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By Email: fundspolicy@centralbank.ie

Our Ref Your Ref 25 August 2014

Dear Sirs

Response to Consultation on loan originating Qualifying Investor AIF

We welcome the opportunity to respond to Consultation Paper CP 85 ("**CP 85**") on the proposed rules to apply to a loan originating Qualifying Investor AIF.

The Asset Management and Investment Funds Group at Matheson comprises ten partners and over 50 fund professionals in total. Our lawyers have legal and regulatory expertise in all aspects of Irish UCITS and non-UCITS investments funds and our client portfolio includes a number of Europe's largest hedge fund managers. We act on behalf of clients representing approximately 27 per cent by net asset value of all Irish domiciled funds as at 30 June 2013. This includes a number of clients with experience in credit markets who have launched Irish Qualifying Investor Alternative Investor Funds ("**QIAIFs**") in order to obtain exposure to loans in the secondary markets. In many cases, these managers had also considered the possibility of domiciling loan originating funds in Ireland but have been unable to do so under current Central Bank policy.

Accordingly, we strongly support and welcome the initiative taken by the Central Bank in proposing a new regime for loan originating QIAIFs. As noted by the European Commission, the reduction in lending by traditional banking institutions to the corporate sector in recent years has left enterprises in Europe unable to obtain the credit needed to generate growth and employment. At the same time, there is a significant body of expertise within the global asset management community in facilitating beneficial long-term investment in businesses through loan originating funds. A number of these managers have existing connections to Ireland and have structured Irish QIAIFs and other vehicles to acquire loans in the secondary market. However, the prohibition on lending by an Irish fund has forced many of these managers to locate their loan origination strategies, and in some cases their entire range of credit funds, outside Ireland. The Irish funds industry employs more than 13,000 people in the administration, custody and servicing of funds and the current absence of a loan origination vehicle in Ireland has direct implications in relation to the number of people employed here.

Chairman: Sir Anthony O'Reilly - Managing Partner: Liam Quirke - Partners: Pauline O'Donovan, Robert Heron, Patrick Sweetman, Brian Buggy, Paul Glenfield, Michael Jackson, Chris Quinn, Tim Scanlon, Helen Kelly, Sharon Daly, Ruth Hunter, Tony O'Grady, Paraic Madigan, Michael O'Connor, Tara Doyle, Anne-Marie Bohan, Patrick Spicer, Turlough Galvin, Patrick Molloy, George Brady, Bríd Munnelly, Robert O'Shea, Joseph Beashel, Deirdre-Ann Barr, John Dunne, Damien Keogh, Cara O'Hagan, Dualta Counihan, Barry Lynch, Ronan McLoughlin, Niall Horgan, Deirdre Dunne, Alistair Payne, Fergus Bolster, Christian Donagh, Bryan Dunne, Libby Garvey, Shane Hogan, Peter O'Brien, John O'Connor, Thomas Hayes, Nicola Dunleavy, Julie Murphy-O'Connor, Helen Noble, Alan Connell, Bonnie Costelloe, Brian Doran, John Gill, Alan Chiswick, Joe Duffy, Pat English, Carina Lawlor, Shay Lydon, Aidan Fahy, Niamh Counihan, Gerry Thornton, Liam Collins, Darren Maher. - Tax Principals: Anthony Walsh, Greg Lockhart, John Kelly, Catherine Galvin. - London: Stanley Watson. - New York: John Ryan. - Palo Alto: Mark O'Sullivan. Of Counsel: William Prentice, Roderic Ensor. - Consultants: Arthur Moran, Emer Hunt, Frank Nowlan, Elizabeth Grace, Michael Tyrrell, Graham Richards, James Hickey, Don McAleese, Stuart Margetson.

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We believe that there is significant demand amongst promoters and investors for an Irish loan originating QIAIF and that the proposed regime will have an immediate and measurable impact on employment in Ireland. We believe that the Central Bank proposals will benefit businesses in Ireland, Europe and elsewhere which have been denied access to finance and are consistent with initiatives at European level to promote sustainable non-bank financing options through fund vehicles including the European Long Term Investment Fund ("**ELTIF**") and the European Venture Capital Fund ("**EUVECA**").

We agree with the Central Bank that, notwithstanding the substantial and significant regime for regulation of alternative investment fund managers ("**AIFMs**") under the Alternative Investment Fund Managers Directive ("**AIFMD**"), the Central Bank may usefully set out additional rules in relation to certain product types in order to ensure that particular risks attached to such product are addressed. We note the various risks that the Central Bank has identified in CP 85 in respect of loan origination and believe that the set of rules identified by the Central Bank represent, for the most part, a proportionate response to address those risks. In particular, we fully support the Central Bank's rationale underpinning proposed rules around credit assessment, granting and monitoring, diversification of investment, investor access to due diligence and reporting.

