.

4.	***Due diligence by investors on the management of a loan originating Qualifying Investor AIF:*** *In our consultations and research we found that detailed due diligence by investors in loan funds is a widespread practice. In effect this due diligence by investors appears to us to supplement reliance on prospectus disclosure to a unique degree. While it is likely that this is currently working well, simply as a consequence of market discipline in this small market sector, we need to ensure that due diligence continues to be done in an orderly way if the sector expands. The envisaged rule does not require due diligence access to be provided by all such funds. It merely requires that where provided, a non-discriminatory outcome for all investors is achieved.* *It is true that AIFMD already sets out specific rules which require an AIFM to "treat all investors fairly". Additionally, Article 23 of the AIFMD Level 2 Regulation states that "any preferential treatment accorded by an AIFM to one or more investors shall not result in an overall material disadvantage to other investors". Nevertheless it may be useful for the Central Bank to have a more specific rule with regard to due diligence in the context of this type of AIF. The proposed rule requires that there will have been non-discriminatory access for investors - it does not require that all potential investors who approach the AIF expressing an interest in investing will be given the same access. We intend to leave managerial discretion as to how to achieve this outcome. It would not necessarily require that all potential investors get equivalent initial access. Do you think that we should include this rule? We welcome feedback on this matter particularly from investors on whether they consider it is a useful protection measure.*

We note the proposal that where the 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 is being made available on a "*non-discriminatory basis to all unitholders*" (Part II, section 4, paragraph 10 of the draft amended AIF Rulebook).

We agree that the use of the term "*unitholders*" in the draft amendments to the AIF Rulebook is the correct one and understand that the Central Bank does not intend that all potential investors who approach the AIF expressing an interest in investing will be given the same access. CP85 states that the Central Bank will leave "*managerial discretion as to how to achieve this outcome*". We suggest that this element of discretion be explicitly referred to in the amended AIF Rulebook. In addition, we suggest that the AIF Rulebook clarify that "*such information shall be made available to a unitholder upon request by that unitholder*". This should avoid any implication that the AIFM has a positive obligation to pro-actively provide such information to all unitholders and that the onus is on the unitholder to request such access.

We believe that it is important to ensure consistency in the terminology used in the AIF Rulebook and the regime implementing AIFMD (Directive 2011/61/EU) generally. We note the principle referred to at Article 23 of the AIFMD Level 2 Regulation that "*any preferential treatment accorded by an AIFM to one or more investors shall not result in an overall material disadvantage to other investors*". For the avoidance of doubt, the AIF Rulebook should state that "*preferential treatment accorded by an AIFM to one or more unitholders in the loan originating Qualifying Investor AIF in terms of access to its records/staff shall not be considered to be discriminatory where the granting of such access rights is determined by the AIFM not to result in an overall material disadvantage to other unitholders and an appropriate description of such access rights shall be made available to all unitholders*". We think this is an important clarification as there may be instances in which preferential access rights are appropriate but do not operate to disadvantage other investors. It would be very important that the managerial discretion referred to above is explicitly stated in the AIF Rulebook so that the AIFM can make the determination.

We suggest that paragraph 10 in the draft amended AIF Rulebook be amended as follows: The penultimate sentence should be deleted. The final sentence should be reworded to state that "*The AIFM shall not intentionally or negligently conceal or fail to disclose information that a reasonable investor in the loan originating qualifying investor AIF would be likely to have considered* ***material*** *in considering an investment in the loan originating Qualifying Investor AIF*" [amendment in bold]. As a general principle, investors should be provided with all information that would be material to an investment decision by a reasonable investor and that the prospectus or other document does not omit any such material information. This materiality test should be referred to in paragraph 10. The penultimate sentence in paragraph 10 seems to be addressing the same issue although we would have a concern that the concepts referred to - "*would not be influenced to invest…because of a lack of access to information*" - adds unnecessary complexity and untested terminology. We would strongly urge the Central Bank to rely on the concept of materiality as suggested for the last sentence of paragraph 10.

