A Guide to Qualifying Investor AIFs

DILLON EUSTACE

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For almost 25 years, Ireland has been one of the world's leading alternative investment fund domiciles, with its original qualifying investor fund ("**QIF**") product internationally recognised as a very flexible alternative fund offering which could be launched quickly and within a regulated framework.

In conjunction with the introduction of the EU Directive 2011/61/EU on Alternative Investment Fund Managers ("**AIFMD**" or the "**Directive**"), the QIF has been replaced by what is considered an even better regulated product known as the qualifying investor alternative investment fund ("**QIAIF**"). Not only is the QIAIF suitable for hedge funds, FoHFs, less liquid and illiquid alternatives, private equity, venture capital, development capital and real estate funds (as well as most other types of investment fund exposure, whether considered "*alternative*" or not), it can also be marketed freely to professional investors throughout the 28 EU Member States (and the 3 additional European Economic Area Members States) by an authorised AIFM using AIFMD's marketing passport.

Latest available statistics at May 2015 indicate that there are now 1,920 QIAIFs (including sub-funds) representing in excess of Euro 355 billion in net assets.

QIAIFs benefit from the following features and Irish domicile infrastructure:

- a QIAIF with an authorised AIFM has access to European professional investors in 28 EU Member States (and the 3 additional European Economic Area Members States) using the AIFMD marketing passport;

- Euro 100,000 minimum subscription requirement (Euro 500,000 for QIAIFs seeking to disapply certain rules in respect of investment in underlying collective investment schemes);

- QIAIFs are available in 5 different legal structures;

- QIAIFs are not subject to Irish tax on income or gains and no Irish withholding taxes on redemption payments or dividends, provided certain straightforward conditions are adhered to;

- very few investment restrictions, the principal ones being those imposed by AIFMD on certain private equity type strategies and on investments in securitisations and certain Central Bank of Ireland imposed restrictions;

- no borrowing or leverage restrictions (other than for loan origination funds);

- fast-track, 24 hour regulatory approval process;

- internally(self)-managed, own AIFM, external AIFM and platform models all available;

- listing readily available on the Irish Stock Exchange, if desired;

- significant service provider infrastructure in Ireland, with 47 fund administrators and 18 depositories);

- capacity to migrate offshore funds from a number of domiciles to Ireland as QIAIFs, via a reasonably efficient process, avoiding any asset realisation;

- and many more.

At Dillon Eustace, assisting asset managers, fund sponsors, platform providers, investors and fund service providers (administrators, depositaries, prime brokers and others) with the structuring, formation and cross-border distribution of QIAIF (and prior QIF type) alternative funds has been a core part of our practice since the early 1990s. Our 40 lawyer (15 partner) Investment Funds legal team includes Irish, US, UK and Cayman qualified lawyers advising on product design, formation, authorisation and launch, prospectus and contractual documentation negotiation, interaction with regulators and exchanges.

We also offer funds listing and tax expertise, as well as follow-on regulatory and compliance advices, bringing to bear in-depth knowledge with a "*can do*" attitude. We are regular advisers to first-of-kind transactions and our team is recognised internationally as one of the most innovative and dynamic groups of lawyers in this practice area. The team has consistently been ranked as top tier by IFLR1000, The Legal 500, Chambers Global and Chambers Europe.

We hope you find this Guide of assistance.

Dillon Eustace Asset Management Team
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1. Introduction

Before getting into the detail, it is worth taking a few moments to explain where QIAIFs fit in within the regulated fund space. First and foremost, they are Irish domiciled regulated funds.

The term *qualifying investor alternative investment funds* (or "**QIAIF**") is a Central Bank of Ireland ("**Central Bank**") regulatory categorisation, not a legal structure, used to designate those Irish domiciled alternative investment funds ("**AIFs**") which have adopted one of five different legal forms available under Irish law (ICAV, PLC, unit trust, CCF or ILP) and which have been granted authorisation by the Central Bank to be marketed solely to so-called "*qualifying investors*" and which are subject to a minimum initial subscription requirement of EUR 100,000 (or equivalent in other currencies) per investor. A higher EUR 500,000 per investor figure applies for QIAIFs seeking to disapply certain rules in respect of investment in underlying collective investment schemes.

When considering the QIAIF product, it is also important to appreciate that a QIAIF needs a depositary and also an alternative investment fund manager (**AIFM**) and that the status of its AIFM (authorised or registered, EU or non-EU) determines how the QIAIF can be managed and where and how it can be marketed.

In this Guide we focus on the QIAIF but, of necessity, we also include those AIFM related matters which impact operationally on QIAIFs and, particularly, on how they are marketed. We have a separate "**Guide to AIFMD in Ireland**" available on our website which deals with AIFM specific regulation in greater detail.

1.1 Pre-AIFMD background

Following the introduction of Directive 2011/61/EU ("**AIFMD**") into European law in July 2013, European investment funds are now categorised as either UCITS or AIFs.

UCITS are those EU domiciled investment funds which are highly regulated at product level, with strict investment, borrowing and leverage limits, as well as portfolio liquidity and diversification requirements. With a minimum fortnightly dealing requirement, UCITS are intended for sale (or at least capable of being sold to) to the retail market. The original 1985 UCITS Directive regime required that the UCITS fund itself obtain home EU Member State authorisation and gave an authorised UCITS an EU wide marketing passport.

That the UCITS authorisation and the UCITS passport attached to the product (i.e. the fund) itself reflected the fact that UCITS was originally very much a product directive, only requiring independent authorisation of UCITS management companies in a later incarnation.

Sitting alongside UCITS, most EU Member States also had their own forms of non-UCITS fund products, under regimes varying widely from one jurisdiction to another and even within jurisdictions, from one product to another. Unlike UCITS, there were no harmonised product rules for non-UCITS funds and no harmonised regime for how they were to be managed or how they could be sold.

Some jurisdictions regulated their non-UCITS products, or at least some of them, and others did not. Ireland was one of the EU Member States that did regulate non-UCITS funds, requiring that Irish domiciled non-UCITS variable capital investment companies, unit trusts, investment limited partnerships and common contractual funds obtain a prior authorisation from the Central Bank before they could operate, as well as imposing a reasonably strict regulatory regime on their managers, administrators and custodians.

In its role as regulator of non-UCITS funds, the Central Bank set its fund level product requirements by reference to the type of investor targeted – retail, professional or qualifying investor - imposing minimum subscription requirements on those dedicated for sale to professional or qualifying investors.

Although the retail investor non-UCITS product proved popular for the domestic market, the really successful Irish domiciled non-UCITS product was the *qualifying investor fund* (**QIF**) product which became widely used for a broad range of alternative strategies. One drawback, however, was that QIF distribution was always dependent upon the patchwork of local inward marketing / private placement rules of other EU Member States.

1.2 AIFMD changes the landscape

The introduction of AIFMD in 2013 changed the alternative funds landscape in Ireland and the rest of the EU in a dramatic fashion by imposing a harmonised set of organisational and operational rules and authorisation requirements on AIFMs, by introducing a harmonised set of legal obligations and liability standards for depositaries and by opening up the 28 EU Member States to a progressive, harmonised marketing regime for AIFs managed and marketed by, initially, EU domiciled authorised AIFMs.

In that latter regard, AIFMD has created a single marketplace within the EU for the marketing of AIFs, by providing for what is known as a marketing “passport”.

The capacity to market AIFs on a cross-border basis within the EU depends on whether the AIFM is an EU AIFM or a non-EU AIFM, whether it is authorised or registered, the types and domiciles of the AIFs it manages or markets as well as when certain of the capacities under the Directive – particularly relevant for non-EU AIFMs – are “switched on”. It will also depend on whether the AIFM is an external AIFM or an internally managed AIF. For the moment, only EU authorised AIFMs are able to use the marketing passport and initially only in respect of EU AIFs.

In other words, an Irish QIAIF (being an EU AIF) can be marketed throughout the EU using the marketing passport as long as it has either an Irish domiciled authorised AIFM or else an authorised AIFM based in another EU Member State.

Non-EU AIFs can be marketed by EU and by non-EU AIFM under a private placement regime in EU Member States (which is subject to a set of minimum harmonised rules under AIFMD) until at least 2018, provided the individual EU Member State allows for private placement – although all are obliged to, they can impose additional rules which may in practice block private placement or make it difficult. If and when the private placement regime is turned off by the European Commission, the marketing passport will be the only means of marketing AIFs in the EU.

Where the EU AIF is a feeder AIF *(i.e. one which invests not less than 85% of its assets in shares of another AIF or invests at least 85% of its assets in more than one master AIF where those master AIFs have identical investment strategies or has otherwise an exposure of at least 85% of its assets to one or more such master AIF)*, then the right to market via the marketing passport (as opposed to via private placement) is subject to the condition that the master AIF is also an EU AIF and is managed by an authorised AIFM.

1.3 What is "marketing" under AIFMD?

The activity of "marketing" is defined in AIFMD as "*a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the [European] Union*", and even offerings or placements not undertaken by or on behalf of the AIFM, but at its initiative.

As the definition says, it covers both direct and indirect offerings or placements and not only covers activities of the AIFM but also those of others such as intermediaries or placement agents acting "*on behalf of the AIFM*".

Although many commentators argue that "reverse solicitation" (i.e. where the investor approaches the AIFM on its own initiative) does not constitute "marketing" under AIFMD, caution is advised if seeking to rely on the reverse solicitation argument. The AIFM would, we believe, need to consider at a minimum whether it had, for example, followed up with prospective investors after a conference or road show or whether it had corresponded with prospective investors in a way which would be considered "indirect" offering or placement. It would also need to take care in preparing offering and marketing materials, web portals etc. to ensure express and appropriate selling restrictions are included. Readers should take specific legal advice on a case by case and jurisdiction by jurisdiction basis if looking to rely on a reverse solicitation argument.

Notwithstanding that it is a very broad definition of "marketing", no additional guidance on the concept is provided by AIFMD leaving the definition open to interpretation across the various EU Member States. Most Member States have chosen not to provide guidance, but the UK Financial Conduct Authority (FCA) has done so, stating that marketing will occur when:

> *"a person seeks to raise capital by making a unit or share of an AIF available for purchase by a potential investor. This includes situations which constitute a contractual offer that can be accepted by a potential investor in order to make the investment and form a binding contract, and situations which constitute an invitation to the investor to make an offer to subscribe for the investment" (FCA Handbook).*

It does seem that some market participants may be over relying on the UK guidance, or at least on the most literal interpretation of it that they think best favours their fact set. Other Member States may just look to the broad AIFMD definition and apply a wider, catch-all interpretation.

1.4 What is the "marketing passport"?

As indicated above, a QIAIF can be marketed throughout the EU under the marketing passport of an authorised EU AIFM or privately placed in all other cases.

What exactly is the "marketing passport"?

Since the implementation of AIFMD in late July 2013, an EU authorised AIFM has a "*passport*" to freely market its EU domiciled AIFs to "*professional investors*" in its own Member State <u>and</u> in other EU Member States, subject to a straightforward notification process.

In other words, once the AIFM is authorised in one EU Member State it does not need any further authorisation in any other EU Member State to market its EU AIFs to professional investors in those Member States. Unlike under the UCITS regime, the passport does not attach to the AIF. It is a passport granted to the AIFM. The Irish QIAIF is an EU AIF and, therefore, it can be marketed by an EU AIFM throughout the EU via the passport.

The marketing passport can only be used to market to *professional investors*. A "*professional investor*" is any investor which is considered to be a professional client or may be treated as a professional client on request within the meaning of Annex II of Directive 2004/39/EC (i.e. the "**MiFID Directive**"). Such investors comprise:

(a) credit institutions

(b) investment firms

(c) other authorised or regulated financial institutions

(d) insurance companies

(e) collective investment schemes and management companies of such schemes

(f) pension funds and management companies of such funds

(g) commodity and commodity derivatives dealers

(h) locals

(i) other institutional investors

(j) large undertakings meeting two of the following size requirements on a company basis:

- balance sheet total: EUR 20,000,000

- net turnover: EUR 40,000,000

- own funds: EUR 2,000,000.

(k) national and regional governments, public bodies that manage public debt, Central Banks, international and supranational institutions such as the World Bank, the IMF, the ECB, the EIB and other similar international organisations.

(l) other institutional investors whose main activity is to invest in financial instruments, including entities dedicated to the securitisation of assets or other financing transactions.

(m) clients other than those mentioned in sections (a) to (l) above, including public sector bodies and private individual investors, who, as a minimum, meet two of the following criteria and have opted to be treated as a professional client:

- the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters,

- the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds EUR 500,000,

- the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

1.5 QIAIF Marketing Passport Notification Procedure

An Irish QIAIF can be freely marketed by an Irish/EU authorised AIFM to professional investors throughout the EU via the AIFMD marketing passport, subject to a straightforward notification process.

Under the AIFMD, the process of marketing an Irish QIAIF by an EU AIFM in the AIFM's home Member State, or in any other Member State, is set out in Articles 31 and 32 of the AIFMD, respectively.

The Central Bank has under Regulation 33 of the European Union (Alternative Investment Fund Managers) Regulations 2013, as amended (the "**AIFM Regulations**") issued specific guidance in relation to the process of marketing an Irish QIAIF managed by an Irish AIFM in another EU Member State.

In that guidance, the Central Bank notes that Irish AIFMs proposing to market EU AIFs – including QIAIFs - to professional investors in another Member State must notify the Central Bank in accordance with Regulation 33 of the AIFM Regulations. The notification letter and accompanying prescribed form (available on the Central Bank website) should be submitted by the Irish AIFM to the Central Bank for each Member State in respect of the AIF(s) it intends to market, together with the following:

(i) the AIF rules or instruments of incorporation for each AIF being marketed;

(ii) any additional information referred to in Regulation 24(1) of the AIFM Regulations for each AIF that the AIFM intends to market;

(iii) a description of, or any information on, the AIF available to investors.

(iv) a letter, signed by a director of the AIFM, stating that the AIFM will market the relevant AIFs in accordance with AIFMD.

The notification should be submitted to AIFMDpassportingout@centralbank.ie. The Central Bank will inform the AIFM once transmission to the relevant host Member State competent authority(ies) has taken place and the AIFM can then commence to market the QIAIF in the relevant Member States.

2. What are QIAIFs?

As has been explained earlier, the term *qualifying investor alternative investment funds* or "**QIAIF**" is a Central Bank regulatory categorisation, not a legal structure. It is used to designate those Irish domiciled AIFs which have adopted one of five different legal formats available under Irish funds law (ICAV, VCC, unit trust, CCF or ILP) and which have been granted authorisation by the Central Bank to market solely to so-called "*qualifying investors*", subject to a minimum initial subscription requirement.

By comparison, an Irish domiciled regulated AIF which has no minimum subscription requirement or has a minimum subscription which is less than EUR 100,000 (or equivalent in other currencies) per investor will be considered to be a "**Retail AIF**".

2.1 Qualifying Investors

The Central Bank, in its role as regulator of Irish domiciled funds, has determined that QIAIFs can only be marketed to those categories of investor who fall within its definition of "*qualifying investor*". Those categories are:

(i) an investor who is a *professional client* within the meaning of Annex II of MiFID [i.e. the same as "professional investors" under AIFMD]; or

(ii) an investor who receives an appraisal from an EU credit institution, a MiFID firm or a UCITS management company that the investor has the appropriate expertise, experience and knowledge to adequately understand the investment in the QIAIF; or

(iii) an investor who certifies that he/she/it is an informed investor by providing:

 (a) a confirmation (in writing) that the investor has such knowledge of and experience in financial and business matters as would enable the investor to properly evaluate the merits and risks of the prospective investment; or

 (b) a confirmation (in writing) that the investor's business involves, whether for its own account or the account of others, the management, acquisition or disposal of property of the same kind as the property of the QIAIF.

Investors in a QIAIF must certify in writing to the QIAIF that they meet the above minimum criteria and that they are aware of the risk involved in the proposed investment and of the fact that inherent in such investments is the potential to lose all of the sum invested.

NOTE: Within the EU, QIAIFs can only be marketed to "*professional investors*" as defined in the AIFMD (i.e. category (i) above), unless the particular targeted EU Member State permits, under its laws, AIFs to be sold to other categories of investors and that permission encompasses investors falling within categories (ii) and (iii) above.

In other words, the Central Bank authorises a QIAIF to be marketed to a slightly wider range of potential investors than are covered by the AIFMD marketing passport (i.e. "*qualifying investors*" v. "*professional investors*"). Some care needs to be taken, accordingly if looking to sell to categories (ii) or (iii) above.

2.2 Minimum Initial Subscription

Under Central Bank rules, QIAIFs are subject to a minimum initial subscription requirement of EUR 100,000 (or equivalent in other currencies) per investor, with a higher EUR 500,000 figure applicable to QIAIFs seeking to disapply certain rules in respect of investment in underlying collective schemes.

Where the QIAIF is an umbrella scheme, the investor's aggregate subscriptions across the entire umbrella can normally be taken into account to meet the EUR 100,000 minimum subscription requirement and, unless otherwise provided in the relevant prospectus, the amounts of subsequent subscriptions are generally unrestricted.

However, in the case of a QIAIF which invests more than 50% of net assets in one other investment fund utilising the higher EUR 500,000 minimum subscription, the aggregate subscriptions across multiple sub-funds of an umbrella cannot be taken into account.

NOTE: a QIAIF must not accept subscriptions from persons that group amounts of less than EUR 100,00 for individual investors. Although the Central Bank has not provided any guidance as to what that means we do not consider it applicable to, for example, other collective investment schemes or to unit-linked life assurers investing unit-linked funds or to investment managers investing client monies under discretionary mandates.

2.3 Knowledgeable Employee Exemption

A QIAIF may grant an exemption from the EUR 100,000 minimum subscription requirement to its management company or general partner; to the investment manager or investment advisor; to directors of those entities; and to certain of their employees who are either directly involved in the QIAIF's investment activities or is a senior employee with experience in the provision of investment management services (the "*knowledgeable employee"* exemption).