We have set out in Schedule 1 our comments in relation to questions raised by the Central Bank in CP 85. We have also been actively involved in the preparation of the Irish Funds Industry Association's ("**IFIA**") response to CP 85 and support the detailed submissions made in that response, including in particular those in relation to the ability of a loan originating QIAIF to acquire loans on the secondary market and in relation to permitted leverage.

While we have discussed a number of the issues arising from CP 85 with our clients, please note that the below comments represent our own views and do not necessarily reflect the views of all clients.

We are committed to advocating positive change at industry level, and we would be more than happy to discuss any of the points raised in this response in further detail over the phone or in person with you. In this regard, please do not hesitate to contact Shay Lydon of this office at shay.lydon@matheson.com or on +353 1 232 2735.

Yours faithfully

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SCHEDULE

General Comment

Loan origination and secondary market acquisitions

The most significant comment we have in relation to CP 85 relates to the ability of a loan originating QIAIF to acquire loans on the secondary market and engage in other activities which are related to the granting of credit.

In this regard, we note that paragraphs 13 and 14 of the proposed new section 4 for insertion into the AIFM Rulebook ("**Section 4**") clearly contemplate that a loan originating QIAIF may acquire loans from a credit institution on the secondary market. However, we believe that paragraph 2 of Section 4 to be unduly restrictive in terms of the proposed scope of investment by stating that "*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 business*". We also note the statement in the Introduction to CP 85 that the Central Bank has drafted a set of rules which would apply to a type of AIF "*whose sole strategy is loan origination*".

This would be a significant concern for us and has been raised by the vast majority of the asset managers we have consulted with as part of the CP 85 process. We note that the Central Bank identified in its July 2013 Discussion Paper on loan origination (the "**2013 Discussion Paper**") a number of substantive differences between loan origination and loan participation. In particular, the Central Bank stated that it sees loan origination as requiring additional specialist skills and procedures in relation to the identification of projects, negotiation of loan terms, extension of credit and monitoring progress of loans. We believe that it was clear from the 2013 Discussion Paper and is consistent with our discussions with investment managers that, if an investment manager is able to demonstrate these specialist skills and expertise to identify and structure investment opportunities in the primary market and to comply with the proposed provisions of Section 4. It will also be able to conduct credit, risk analysis and other activities necessary to evaluate a loan on the secondary market. In other words, an investment manager who has shown the expertise necessary to comply with Section 4 and engage in primary lending should also be able to invest in the secondary market.

Furthermore, a fund which has a primary focus on the origination of loans may be required, due to market circumstances, to acquire on the secondary market or to hold securities related to such origination. For example, there are some jurisdictions where local rules or market practice render it impractical or costly to directly originate loans in bilateral facility agreements (examples include France and Italy). If a loan originating fund targeting a diversified exposure across Europe seeks to invest in those markets, it may be best served by doing so through secondary market acquisition or participation in a syndicate. In addition, market practice in some jurisdictions is that company borrowing is documented by the private issuance of a debt security or note, rather than a bilateral facility or credit agreement. Any existing Irish AIF has the ability to purchase such debt securities, under AIFMD and the AIF Rulebook. It would appear counterintuitive to deny the group of asset

managers with most expertise in this area the ability to acquire such securities as part of their investment programme. Finally, it is possible that a loan originating QIAIF might find itself holding debt, equity or other securities or property as part of the restructuring or enforcement of any existing loans or securities.

Accordingly, we believe that Section 4 should clearly state that a loan originating QIAIF will have the ability to engage in loan origination, to acquire loans in the secondary market, engage in sub-participations and to hold debt, equity and other securities related to the credit strategy of the fund. We have been clearly advised by investment managers who are active in this area that they will simply be unable to use an Irish loan origination structure if it is subject to an 'origination only' requirement and believe that there are compelling reasons to allow any manager with the expertise to originate loans to also conduct secondary market and other transactions related to this strategy.

Question 1

Credit assessment granting and monitoring

We support the proposal to require the loan originating QIAIF to have an effective credit assessment and management process. We believe that the majority of investment managers already conduct detailed due diligence as a matter of practice and have internal policies in place to meet these requirements. We welcome the approach taken by the Central Bank identifying the policies and procedures to be implemented in respect of credit monitoring, collateral management, problem debt management policies, without prescribing the content of such standards. There had been a concern by some managers that any proposals to impose minimum requirements as part of this process (eg, relating to credit rating of borrowers, rate of return on loans and security / enforcement provisions) would impact on the investment manager's ability to make its own assessment of a potential investment and to disclose to investors.

