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Loan Originating QIAIFs – Central Bank of Ireland offers greater flexibility

Introduction

As readers will recall, the Central Bank of Ireland (“**Central Bank**”) announced on 25 November, 2016 that it would be amending the rules that apply to Irish domiciled qualifying investor alternative investment funds (“**QIAIFs**”) which originate loans to allow for non-loan asset investments linked to the loan origination strategy to be undertaken. A link to our bulletin on the Central Bank announcement can be found [here](#).

The Central Bank has now issued these new rules as described below. By way of reminder, up until now, Irish loan originating QIAIFs were required to limit their operations to issuing loans, participating in loans, participating in lending and to operations directly arising therefrom, including handling assets realised through the enforcement of security.

New rules¹

Loan originating QIAIFs must now limit their operations to issuing loans, participating in loans, participations in lending *and to operations relating thereto, including investing in debt and equity securities of entities or groups to which the loan originating QIAIF lends or which are held for treasury, cash management or hedging purposes.*

This permits loan originating QIAIFs to include equity elements in their financing arrangements, such as warrants, options and

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¹ Paragraph 2 of sub-section i of section 4 of Chapter 2 of the Central Bank’s AIF Rulebook.

convertibles as well as other forms of debt, provided that such investments are issued by entities or groups to which the loan originating QIAIF lends and are linked to the loan origination strategy.

The new rules also clarify that a loan originating QIAIF can engage in treasury (short term securities, repo and so on), cash management and hedging transactions (facilitating, for example, exchange rate and interest rate hedging).

While the explicit reference to QIAIFs being permitted to handle assets which are realised as security has been deleted, the handling of security, including equity following a loan workout clearly continues to be permitted.²

Guidance from Central Bank³

The Central Bank has provided some helpful clarifications as to the application of these new rules.

It states that the QIAIF can combine lending (whether syndicated or bilateral), debt securities, subordinated debt and equity in a package of related investments provided that these are related to the QIAIF's lending activities. The Central Bank considers that typically a loan and a non-lending investment are 'related' if they form an investment package such that, for both parties, the willingness to enter into one type of investment is contingent on the other also being entered into.

The Central Bank has also confirmed that a loan originating QIAIF can structure its lending activities other than as bilateral loans, for example, as debt securities (for example, loan notes) or as a participation in a syndicated lending arrangement.

Importantly, the Central Bank's expectation is that its existing rules relating to the assessment of individual lending proposals⁴ will not apply to "related" investments but rules that apply to the management of the overall portfolio of the QIAIF will.

Analysis

The above is clearly a significant improvement on the previous position and will make the loan origination QIAIF a far more attractive proposition for a broader universe of managers and investors, particularly in the middle market space where lending is commonly characterised by the inclusion of an equity participation.

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² Central Bank AIFMD Q&A of 3 January, 2017, ID 1082.

³ The Central Bank published an updated AIFMD Q&A on 3 January, 2017 which contained a number of new Q&A relating to the Central Bank's revised rules.

⁴ See sub-section ii of section 4 of Chapter 2 of the Central Bank's AIF Rulebook which is headed "Credit granting, monitoring and management".

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