In the case of investments by employees, the management company or investment company or general partner, as appropriate, must satisfy itself that the investing employees do fall within the criteria outlined above and the investing employees must certify to the QIAIF that they are availing of the exemption and that they are aware that the QIAIF is normally marketed solely to qualifying investors who are subject to a minimum subscription of EUR 100,000.

2.4 Who is or can be an AIFM?

AIFMD defines "AIFMs" as legal persons whose "*regular business is managing one or more AIFs*". Depending on the structure of the QIAIF, there may be more than one legal entity which could be appointed as AIFM to the QIAIF but in the end there can only be one AIFM appointed to a QIAIF. The AIFM shall be either:

- an external manager, which is the legal person appointed by the QIAIF or on behalf of the QIAIF and which, through this appointment, is responsible for managing the QIAIF (referred to as an "**external AIFM**"); or

- the QIAIF itself, where its legal form permits an internal management and where its board (i.e. its governing body) chooses not to appoint an external AIFM. In such a case, the QIAIF shall then be authorised as the AIFM (referred to as an "**internally-managed QIAIF**").

2.5 AIFM of an Irish QIAIF?

Under Irish funds law, a QIAIF can be established in one of five different forms – as an ICAV, as a VCC, as a unit trust, as a CCF or as an ILP. Although very different legal structures, each can be authorised as a QIAIF and each must have an AIFM.

The entities who might be (or be chosen as) AIFM for an Irish QIAIF include:

- an external AIFM authorised in Ireland by the Central Bank (or registered with the Central Bank, see 2.7 below);

- an external AIFM authorised by a competent authority of another EU Member State (managing on a direct or branch basis);

- a self-managed QIAIF ICAV or VCC (i.e. as an internally-managed AIF); or

- a non-EU AIFM authorised by an EU Member State (the Member State of Reference) (not available as an option currently);

- a non-EU investment manager, designated as AIFM (see 2.6 below).

QIAIFS structured as unit trusts, CCFs or ILPs require management companies or (in the case of an ILP) general partners, which may (or may not) also be the AIFM of the structure and, if the AIFM, can be either category of AIFM identified in the first two bullet points above.

2.6 QIAIF with non-EU AIFM

In addition to the options above, it is also currently possible to establish an Irish QIAIF which does not appoint an entity which is authorised as either an authorised or registered AIFM.

This is where the QIAIF appoints a non-EU investment manager which the QIAIF designates as a "non-EU AIFM". In that case, the non-EU entity must be approved by the Central Bank to act as investment manager to Irish AIFs but it is not authorised by the Central Bank. Such a QIAIF which designates a non-EU AIFM will be allowed to avail of the transition period provided that it and its non-EU AIFM comply with the provisions of the AIF Rulebook that apply in the case of QIAIFs which registered AIFMs.

This, however, is a temporary arrangement only which should remain in place during the AIFMD transition period. We do not, at this point in time, know when that will actually end. In addition, the QIAIF cannot avail of the AIFMD passports.

2.7 QIAIFs which have a Registered AIFM

A QIAIF can have a registered AIFM (or be an internally-managed QIAIF which is a registered AIFM).

The following AIFMs are subject to that lighter registration (not full authorisation) regime:

- AIFMs which either directly or indirectly through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manage portfolios of AIFs whose assets under management, including any assets acquired through use of leverage, in total do not exceed a threshold of EUR 100 million; or

- AIFMs which either directly or indirectly through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manage portfolios of AIFs whose assets under management, in total do not exceed a threshold of EUR 500 million when the portfolio of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of 5 years following the date of initial investment in each AIF.

Although registration is a lighter regime by comparison to authorisation, registered AIFMs will still need to comply with certain requirements, including those relating to monitoring of systemic risk. Registered AIFMs do not benefit from any of the rights granted under the Directive unless they choose to “opt-in” to full authorisation. That means that they cannot manage AIFs in other EU Member States, nor can they market their AIFs in other EU Member States. The European Commission has issued Implementing Regulation No. 474/2013 which establishes the “opt-in” procedure.

Where a QIAIF has a registered (i.e. not authorised) AIFM, the AIFM must be established in Ireland because a registered AIFM does not benefit from any of the rights (i.e. the right to manage an AIF domiciled in another EU Member State or the right to market the AIF which it manages in other EU Member States) under AIFMD.

2.8 AIFMD Depositary Requirements and Depositary Liability

One of the AIFMD’s means of achieving greater levels of investor protection has been to require the appointment of a depositary to carry out specific functions including the monitoring of cash flows, the safekeeping of certain assets and the verification of ownership of others as well as general regulatory oversight responsibilities and to impose stringent liability provisions on depositaries in respect of certain assets.

An AIFM is required by AIFMD to ensure that, for each AIF it manages, a single depositary has been appointed and that the appointment is formalised in a written contract regulating at least the flow of information necessary to enable the depositary to perform its functions.

The Central Bank AIF Rulebook also requires that a QIAIF shall entrust its assets to a depositary for safekeeping and that that must be expressly specified in the QIAIF’s constitutional document. See Section 12 for more on Depositaries.

3. The Legal and Regulatory Framework for QIAIFs

The legal and regulatory framework applicable to QIAIFs comprises domestic Irish funds law which is primarily product focused, European law as it applies to AIFMs, domestic Irish legislation implementing AIFMD into Irish law as well as the Central Bank's AIF Rulebook with guidance on certain related matters being included in the Central Bank's Q&A document and in other guidance on its website.

3.1 Irish Funds Law

QIAIFs are Irish fund products which are creations of domestic Irish fund law. Under Irish funds law, a QIAIF can be established in one of five different forms – as an Irish collective asset-management vehicle ("**ICAV**"), as a variable capital investment company ("**VCC**"), as a **unit trust**, as a common contractual fund ("**CCF**") or as an investment limited partnership ("**ILP**"). The legislative <u>basis</u> for the different forms of QIAIF is found in the following pieces of Irish funds law:

(i) ICAVs – Irish Collective Asset-management Vehicles Act 2015;

(ii) VCCs – Part 24, Companies Act 2014;

(iii) Unit Trusts - Unit Trusts Act, 1990;

(iv) ILPs - Investment Limited Partnership Act, 1994;

(v) CCFs - Investment Funds, Companies and Miscellaneous Provisions Act, 2005;

each, as amended. These pieces of product level legislation are the foundations of the Irish QIAIF product and must be complied with at all times.

3.2 European Law

How QIAIFs are to be managed and how they can be marketed are matters of European law, principally AIFMD and the Level 2 Regulation, as well as various ESMA Guidelines and opinions etc. These are outlined briefly below.

(i) AIFMD

AIFMD is divided into ten chapters covering:

Chapter 1: The scope of the Directive and exemptions

Chapter 2: Rules governing the authorisation of AIFM

Chapter 3: Operating conditions for AIFM (including principles of governance, risk management, liquidity management, valuation and custody)

Chapter 4: Transparency requirements

Chapter 5: Rules for AIFM managing specific types of AIF (leveraged AIF and private equity type AIF)

Chapter 6: The rights of EU AIFM managing and marketing EU AIF

Chapter 7: Third Country Rules

Chapter 8: Marketing to retail investors

Chapter 9: Designation of competent regulatory authorities; and

Chapter 10: Transitional and final provisions.

AIFMD is focused primarily on the authorisation (how and for what) of AIFMs and their obligations in respect of the AIFs they manage and/or market, as well as on eligibility and duties and liabilities of depositaries.

(ii) Levels 1, 2, 3 and 4?

Readers may often hear reference to or read of the Level 2 Regulation. In fact the AIFMD has 4 Levels as it is subject to an EU legislative process known as the “Lamfalussy Process” involving:

- the adoption of the framework Directive by the European Council of Ministers and European Parliament (“**Level 1**”);

- technical implementing measures adopted by the European Commission and approved by the European Securities Committee, in consultation with the European Parliament, on the basis of advice from the European Securities and Markets Authority (“ESMA”) (“**Level 2**”);

- recommendations from ESMA on interpretation to ensure consistent implementation and application (“**Level 3**”); and

- Commission enforcement of the timely and correct transposition of EU legislation into national law ("**Level 4**").

(iii) *Level 1 measure*

The AIFMD itself constitutes the Level 1 measure.

(iv) *Level 2 measures*

The principal Level 2 measures are contained in Commission Delegated Regulation (EU) 231/2013 of 19 December 2012 supplementing Directive 2011/611 EU of European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (referred to generally as the "**Level 2 Regulation**").

The European Commission adopted a further Delegated Regulation (EU) No. 694/2014 on 17 December 2013 supplementing AIFMD with regard to regulatory technical standards determining types of alternative investment funds managers. That Delegated Regulation determines whether an AIFM is an AIFM of open-ended AIF(s) and/or closed/ended AIF(s). Under the AIFMD, AIFMs have to follow specific rules depending on whether or not they are AIFMs of open-ended and/or closed-AIFs.

A further European Commission Delegated Regulation [EU 2015/514] of 18 December 2014 deals with the information to be provided by EU competent authorities to ESMA to enable ESMA evaluate the AIFMD passports (managing or marketing).

The European Commission has also issued several Implementing Regulations. The first, Commission Implementing Regulation (EU) No. 447/2013, establishes the procedure for AIFMs which choose to “opt-in” under AIFMD. This applies to AIFMs which are either registered AIFMs under AIFMD or were authorised as UCITS management companies. The second, Commission Implementing Regulation (EU) No. 448/2013, establishes the procedure for determining the Member State of reference of a non-EU AIFM.

(v) *Level 3 Measures*

The principal Level 3 measures are currently ESMA’s Guidelines on sound remuneration policies under the AIFMD [ESMA 2013/201] (“**ESMA Remuneration Guidelines**”), its Guidelines on key concepts of the AIFMD [ESMA/2013/600] (“**ESMA Key Concepts Guidelines**”) and its Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD. [ESMA 2013/1339 revised] (“**ESMA Reporting Guidelines**”).

The Commission has published on its website a series of answers to specific questions on AIFMD matters (the “**Commission Q&A**”) which is updated regularly, as has ESMA (the “**ESMA Q&A**”).

3.3 Irish AIFM Regulations

As AIFMD is a directive, it needed to be transposed into the domestic laws of an EU Member State to be legally effective. In Ireland, that has been effected by the European Union (Alternative Investment Fund Managers) Regulations (S.I. No. 257 of 2013), as amended by the European Union (Alternative Investment Fund Managers) (Amendment) Regulations (S.I. 379 of 2014) (the "**AIFM Regulations**").

In this Guide when we refer to AIFMD, we refer to AIFMD as transposed into Irish law by the AIFM Regulations which follow AIFMD very closely.

3.4 The AIF Rulebook

Sitting alongside Irish funds law and the AIFMD legal regime are the Central Bank rules which deal with the QIAIF as a product and its AIFM and which are found in its AIF Rulebook.

The AIF Rulebook deals with:

(a) Retail Investor AIF Requirements (Chapter 1);

(b) Qualifying Investor AIF Requirements (Chapter 2);

(c) AIFM Requirements (Chapter 3);

(d) AIF Management Company Requirements (Chapter 4);

(e) Fund Administrator Requirements (Chapter 5); and

(f) AIF Depositary Requirements (Chapter 6).

NOTE: The AIF Rulebook does not include legislative requirements which apply directly (i.e. which apply in any event by virtue of law). Furthermore, although the AIF Rulebook is stated to set out the rules which apply to the Central Bank authorised AIFs and AIFMs, the "definitive rules" for each AIF and AIFM are actually set out in the letter of authorisation for the individual AIF or AIFM, as issued by the Central Bank.

3.5 Central Bank Guidance

Under the pre-AIFMD regime, the Central Bank issued a detailed set of NU Notices, supplemented by Central Bank Guidance Notes. The NU Notices and Guidance Notes addressed retail, professional and qualifying investor schemes across a broad range of fund types such as property funds, venture and development capital funds, fund of funds, feeder funds, futures and options funds, guaranteed funds, funds of unregulated funds etc.

AIFMD, however, does not regulate AIFs in that fashion. In fact, it is not designed to regulate AIFs at all (at least not directly) as its focus is on AIFMs. It does impose certain obligations (principally notification/disclosure and anti-asset stripping provisions) on what might usually be considered private equity funds, as well as leverage disclosure (and regulatory intervention powers) and rules on acquiring securitisation provisions, but otherwise does not impose rules relating to individual fund or strategy types.

As a result, in contrast to the pre-AIFMD regime's NU Notices/Guidance Notes which addressed a wide range of fund types, under the new regime for QIAIFs the AIF Rulebook does not have detailed product by product type rules. It sets out general QIAIF restrictions, with some additional more specific rules for money market funds, for funds which invest more than 50% of net assets in another investment fund and for loan origination funds, as well as the use of wholly owned subsidiaries.

A QIAIF's letter of authorisation will set out whatever other parameters applicable to the individual QIAIF that may be negotiated as part of its authorisation. These parameters may, for example, address matters such as investment in joint ventures, development capacities, investing partly by equity/partly by loan etc.

3.6 Central Bank AIFMD Q&A

The Central Bank has also published (and regularly updates) an AIFMD Q&A document which sets out answers to queries regularly raised around AIFMD related matters. This has proved to be very helpful and is a useful resource.

It has also issued "*Guidance related to AIFs and their service providers*" on the AIFMD section of its website but that is quite dated, albeit still relevant when dealing with matters such as mergers and amalgamations of QIAIFs.

4. Available Legal Structures for QIAIFs

In this Chapter we explain the different legal structures in Ireland which can be used to house QIAIFs, namely, the two corporate structures (the ICAV and the VCC), unit trusts, investment limited partnerships (ILPs) and common contractual funds (CCFs).

Although quite distinct legal structures, it is important to remember that each remains subject to the same QIAIF investment limitations and disclosure obligations, each must have an AIFM and each must have a depositary responsible for safekeeping of assets and performance of certain fiduciary type duties.

4.1 Choice of Legal Structure

The choice of legal structure for a QIAIF will usually depend on a number of issues, including:

(i) investor familiarity;

(ii) investor capacity to invest. For example, certain types of Japanese investors seem to be able to invest higher proportions of their portfolios in unit trusts, as opposed to in corporate funds;

(iii) tax treatment. For example, natural persons, or their nominees, cannot invest in a common contractual fund without undermining its tax transparency under Irish tax law. As another example, ICAVs and unit trusts can be structured to "check-the-box" to be treated as a partnership or disregarded entity for US federal tax purposes, whereas a VCC cannot;

(iv) administrative burden. It is generally felt that of the two corporate type funds – ICAV and VCC – the ICAV is less administratively burdensome as it is not subject to Irish company law and benefits from several flexibilities not available to a VCC (e.g. not requiring investor approval for non-material changes to instrument of incorporation; can dispense with AGM requirement etc.);

(v) sponsor willingness to set up an Irish management company (required for unit trust and common contractual fund but not for investment company) where that management company may (but it is not required to) become the AIFM. It should be noted that there are several professional management companies and AIFMs operating in Ireland which offer tailored solutions for sponsors who want a legal structure for a QIAIF that needs a management company, but do not want the set-up / running cost in having their own one;

(vi) portfolio diversification. VCCs are subject to a statutory based risk spreading requirement whereas none of the other QIAIF structures are; and

(vii) borrowing/leverage can be utilised in all structures but the legal arrangements often clearer to counterparties when dealing with corporate type funds – ICAV and VCC.

We have summarised below the principal features of the different legal structures – the ICAV, the VCC, the unit trust, the ILP and the CCF.

4.2 ICAVs

The most recent addition to the menu of available Irish legal structures - and likely to become the most popular choice of structure - is the Irish collective asset-management vehicle (the "**ICAV**"). This is a corporate type fund with its own separate legal personality which issues shares and has a board of directors and which is governed by a very specific and bespoke piece of legislation, the Irish Collective Asset-management Vehicles Act 2015 (the "**ICAV Act**"). Although an ICAV is a corporate fund, it is not a public limited company ("**PLC**") and therefore is not subject to normal Irish company law which applies to Irish trading companies and to VCC type investment companies.

(i) Unique ICAV Features

Because it is subject to its own bespoke ICAV Act, the ICAV offers many operational efficiencies which normal corporates or VCCs cannot offer, including that:

- amendments to its Instrument of Incorporation can be implemented without the need for proposed amendments to be sanctioned by the shareholders, provided that the Depositary of the ICAV certifies that the proposed amendments will not prejudice the interests of the shareholders;

- the requirement to hold an annual general meeting may be avoided by giving at least sixty days' written notice to all of the ICAV's shareholders;

- financial statements may be published on a <u>sub-fund by sub-fund</u> basis in the case of an umbrella ICAV. In the case of the other QIAIF corporate fund, the VCC, Irish company law requires the accounts of <u>all</u> sub-funds of an umbrella VCC be included in the financial statements of that company;

- the ICAV is subject to a more simplified procedure for facilitating schemes of amalgamation, mergers, divisions and other general reorganisations;

- in addition to the above features, it is possible for existing Irish VCCs to convert to an ICAV; and

– funds domiciled outside of Ireland can re-domiciled into Ireland by continuation as ICAVs.

(ii) Check-the-box

An ICAV can be structured so that it can "check-the-box" to be treated as a partnership or disregarded entity for US federal tax purposes. Therefore, an ICAV can facilitate investment by US taxable investors and/or US taxable and tax-exempt investors in a master feeder fund structure.

This is quite different from the treatment of QIAIF VCCs, which cannot check-the-box to be a flow-through for US tax purposes.

(iii) Other Distinguishing ICAV Features

While an ICAV issues shares to investors and has some other common features with VCCs, the following features further distinguish it from the VCC structure:

(a) incorporation is effected by the filing of certain prescribed documents with the Central Bank (not the Irish Companies Registration Office which is the registry applicable to a VCC);

(b) the constitutive document of the ICAV is the Instrument of Incorporation, not a Memorandum and Articles of Association;

(c) unlike VCCs, there is no statutory requirement to diversify investment risk in the case of an ICAV.