We note that the Central Bank has highlighted that the loan originating QIAIF will be subject to the Central Bank's Code of Conduct in relation to Business Lending to Small and Medium Enterprises (the "**Code"**) insofar as it lends to certain borrowers in Ireland and agree that this is the correct interpretation of those provisions setting out the scope of the Code. However, given that the Code was drafted at a time when it was not possible for a QIAIF to originate loans, there are some provisions which were not drafted with an AIFMD compliant fund structure in mind. Accordingly, we believe that it would be worth including a provision in Section 4 to confirm that the Code is applicable, save to the extent that a requirement is addressed by AIFMD or inconsistent with AIFMD. We would be happy to provide additional detail on those sections which may be inconsistent should you wish.

We also had a query as to the purpose of paragraph 8 of Section 4 which anticipates a policy or process to control the risk that credit risk mitigation techniques may prove less effective than expected. We believe that this is already addressed within the credit risk policies contemplated in paragraph 5 of Section 8.

Question 2

Diversification

We accept the Central Bank's approach with regard to the diversification requirement and believe that most investment managers will be able to operate within the proposed limits.

However, we believe that the proposal to seek unitholder approval would be excessive in circumstances where the diversification limits are exceeded due to early repayment of a portion of the portfolio, market movements or where the loan originating QIAIF is in its 'ramp-down' period at the end of its investment cycle. We agree with the proposals made by the IFIA to simplify the process in such cases.

We understand that there may also be some sectors where market practice is for greater concentration of investments. For example, in the case of some lending into the real estate sector, a fund product may be launched with the intention of providing finance to a relatively small number of real estate projects, with a recent example being the financing of some of the recent shopping 'mega-malls' in the UK. We understand that the Commercial Real Estate Finance Council as part of its submission on CP 85 intends to highlight this point, noting that in such cases the lender will have regard to the leases, rental flows, real estate value and other factors in order to ensure risk diversification before committing to a particular investment. Given that it would be possible for an Irish QIAIF property fund to hold a concentrated portfolio or a single investment, we would be happy to discuss in further detail with you should you wish to explore whether it might be possible to permit greater concentration for certain asset types in the context of loan origination.

Question 3

Liquidity

We note the concerns raised by the Central Bank in relation to liquidity and agree that the requirement that loan originating QIAIFs are set up as closed ended funds is an effective tool to mitigate against liquidity runs.

However, we believe that the provisions which permit the loan originating QIAIF to return assets to investors should be more flexible. In particular, we would have a concern around the requirement for unitholder approval for a distribution or redemption where assets are not valued by reference to prevailing market prices. Given that loan portfolios may be valued in accordance with valuation models developed in accordance with AIFMD requirements, we believe that a unitholder approval requirement to be excessive and will effectively prevent the return of assets to unitholders, even where the investment manager and the loan originating QIAIF believe it to be in the interests of investors to do so. We agree with the concern raised by the IFIA that unitholders holding a majority of the units could block a distribution or redemption approved by the investment manager that could be otherwise be made available to all unitholders. This would put minority unitholders at a disadvantage as they would be relying on the vote of unitholders with whom they may hold conflicting interests, as opposed to the judgment of the investment manager.

We also believe that, in the event that the consent requirement was to be retained, investors should be able to provide their consent in advance, through the prospectus and their subscription documents, to certain distributions or repayments in clearly defined circumstances. These might include quarterly liquidity distributions or the return of cash amounts where an originated loan is repaid by the borrower before maturity and the investment manager has not identified an equivalent replacement loan.

Question 4

Due diligence by investors on the management of a loan originating Qualifying Investor AIF

We agree with the Central Bank's approach in requiring that where access to due diligence is provided to investors, it must be done on a non-discriminatory basis. We note the Central Bank's clarification in Question 4 of CP 85 that the intention is to ensure non-discriminatory access for investors but that the Central Bank does not require that all potential investors who approach the loan originating AIF expressing an interest in investing will be given the same access. We agree with the IFIA that Section 4 should be amended to clarify this point and in order to avoid any implication that the loan originating AIF or the AIFM has a positive obligation to pro-actively provide such information to all unitholders.

In addition, we note that paragraph 10 states that the loan originating QIAIF should 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*". There is already a general disclosure standard in the AIF Rulebook that a QIAIF "*must provide investors with sufficient information to make an informed judgement on the investment proposed to them*". While we have no objection to the inclusion in Section 4 of provisions outlining specific information requirements which should be provided by a loan originating fund, we believe that it will only case confusion to set out a different standard of care in respect of general prospectus disclosures (including disclosures in relation to areas unrelated to the investment policy).

Question 5

Valuation

We agree with the Central Bank's approach in relation to valuation.

Question 6

Leverage

This is an issue which has prompted considerable input from investment managers and we would have a significant concern that a 1:1 leverage limit would ultimately impact on the success of the loan originating QIAIF as a product.