5. ***Valuation:*** *AIFMD contains detailed rules, particularly in the Level 2 Regulation on valuation and imposes a number of obligations on AIFM which apply notwithstanding that they may not carry out the valuation function. For example, an AIFM must ensure that for each AIF, there are fair, appropriate and transparent valuation methodologies. These must be disclosed to investors. AIFMD does not require that the assets of AIFs are valued by reference to market prices and recognises that for certain types of AIF this may not be possible. Accordingly there are a number of mitigants to address risks arising where market prices are not available and for example, valuation procedures must include a review process particularly where a material risk of an inappropriate valuation exists. We are not proposing to include any additional rules in relation to the valuation of the assets of a loan originating Qualifying Investor AIF. In the light of our proposal, set out in number 3 above regarding redemptions and distributions, do you consider that this is the correct approach or should any distributions be prohibited unless market pricing is available?*

We agree that AIFMD rules are sufficient in relation to valuation. With respect to the Central Bank's proposal regarding redemptions and distributions, we have considered this point under Number 3.

6.

Leverage: *We believe that leverage is a key potential source of cyclical vulnerability. The ESRB has advised us of the importance of mitigating pro-cyclical vulnerabilities in funds which originate loans. In our view, there should be a leverage limit in such funds for this reason. However, we also recognise that AIFs operate without any statutorily specified leverage limit. Neither AIFMD nor our AIF Rulebook apply a leverage limit to Qualifying Investor AIFs. Under AIFMD, AIFMs are required to set a maximum level of leverage for each AIF and disclose this to investors. They are required to be able to demonstrate that the limit set for each AIF is reasonable and that they are complying with it at all times. Nevertheless, in light of the specific risks attached to loan origination, we propose to impose a leverage limit on loan originating Qualifying Investor AIFs and we have set this at a ratio of 1:1. For example, an AIF with assets of 100 may borrow 100. The requirement for total asset coverage of at least 200% means that should the value of the assets decline, the leverage level must also be reduced and, accordingly, leverage must be managed to ensure compliance with the leverage limit in changing market conditions. Do you agree that this is an appropriate level of leverage?*

The Central Bank has the ability to tighten the leverage limit including in cases where this is deemed desirable in order to manage credit growth or to address a threat to financial stability.

In recognition of difficult market conditions which may result in a breach of the limit and that these market conditions may prevent the AIFM from immediate deleveraging, an additional rule sets out the process which must be followed in the event of a breach. Do you consider that there is sufficient detail around that process?

IFIA members and managers involved in this response note that the AIFMD imposes detailed requirements in relation to the use of leverage by AIFMs and their AIFs. However, no leverage limits are imposed and instead the regime is built on transparency, including disclosure to investors on a pre-investment and continuing basis (Article 23(5)); and comprehensive reporting obligations. Indeed, the AIFMD considers that leverage is only employed on a substantial basis when the exposure exceeds three times the net asset value of the AIF.

Imposing a leverage limit of 1:1 would constitute a material constraint for a significant number of managers who have indicated that they would not be able to trade within these limits. The managers who were concerned about the leverage limit commented that a low level of leverage will operate to push lenders to riskier underlying loans such as mezzanine type loans or to borrowers not served by the current market.

Several managers commented that the totality of the Central Bank approach is aimed at replicating the processes and procedures that are in place for bank lending and that the approach to leverage is the one big exception to this approach when compared to the Basle limits imposed on banks. That said, there is recognition that obtaining bank levels of leverage is not a realistic proposition.

We note that one of the principles of the loan QIAIF is to provide a viable source of non-bank financing. However, the leverage restrictions in the banking sector typically permit much greater leverage than those contemplated by CP 85, which could adversely affect the ability of QIAIFs to offer competitive products.

If, notwithstanding the points above, it is deemed appropriate by the Central Bank to introduce leverage restrictions at the level of the QIAIF, the IFIA submits that the regime should permit greater access to borrowing and leverage in order for loan originating QIAIFs to achieve their investment objectives and to offer sufficient returns to investors.

It is worth noting that currently Business Development Corporations ("BDCs") in the US have a similar 1:1 leverage ratio but BDCs are available to retail investors in the US and it is expected that this leverage limit will increase to 2:1 in 2015. No leverage limits applied to alternative investment funds in the US.