(iv) Internally-Managed ICAVs

It is possible to have an internally managed ICAV. In which case, it must also be authorised as an AIFM and must meet the AIFM regulatory capital / own funds requirements.

4.3 QIAIF VCCs

QIAIF variable capital investment companies (or "**VCCs**") are public limited liability corporate vehicles with their own legal personality. In addition to the specific provisions of Part 24 of the Companies Act 2014, they are subject to Irish company law (with relevant exceptions) as it applies to public limited companies generally.

The VCC's constitutive document is the Memorandum and Articles of Association and ultimate management authority resides with a board of directors, two of whom must be

Irish resident. VCCs issue shares to investors which shares do not represent a legal or beneficial interest in the VCCs assets, those assets being legally held by the depositary (or in certain cases by either the QIAIF or its AIFM) and owned beneficially by the VCC itself.

Unlike the other types of QIAIF vehicles, VCCs are required to convene and hold an annual general meeting of shareholders and any changes (irrespective of materially) to their Memorandum and Articles of Association require investor approval. VCCs have legal personality and can enter into contracts themselves and will do so, principally with the AIFM, with an investment manager, depositary, distributor and administrator.

VCCs are subject to a statutory requirement under Part 24 of the Companies Act, 2014 to aim to spread investment risk. It is for the directors of the VCC to determine compliance with this requirement but it is considered that a VCC, unlike the other legal structures, cannot be 100% exposed to a single asset. The risk spreading requirement in the case of an umbrella VCC is stated in a way that indicates that it should apply at the overall umbrella, not individual sub-fund, level.

Umbrella type VCCs benefit from statutory based segregated liability between sub-funds and it is possible for one sub-fund within an umbrella to invest in one or more sub-funds of the same umbrella provided that the investee sub-fund does not itself invest in other sub-funds of the same umbrella.

It is possible to have an internally-managed VCC, in which case it must also be authorised as an AIFM and must meet the AIFM regulatory capital / own funds requirements.

4.4 QIAIF Unit Trusts

QIAIF unit trusts are contractual arrangements created under a deed of trust (the “trust deed”) made between the management company (or manager) and a trustee/depositary. Unit trusts do not have their own legal personality and contracts are entered into by the management company or its delegate(s) and, in certain cases, by the trustee/depositary.

Unit trusts are governed by the Unit Trusts Act, 1990 and ultimate managerial authority rests with the board of directors of the unit trust’s management company. Such a company may act as management company for different types of Irish collective investment schemes and can be authorised as an AIFM, subject to complying with the AIFM requirements (or be a registered AIFM), or can appoint an AIFM. The management company must itself be authorised separately to the unit trust’s own authorisation as a QIAIF.

Unit trusts issue units to investors and a unit represents an undivided beneficial interest in the assets of the unit trust which must be entrusted to a trustee/depositary for safekeeping.

Unit trusts are not required to hold annual investor meetings and, provided both the management company and trustee/depositary certify that such a change does not prejudice the interests of investors, a change to the trust deed can be made without having to obtain prior unitholder approval.

4.5 QIAIF Investment Limited Partnerships

QIAIFs can also be established as investment limited partnerships (or "**ILPs**") under the Investment Limited Partnerships Act, 1994. An investment limited partnership is a partnership of two or more persons having as its principal business the investment of its funds in property of all kinds and consisting of at least one general partner – ultimately liable for the ILP's debts - and at least one limited partner. The general partner acts in a role roughly equivalent to that of a management company of a unit trust, CCF or corporate fund.

The limited partner is admitted to the partnership and a capital account established in its name which reflects the capital contributed and its net profit and loss.

The main advantage of an investment limited partnership is that the partnership does not have an independent legal existence in the way that a company does. All of the assets and liabilities belong jointly to the individual limited partners in the proportions agreed in the partnership deed. Similarly, the profits are owned by the limited partners.

4.6 QIAIF Common Contractual Funds

The final structure which can be used by QIAIFs is the common contractual fund (or "**CCF**"). CCFs were originally introduced under the UCITS regime to enable pension funds and trustees or custodians of pension funds to pool investments in a tax efficient manner. AIF type CCFs were introduced in 2005 by the Investment Funds, Companies and Miscellaneous Provisions Act, 2005. Subsequently, Irish tax law was amended to widen the investor base for CCFs to include not only pension funds, but all other types of institutional investors and corporate entities but not natural persons (or their nominees).

The CCF is a contractual arrangement similar to the FCP (fonds commun de placement) structures in other European jurisdictions (notably Luxembourg and France) and the Dutch FGR (fonds voor gemene rekening) enabling the assets held on behalf of investors to be managed through a single pool in proportion to the assets or cash subscribed to the pool. A CCF is constituted under contract law by means of a deed of constitution executed under seal by a management company. The deed provides for the safekeeping of assets of the CCF by a depositary who is also a party to the deed and the deed specifies the fiduciary responsibilities of the depositary. The deed also provides that the depositary will be appointed on the terms of a depositary agreement to be entered into by the management company and the depositary.

As the CCF is an unincorporated body and does not have a legal personality, it may act only through the manager (or investment manager, if authority is delegated to an investment manager).

Participants in the CCF hold their participation as co-owners and each participant holds an undivided co-ownership interest as a “tenant in common” with other participants. A "tenancy in common" is a form of co-ownership in which the joint owner (the "tenant in common") has a distinct but undivided interest or share in the property the subject of the co-ownership but with no right of survivorship (e.g. on death of one co-owner) in favour of any of the other joint owners (tenants in common). Investors do not have any beneficial entitlement to any particular asset. Instead, they have a proportional beneficial entitlement to an interest in the underlying pool of assets.

The main driver for establishing a CCF is its capacity to provide participants with a tax transparent arrangement, where participants should be treated as investing directly in the pool of assets, and which benefits from all of the advantages of investing via a pooled arrangement. To assist in achieving tax transparency (these characteristics differentiate a CCF from an opaque corporate body), a CCF will normally have the following additional characteristics:

(i) income derived through the pooling vehicle should generally be distributed on a mandatory basis annually, pro rata to each participant’s investment in the CCF. This ensures that the income is both accounted for and taxed on an “arising”/ current basis. Nevertheless, we understand that it is possible in certain circumstances to have non-distributory (accumulating) unit-classes without jeopardising the tax transparency of the vehicle;

(ii) the CCF participant should be provided with an annual breakdown of income on investments by type and source;

(iii) no redemption charge should be levied on participants;

(iv) no “investor” meetings (i.e. meetings similar to shareholder meetings) should be permitted;

(v) the Irish tax authorities must view a CCF as a transparent vehicle for Irish tax purposes;

(vi) holdings/units in a CCF should not be freely transferable but are redeemable. It has, however, been accepted that units may be transferred in limited circumstances, i.e. with the prior consent of 100% of unitholders and the management company; and

(vii) assets should be jointly held by participants pro-rata to their investment.

Tax transparency ultimately depends on whether that status is accepted by treaty counterparts. Positive rulings have been obtained from the tax authorities in several jurisdictions and tax opinions in several others supporting the tax transparent treatment. In more recent years, some of Ireland's treaty counterparties have addressed tax transparency expressly within the relevant double tax treaty.

4.7 Stand-alone QIAIFs, Umbrellas and Sub-Funds

QIAIFs can be established as single, stand-alone funds or (save for ILPs) as umbrella funds with one or more sub-funds. Investment and borrowing limits apply at sub-fund level as each sub-fund is treated from a regulatory perspective as a separate QIAIF.

It is not currently possible to have an umbrella ILP.

Within an umbrella, it is possible to have sub-funds with different liquidity profiles – open-ended, open-ended with limited liquidity or closed-ended – and one sub-fund can invest in another sub-fund of the same umbrella. Segregated liability between sub-funds within an umbrella exists either under statute (for ICAVs and for investment companies), or under trust law (unit trusts) or can be imposed contractually (CCFs).

Certain additional prospectus disclosure and constitutional documentation provisions are required for umbrellas, principally relating to segregation of assets/liabilities of one sub-fund from the others.

4.8 Share Classes

The general principles behind the Central Bank's approach to the creation of different share or unit classes with a QIAIF or sub-fund are that each QIAIF/sub-fund must consist of a single common pool of assets; assets cannot be allocated to individual classes; and income and capital gains/losses on the asset pool must be distributed to and/or accrue equally to investors in proportion to their respective holdings. Importantly, the Central Bank requires that investors within a class be treated equally and, where there are two or more classes in existence, that all investors in the different classes must be treated fairly.

Common class level distinguishing features include different target audiences, different management/performance fees, different entry/exit charges and minimum subscription or holding requirements. Hedged currency or interest rate classes can also be created which allow the gains/losses and costs on the hedging contracts to be attributed to the relevant hedged classes.

Notwithstanding the above, and subject to clear prospectus disclosure (including as to the attendant risks) and to there being power to do so under the constitutional documents of the QIAIF (including clear valuation and allocation provisions), it is possible to allocate assets (including derivatives) within a QIAIF/sub-fund to individual classes provided that the allocation arrangement is not made to pursue a separate investment objective at class level, does not result in the class operating as a *de facto* sub-fund and is not created to circumvent the general principles referred to above.

Where this latter capacity is used, provisions aimed at achieving segregation of liability between such a share class and the share classes participating in the QIAIF’s or sub-fund’s common pool of assets should, to the extent legally possible, be included in the constitutional document.

ILPs cannot have share classes. They do not issue shares, rather investors have capital accounts.

4.9 Voting Rights

A QIAIF's prospectus must describe the voting rights attaching to shares or units in the fund. The Central Bank does allow for non-voting shares and units.

Prior to the AIFM Regulations, the Central Bank normally required that investors be given the capacity to choose between investing in voting and non-voting shares/units and the ability to switch from a non-voting class to a voting class without penalty. This explicit requirement no longer applies.

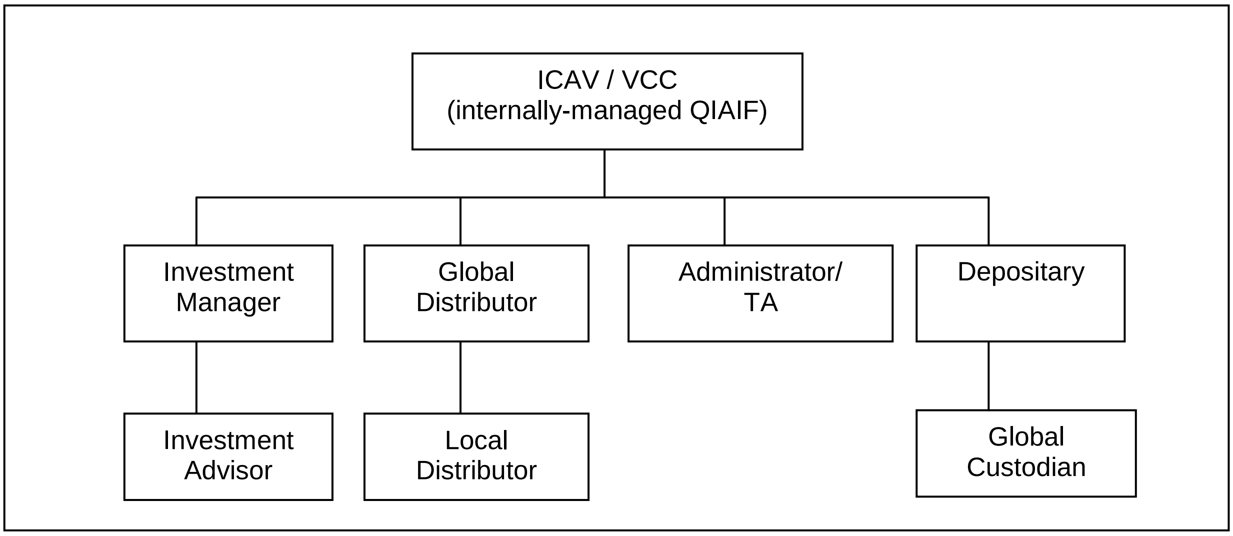
However an EU authorised AIFM is under a requirement to ensure that all investors in the QIAIF are treated fairly and whenever an investor (or class of investors) obtain preferential treatment (or the right to obtains preferential treatment), the type of investors who obtain such preferential treatment and, where relevant, their legal or economic links with the QIAIF or AIFM must be disclosed to investors prior to investing in the QIAIF. Similarly, the QIAIF (if corporate, or its management company) is also subject to a requirement that it must treat all investors fairly, as well as a requirement that investors in the same class of shares or units are treaty equally. The foregoing requirements need to be taken into account when determining the voting rights of investors and how such rights are disclosed to investors.

4.10 Structure Charts

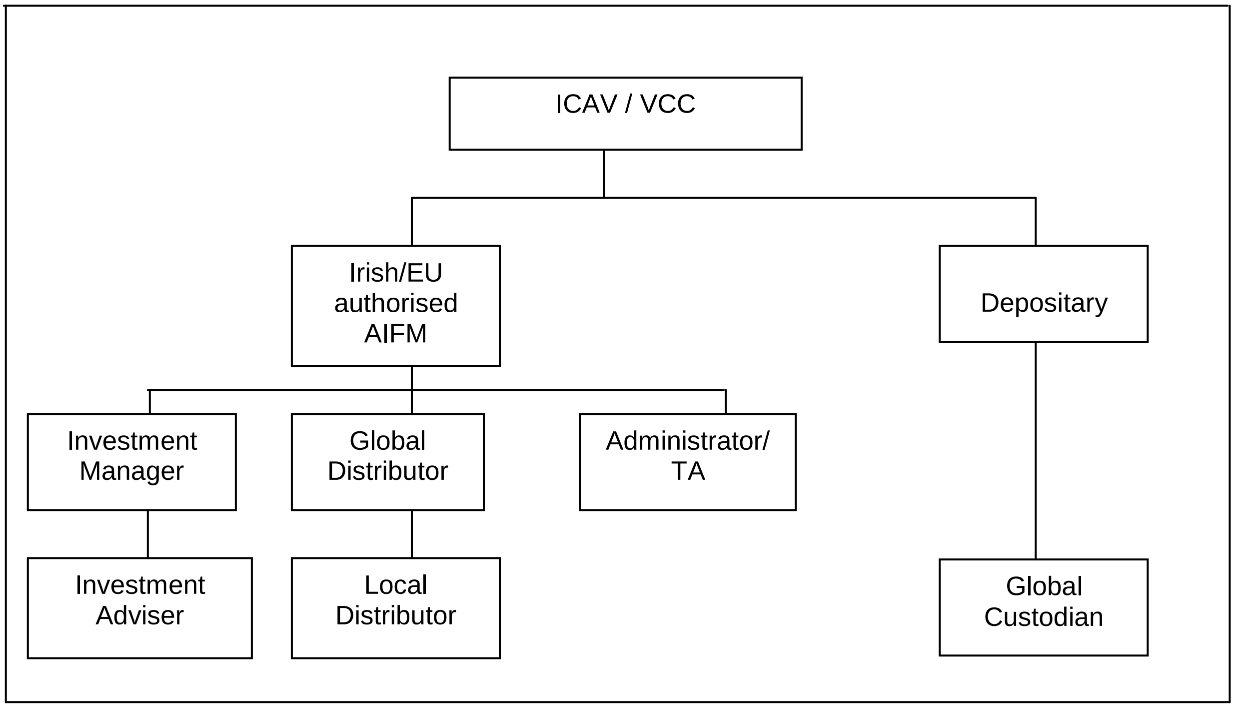
5 slightly different structure charts are given below. The first two deal with corporate funds and apply equally whether the corporate fund is an ICAV or VCC. Box 1 is for an internally-managed (i.e. no external AIFM) ICAV or VCC, whereas Box 2 is for a corporate fund which has an external AIFM.

Boxes 3 and 4 are for unit trusts and CCFs, respectively. Box 5 is for an investment limited partnership.