The feedback from managers is that the 1:1 level is restrictive and would be a factor which would leave them inclined to choose other regimes over an Irish loan originating QIAIF. One manager has noted that their focus is on the quality of their loan book and that they place significant emphasis on screening of potential borrowers against the credit granting, monitoring and assessment criteria set

out in Question 2 of CP 85. However, if that investment manager was to construct a loan portfolio which lends to highly rated borrowers with the loan originating QIAIF holding senior security rights, it will receive a far lower yield on such loans than would be the case in relation to lending to less highly rated borrowers or the acquisition of lower tier security. Ordinarily, the manager would address returns to investors by increasing leverage at the level of the loan originating QIAIF. However, this would be very quickly precluded by the imposition of a 1:1 level. We understand that similar constraints have impacted on investment managers using the US Business Development Model ("**BDC**") and that proposals to increase the leverage ratio available to BDCs are at an advanced stage.

While we understand the Central Bank's concern in relation to pro-cyclicality within the market, we believe that this is best addressed by rules and / or reporting requirements addressed to all participants in the market, including banks and credit institutions, rather than a set of restrictive rules addressed to Irish loan originating QIAIFs, as one relatively small participant in the market. As it stands, the leverage restrictions that are imposed in the banking sector would typically permit greater leverage than those contemplated by the Central Bank in CP 85 which would adversely affecting the ability of the loan originating QIAIF to offer competitive products. We have also seen investment managers raise concerns in relation to the potential implication of an instruction from the Central Bank to reduce leverage levels within a portfolio, noting the commercial costs of closing out of facilities ahead of maturity and on the terms on which leverage has been provided to the loan originating QIAIF.

We agree with the proposals made by the IFIA in relation to potential amendments to address leverage within the loan originating QIAIF structure in such a way as to ensure the product will be attractive to fund managers, while still maintaining leverage levels far below those available to banks.

A final comment has been from a fund manager who has noted that they typically negotiate their financing terms available to their loan originating funds upon launch of the product, with the relevant terms granted by leverage providers (including rates and security terms) depending largely on capital commitments received by the relevant fund. Given that the Irish loan originating QIAIF will be structured as a closed ended fund, which will typically obtain capital commitments up-front from investors and accordingly know its maximum potential NAV in terms of investment capital, we believe that leverage should calculated by reference to capital commitments rather than NAV.

Questions 8 & 9

Interconnectedness with the banking sector

As questions 8 and 9 both consider proposals address interconnectedness with the banking sector, we propose to consider these together.

We have no objection to the proposal that the loan originating QIAIF include details of undrawn credit commitment lines in periodic reports. Given that the purpose of this reporting is to allow the Central Bank to assess the relationships between the banking and non-banking sectors, we would propose a clarification that this information should form part of the periodic regulatory reporting provided to the Central Bank rather than the financial statements issued to investors.

In relation to the other proposals made in paragraphs 13 and 14 of Section 4, we note that 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. We believe that this regime addresses the concerns by the ESRB in relation to regulatory arbitrage opportunities between the banking and non-banking lending sectors. Accordingly, we believe that many of these (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 elsewhere in Section 4. 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 believe the requirements in paragraph 13 should be clarified as being cumulative by stating that the provisions of paragraph 14 will also apply where the originating credit institution will retain a portion of the loan **and** it is providing the ongoing credit assessment and monitoring requirements. We also believe that the reference to 'administration' services should be deleted from paragraph 13(ii). A bank which arranges or originates a loan may provide routine administration services in relation to a loan which is sold in the secondary market. However, this is different to credit assessment and / or credit monitoring services which might trigger some of the paragraph 14 requirements for the loan originating fund (to the extent they are not addressed elsewhere).

We are also aware of significant 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 Section 4.

There are no existing 'skin in the game' or retention requirements at the point of loan origination in the 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 QIAIF, thereby limiting the ability of the new product to access this market. To introduce this requirement on a unilateral basis would disincentivise banks from selling to Irish loan origination QIAIFs in the secondary market, thereby reducing investment opportunities or increasing costs for Irish QIAIFs.

Accordingly, if a 'skin in the game' requirement is to be applied to loan arrangers in this manner, it 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 through the back-door as a local Irish restriction which will not be able to achieve the intended aim and will only damage the interests of Irish loan originating QIAIFs and their investors.

Question 10

Reporting and stress testing

We agree that prudential supervision, such as reporting and stress testing, is necessary to protect investors, mitigate against systemic risks and to reduce opportunities for regulatory arbitrage.

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However, we also consider that such supervision should be appropriate to the context for which it is designed and have regard to the existing regime under AIFMD and the AIF Rulebook. We note concerns raised with us by managers in relation to the implications of imposing a stress testing regime, designed for deposit taking banks, upon a loan originating fund. Accordingly, we agree with the comments made by the IFIA in relation to this question