In this regard, we suggest that:

- the limit should be raised to be consistent with AIFMD's concept of leverage on a substantial basis (Article 24(4)) which is three times NAV (we consider that use of consistent leverage terminology between AIFMD and any proposed leverage test would be helpful in order to avoid any risk of confusion);

- the limit of three times NAV may be disapplied if the Qualifying Investor AIF has a minimum subscription limit of €500,000 or its equivalent in other currencies. The aggregate of an investor's investments in the sub-funds of an umbrella Qualifying Investor AIF cannot be taken into account for the purposes of determining this requirement. The amounts of subsequent subscriptions from unitholders who have already subscribed the minimum subscription of €500,000 are unrestricted. Institutions may not group amounts of less than €500,000 for individual investors;

- if these limits are subsequently exceeded for reasons beyond the control of the Qualifying Investor AIF or as a result of investment in FDI or the exercise of subscription rights, the Qualifying Investor AIF must record such matters and adopt as a priority objective the remedying of that situation, taking due account of the interests of its unitholders; and that

- any subsequent reduction in the leverage limits can only be applied to new lending.

7.

Disclosure: *Detailed disclosure to investors of an AIF's investment objectives, policies/ strategies and the risks attached to these, is a significant part of the AIFMD regulatory regime. Given the nature of this asset class however we are proposing to impose supplementary disclosure requirements, both in the prospectus and periodic reports of a loan originating Qualifying Investor AIF. These include specific risk warnings and detail on the credit assessment and monitoring process and any amendments to that process.*

We are also proposing to require itemised disclosure to investors of each loan in periodic reports under prescribed categories and, in particular, propose to require that loans which are either non-performing or have been subject to forbearance activities are identified. These are matters which are prescribed in the final draft Implementing Technical Standard to be adopted under Article 99 of Regulation EU No 575/20131. Our approach is that loan originating Qualifying Investor AIFs apply the same criteria as banks to distressed loans and investors can have some assurances that appropriate categorisation is applied. Do you consider that this is the correct approach?

For the most part, we have no issues with the proposals in relation to the disclosure requirements outlined in the consultation paper.

However, it should be noted that the disclosures required in the periodic reporting may include some confidential, proprietary or price sensitive information particularly in respect of the underlying borrower which may not be appropriate to release in a periodic report under paragraph 24. Points 24 (iii) and (iv) in particular, require periodic disclosure of loan to value information on each loan and information in respect to non-performing exposure and exposure subject to forebearance activities. This information could be seen as confidential or price sensitive to the loan parties involved. In order to address this concern we propose that the fund could provide details by way of percentage of loans made that are non-performing, without identifying the specific loans in question.

Also, paragraph 10 of the draft rules contains a provision that *"The AIFM shall not intentionally or negligently conceal or fail to disclose information that a reasonable person would be likely to have considered important in considering an investment in the loan originating Qualifying Investor AIF"*. There is already a general requirement in the AIF Rulebook that a QIAIF's prospectus must contain *"sufficient information for investors to make an informed judgment of the investment proposed to them"*.[2] We would suggest that the standard wording in relation to the obligation to provide relevant information should be consistent with that for other QIAIFs.

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.

Under paragraph 24(i) the terms *"senior secured debt, junior debt and mezzanine debt"* are used but not defined. In order to provide the AIFM with a clear frame of reference we suggest inserting *"as defined in the governing documentation of the Qualifying investor AIF"* at the end of this sentence.

[2] Paragraph 2 of the general prospectus requirements under Section 3, Part I, Chapter 2 of the AIF Rulebook

8.	***Interconnectedness with the banking sector:*** *The ESRB has advised us that loan origination by investment funds could increase regulatory arbitrage opportunities between the banking and non-banking lending sectors. They advise us to monitor and mitigate such risks. Identification of suitable lending opportunities is a central business challenge for loan origination funds. It is likely that AIFMs of loan originating AIFs will seek partnerships with banks particularly to leverage off their expertise with regard to credit analysis, risk management and the structuring and servicing of loans and to access their client base. Such arrangements may also be desirable for banks. Banks may find it beneficial to use the balance sheets of AIFs for risk sharing purposes as well as meeting demand from clients which a bank is not in a position to take on its own balance sheet. While there can be benefits in such partnerships, this may also introduce systemic risks arising from arbitrage and we are proposing to address this risk by a requirement for each loan originating Qualifying Investor AIF to include detail of any undrawn committed credit lines in periodic reports. When aggregated by bank and looked at in conjunction with data on drawn facilities, this should provide useful information to regulators on the relationships between the banking and non-banking sectors.*

Please see responses below.