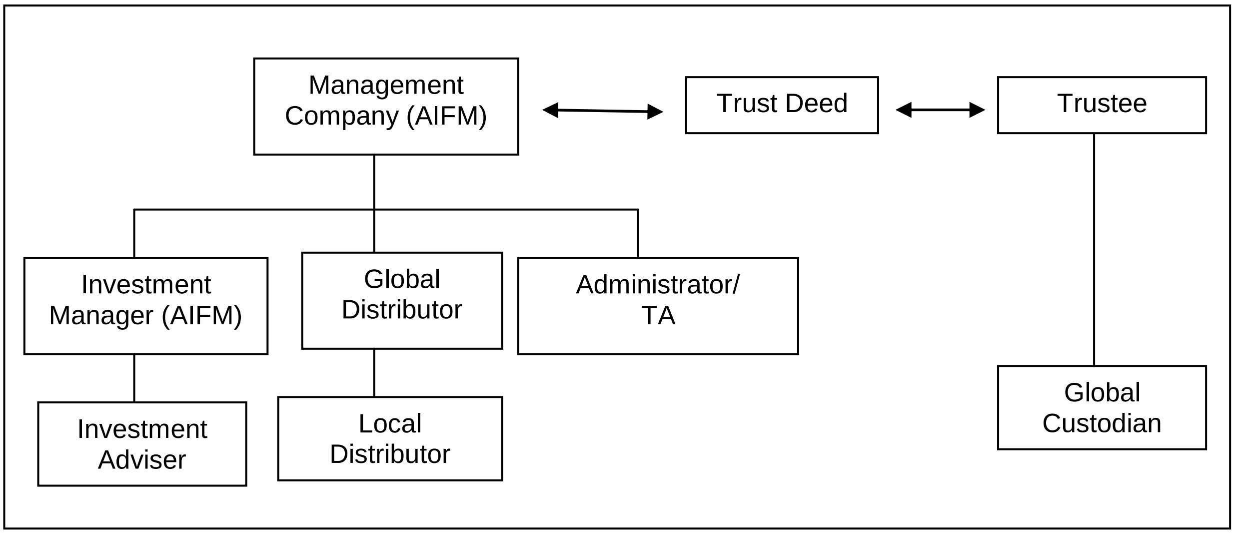
Box 1 – Internally Managed QIAIF ICAV / VCC



Box 2 – QIAIF ICAV / VCC with authorised AIFM

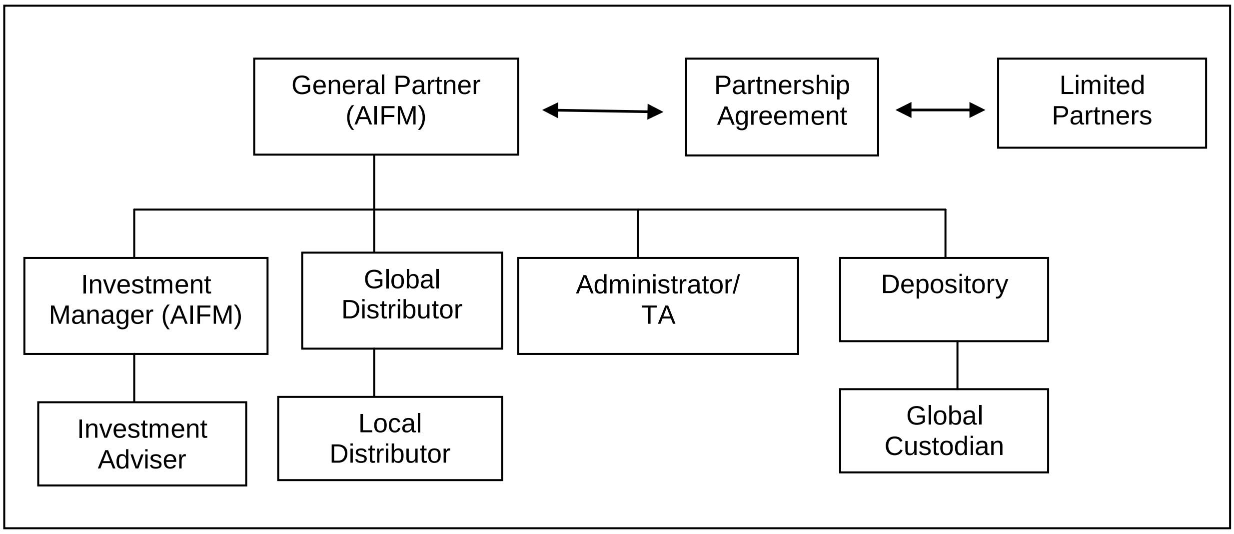


Box 3 – QIAIF Unit Trust



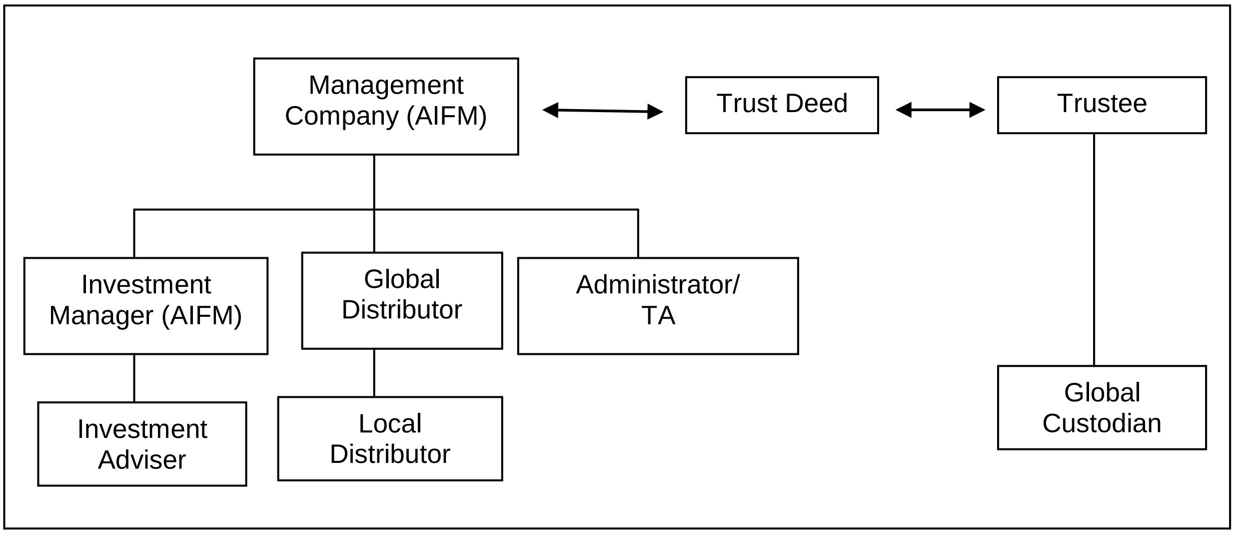
NOTE: There must be a single AIFM. It may <u>either</u> be the Management Company <u>or</u> the Investment Manager (are other options) in the structure above, <u>but not both</u>.

Box 4 – QIAIF Investment Limited Partnership (ILP)



NOTE: There must be a single AIFM. It may <u>either</u> be the General Partner <u>or</u> the Investment Manager (are other options) in the structure above, <u>but not both</u>.

Box 5 – QIAIF Common Contractual Fund (CCF)



NOTE: There must be a single AIFM. It may either be the Management Company or the Investment Manager (are other options) in the structure above, but not both.

5. Liquidity Options

QIAIFs can be structured as *open-ended*, *open-ended with limited liquidity* or *closed-ended* funds and can utilise a variety of features to address liquidity and/or valuation issues including gates, deferred redemptions, holdbacks, in-kind redemptions and side pockets. It is also possible to establish sub-funds with different liquidity profiles within a single segregated umbrella structure so as to take advantage of operational and other economies of scale.

The concepts of *open-ended*, *open-ended with limited liquidity* and *closed-ended,* explained below are those set down by the Central Bank in its AIF Rulebook.

5.1 Liquidity Categories

The concepts of open-ended, open-ended with limited liquidity and closed-ended QIAIFs are explained below. Note that the front cover of the QIAIF's prospectus must identify the category of scheme into which the QIAIF falls.

(i) *Open-Ended*

An *open-ended* QIAIF is one which provides redemption facilities for investors (at their request) on at least a quarterly basis, must redeem when requested at least 10% of net assets on a monthly basis or 25% of its net assets on a quarterly basis and must not impose redemption fees in excess of 5%.

While open-ended QIAIFs may provide for dealing on a quarterly basis, the Central Bank requires that the time between submission of a redemption request and payment of settlement proceeds must not exceed 90 calendar days. This period can however be extended to 95 calendar days in the context of a QIAIF which invests in other investment funds, including a QIAIF which provides for dealing on a more frequent basis (e.g. monthly, weekly, etc.).

(ii) *Open-Ended with Limited Liquidity*

An *open-ended with limited liquidity* QIAIF is one which offers redemption and/or settlement facilities on a less than quarterly basis or provides for a period of greater than 90 days between the dealing deadline and the payment of redemption proceeds. Although such open-ended with limited liquidity QIAIFs are not subject to any regulatory parameters in terms of dealing frequency, minimum redemption quotas or timeframe for settlement, the payment of redemption proceeds should normally be made by the redemption payment date specified in the prospectus but that may be dependent upon circumstances relating to, inter alia, investments in underlying assets.

The QIAIF's prospectus will normally provide that if the QIAIF does not receive sufficient funds from the liquidation of underlying assets in order to satisfy redemption requests in a timely manner, then the related payments may be limited or temporarily suspended and the QIAIF will pay redemption proceeds on the earliest practicable date following such funds being made available to it.

(iii) *Closed-Ended*

Closed-ended QIAIFs are funds which do not provide capacity for investors (at their request) to redeem during a finite closed-ended period set out in the prospectus. The constitutional document of a closed-ended QIAIF must provide that on a future date specified in either that document or in the prospectus, the QIAIF will either:

- wind-up and apply for revocation of authorisation;
- redeem all outstanding shares/units and apply for revocation of authorisation;
- convert into an open-ended scheme; or
- obtain investor approval to extend the closed-period for a further finite period.

Closed-ended QIAIFs may issue shares/units otherwise than at NAV, subject to prior Central Bank approval.

For the purposes of imposing requirements regarding the required investor approvals for certain changes to closed-ended funds the Central Bank makes a distinction between closed-ended QIAIFs which do and those which do not provide liquidity provisions which realistically contribute to the ability of an investor to realise its investment prior to the end of the finite closed-ended period.

For example, where a closed-ended QIAIF which does not provide realistic liquidity wishes to change the duration of the closed-ended period or where it wishes to make changes to its investment objective or a material change to its investment policy or to make changes to fees or charges, the vote in favour of any such change must represent at least 75% of the votes cast. In the case of QIAIFs that do provide realistic liquidity, votes in favour of the relevant change must represent at least 50% of votes cast.

In both cases, where there are non-material changes made to the investment policies, investors must be notified of the changes which can include by means of disclosure the next annual report.

Closed-ended funds may also have to comply with the EU Prospectus Directive as well as certain other EU Directives (the Transparency Directive, etc.) but QIAIFs can normally avail of exemptions, unless they list on or are admitted to trading on a regulated market within the EU.

5.2 Gates

For open-ended QIAIFs, redemption gates can be applied (once provided for in the fund documentation) limiting the number of share/units to be redeemed on a dealing day to 10% or, in the case of a quarterly dealing fund, 25% of the total number of shares/units in issue on that day. There are no quantitative restructures on the gates that can be applied with respect to QIAIFs that are not open-ended.

Gates should be applied on a *pro rata* basis. To date, it has been acceptable to provide that requests carried over from a prior dealing day as a result of the application of a gate be complied with in priority to later requests. However, the Central Bank has very recently (October 2015) indicated that such priority is not appropriate in UCITS schemes. It may look to apply that position to AIFs in the future.

5.3 Holdbacks

A QIAIF which invests in one or more other funds may retain up to 10% of redemption proceeds where this reflects the redemption policy of the underlying fund(s) in which the QIAIF invests and may do so until such time as the full redemption proceeds from the underlying fund(s) are received.

5.4 Side-pockets

Subject to being provided for in the QIAIF's constitutional document (with clear parameters) and to prior disclosure to investors (normally by prospectus disclosure), side-pockets are permitted for QIAIFs where assets which are illiquid or hard to value can be allocated to a separate side pocket class (or classes) of share until they can be realised. This is usually achieved by allocating the relevant assets into a separate portfolio represented by the side-pocket shares and by effecting a mandatory pro-rata reduction in the number of shares held by investors in the common pool and by creating for the benefit of such investors a corresponding pro-rata interest in the side-pocket share class.

The Central Bank will permit QIAIFs to use side-pockets not only for assets which become distressed or illiquid after purchase, but also to purchase distressed/illiquid assets and place them immediately into a side-pocket, subject to appropriate prospectus disclosure. QIAIFs which have that latter capacity must, as indicated above, be classified as either open-ended with limited liquidity or closed-ended. The capacity to utilise side pockets must be contained in the constitutional document and disclosed to investors in advance, normally by prospectus disclosure.

Before establishing a side pocket, the QIAIF and its depositary must provide confirmations to the Central Bank that the proposed establishment is in accordance with the QIAIF's constitutional document and takes into account the interests of all investors and, on an annual basis, the AIFM must report to the QIAIF confirming that the parameters have been respected and future plans for side pocketing.

6. General Regulatory and Ongoing Supervision Requirements for QIAIFs

Set out below is a summary of the general regulatory and principal ongoing supervision requirements for QIAIFs, as well as answers to some of the more common operational questions that QIAIF sponsors have asked us.

6.1 Financial Resources/Capital

The AIF Rulebook requires that a corporate type QIAIF (ICAV or VCC) must have sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities.

In addition, although capital requirements are generally seen as being imposed only on the AIFM itself, it is very important to bear in mind that an internally-managed QIAIF ICAV or VCC will be considered to be an AIFM and, as such, will be subject to a EUR 300,000 initial capital requirement. In addition, it will also be required to have either additional own funds appropriate to cover potential liability risk arising from professional negligence or have appropriate professional indemnity insurance coverage.

That also means that an internally–managed QIAIF must submit minimum capital requirement reports periodically to the Central Bank.

In its AIFMD Q&A, the Central Bank has noted that internally-managed QIAIFs can use shareholder funds to meet these capital requirements but it also refers to the requirement in Article 9(8) of AIFMD which is that "*Own funds, including any additional own funds as referred to in point (a) of paragraph 7, shall be invested in liquid assets or assets readily convertible to cash in the short term and shall not include speculative positions*".

Where a QIAIF ICAV or VCC does not employ the services of a management company or an authorised AIFM, it must have a minimum paid up share capital equivalent to EUR 125,000 within three months of authorisation and must satisfy the Central Bank on a continuing basis that it has sufficient management resources to effectively conduct its business and otherwise comply with Central Bank imposed provisions regarding AIF management companies as contained in the AIF Rulebook.

6.2 Changes to objectives/material changes to investment policies

A change to the investment objectives, or a material change to the investment policies of a QIAIF, as disclosed in the prospectus, may not be effected without the prior written approval of all investors or approval on the basis of a majority of votes cast at general meeting. “Material” shall be taken to mean, although not exclusively, “*changes which significantly alter the asset type, credit quality, borrowing or leverage limits or risk profile of the QIAIF*”.

In the event of a change of investment objectives and/or investment policy, on the basis of a majority of votes cast at a general meeting, a reasonable notification period must be provided by the QIAIF to enable investors redeem their shares/units prior to implementation of these changes.

There are particular additional voting rules applicable in the case of closed-ended funds, with the Central Bank distinguishing between those which do and those that do not provide realistic liquidity provisions. See Section 5.1 “*Closed-Ended*” for more detail.

6.3 Breaches of Investment Restrictions

The limits on investments set down in a QIAIF’s prospectus are deemed to apply <u>at the time of purchase of the investments</u>. If the limits laid down are subsequently exceeded for reasons beyond the control of a QIAIF or as a result of the exercise of subscription rights, the QIAIF must adopt as a priority objective the remedying of that situation, taking due account of the interest of its unitholders.

6.4 Board Appointments

Board appointments to QIAIFs and to QIAIF management companies require prior Central Bank approval. This requires completion of an online questionnaire by the prospective director. Departures from the board of directors must be notified to the Central Bank immediately. Two directors must be Irish resident and there is a prohibition on common directors between the QIAIF (or its management company) and the board of directors of the depositary.

In all cases where a director wishes to resign and prior to completing the relevant Central Bank form, the Board or its Chair must form a view as to the impact of the resignation on the AIF management company having regard to the current and prospective financial state of the AIF management company and the AIFs under management. In the event that the Board or, in the absence of a Board meeting, the Chair forms the view that the situation is one which could create such concern on the part of the Central Bank, it shall state this on the relevant Central Bank form. The Board or its Chair may consult the Central Bank in order to help it form a view on that matter.

In addition to the Central Bank pre-approval requirement, directors are also subject to obligations under the Irish fitness and probity regime which requires due diligence checks to be performed and records maintained.

6.5 IF Corporate Governance Code and CP86

Although a voluntary code, there is an expectation on the part of the Central Bank that QIAIF's will adopt Irish Funds' (the industry association) Corporate Governance Code (the "Code"). The Code applies to the boards of corporate funds and to the boards of management companies/general partners of unit trusts, CCFs and investment limited partnerships.

The Central Bank has also partially concluded its own deliberations on several fund governance and delegate oversight matters, raised in its Consultation Paper No. 86 ("**CP86**"). This has resulted in new obligations such as having a document explaining one's board composition, as well as a streamlining of various managerial functions, etc. We do not further consider here as it is more relevant to AIFMs and UCITS management companies. Internally-managed QIAIFs will, however, need to comply with its requirements.

6.6 Change in name of QIAIF

Prior Central Bank approval is required for a change in the name of a QIAIF or of a Sub-Fund. Shareholder approval may also be required for change of name of a corporate fund.

6.7 Changes to QIAIF documentation

Prior notification to the Central Bank is required for changes to a QIAIF's documentation including its prospectus, constitutional document and material contracts. If the Central Bank objects to a change, the change may not be made. Particular care needs to be taken with the timing of obtaining pre-approvals for ICAV documentation.

6.8 Suspensions

Where a QIAIF temporarily suspends the calculation of its NAV and the redemption of shares/units, the Central Bank must be notified immediately, in any event within the working day on which the suspension takes effect.

6.9 Initial Offer Periods

The general Central Bank rule is that the initial offer period of a QIAIF cannot commence prior to the authorisation of the QIAIF or prior to approval in the case of a sub-fund and must be for a period no longer than six months. However, in the case of private equity, real estate, venture or development capital QIAIFs, the initial offer period may extend up to two years and six months provided that the terms of offer ensure that early investors are not prejudiced by the arrangements. Where such a QIAIF has multiple closings, the initial offer period must commence no later than the date of first closing.

Extensions to initial offer periods may be made without prior notification to the Central Bank provided that no subscriptions have been received at the date of the proposed extension. Notifications of any such extensions must be made to the Central Bank on an annual basis. Where subscriptions have been received, the initial offer period can only be extended with prior Central Bank approval.

After the initial offer period, a QIAIF can launch share classes at a fixed price only where it has been confirmed to the Central Bank that existing shareholders in the QIAIF are not prejudiced.

6.10 Commitments/Partly Paid Shares/Units

Commonly found in closed-ended private equity and real estate schemes, QIAIFs can provide for partly-paid shares or units and for commitment arrangements (including through draw downs of commitments through the issue of fully paid shares/units), and can provide for standard forms of penalties for defaulting investors.

