Opportunities post AIFMD –
The sky is the Limit

Ireland, as you would expect from a domicile that services over 40% of the world's alternative investment products, was in the vanguard when it came to the implementation of the Alternative Investment Fund Managers Directive ("**AIFMD**"). At the time of writing there are over 127 Alternative Investment Fund Managers ("**AIFMs**") regulated in Ireland, with in excess of 2,000 AIFs.

While we can certainly expect the number of AIFs domiciled in Ireland with so called "*traditional"* alternative asset classes to increase in the coming months, some of the more progressive AIFMs have been seeking out fresh asset classes, in order to utilise the robust framework provided by regulated AIFs. In this regard, the aviation sector may offer an asset class that will appeal to investors' growing appetites.

Prior to the development of the Irish funds industry in the late 1980s, Ireland had already become the jurisdiction of choice for both aircraft financing and leasing operations. The catalyst for this was the establishment of Guinness Peat Aviation ("**GPA**") in Shannon, County Clare in the mid-1970s.

GPA spawned an industry of global aircraft lessors either headquartered or exercising an established presence in Ireland. The industry here has grown year on year, due primarily to the number of experienced executives and professional services firms available and the attractive legal and taxation regimes in place. To give some idea of the scale of the industry in Ireland currently, nine of the world's ten largest aircraft lessors are located here, with approximately 50% of the entire global aircraft fleet of leased aircraft being managed out of Ireland.

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Aviation companies based in Ireland include

ORIX	AWAS
ICBCI	AVOLON
BOCI	GE Aviation
SMBC	AerCap

More recently, the manner in which aircraft financing is being structured has started to evolve and become more sophisticated. We see private equity and hedge funds assuming an ever more important place in the aviation market. These act as significant sources of equity, and provide capital for both lending and leasing. The range of aviation related assets in which such entities can invest are broad and varied and can include, for example, direct investment in aircraft or aircraft owning entities, secured and unsecured privately placed notes, equity investment in leasing firms as well as aircraft and lease asset backed securities.

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Aircraft assets, particularly newer aircraft, have generally not been subject to the wide fluctuations in value seen with many other asset classes. In addition, significant amounts of capital can be put to work relatively easily and effectively in aircraft related investments. Aviation assets are so called *"hard assets"*, which have traditionally proven popular with investors, particularly at less economically certain times. Moreover, aircraft as an asset class has shown notable resilience in the face of inflation, as they are assets that reset their financial terms on a regular periodic basis.

The aviation industry is currently enjoying a period of strong growth. This can be attributed to a number of factors, including growing passenger numbers in Asia and the fact that we are in the middle of a period of global aircraft replacement with many aircraft currently coming to the end of their lifecycle, and new orders for aircraft at all-time highs. In addition, investors are becoming more and more aware of the importance of diversification in terms of asset class and portfolio and are enticed by historically predictable cash flows that aircraft have shown to yield (while remaining quite a liquid asset class). As a result, aircraft as an asset class are becoming more and more attractive to investors and clients of AIFMs.

The Qualifying Investor Alternative Investment Fund ("**QIAIF**") is one way in which sophisticated investors can go about diversifying into aircraft as an asset class. Nevertheless, while the QIAIF can invest directly, it is more likely (e.g. for treaty benefit reasons) to use the "Super QIAIF" structure. This structure combines the favourable investment funds regime for QIAIFs with the favourable Irish securitisation regime (in respect of which Irish tax neutrality can effectively be achieved through the use of profit equalisation securities). Essentially, the QIAIF finances the securitisation vehicle (SPV)

(which will be a 100% subsidiary of the QIAIF) by taking up a profit participating security issued by the SPV. The SPV then uses the monies raised through the issue of the profit participating security to purchase the aircraft (in the normal manner) as set out in the investment funds' policy documentation. As the SPV is a fully taxable vehicle in Ireland (albeit its taxable profits can be managed to a desired level including taxable profits of zero if so desired – through the use of profit participating securities) and the SPV is the entity making the investments, it typically removes one of the obstacles to tax-exempt regulated funds obtaining treaty benefits, namely the requirement to be "liable to tax".

A number of recent legislative developments also lend themselves to increasing both Ireland's attractiveness and the attractiveness for investors of aircraft as an asset class. One such significant development is the enactment into Irish law of the State Airports (Shannon Group) Act, 2014 (the "**2014 Act**"), which provides for amendments to the International Interest in Mobile Equipment (Cape Town Convention) Act, 2005 (the "**2005 Act**") and the associated Aircraft Protocol (the "**Protocol**"). The 2005 Act incorporated the Cape Town Convention (the "**Convention**") into Irish law. However, in accordance with EU rules, Ireland did not make a declaration in respect of the insolvency remedies provided for in the Convention, nor did it modify its domestic insolvency regime to incorporate such remedies. Now, the 2014 Act enhances Ireland's aviation insolvency regime by giving effect to Alternative A in Article XI of the Protocol ("**Alternative A**").

Alternative A is very similar to the long established Chapter 1110 regime in the USA, which has proven very effective from a practical perspective in dealing with airline re-organisations. Restructurings under the regime have been undertaken by numerous notable players in the industry, including Continental, Delta, US Airways and United. Given the fact that many aircraft lessors have strong US operations, it is significant that Ireland now offers a regime not dissimilar to that which has been tried and tested in the USA.

Separately, and perhaps more importantly, the introduction of Alternative A better facilitates the issuance of Equipment Trust Certificates ("**ETCs**") in Ireland going forward. ETCs operate whereby a "trust certificate" is sold to investors in order to finance the purchase of aircraft by a trust, managed on the investor's behalf. The trust will then in turn lease the aircraft to a lessee routing payments through the trust back to investors. The lessee will receive title to the aircraft once the trust certificate matures. Effectively, the ETC is a type of secured debt financing not dissimilar to a mortgage. Enhanced Equipment Trust Certificates ("**EETCs**") or double ETCs are similar to ETCs except for the division of the entitlement to payment conferred thereby into two or more classes of securities e.g. senior and junior securities.

We expect to see further developments in this area over the coming year, as the main players in the Irish aviation finance and leasing sector and the Irish funds industry seek out synergies across related investment platforms. We hope to see increased activity in the area, and capitalisation on the combination of favourable Irish legal, regulatory and taxation frameworks, the wealth of experience domestically in this area, the sustained growth of the aviation sector and the attractive and historically solid return that aircraft as an asset class offers to investors.

Dillon Eustace – February, 2015

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