9.	*In addition to requirements in AIFMD regarding investment in securitisations and rules in our AIF Rulebook on transactions with connected parties, we are requiring that specific rules apply where there is any on-going connection between a credit institution and a loan originating Qualifying Investor AIF. Do you think that this is sufficient?*

As questions 8 and 9 both outline proposals relating to interconnectedness with the banking sector, we have considered these items together.

Any QIAIF that is permitted to engage in loan origination will:

i. be an internally managed AIF or have an external AIFM, in either case subject to the provisions of the AIFMD;
ii. be regulated by the CBI as a collective investment scheme under the relevant Irish statutory provisions; and
iii. comply with the specific regime set out in the consultation and to be inserted in Chapter 2, Part II, Section 4 of the AIF Rulebook (the "Draft Amendments").

As noted elsewhere in this response, the approach of placing loan origination funds firmly within the AIFMD regime imposes a high standard of prudential regulation and regulatory reporting obligations upon the structure. In addition, the Central Bank has invested significant effort and resources, through the July 2013 Discussion Paper and its subsequent discussions with industry participants and international colleagues, in developing additional prudential rules to address concerns around regulatory arbitrage, contagion risk, liquidity risk and pro-cyclicality, which are set out in the Draft Amendments. For example, the detailed provisions in relation to credit granting, monitoring and management in paragraphs 5-9 of the Draft Amendments create a tailored set of rules to supplement the existing general provisions of AIFMD and the AIF Rulebook.

We believe that this rigorous regime addresses the concerns by the ESRB[3] in relation to regulatory arbitrage opportunities between the banking and non-banking lending sectors.

We note the proposals in paragraph 25 of the Draft Amendments to require the loan originating QIAIF to include a *"list of any undrawn committed credit lines"* in its periodic reports. We recognise that such information may be useful for regulators in determining the relationships between banking and non-banking sectors, but believe that any regulatory measures should be proportionate to the risks posed to the regulatory system. In addition, we believe that loan originating QIAIFs may view such information as sensitive and, as such, be reluctant to disclose it publically via its periodic reports. Given that the intention behind this proposal is to facilitate regulatory supervision, rather than serve any investor disclosure purpose, and in light of the above concern around confidentiality, we would propose that such information be provided directly to the Central Bank as part of ongoing reporting, rather than form part of the periodic reports.

We note also the series of rules in paragraph 14 which will apply in certain circumstances where a loan originating QIAIF acquires a loan from a credit institution. While we have no fundamental objection to most of these, we believe that many of the provisions of paragraph 14(a) of the Draft Amendments, including for example the requirements to be able to value the loan, monitor performance of the loan and to stress test the loan are addressed in other sections of the Draft Amendments. For example, paragraph 16 includes detailed stress testing obligations on the loan originating QIAIF, regardless of whether it originates directly or acquires from a credit institution.

We are also aware of concerns raised by market participants as to the ability or willingness of arranging banks in the existing syndicated loan market (which would be the vendor for the purposes of these provisions) to provide a warranty to the QIAIF that it will retain 5% of the nominal value of the loan as measured at origination (as contemplated by paragraph 14(b)(i) of the Draft Amendments.

In this regard, it is worth recalling the review of the existing syndicated loan market for secondary loans conducted by the Central Bank in the context of the July 2013 Discussion Paper. As part of that review the Central Bank had noted that it *"is a highly structured market, with specialised teams operating in banks and asset managers to review loan participations which are circulated by other financial institutions which structure a deal on the basis of their own detailed credit assessment and on the basis of bespoke structured documentation, fees and interest rates particular to that deal"*. It goes on to note that *"the syndicated loan market has an inherent discipline around the credit assessment and monitoring because loans must be structured and priced to be credible to a range of potential lenders"*.

There are no existing 'skin in the game' or retention requirements at the point of loan origination in the Irish syndicated loan market and we are not aware of similar provision in loan markets in other jurisdictions. We have been advised that arrangers may prove unwilling to accept this additional requirement as a cost of dealing with Irish loan originating QIAIFs, thereby limiting the ability of the new QIAIF product to access this market. The purpose of a retention requirement is generally to ensure alignment of interests between the originator and any purchasers in the secondary market. However, as the Central Bank has noted above, the syndicated loan market is a sophisticated market with loan arrangers subject to the inherent discipline around credit

[3] http://www.esrb.europa.eu/news/pr/2014/html/pr140331.en.html

assessment and monitoring in order to ensure that loans are structured and priced in a way that is credible to a range of potential investors.