6.11 Valuation and Pricing

The AIFM is the entity who is responsible for the valuation of a QIAIF's assets and the publication of NAV. Assets must be valued by a method clearly defined in the QIAIF's constitutional document (and disclosed in the prospectus) which clearly define an expected method of valuation and which shall set out a framework for variation from this method of valuation. Additional details may be set out elsewhere (e.g. in the prospectus). In respect of an open-ended QIAIF, its assets must be valued as often as the QIAIF deals and the calculation procedures and methodologies must be subject to regular verification by the AIFM. Different rules apply for closed-ended funds. The AIFM also needs to ensure remedial action in the case of NAV error.

Valuations can be performed by the AIFM itself or by external valuers who meet certain specified criteria. Where the AIFM carries out the valuation function, this must be performed independently from portfolio management and any conflicts of interest must be managed. Note that where an external valuer is appointed, the AIFM remains responsible for the valuation function.

In practice, third party fund administrators will not be considered to be an "external valuer" on the basis that their role is restricted to fund accounting and calculation of the NAV unless they provide actual valuations for individual assets (including those requiring subjective judgement) and are licensed to do so.

6.12 In-Kind Subscriptions and Redemptions

In-kind subscriptions are permitted provided that the assets being subscribed are consistent with the QIAIF's investment objectives, policies and restrictions; are vested in the depositary; and the number of shares/units being issued for those assets is no greater than for an equivalent cash subscription. The depositary must also be satisfied that the in-kind subscription will not result or is unlikely to result in material prejudice to existing investors.

In-kind redemptions are also allowed at the QIAIF's discretion but generally require the consent of the redeeming investor and asset allocation is subject to the approval of the depositary. However, where a redeeming investor requests redemption of a number of units representing 5% or more of the net asset value (NAV) of the QIAIF, the QIAIF may determine, at its sole discretion, to satisfy the redemption in-kind, in which case it must, if requested, sell the assets on behalf of the investor. The cost of the sale can be charged to the investor.

Where the QIAIF is an exchange traded fund and the investor's original subscription was in-kind, the only requirement is that the asset allocation is subject to the depositary's prior approval.

6.13 Management and Depositary Fees

The nature of the costs to be borne by a QIAIF ICAV or VCC should be set out in its instrument of incorporation or articles of association. The constitutional documents of other types of QIAIF must prescribe the costs to be borne by the QIAIF and the remuneration/ expenditure which can be charged to the QIAIF by the management company/general partner and depositary and the applicable calculation methodology.

The maximum annual fee (including performance fee) which can be charged by an AIFM, by a management company or by a general partner must be set down in the QIAIF's constitutional document or management agreement and can only be increased if approved by majority vote of investors at a general meeting, with reasonable advance notice being given to enable investors redeem prior to the increase coming into force. This also applies to the fees of an investment manager where they are paid directly out of the QIAIF's assets. If the fee disclosed in the prospectus is less than the maximum fee permitted in the documents referred to above, investor approval will also be required for an increase in the fee disclosed in the prospectus unless the prospectus also provides that a higher fee may be charged.

The calculation of performance fees must be verified by the depositary or by a competent person appointed by the AIFM and approval for that purpose by the depositary.

The QIAIF must also specify in its constitutional document or prospectus the maximum charge relating to the redemption or repurchase of units.

6.14 Replacement of Management Company or Depositary

The QIAIF's constitutional documentation must also set out the conditions/procedure for replacing the AIFM / management company / general partner and depositary. Central Bank prior approval is required for replacing the depositary.

6.15 Connected Party Dealings

The Central Bank has set out specific rules for transactions carried out with a QIAIF by a general partner, manager, depositary, AIFM, investment manager and/or its delegate or associated or group companies. The general principle is that any such transaction has to be carried out as if effected on normal commercial terms, negotiated at arm's length and must be in the best interests of the investors. There are specific limitations imposed around such transactions, as well as procedural and periodic disclosure requirements.

6.16 Conflicts of Interest

The QIAIF's prospectus must include a description of the potential conflicts of interest which could arise between the AIFM, management company, general partner and investment manager and/or delegate or group companies thereof and the QIAIF, for example, directed brokerage services and/or the receipt of commissions by virtue of an investment in the units of another investment fund with details, where applicable, of how these are going to be resolved. A description of soft commission arrangements which may be entered into by a QIAIF must also be included.

The QIAIF should only enter into a transaction with, as appropriate, its general partner, management company, depositary, AIFM, investment manager and/or its delegate or associated or group companies, where there has been full disclosure of that possibility in the QIAIF's prospectus.

6.17 Warehousing

A QIAIF may only acquire assets pursuant to a warehousing arrangement where the use of such arrangements is fully disclosed in the prospectus, including details of any fee payable in relation to such arrangements. The prospectus must also state that the QIAIF will pay no more than current market value for such assets.

6.18 Subsidiary disclosure

A QIAIF intending to invest through wholly-owned subsidiaries must disclose that ability in the prospectus and state in the prospectus that the names of any subsidiaries will be disclosed in the QIAIF's annual report.

6.19 Regulatory Levies

The Central Bank imposes an annual industry funding levy on collective investment schemes. Rates (at time of writing) include a minimum annual fee of EUR 1,700 whether an umbrella or a single structure fund. Umbrella funds also pay a contribution of EUR 260 per sub-fund on the first ten sub-funds and a further contribution of EUR 160 per sub-fund on sub-fund numbers greater than ten up to a maximum of twenty sub-funds, resulting in a maximum contribution for umbrella funds of EUR 5,900.

6.20 Mergers of QIAIFs

A QIAIF may only merge or amalgamate with another investment fund where the proposed merger or amalgamation has received the prior approval of the Central Bank.

In the AIFMD "*Guidance*" section of its website, the Central Bank has set down specific rules for QIAIFs which seek to merge or amalgamate with other investment funds. These provide that where a QIAIF is the merging AIF, a proposal to amalgamate it with a receiving investment fund must first be presented to the Central Bank before the proposal is put forward for consideration by its investors. The proposal needs to indicate how the conditions set out below will be satisfied and any proposal to which the Central Bank objects will not be permitted to proceed.

The minimum conditions which the Central Bank will require are as follows:

(a) the receiving investment fund must be authorised and supervised by a relevant competent authority;

(b) there must be full disclosure to the merging QIAIF's investors of all material facts and considerations relevant to the proposal by the ICAV/VCC/management company/general partner.

The cover of the circular containing this information must prominently disclose that the information contained therein is important and that investors must take advice if they do not fully understand it. The circular must include, inter alia, full disclosure in relation to the following:

(i) the background to, and rationale for, the proposal;

(ii) a description of the receiving investment fund, which must be sufficient to enable investors to make an informed judgement of the proposal being put to them. In particular, this description must highlight any material differences by comparison with the merging QIAIF;

(iii) the procedures to be adopted for the transfer of assets;

(iv) the alternatives for investors who do not wish to become holders of units / shares in the receiving investment fund. These investors must be offered an opportunity to redeem their holdings in cash prior to the amalgamation taking effect;

(v) the regulatory status of the receiving investment fund. It must be made clear, where relevant, that the receiving investment fund has not been authorised by and will not be supervised by the Central Bank;

(vi) details on how investors, if they so require, may obtain the prospectus, constitutional document and financial statements of the receiving investment fund; all relevant costs including, where applicable, costs associated with the winding-up of the merging QIAIF and who will bear these costs;

(vii) other material information concerning, inter alia, tax treatment and details of the service providers to the receiving investment fund including their relationship, if any, with the service providers to the merging QIAIF; and

(viii) if the receiving fund does not provide redemption facilities at least as frequently as the merging QIAIF, this matter must be highlighted in a prominent position at the beginning of the circular;

(c) prior to notification to investors, the depositary of the merging QIAIF must review and be satisfied with the proposal and confirm to the Central Bank in writing that it has no objection to the proposal being put before investors for approval;

(d) a general meeting of merging QIAIF's investors must be convened to consider and to approve the amalgamation proposal including, if appropriate, a resolution to amend the constitutional document of the merging QIAIF to provide that the assets of the merging QIAIF may be passed to a non-Irish depositary to coincide with the time that the amalgamation becomes effective; and to wind-up the merging QIAIF;

(e) approval of the proposal will be effective only if: it is approved by not less than three fourths of the votes cast, in person or by proxy, at the meeting; and the votes in favour represent more than half of the total number of units / shares in issue;

(f) all investors must be notified of the outcome of the general meeting. In the event that the resolution is passed, investors must be advised of the procedures and deadlines by which they must submit their redemption request, if they so wish.

7. QIAIF Investment Restrictions

QIAIFs are subject to very few investment restrictions and no borrowing or leverage limits apply (subject to appropriate disclosure). The restrictions which do apply are summarised below.

7.1 General Restrictions

QIAIFs are subject to the following general restrictions:

(i) QIAIFs may not raise capital from the public through the issue of debt securities. However, that does not preclude the issue of notes by QIAIFs, on a private basis, to lending institutions to facilitate financing arrangements. Details of the note(s) issued must be clearly provided for in the prospectus;

(ii) QIAIFs are not permitted to grant loans or act as a guarantor on behalf of third parties, other than where authorised as a Loan Originating QIAIF. This is without prejudice to the right of a QIAIF to acquire debt securities. It will not prevent QIAIFs from acquiring securities which are not fully paid or from entering into bridge financing arrangements where the financing extended to the QIAIF is backed by sufficient legally binding commitments to discharge the financing within a time period determined by the at least simultaneous triggering of obligations on unitholders to make capital contributions which they are previously contractually committed to making at the time the bridge financing is entered into;

(iii) QIAIFs are not permitted to acquire shares carrying voting rights which would enable them to exercise significant influence over the management of issuing bodies, nor are they permitted to appoint an AIFM, management company or general partner who would do so. This requirement does not apply to investments in other investment funds. It is also disapplied where the QIAIF is a venture capital, development capital or private equity QIAIF, provided its prospectus indicates its intention regarding the exercise of legal and management control over underlying issuers;

(iv) where a QIAIF invests in funds managed by its AIFM or its management company or by an associated or related company of either the AIFM or management company, the manager of the underlying fund must waive any sales/initial charge/redemption charge it would normally charge in respect of the investment;

(v) QIAIFs structured as investment companies must comply with the aim of “spreading investment risk” as required under section 1386 (1)(a) of the Companies Act, 2014 and must include this requirement in its constitutional document. It is left to the discretion of the board of directors to determine actual diversification with reference to particular strategies.

Other specific fund type QIAIF restrictions apply as considered further below. Unlike the pre-AIFMD regime, there are no stated limitations or restrictions imposed on any type of QIAIF other than those set out in the AIF Rulebook and repeated (as conditions imposed) in the QIAIF's letter of authorisation.

It is not entirely clear if that really means that there are no other rules, but that is what it seems.

NOTE: The limits on investments contained in the AIF Rulebook and those set down in the QIAIF's prospectus apply at the time of purchase of the investments and continue to apply thereafter. If these limits are subsequently exceeded for reasons beyond the control of a QIAIF or as a result of the exercise of subscription rights, the QIAIF must record such matters and adopt as a priority objective the remedying of that situation, taking due account of the interests of its investors.

7.2 No Leverage Restrictions

QIAIFs are not subject to borrowing or leverage limits. It is a matter of prospectus disclosure only. QIAIFs must disclose in the prospectus the circumstances in which they may use leverage, the type/source of leverage, the maximum leverage levels and any collateral or asset re-use arrangements.

The QIAIF (if it is also the AIFM) must, however, be able to demonstrate that the leverage limit set by it is reasonable and that it complies with that limit at all times.

7.3 QIAIF Fund of Funds

A QIAIF may invest up to 100% of its assets in other funds, subject to a maximum of 50% of net assets in any one underlying unregulated fund (subject to Section 7.5 below). A QIAIF must not make investments which circumvent this restriction, for example, by investing more than 50% of net assets in two or more unregulated investment funds which have identical investment strategies.

7.4 QIAIFs investing more than 50% of net assets in one other investment fund

Where a QIAIF invests more than 50% of net assets in one other investment fund, the underlying investment fund must be authorised in Ireland or in another jurisdiction by a supervisory authority established in order to ensure the protection of unitholders and which, in the opinion of the Central Bank, provides an equivalent level of investor protection to that provided under Irish laws, regulations and conditions governing QIAIFs. This is subject to an exception which is described in Section 7.5.

Acceptable investment funds are broken down into two categories:

Category 1 Investment funds:

- established in a Member State of the European Union which are authorised under Directive 2009/65/EC;
- established in a Member State of the European Economic Area which are authorised under domestic legislation implementing Directive 2009/65/EC;
- established in Guernsey and authorised as Class A Schemes;
- established in Jersey as Recognised Funds;
- established in the Isle of Man as Authorised Schemes;
- authorised AIFs.

Category 2 Investment funds:

- authorised in a Member State of the European Union;
- established in Guernsey and authorised as Class B Schemes;
- established in Jersey which are not Recognised Funds;
- established in the Isle of Man as unauthorised schemes;
- authorised by the US Securities and Exchanges Commission under the Investment Companies Act 1940;
- such other funds which the Central Bank may specify upon application and which comply, "*in all material aspects*", with the provision of these requirements in respect of QIAIFs.

The consideration of "all material respects" should include, inter alia, consideration of the following:

- supervision by the regulatory authority of the investment fund;
- the existence of an independent depositary with similar duties and responsibilities in relation to both safe-keeping and supervision;
- availability of pricing information and reporting requirements; and
- restrictions in relation to dealings by related parties.

In the case of Category 1 investment funds, the QIAIF must provide the Central Bank with the prospectus of the underlying investment fund in advance of investing more than 50% of net assets in one other investment fund.

In the case of Category 2 investment funds, the QIAIF must not invest more than 50% of net assets in one other investment fund without having obtained a confirmation in writing from the Central Bank that it has no objection. In addition, the QIAIF must provide the Central Bank with the prospectus of the underlying investment fund.

The QIAIF shall provide a letter to the Central Bank confirming that the underlying investment fund complies in all material respects with the provisions of the AIF Rulebook in respect of QIAIFs.

The oversight function of the depositary for Category 2 investment funds must, at a minimum, include requirements to:

- ensure that valuations of assets are carried out in accordance with the valuation policy;
- ensure that units of the underlying investment fund are issued and redeemed correctly; and
- ensure that the management of the assets is carried out correctly.

The QIAIF shall inform the Central Bank immediately it becomes aware that the underlying investment fund has materially breached any of its legal regulatory or constitutional obligations.

A QIAIF may not invest in an investment fund which itself invests more than 50% of net assets in another investment (subject to the exception identified in Section 7.5 below).

The periodic reports of the QIAIF must have the periodic reports of the underlying investment fund attached.

7.5 Disapplication where EUR 500,000 minimum subscription

The requirement that a QIAIF cannot invest more than 50% of net assets in an investment fund other than a Category 1 or Category 2 investment fund does not apply where;

- the QIAIF imposes a minimum initial subscription requirement of 500,000 Euro on its investors (however, the aggregate of an investor's investments in the sub-funds of an umbrella QIAIF <u>cannot</u> be taken into account for the purposes of determining this requirement); and
- the prospectus of the QIAIF contains a detailed and prominent disclosure which identifies on an item-by-item basis those obligations and conditions which apply to

the QIAIF and its AIFM but which do not apply to the underlying investment fund and its management company.

The requirement that a QIAIF may not invest in an investment fund which itself invests more than 50% of net assets in another investment fund is disapplied where the above requirements are observed.

7.6 QIAIF Private Equity Funds

QIAIFs structured as private equity funds will need to consider and comply with the disclosure and notification obligations and anti-asset stripping applicable to EU authorised AIFMs or non-EU AIFMs marketing the QIAIF's units or shares to one or more EU investors, where the QIAIF (alone or with one or more AIFs managed by the same AIFM) acquires "control" of non-listed companies and issuers within the scope of AIFMD. See Section 7.10 for more detail.

7.7 QIAIF Real Estate Funds

Reflecting the AIFMD itself, the Central Bank has not imposed any specific investment restrictions on QIAIFs investing in real estate or in real estate assets. Whereas Retail AIFs making such investments are subject to quite a number of real estate specific investment limits, QIAIFs investing in real estate or in real estate assets are simply subject to the general QIAIF restrictions set out above.

7.8 QIAIF Money Market Funds

Although many QIAIFs may invest significantly or even principally in money market instruments, only those who meet the following additional requirements can label or market themselves as "money market funds". The Central Bank distinguishes between "Short-Term Money Market Funds" and "Money Market Funds", setting out detailed rules in its AIF Rulebook as to the terms and basis upon which a QIAIF may label itself or market itself as a money market fund.

A Short-Term Money Market Fund may have either a constant or fluctuating NAV and is permitted to follow an amortised cost valuation methodology, as set out below.

A Money Market Fund must have a fluctuating NAV and is not permitted to follow an amortised cost valuation methodology.

Both types must have a primary investment objective of maintaining the principal of the fund and must aim to provide a return in line with money market rates. Both must limit investment to "high quality" money market instruments, as determined by the QIAIF, and deposits with credit institutions. The distinctions between the two types – Short-Term Money Market Funds and Money Market Funds – turn (i) on the maximum residual maturity of its investments; (ii) the Weighted Average Maturity ("**WAM**"); (iii) the Weighted Average Life ("**WAL**"); (iv) the capacity to have a fixed or floating NAV; and (iv) the capacity to use amortised cost valuation methodology.

(i) Disclosure Requirements

A QIAIF money market fund must indicate in its prospectus whether it is a Short-Term Money Market Fund or a Money Market Fund and must provide appropriate information to investors on the risk and reward profile of the fund so as to enable investors identify any specific risks linked to the investment strategy of the fund taking into account, where relevant, of investment in new asset classes, financial instruments or investment strategies with unusual risk and reward profiles.

It must also include a risk warning drawing attention to the difference between the nature of a deposit and the nature of an investment in a money market fund with particular reference to the risk that the principal investment in a money market fund is capable of fluctuation.

In the case of a QIAIF classified as a Money Market Fund, this must take into account the longer WAM and WAL (see further below). In the case of both types of QIAIF money market fund, the information provided must take account, where relevant, of investment in new asset classes, financial instruments or investment strategies with unusual risk and reward profiles.

(ii) Investment Objective

The primary investment objective of a QIAIF money market fund structured either as a Short-Term Money Market Fund or as a Money Market Fund must be to maintain the principal of the fund and aim to provide a return in line with money market rates.

(iii) Eligible Investments

The following conditions apply to both types of QIAIF money market funds:

(a) investments must be limited to "high quality" money market instruments as determined by the QIAIF and deposits with credit institutions. To determine "high quality", the following factors must at least be taken into account:

    (i) the credit quality of the instrument (a money market instrument may not be considered to be of high quality unless it has been awarded one of the two highest available short-term credit ratings by each recognised credit rating agency that has rated the instrument, or, if the instrument is not rated, it is of an equivalent quality as determined by the QIAIF). Credit quality must be monitored on an ongoing basis;

(ii) the nature of the asset class represented by the instrument;

(iii) the operational and counterparty risk, in the case of structured financial instruments; and

(iv) the liquidity profile.

(b) Direct or indirect exposure to equities or commodities, including through financial derivative instruments, is not permitted.

(c) Where the QIAIF is a Short-Term Money Market Fund, financial derivative instruments may be used but only when they are in line with the QIAIF's money market investment strategy. Financial derivative instruments which give exposure to foreign exchange may only be used for hedging purposes. Investment in non-base currencies is not permitted unless the exposure is fully hedged.

(d) Where the QIAIF is a Money Market Fund, only financial derivative instruments which give exposure to foreign exchange may be used and only for hedging purposes. Investment in non-base currencies is not permitted unless the exposure is fully hedged.

(e) Investment in other investment funds is not permitted unless they satisfy the following: (i) if the investing fund is a Short-Term Money Market Fund, the other fund must also be a Short-Term Money Market Fund (ii) if the investing fund is a Money Market Fund, the other fund must be either a Short-Term Money Market Fund or a Money Market Fund.

(iv) Daily NAV and Dealing

Both Short-Term Money Market Funds and Money Market Funds must provide daily NAV and price calculations and have daily subscription and redemption of units/shares.

(v) Residual Maturity

Investments are limited to securities or instruments with a residual maturity until the legal redemption date of less than or equal to 397 days in the case of Short-Term Money Market Funds. This is increased to 2 years in the case of Money Market Funds provided that the time remaining until the next interest reset date is less than or equal to 397 days. Floating rate securities must reset to a money market rate or index.

*(vi) Weighted Average Maturity ("**WAM**")*

The WAM of the portfolio of a Short-Term Money Market Fund must not exceed 60 days, whereas the WAM of the portfolio of a Money Market Fund must not exceed 6 months.

*(vii) Weighted Average Life ("**WAL**")*

The WAL of the portfolio must not exceed 120 days in the case of a Short-Term Money Market Fund, or 12 months in the case of a Money Market Fund.

When calculating the WAL for securities, including structured financial instruments, the QIAIF must base the maturity calculation on the residual maturity until the legal redemption of the instruments. However, when a financial instrument embeds a put option, the exercise date of the put option may be used instead of the legal residual maturity only if the following conditions are fulfilled at all times:

(a) the put option can be freely exercised by the QIAIF at its exercise date;

(b) the strike price of the put option remains close to the expected value of the instrument at the next exercise date; and

(c) the investment strategy of the QIAIF implies that there is a high probability that the option will be exercised at the next exercise date.

When calculating the WAM and WAL, the impact of financial derivative instruments, deposits and efficient portfolio management techniques must be taken into account.

(viii) Short-Term Money Market Funds - Valuation on the basis of amortised cost

Valuation on the basis of amortised cost is permitted in the case of Short-Term Money Market Funds provided the QIAIF or, where relevant, its delegate has demonstrable expertise in the operations of money market funds which follow this method of valuation.
This condition is satisfied where:

(a) the Short-Term Money Market Fund has obtained a triple-A rating from an internationally recognised rating agency; or

(b) the management company or investment manager is engaged in the management, or has been engaged in the management, of a triple-A rated money market fund; or

(c) in circumstances other than (a) or (b), where the QIAIF has demonstrated to the Central Bank (through separate application) that appropriate expertise exists in the operation of this type of money market fund.

The QIAIF must ensure and be satisfied at all times that the persons responsible for the operation of the Short-Term Money Market Fund including under any delegation arrangements have and continue to have the necessary expertise.

A QIAIF Short - Term Money Market Fund must carry out a weekly review of discrepancies between the market value and the amortised cost value of its money market instruments and must put in place escalation procedures to ensure that material discrepancies are brought to the attention of the personnel charged with the investment management of the QIAIF.

Discrepancies in excess of 0.1% between the market value and the amortised value of the portfolio should be brought to the attention of the investment manager or management company.

Discrepancies in excess of 0.2% should be brought to the attention of the senior management/directors of the management company or of the QIAIF <u>and</u> the depositary. If discrepancies in excess of 0.3% between the market value and the amortised cost value of the portfolio occur, a daily review must take place. The QIAIF must also notify the Central Bank with an indication of the action, if any, which will be taken to reduce such dilution.

The constitutional document of the QIAIF must provide for the escalation procedures set out above or, alternatively, provide that a review of the amortised cost valuation vis-à-vis market valuation will be carried out in accordance with the requirements of the Central Bank. Weekly reviews and any engagement of escalation procedures must be clearly documented.

A QIAIF which uses amortised cost must also undertake and complete a monthly portfolio analysis (incorporating stress testing) to examine portfolio returns under various market scenarios to determine if the portfolio constituents are appropriate to meet pre-determined levels of credit risk, interest rate risk, market risk and investor redemptions. The results of the periodic analysis must be available to the Central Bank on request.

(ix) ECB Reporting

ECB Reporting rules also apply and are detailed in the AIF Rulebook.

7.9 Loan Originating QIAIFs

In response to industry requests for QIAIF products which could lend to the real economy as an alternative to traditional forms of bank financing, the Central Bank consulted on a proposal to allow for loan originating QIAIFs. Such loan originating QIAIFs are now permitted subject to the parameters set out below.

(i) Require an EU authorised AIFM

Loan originating funds are permitted under the QIAIF regime and require an EU authorised AIFM. It is not possible to avail of the registered QIAIF option for a loan originating QIAIF.

Where the QIAIF is the authorised AIFM itself (i.e. as an internally-managed vehicle), it will likely appoint an external credit/portfolio manager. Alternatively, the QIAIF may appoint an external AIFM which either itself carries on the credit management process or appoints a credit/portfolio manager to do so.

(ii) Legal Structure

Although no regulatory limitation imposed on the choice of legal structure for loan origination QIAIFs, we think it likely that ICAVs or VCCs (and not unit trusts, CCFs or ILPs) will be the vehicles predominately used for loan originating funds given their legal personality.

(iii) Limited Activity

A loan originating QIAIF must limit its operations to the *"business of issuing loans, participating in loans, participations in lending and to operations directly arising therefrom, including handling assets which are realised security, to the exclusion of all other commercial business."*

The Central Bank has clarified that treasury management and the use of derivatives for hedging purposes fall within "*operations directly arising therefrom*".

(iv) Prohibited Investments

In addition to the general QIAIF investment restrictions, note that loan originating QIAIFs cannot invest in other funds. The Central Bank feels that that could confuse the supervisory approach and that investment in other funds could be used to circumvent the requirements applied to the loan originating QIAIF.

In addition, loan originating QIAIFs cannot invest in other asset classes such as equities, debt securities, etc. The Central Bank has explained in that regard that if a loan originating QIAIF wishes to invest in other assets, the solution is to set up an umbrella structure with a loan originating QIAIF sub-fund and a separate sub-fund for non-loan strategies.

(v) Prohibited Loans

Loans cannot be originated to natural persons; to certain related parties (the AIFM, management company, GP, depositary or to delegates or group companies of these); to other funds; to financial institutions or to their related companies (save in the case where there is a *bona fide* treasury management purpose which is ancillary to primary objective of the loan originating QIAIF); nor to persons intending to invest in equities or other traded investments or commodities.

(vi) Acquiring loans from credit institutions

A loan originating QIAIF shall not "acquire a loan"[1] from a credit institution under arrangements which involve:

- the retention by the credit institution or a member of its group of an exposure correlated with the performance of the loan;

- the provision of an administration, credit assessment or credit monitoring service in relation to the loan whether on an individual or portfolio basis, by the credit institution or a member of its group,

unless the loan originating QIAIF is satisfied that it has in place and implements particular policies and procedures (including as to valuation, performance, monitoring, stress testing, etc.) and has received from the vendor warranties that:

- the vendor (or, where within scope of banking consolidated supervision, an entity within its group) will retain, on an on-going basis, a material net economic interest of at least 5% of the nominal value of the loan as measured at origination;

- the exposure will not be subject to any credit risk mitigation techniques; and

- the loan originating QIAIF will have readily available access to all materially relevant data on the credit quality and performance of the underlying exposures and on cash flows relating to and collateral supporting the exposures so as to be able to conduct comprehensive and well informed stress tests on the cash flows and collateral values supporting the exposures.

The Central Bank has noted that this 5% "skin in the game" requirement *applies only where the loan acquired from a credit institution is a bilateral arrangement. The retention rule does not apply if the loan purchased has been offered to multiple parties and is acquired on an arm's length open market basis.*

[1] For the purpose of this paragraph, "acquire a loan" means any of: to purchase; take transfer of; take credit risk or part of credit risk attaching to; take other exposures to, a loan.

(vii) Portfolio Diversification

Exposure to any one issuer or group cannot exceed 25% of net assets. The loan originating QIAIF has to set out its risk diversification strategy in its prospectus, designed to achieve a portfolio of loans which is diversified and which will limit exposure to any one issuer or group to 25% of net assets within a specified time-frame. The QIAIF must not intentionally breach its risk diversification strategy and, in the event that it is not able to achieve that strategy within the time-frame set out in its prospectus, it must seek investor approval to continue with the actual level of diversification.

Diversification limits will not apply to a loan originating QIAIF which has reached its *end of life* phase and is closing out positions. Otherwise, the normal QIAIF rules regarding breaches of investment limits will apply - if the limits are exceeded for reasons beyond the control of the QIAIF, the QIAIF must record such matters and adopt as a priority objective the remedying of that situation, taking due account of the interests of its investors.

(viii) Leverage

The Central Bank has imposed a leverage limit on loan originating QIAIFs. The limit is that the loan originating QIAIF must not have gross assets of more than 200% of net asset value (or such other limit as may be set by the Central Bank from time to time for loan originating QIAIFs or for one or more classes of loan originating QIAIFs). In other words, the ratio of debt to equity is set at 1:1.

If the limit is breached, the QIAIF is required within 30 days (or such longer period as the Central Bank may specify) to obtain approval for a formal plan to bring it back into compliance with the leverage ratio.

(ix) Liquidity and Distributions

Loan originating QIAIFs must be *closed-ended* and must be established for a finite period. However, they can have discretion to invite, at dates determined at the authorisation date or such other dates as may be approved by the board of the AIFM / investment company / management company / general partner, without commitment and on a non-preferred basis, requests for redemption of holdings from investors.

Distributions to or redemptions of investors holdings can only be effected during the life of the loan originating QIAIF to extent that there is unencumbered cash or liquid assets available for such purposes and will not endanger regulatory compliance or liquidity regulated obligations of the QIAIF.

In addition, unless the assets can be valued by reference to prevailing market prices, a redemption cannot be made without the approval of the investors in accordance with the approval process set out in the QIAIF's constitutional document on each occasion.

(x) Credit Granting, Monitoring and Management

Loan originating QIAIFs must establish and implement a variety of documented and regularly updated procedures, policies and processes in respect of a variety of credit granting, monitoring and management activities, including:

- the setting of a risk appetite statement;
- the assessment, pricing and granting of credit as well as the monitoring of credit and its renewal and refinancing (including, in both cases, criteria, governance and decision making and committee structures);
- collateral management policy;
- concentration risk management policy;
- valuation, including collateral valuation and impairment;
- credit monitoring;
- identification of problem debt management;
- forbearance;
- delegated authority;
- documentation and security.

The relevant Chapter to the AIF Rulebook sets out a variety of additional controls and restrictions around the credit granting, renewal and refinancing processes; the credit risk assessment process; and processes for value adjustments and provisions (including the requirement for effective systems) and adequacy of credit position diversification.

Loan originating QIAIFs will also be subject to the Central Bank's Code of Conduct for Business Lending to Small and Medium Enterprises when lending to Irish SMEs.

(xi) Due Diligence by Investors

Where an AIFM intends to provide access to its records/staff to any investor for the purposes of the investor carrying out due diligence on the AIFM, the AIFM must ensure that such access is made available on a non-discriminatory basis to all investors and not be structured so to materially mis-represent the business of the loan originating QIF.

In response to comments received on this provision during the consultation process, the Central Bank clarified its position on this point by explaining that "*Once a loan originating Qualifying Investor AIF decides to provide access to its records or staff, this facility must be transparently available so that any unit holder will have been aware of the due diligence possibility. The onus is on the unitholders to pursue this opportunity. It may arise therefore that some unitholders will have put resources into due diligence processes while others have chosen not to.*"

"*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 QIAIF.*"

The AIFM is required to ensure that a single person within senior management is designated with responsibility to ensure that the access given has been non-discriminatory and that person must be satisfied that a reasonable person relying on the access provided would not be influenced to invest in the loan originating QIAIF because of lack of access to information. The rule also makes it clear that the AIFM must 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 QIAIF.

(xii) Stress Testing

The QIAIF must have a comprehensive stress testing programme which includes a variety of specific requirements including a programme which identifies possible events or future changes in economic conditions that could have unfavourable effects on the fund's credit exposures. It also requires an assessment of the fund's ability to withstand such changes.

Transactions and aggregate exposures across all forms of counterparty credit risk at the level of specific counterparties must be comprehensively captured in a sufficient timeframe to conduct the regular stress testing, with a minimum monthly frequency for exposure stress testing of principal market risk factors such as interest rate, FX and credit spreads for all counterparties.

At least quarterly multifactor stress testing requirements are imposed as are minimum scenarios which must be addressed. Reporting of stress testing results to senior management must occur at least quarterly basis.

The Central Bank has also indicated that it intends to put in place similar reporting on individual loans as is provided by the banking sector and that its requirements in that regard will evolve with developments in banking.

(xiii) Disclosure to Investors

Certain minimum information must be included in the QIAIF's prospectus including information on risk and reward profile, on levels of concentration, geographical location and sectors as well as risks arising from the proposed concentration. Details of the credit assessment monitoring process and information on whether the AIFM would provide investors with access to records and staff for the purpose of due diligence must also be disclosed.

A prominent risk warning must appear in the prospectus and sales material drawing attention to the unique risks which arise from loan origination and how investment in a loan originating investment fund is not guaranteed and is subject to the possibility of investment losses and illiquidity. Similarly, that the Central Bank has the capacity to tighten lending standards and leverage limits and the impact that may have on the QIAIF in following its investment strategy. Also required is a risk warning drawing attention to the potential implications from the application of the Central Bank's Code of Conduct for business lending to SMEs (where loans are issued to SMEs operating within Ireland).

Requirements as to the minimum content of periodic reports are also imposed including, for example, the breakdown of the originated loans between senior secure debt, junior debt and mezzanine debt etc.

7.10 Obligations for AIFMs managing QIAIFs which acquire control of non-listed companies/issuers

When a QIAIF acquires, disposes of or holds shares of a non-listed company within the scope of AIFMD at, above or below various thresholds, its AIFM will be obliged to make certain notifications (as required by Articles 26 to 30 of AIFMD). It is important to note that these requirements only apply to EU authorised AIFMs and to non-EU AIFMs which are marketing the QIAIF's units or shares to one or more EU investors. In the case of non-EU AIFMs, the rules are subject to any additional requirements that are applied in the EU Member State in which the QIAIF's units or shares are being marketed.

Notifications and disclosures to the affected company, its shareholders, employees and to regulators will also be required where AIFMs which manage one or more AIFs which (either individually or jointly) acquire "control" of a non-listed company or issuer within the scope of the Directive.

Non-listed companies and issuers which fall <u>outside</u> of the scope of AIFMD are (a) small and medium-sized enterprises within the meaning of Article 2(1) of the Annex to Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises; and (b) special purpose vehicles whose purpose is the purchasing, holding or administering of real estate.

For the purposes of these obligations, "control" is defined to mean more than 50% of the voting rights of the company. When calculating the percentage of voting rights held by the relevant AIF, one must take into account not only any voting rights held directly by the AIF but also of any undertaking controlled by the AIF or by any natural or legal person acting in its own name but on behalf of the AIF or of an undertaking controlled by it.

(i) *Disclosure and Notification Obligations*

When an AIF acquires, disposes of or holds shares of a non-listed company, its AIFM (if Irish) must notify the Central Bank of the proportion of voting rights of the non-listed company held by the AIF any time when that proportion reaches, exceeds or falls below the thresholds of 10 %, 20 %, 30 %, 50 % and 75 %.

AIFMs which manage one or more AIFs which (either individually or jointly on the basis of an agreement aimed at acquiring control) acquire "control" of a non-listed company must notify the non-listed company, its shareholders to which the AIFM has or can obtain access and the Central Bank of:

(a) the resulting situation in terms of voting rights;

(b) the conditions subject to which control was acquired (certain minimum information required); and

(c) the date control was acquired.