We have been advised by managers in this market that the introduction of this requirement on a unilateral basis would place Irish loan origination funds at a significant disadvantage in the purchase of debt from banks in the secondary market. Effectively, the banks would be unwilling to sell to an Irish loan origination fund if the cost was the imposition of a 5% 'skin in the game' requirement. This would result in a smaller pool of potential investment for Irish funds and increased costs in respect of those transactions in which they do engage. To introduce this requirement would disincentivise banks from selling to Irish loan originating QIAIFs in the secondary market, thereby reducing investment opportunities and increasing costs for Irish QIAIFs.

Any 'skin in the game' requirements applied to loan arrangers in this manner should be imposed on a harmonised level (whether as an EU or global initiative) in regulation aimed at loan arrangers and credit institutions, rather than as a local Irish restriction which will not be able to achieve the intended aim and could damage the interests of Irish loan origination QIAIFs and their investors.

10.	***Reporting and stress testing:*** *Macro prudential supervisors need information on the activities of loan originating AIFs in order to address systemic risks associated with excessive credit growth and leverage. AIFMD imposes substantial reporting requirements on AIFMs who must, inter alia, provide periodic information on the ten principal exposures of each AIF; the five most important portfolio concentrations; borrowings of cash or securities; and borrowing embedded in financial instruments. In addition we intend to put in place similar reporting on individual loans as is provided by the banking sector. It is also intended that our requirements in this regard will evolve with developments in banking. The rules also provide for periodic stress testing. Do you agree with our approach?*

We agree that macro prudential supervision, including reporting and stress testing of the loans originated by QIAIFs, is necessary to provide appropriate protection for investors, to mitigate systemic risks and to reduce opportunities for regulatory arbitrage between bank and non-bank lenders. Our comments set out below focus on ensuring alignment with existing reporting and risk management frameworks insofar as possible and on ensuring that requirements intended for banking are applied in a proportionate manner to loan originating QIAIFs, which differ from the banking business in several key ways:

- The prudential framework needs to be appropriate to investment management in order to mitigate the risks involved. The requirements should reflect that the asset and liability profiles are different between QIAIFs and banks. On the liability side, QIAIFs will raise the funds from qualifying/professional investors (minimum €100k investment) as opposed to banks which are dealing with depositors (retail, corporate and institutional). On the asset side, it is proposed that QIAIFs will be restricted from lending to natural persons, AIFMs or related entities, other funds, institutions (with some exceptions) and to persons intending to invest in certain instruments. Banks are not subject to any such restrictions.

- As a general observation, we note that Business Development Companies in the US can originate loans, and are doing so successfully in a regulated framework without reporting and stress testing requirements being placed on them. We are not suggesting that a similar approach be taken here, but rather wish to highlight this as evidence that although regulation is necessary, it should be tailored to the actual risks involved.

- A key tenet of the approach to loan origination by QIAIFs is that the QIAIF must have a fully authorised AIFM. We agree that AIFMD imposes significant reporting, risk management requirements, liquidity management and stress testing requirements on AIFMs. Consequently, we consider that stress testing, scenario and risk testing under paragraph 16 should supplement AIFMD requirements rather than imposing overlapping requirements. Therefore, we propose that where the AIFM has already stress tested market, credit and other risks of the fund, a proportionate response would be for these to also satisfy the testing required under paragraph 16 of the draft amended AIF Rulebook.

- Paragraph 24 of the draft AIF Rulebook amendments sets out extensive periodic reporting on individual loans. We note that there is no scope for portfolio analysis or for aggregate figures to be reported according to the principle of proportionality as applied in banking. Please also note our comments in relation to the disclosure of proprietary or sensitive information in relation to individual loans under number 7. Accordingly, we propose to alternatively disclose non-performing loans by way of aggregate percentage in order not to identify the specific loans in question.

Annex III: Role of the depositary

We note that there are no specific depositary requirements attaching to loan originating QIAIFs and our understanding is that only the existing depositary obligations and duties apply as per the requirements specified under the AIFM Regulations and AIF Rulebook. We would favour this approach in line with ensuring that the depositary framework is applied consistently across all QIAIFs.