The AIFM must also request that the board of directors of the non-listed company inform the employees' representatives or, where there are none, the employees themselves, without undue delay of the acquisition of control by the AIF managed by the AIFM and the AIFM must use its best efforts to ensure that the employees' representatives or, where there are none, the employees themselves, are duly informed by the board of directors of such change of control. The notifications must include certain specified information, including the repercussions on employment, including any material change in the conditions of employment for employees of the non-listed company.

The AIFM must also notify the relevant company, its shareholders and the AIFM's own competent authority of:

(a) the identity of the AIFMs which either individually or in agreement with other AIFMs manage the AIFs that have acquired control;

(b) the policy for preventing and managing conflicts of interest, in particular between the AIFM, the AIF and the company, including information about the specific safeguards established to ensure that any agreement between the AIFM and/or the AIF and the company is concluded at arm's length; and

(c) the policy for external and internal communication relating to the company in particular as regards employees.

The AIFM managing such an AIF must also ensure that the AIF, or the AIFM acting on behalf of the AIF, discloses its intentions with regard to the future business of the non-listed company and the likely repercussions on employment, including any material change in the conditions of employment. It must also provide the competent authorities of its home Member State and the AIF's investors with information on the financing of the acquisition.

The annual report of the non-listed company must also include, in relation to the non-listed company, an indication of any important events that have occurred since the end of the financial year, the company's likely future development. The annual accounts of the AIFM or AIF must include disclosures in relation to the non-listed companies in which it invests.

(ii) Anti-asset stripping measures

AIFMs which manage one or more AIFs which (either individually or jointly) acquire(s) control of a non-listed company or issuer must, for a period of 24 months following the acquisition of control of the non-listed company:

(a) not facilitate, support or instruct any distribution, capital reduction, share redemption and/or acquisition of own shares by the non-listed company;

(b) not vote in favour of a distribution, capital reduction, share redemption and/or acquisition of own shares by the company;

(c) use its best efforts to prevent distributions, capital reductions, share redemptions and/or the acquisition of own shares by the company.

These obligations relate to the following:

(a) any distribution to shareholders made when on the closing date of the last financial year the net assets as set out in the company's annual accounts are, or following such a distribution would become, lower than the amount of the subscribed capital plus those reserves which may be not distributed under the law or the statutes, on the understanding that where the uncalled part of the subscribed capital is not included in the assets shown in the balance sheet, this amount shall be deducted from the amount of subscribed capital;

(b) any distribution to shareholders the amount of which would exceed the amount of the profits at the end of the last financial year plus any profits brought forward and sums drawn from reserves available for this purpose, less any losses brought forward and sums placed to reserve in accordance with the law or the statutes;

(c) to the extent that acquisitions of own shares are permitted, the acquisitions by the company, including shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company's behalf, that would have the effect of reducing the net assets below the amount mentioned in point (a).

The term "distribution" shall include, in particular, the payment of dividends and of interest relating to shares. The provisions on capital reductions shall not apply on a reduction in the subscribed capital, the purpose of which is to offset losses incurred or to include sums of money in a non-distributable reserves provided that, following that operation, the amount of such reserve is not more than 10% of the reduced subscribed capital.

7.11 QIAIFs Investing in Securitisations

AIFMD provided for the adoption by the European Commission of requirements to be imposed on AIFMs who seek to invest on behalf of their AIFs in securitisation positions and for requirements to be imposed on the originator or sponsor or original lender. It is important to note that these requirements apply pursuant to AIFMD and only apply to EU authorised AIFMs.

The requirements adopted are set out in the Level 2 Regulation where, subject to certain exemptions, there is a requirement imposed on the originator, sponsor or original lender to retain on an ongoing basis, a material net economic interest which in any event shall not be less than 5%, with the 5% being given as a percentage of a number of different possibilities. This is the so called "skin in the game" requirement.

In addition, the requirements imposed on the AIFM include requirements to have a comprehensive and thorough understanding of the relevant positions and to have implemented formal policies and procedures appropriate to the risk profile of the relevant AIF's investments in securitised positions.

Requirements to regularly perform stress tests, to create and establish formal monitoring procedures and risk management type procedures as well as specific rules regarding when corrective action must be taken in the best interests of the investors in the relevant AIF are also imposed.

7.12 QIAIFs Investing via Subsidiaries / other SPVs / Conduits

QIAIFs can establish and invest through wholly-owned and controlled subsidiaries if that is provided for in the QIAIF's constitutional document and if prior Central Bank approval to establish such a subsidiary is obtained. The subsidiary must not be an investment fund or issuing body, cannot appoint third parties or enter into contractual arrangements unless the QIAIF is also a party to such appointments/arrangements and the directors of the QIAIF must form a majority of the subsidiary board. The assets of the subsidiary must be valued in accordance with the QIAIF's valuation rules and the subsidiary's own constitutional document must include provisions which restrict the subsidiary from acting other than under the control of the QIAIF and which restrict any person or entity other than the QIAIF from holding shares in the subsidiary.

Neither AIFMD nor the Central Bank's AIF Rulebook set out any specific prohibitions on other forms of non-wholly owned investment arrangements or conduits. For example, it has been previously accepted by the Central Bank under the prior QIF regime that *co-investment* arrangements (i.e. where the fund would invest side by side with other investors in an underlying asset, including potentially persons who are also invested in the fund) were acceptable where disclosed in the prospectus together with the basis on which co-investment opportunities are offered and the reasons why it is considered that such co-investment arrangements are in the interests of the fund/investors. The Central Bank has also previously required that the fund's investment could be dealt with (i.e. disposed of) independently of the co-investors.

The Central Bank also previously permitted funds, particularly those in the private equity and real estate sectors, to enter into *joint venture* arrangements and to invest in underlying assets through other forms of conduit vehicles where the conduit vehicle was not wholly-owned by the fund. It also allowed funds to have an interest in, for example, companies which control common areas of real estate developments.

We believe the Central Bank will continue to allow these types of arrangements but, as in the past, may likely treat investments in non-wholly owned arrangements/conduits as equivalent to investing in unregulated funds (and therefore be subject to the express limitations on investing in unregulated funds) as well as being subject to the AIFM's conduct of business type obligations (e.g. obligations to act in the best interests of the AIF and its investors) as well as the other requirements regarding investment due diligence and risk management in particular. We expect that this will fall to be negotiated in individual QIAIF's letters of authorisation.

Care will also need to be taken to ensure, if possible, that the conduit vehicle itself does not become an AIF.

It is important to note that where the QIAIF has appointed an EU authorised AIFM, Regulation 89(3) and/or 90(5) of the Level 2 Regulation require that certain of the QIAIF's depositary's safe-keeping duties under AIFMD will apply on a look-through basis to underlying assets held by financial and, as the case may be, or legal structures established by the QIAIF or by the AIFM acting on behalf of the QIAIF for the purposes of investing in the underlying assets and which are controlled directly or indirectly by the QIAIF or by the AIFM acting on behalf of the QIAIF.

This requirement does not apply to fund of funds structures and master-feeder structures where the underlying funds have a depositary which provides ownership verification and record-keeping functions for this fund's assets.

8. The Prospectus (and other disclosures to investors)

As we have noted in earlier Chapters, AIFMD is a manager focused directive which does not seek to regulate AIFs, whereas under domestic Irish funds law, Irish domiciled AIFs (or at least those that adopt the ICAV, VCC, unit trust, CCF or ILP structures) are required to be regulated, with the Central Bank as regulator.

One particular requirement of the Central Bank is that a QIAIF must publish a prospectus. This reflects the product nature of a QIAIF, where the persons responsible for the content of the prospectus are the directors of the ICAV or VCC or, in the case of unit trusts, CCFs and ILPs, the directors of the management company or general partner. The Central Bank has prescribed certain minimum content for the prospectus as set out in section 8.1 below.

Separately, AIFMD has imposed on the AIFM an obligation to make available to investors in its AIFs a certain level of information to investors and to do so both pre-investment and on an ongoing basis. In practice, the Central Bank prospectus requirements and the AIFMD pre-investment disclosures are dealt with together in the prospectus issued by the QIAIF.

8.1 Prospectus

The Central Bank requires a QIAIF to publish a prospectus which must be dated and the essential elements of which must be kept up-to-date. The prospectus must contain sufficient information to enable investors to make an informed judgement of the proposed investment.

(i) Minimum content requirements

The minimum content requirements of the prospectus to be issued by a QIAIF are set out in the AIF Rulebook and include requirements to disclose specific information in relation to the QIAIF itself (name, form in law, registered/head office, date of establishment / incorporation and limited duration, if any). The prospectus must also disclose where the constitutional document and annual reports may be obtained; must provide a brief indication as to the tax system applicable to the QIAIF including as to whether deductions are made at source from income and capital gains paid to investors; accounting dates and distribution frequency; and a description of the rules for determining and applying income.

The prospectus must also include specific details regarding the directors and their experience, must identify the persons who accept responsibility for information contained in the prospectus and must disclose the material provisions of material contracts with third parties types. It should also outline the main characteristics of the units/shares and, in the case of an investment company, disclose its authorised share capital. Descriptions of fees and charges and other applicable expenses, directly or indirectly borne by the investors should be disclosed as well as a description of the AIFM's remuneration policies and practices.

(ii) Fund type specific disclosures

Additional disclosures are required for particular types of funds, including, for example, where a QIAIF issues partly-paid units/shares; where, if applicable, units or shares are listed or dealt in; capacity for cross-investment between sub-funds of an umbrella; as well other specific disclosures regarding investments in other funds.

Disclosures regarding redemption facilities where a QIAIF is open-ended with limited liquidity; the rules applicable to in-kind redemptions; dealing procedures generally; as well as information regarding certain of the service providers (management company, general partner, investment manager and other service providers) are also required.

(iii) Authorisation legend/Conflicts etc.

It is also required to have a specific authorisation legend, to disclose potential conflicts of interest (including any directed brokerage programmes, receipt of commissions by virtue of investing in other funds, soft commission arrangements), the potential for related party transactions, to disclose segregated liability between sub-fund provisions (for umbrella investment companies) and also any warehousing proposals and any capacity to invest through subsidiaries.

(iv) Segregated liability and umbrellas

If the QIAIF is an umbrella type investment company, the prospectus must state that it is "*An umbrella fund with segregated liability between sub-funds*".

Where an umbrella type QIAIF issues sub-fund specific supplements to its prospectus, the supplement must disclose that it is an umbrella and either name the other sub-funds or state that their names will be available upon request. The prospectus must also disclose the extent to which, and the conditions applicable to, investment can be made by one sub-fund in another and must also disclose switching charges if any.

(v) How offered?

The prospectus must be offered free of charge to prospective investors before a contract for the acquisition of shares/units is entered into and if the prospectus is translated into a language other than English, it can only contain the same information and with the same meaning as in the version submitted to the Central Bank.

(vi) Compliance with terms of Prospectus

The AIF Rulebook contains express requirements that the QIAIF comply with the terms of its prospectus and that details of any derogations granted to the QIAIF by the Central Bank are included within the prospectus.

8.2 Disclosure to Investors

The prospectus will also need to comply with the AIFM's obligations to disclose certain information to investors by including the information which AIFM is required to make available to investors before they invest, as summarised below.

In the case of a QIAIF that has appointed an Irish registered AIFM (or is itself an internally managed registered AIFM), the Central Bank requires that the full disclosure requirements of the AIFM Regulations are observed with the exceptions of the following provisions of the AIFM Regulations: Regulation 24(1)(e) (a description of how the AIFM is complying with capital requirements applicable only to EU authorised AIFMs), 24(1)(p) (a description of how the information required under 24(4) and 24(5) will be disclosed to investors), 24(2) (information on any discharge by the depositary of its liability in favour of a third party or any change in the depositary's liability), 24(4) (periodic disclosure relating to the AIFM's liquidity management and risk management systems and practices) and 24(5) (periodic disclosure regarding the leverage employed by the QIAIF).

In the case of a QIAIF that has appointed a non-EU AIFM which is not marketing the QIAIF's units or shares to one or more EU investors, the same disclosure requirements apply as apply to Irish registered AIFMs.

In the case of a QIAIF that has appointed a non-EU AIFM which is marketing the QIAIF's units or shares to one or more EU investors, the full disclosure requirements of the Directive will apply pursuant to the Directive subject to any additional EU Member State rules. In the case of non-EU AIFMs marketing QIAIFs to Irish investors, no additional disclosure requirements apply.

AIFMD requires that a certain minimum level of information be made available to investors in AIFs marketed within any Member State of the EU and must be made available to investors prior to any investment and on an ongoing basis.

(i) Pre-investment information to be made available to Investors

The minimum level of information to be made available in accordance with the Directive must include a description of the following:

(a) the investment strategy and objectives of the QIAIF; information on where any master fund is or, if a fund of funds, where the underlying funds are, established; the types of assets in which the QIAIF may invest and techniques it may employ and associated risks; investment restrictions; use of leverage (including types and sources of leverage permitted and maximum leverage permitted); and collateral and asset reuse arrangements;

(b) the procedures by which the QIAIF may change its investment strategy and/or policy;

(c) the main legal implications of the contractual relationship entered into for the purpose of investment, including information on jurisdiction, applicable law and the existence or not of any legal instruments providing for the recognition and enforcement of judgements in the territory where the QIAIF is established;

(d) the identity of the AIFM, and the QIAIF's depositary, auditor and other service providers and a description of their duties;

(e) how the AIFM is complying with the requirement to cover professional liability risks;

(f) any delegated management function relating to investment management functions and any delegation of safekeeping function by the depositary, the identity of the delegate and any conflicts of interest from such delegation;

(g) valuation procedures, pricing methodology, methods used in valuing hard to value assets;

(h) the QIAIF's liquidity risk management, including redemption rights in both normal and exceptional circumstances and existing redemption arrangements;

(i) the fees, charges and expenses and the maximum amounts thereof borne directly or indirectly by investors;

(j) how fair treatment of investors is ensured by the AIFM and, whenever an investor obtains preferential treatment or the right to obtain such treatment, a description of that preferential treatment, the type of investors who obtain such treatment and their legal or economic links with QIAIF or AIFM;

(k) the latest annual report;

(l) the procedure and conditions for issuing units;

(m) the latest NAV of QIAIF or latest market price of unit;

(n) where available, the historical performance of QIAIF;

(o) the identity of prime broker(s) and any material arrangements with prime brokers and a description of how conflicts of interest are managed, description of the provision in the contract with the depositary on the possibility of transfer and reuse of QIAIF assets, and information about any transfer of liability to the prime broker that may exist;

(p) a description of how and when information required regarding assets subject to special arrangements arising from illiquidity, liquidity management, risk profile and leverage related matters (see further discussion below) is disclosed.

In addition to the above, the AIFM must inform investors before investment in the QIAIF (though AIFMD does not prescribe how such information is provided), of any arrangement made by the depositary to contractually discharge itself of liability. Any changes to depositary liability must be notified to investors without delay.

(ii) Periodic information to be made available by AIFMs

AIFMs of QIAIFs (other than Irish registered AIFMs and non-EU AIFMs which are not marketing the QIAIF's units or shares to one or more EU investors) are required to periodically disclose, in a clear and presentable way, to investors for each EU AIF (i.e. QIAIFs) they manage, and for each AIF (including QIAIFs) marketed by them in the following:

(a) the percentage of AIF assets which are subject to special arrangements due to their illiquid nature;

(b) any new arrangements for managing liquidity of the AIF; and

(c) the current risk profile of the AIF and risk management systems employed by the AIFM to manage those risks.

Certain of these disclosures should be made as part of the QIAIF's periodic reporting to investors, as required by the QIAIF's constitutional document, or at the same time as the offering document and, as a minimum, at the same time as the annual report is made available.

(iii) Regular Disclosure on Leverage

Where AIFMs (other than Irish registered AIFMs and non-EU AIFMs which are not marketing the QIAIF's units or shares to one or more EU investors) manage EU AIFs (i.e. QIAIFs) employing leverage or where they market AIFs (wherever established) (i.e. QIAIFs) in the EU which employ leverage, the AIFMs must disclose regularly, in a clear and understandable way:

(a) any changes to the maximum leverage that the AIFM may employ on behalf of the AIF as well as any right of the reuse of collateral or any guarantee granted under the leveraging arrangement; and

(b) total leverage employed by that AIF.

The disclosures on the total amount of leverage must be disclosed as part of the QIAIF's periodic reporting to investors, as required by the QIAIF's constitutional document or at the same time as the offering document and, as a minimum, at the same time as the annual report is made available.

More detail on the reporting obligations of AIFMs can be found in our "**Guide to AIFMD in Ireland**".

9. Annual Report and Other Reporting Obligations

Once again, we need to look at several sources to determine which reports in relation to Irish QIAIFs need to be made, by whom, to whom and how frequently. In some cases such as the annual report, obligations and content requirements are imposed both by Irish funds law/Central Bank AIF Rulebook and by AIFMD/Level 2 Regulation.

In others, the reporting is driven by Central Bank prudential requirements or by AIFMD reporting requirements or ECB requirements.

Given that the reporting obligations are quite extensive, we have first summarised the obligations and then have addressed them in some additional detail.

9.1 Summary of QIAIF related Reporting Obligations

In summary, the QIAIF related reporting obligations are as follows:

(i) Annual and Half-Yearly Reports

A newly established QIAIF must submit to the Central Bank a set of accounts (whether an interim report or an annual report) within 12 months of the launch date and publish it within two months if an interim report or six months if an annual report. The first annual reports must be made up to a date within 10 months of incorporation/establishment and published within six months.

On an ongoing basis, a QIAIF must publish an annual report within six months of the end of the financial year. In addition, a QIAIF (established as a unit trust or CCF) must publish, within two months of the reporting period, a half-yearly report covering the first six months of the financial year.

(ii) AIFMs/Non-AIFM Management Companies/Administrators/Depositaries

Where an AIFM, a non-AIFM management company, administrator or depositary is authorised by the Central Bank, such entity must publish and file with the Central Bank (a) an annual report within four months of the end of the financial year, and (b) a half-yearly report, covering the first six months of the financial year, within two months of the reporting period.

However, where an AIFM is an internally-managed QIAIF, the annual audited accounts must be published within six months (as opposed to four months) of the year end. Furthermore, internally-managed QIAIFs are not required to produce half-yearly financial accounts.

(iii) Prudential Reports

A QIAIF is obliged to file the following prudential reports with the Central Bank:

(a) a monthly return setting out prescriptive information relating to the QIAIF;

(b) a quarterly Survey of Collective Investment Undertakings return within 10 working days of the end-quarter to which it refers; and

(c) a Funds Annual Survey of Liabilities return filed with the latter return.

A QIAIF structured as a <u>money market</u> fund that meets the definition of a "monetary financial institution" in the Regulation of the European Central Bank (EU) No. 883/2011 is also obliged to file statistical information on a monthly and quarterly basis with the European Central Bank.

(iv) Minimum Capital Requirement Report

Where an AIFM (including an internally-managed QIAIF), a non-AIFM management company, administrator or depositary is authorised by the Central Bank, such entity must file with the Central Bank a minimum capital requirement report when filing its half-yearly and annual reports.

(v) Other Reports

QIAIFs: A QIAIF may be obliged to file reports on a periodic basis with the Central Bank depending on the composition of its portfolio (e.g. where the QIAIF has side pocket assets, an annual report is required confirming whether or not the Central Bank's parameters continue to be respected and the prospects and/or plans for the side pocketed assets must be outlined).

Depositary: A depositary of a QIAIF must enquire into the conduct of the AIFM and the management company, investment company, ICAV or general partner in each annual accounting period and report thereon to the unitholders via a depositary report included in the annual report of the QIAIF.

Irish AIFMs: A non-EU AIFM marketing an AIF in Ireland without a passport and an Irish-authorised AIFM are required to file reports with the Central Bank in accordance with Regulation 25 of the AIFM Regulations (e.g. reports on the principal markets and instruments in which they trade on behalf of the AIFs they manage, etc.)

9.2 QIAIF Annual Report

At a product level, the Central Bank requires a QIAIF to publish an annual report and specifies content requirements. Separately, AIFMD requires an AIFM to produce for each AIF it manages and for each AIF it markets in the EU an annual report which must be made available no later than 6 months after the financial year end, must be provided to investors on request, and must be made available to competent authorities of the home Member State of the AIFM and, where applicable to the competent authorities of the home Member State of AIF.

Both Central Bank requirements and AIFMD imposed requirements are therefore required to be addressed in the QIAIF's annual report ("**Annual Report**").

(i) Central Bank requirements

The Central Bank requires a QIAIF is required to publish an Annual Report for each financial year which must be submitted to the Central Bank within 6 months of the end of the financial year. The accounting information contained within the Annual Report must be audited and the full auditor's report to investors, including any qualifications, must be reproduced in the annual report.

The annual audited financial statements must comprise a balance sheet, income statement, a portfolio statement and statement of changes in the composition of the portfolio during the period and any significant information which will enable investors to make an informed judgement on the development of the QIAIF and its results. The Annual Report must also contain a report on activities during the financial year including an overview of the investment activities during the period and material changes in information disclosures.

The annual financial statement must be audited by one or more persons empowered to audit accounts in accordance with the Irish Companies Act 2014 and the auditor's report to shareholders, including any qualifications, must be reproduced in full in the annual financials. The QIAIF shall prepare and submit to the Central Bank a set of accounts (whether an interim report or an annual report) within 12 months of the launch date and publish it within 2 months if an interim report or 6 months if an annual report. The first annual reports must be within 18 months of incorporation/establishment and published within 6 months.

Where the QIAIF is an umbrella QIAIF constituted as an ICAV unit trust or common contractual fund, it may produce separate periodic reports for individual sub-funds. In the case of unit trusts and CCFs, the report of each sub-fund must name the other sub-funds and state that the reports of such sub-fund are available free of charge on request from the management company. In accordance with company law, a VCC established as an umbrella QIAIF must include accounts for all sub-funds of that company in its periodic reports.

The QIAIF shall, on request, supply investors with copies of the annual reports free of charge.

(ii) AIFMD Annual Report requirements

AIFMD prescribes certain minimum content requirements for the Annual Report, as follows:

(a) a balance sheet or a statement of assets and liabilities;

(b) an income and expenditure account for the financial year:

(c) a report on activities of the financial year;

(d) any material changes in relation to the required disclosures to investors (e.g. changes in strategies, delegation arrangements etc.) during the financial year;

(e) the total amount of remuneration paid to AIFM staff for the financial year (split into fixed and variable) number of beneficiaries, and any carried interest; and

(f) the aggregate amount of remuneration broken down by senior management and staff of the AIFM whose actions have a material impact on risk profile of the AIF.

The Level 2 Regulation sets out in detail (see Article 104) requirements as to the content and format of the balance sheet or statement of assets and liabilities and of the income and expenditure account.

The Annual Report is also required to include disclosure of any material changes in the information that is required to be disclosed to investors (e.g. changes in strategies, in delegation arrangements, identity of AIFM/depositary/auditors/service providers etc.). The Level 2 Regulation explains that any changes in information shall be deemed to be “material” if there is a substantial likelihood that a reasonable investor, becoming aware of such information, would reconsider its investment in the AIF, including because such information could impact an investor’s ability to exercise its rights in relation to its investment, or otherwise prejudice the interests of one or more investors in the AIF.

(iii) Content and format of Remuneration Disclosure

The information in the Annual Report concerning remuneration must include information on the total amount of remuneration for the financial year, split into fixed and variable components.

Where remuneration details are disclosed, the Annual Report should specify whether the total remuneration disclosed (which should also mention the carried interest paid by the AIF) relates to:

(a) the total remuneration of the entire staff of the AIFM, with an indication of number of beneficiaries;

(b) the total remuneration of those staff of the AIFM who in part or in full are involved in the activities of the AIF with an indication of the number of beneficiaries; or

(c) the proportion of the total remuneration of the staff of the AIFM attributable to the AIF and an indication of the number of beneficiaries.

Where relevant, the total remuneration for the financial year shall also mention the carried interest paid by the AIF.

Where information is disclosed at the level of the AIFM, an allocation or breakdown must be provided in relation to each AIF insofar as that information exists or is readily available. As part of that disclosure, a description of how the allocation or breakdown has been provided must be included. AIFMs must provide general information relating to the financial and non-financial criteria of the remuneration policies and practices for relevant categories of staff to enable investors to assess the incentives created. AIFMs must disclose at least the information necessary to provide an understanding of the risk profile of the AIF and the measures they adopt to avoid or manage conflicts of interest.

9.3 Other Reporting

QIAIF's must also submit a monthly return to the Statistics Division of the Central Bank, within 10 working days of the month-end to which it refers, setting out its total gross and net asset value, number of shares in issue, net asset value per share, subscription and redemptions during the month and net subscription/redemption receipts. This is normally dealt with by the Administrator.

A QIAIF must also submit a quarterly Survey of Collective Investment Undertakings return to the Statistics Division of the Central Bank within ten working days of the end-quarter to which it refers. The QIAIF must also submit a Funds Annual Survey of Liabilities return to the Statistics Division of the Central Bank, along with the quarterly Survey of Collective Investment Undertakings return, for the first quarter of each year.

An AIFM will also be required to report on a regular basis to the Central Bank on the principal markets and instruments traded by it on behalf of the QIAIF. The AIFM will also separately be required to report regularly on liquidity arrangements and risk management systems of the QIAIF.

An investment manager must also file a copy of its audited financial statements with the Central Bank annually.

Note: an internally-managed QIAIF would, in practice, need to engage a third party (typically its fund administrator) to provide AIFMD reporting.

10. QIAIF Authorisation Process

Before a QIAIF can be established or carry on business, prior Central Bank approval is required for the arrangements under which the QIAIF is to be operated. The Central Bank's website provides a link to the application forms which sets out the required information and accompanying documentation requirements.

IT IS IMPORTANT TO BEAR IN MIND THAT AN INTERNALLY-MANAGED QIAIF MUST ALSO COMPLY WITH THE AUTHORISATION REQUIREMENTS (AND APPLICATION FOR AUTHORISATION PROCESS) FOR AIFMS. SEE OUR GUIDE TO AIFMD IN IRELAND FOR MORE DETAIL.

(i) Information

The information required of an applicant QIAIF includes the name and a statement of the general nature of the investment objectives of the QIAIF; details of its proposed AIFM (and of its competent authority) and whether the AIFM is registered or authorised. Information on the proposed management company or general partner and on the proposed depositary, as well as on any proposed investment manager, is also required, as is information on the QIAIF's proposed auditor and on third parties who will be contracted by the QIAIF or its management company to carry out its work.

(ii) Accompanying Documentation

The application must be accompanied by the prospectus, the material contracts with third parties contracted by the QIAIF or its management company to carry out work on its behalf, as well as the QIAIFs constitutional document and the depositary agreement. Certain additional information is required depending on whether the QIAIF is established as an ICAV, VCC, a unit trust, a common contractual fund or an investment limited partnership.

Investment management agreements and investment advisory agreements must also be submitted to the Central Bank as part of the authorisation process.

Where an authorised QIAIF umbrella scheme seeking to launch a new sub-fund, the application forms specify the required filings.

(iii) Fast Track Process

The fast-track authorisation process that existed for the previous QIF regime applies equally to QIAIFs and, accordingly, applications should be filed no later than 5pm (via the Central Bank's Orion system) on the business day before the proposed date of authorisation. Assuming the application is complete and that the Central Bank raises no issues in relation to the application, then a letter of authorisation or approval (in the case of a sub-fund) will issue by close of business on the day of authorisation / approval.

(iv) Derogations

To the extent that derogations are sought from the AIF Rulebook requirements for a QIAIF or from other general policies applicable to QIAIFs, the derogation request should be made in sufficient time to allow the request be considered by the Central Bank. Details of derogations granted must be included not only in the application form for approval but also be set out in the QIAIF's prospectus.

(v) Who makes the Application?

The application for authorisation for a QIAIF should be made by the AIFM, together with the QIAIF (ICAV, VCC or management company or general partner) <u>and</u>, in the case of a unit trust / CCF, the depositary.

(vi) Service Providers to be Pre-Cleared

Importantly, before the Central Bank will approve a QIAIF, the management company / general partner, AIFM, directors (in the case of an investment company), depositary and other service providers (fund administrator, investment manager) must have been pre-approved / pre-cleared by the Central Bank.

In the case of investment managers or sub-investment managers, if they fall into any of the following categories they will not be subject to additional regulatory review by the Central Bank:

(a) UCITS management companies;

(b) MiFID firms authorised to perform portfolio management;

(c) credit institutions holding approvals to perform portfolio management under MiFID;

(d) externally-appointed AIFMs authorised under the QIAIF; or

(e) firms who are subject to regulation in other jurisdictions and recognised as such by the Central Bank.

Where the entity is a European firm but does not appear on the relevant passport register, the Central Bank may require a separate verification of its home EU Member State approval. However, it is important to note that the Central Bank has expressly stated that it is not necessary to utilise a passport in order to act as investment manager to a QIAIF.

In relation to investment advisors, the Central Bank does not apply an approval process but does require a confirmation from the management company or the QIAIF's directors that the investment advisor will only act in an advisory capacity and has with no discretionary powers over any of the assets of the QIAIF).

(vii) Closed-Ended QIAIFs

To the extent that the Prospectus Directive is applicable to a closed-ended QIAIF, then the application must also include a confirmation that the prospectus is being submitted separately for approval in accordance with the Prospectus Directive Regulations.

(viii) Requirement for a full AIFM

Finally, it should be noted that a QIAIF which is authorised by the Central Bank on or after July 22, 2013 and which has appointed an Irish registered AIFM is required to have a fully authorised Irish or other EU AIFM within 2 years from the date of launch (i.e. the date when the initial offer period closes or where there are multiple closings the first and closing date).

A non-EU AIFM managing a QIAIF may be required to seek authorisation from its "Member State of Reference" should the European Commission legislate for the activation of Article 37 of the Directive (which is contingent upon the receipt by the Commission of a positive opinion from ESMA supporting the idea and accompanying technical advice). Alternatively the QIAIF may choose to appoint an Irish or other EU authorised AIFM or to seek authorisation itself as an internally managed AIF or to appoint an Irish registered AIFM subject to the immediately preceding paragraph.

11. QIAIF Service Providers

QIAIFs do not exist on their own. They need an AIFM and a depositary, and will usually also have a fund administrator and often and investment manager, in their structure. Investment advisers, distributors, external valuers and prime brokers are also regularly found as service providers to or in respect of QIAIFs. The principal service providers and Depositary are referred to below.

11.1 AIFMs

See Sections 2.4 and 2.5.

11.2 Management Companies

Depending on the legal nature of a QIAIF, it may have or be required to have an Irish management company. For example, a unit trust scheme requires an Irish management company as part of its structure, as does a common contractual fund. In the case of an ICAV or VCC, it can choose to have or not to have a management company.

It is possible for such a management company to itself be authorised as an AIFM (either in Ireland or another EU Member State), in which case it would be subject to the AIFM authorisation requirements in the relevant jurisdiction. To the extent, however, that the management company (if any) is an Irish company and does not require to be authorised or is not authorised under the AIFM Regulations, it will be subject to the specific Central Bank requirements for AIF Management Companies as set out in the Central Bank's AIF Rulebook. The term "AIF Management Company" refers to any company whose regular business is the collective portfolio management of AIFs.

The requirements that are set out in the AIF Rulebook include capital requirements, operating conditions, the requirement to act honestly, fairly, professionally, independently and in the interest of the AIF and the investors of the AIF. An AIF management company is required to have at all times a minimum capital requirement being the higher of EUR 125,000 and one quarter of its total expenditure taken from its most recent annual accounts. That latter expenditure figure is subject to upward revision by the Central Bank where it is deemed not to reasonably reflect the AIF management company's current position. It is also required to maintain financial resources at least equal to that minimum capital requirement and to hold that minimum capital requirement in assets of a particular type specified by the Central Bank.

The AIF management company must submit half-yearly financial and annual audited accounts of the AIF management company to the Central Bank. The half-yearly accounts must be submitted within 2 months of the half-year end and the annual accounts within 4 months of the year end and must be accompanied by the Minimum Capital Requirement Report.

A variety of organisational requirements are imposed, including a requirement to identify an individual at management level who must be located in Ireland with responsibility for compliance with all legal and regulatory requirements and for co-operation and liaison with the relevant regulatory authorities (to be designated as the "Compliance Officer"). This person must be responsible for the compliance function even if this function is performed by a third party. The AIF Rulebook requires that the compliance officer reports to the AIF management company's board at each board meeting, and at least quarterly.

The organisational requirements imposed by the Central Bank also include requirements to have, implement and maintain adequate control systems and accounting procedures; to develop and maintain policies and systems to identify, monitor and control risk; as well as internal reporting and communication of information requirements; requirements regarding maintenance of adequate and orderly records. Information security, integrity and confidentiality obligations are also imposed as are business continuity requirements. Accounting and financial reporting obligations are also set out in the AIF Rulebook which include requirements as to maintenance of records which contain at a minimum detailed financial and company secretarial records as set out in the AIF Rulebook.

An AIF management company must also (a) satisfy the Central Bank, on a continuing basis, that it has adequate management resources to conduct its activities effectively and (b) employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them.

Similar requirements as apply to the directors of AIFMs are applied to the directors of AIF Management Companies as are similar obligations in relation to the relationship with the Central Bank (regarding expansion of business activities etc., general requirements regarding openness and co-operation in its dealings with the Central Bank and, in particular, notification of breaches, legal proceedings, etc. and notifying the Central Bank as soon as it becomes aware of such matters) as well as a variety of requirements regarding changes in the ownership (10% threshold), change of name, extension of activities, change of auditor (and reasons therefor) etc.

The AIF Rulebook also sets out detailed notes as to the calculation of the minimum capital requirement obligations of AIF Management Companies.

11.3 Fund Administrators

The AIF Rulebook also sets out requirements imposed on Irish entities who provide fund administration services to investment funds. The provision of such a service in Ireland requires a specific authorisation under the Investment Intermediaries Act 1995 (as amended) (the “**IIA**”). This Guide does not discuss the authorisation requirements for fund administrators but rather simply notes that the AIF Rulebook contains specific rules regarding matters such as capital, internal organisational requirements, similar requirements regarding internal controls and systems to those applicable to management companies.

Additional obligations are imposed in respect of matters such as outsourcing of administration services, the imposition of client money rules under the Irish MiFID Regulations as well as linking certain of the obligations to those which arise under the Central Bank’s separate Handbook for IIA investment firms.

11.4 Investment Managers and Advisors

Additional requirements and criteria need to be taken into account when an AIFM – internally managed AIF or external AIFM – delegates investment management functions to an investment manager.

The principal requirement is that the AIFM cannot delegate the performance of investment management functions to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself. Criteria are set out in the Level 2 Regulation which regulators are required to take into account in this regard including the assets under delegation; types of assets; importance of assets under delegation to the risk/reward profile; risk profile; strategies; types of tasks delegated in relation to those retained; configuration of delegates/geographical space of operation and their corporate structure including whether the entity belongs to the same corporate group as the AIFM.

In the case of investment managers or sub-investment managers, if they fall into any of the following categories they will not be subject to additional regulatory review by the Central Bank:

(i) UCITS management companies;

(ii) MiFID firms authorised to perform portfolio management;

(iii) credit institutions holding approvals to perform portfolio management under MiFID;

(iv) externally-appointed AIFMs authorised under the QIAIF; or

(v) firms who are subject to regulation in other jurisdictions and recognised as such by the Central Bank.

Where the entity is a European firm but does not appear on the relevant passport register, the Central Bank may require a separate verification of its home EU Member State approval.

However, it is important to note that the Central Bank has expressly stated that it is not necessary to utilise a passport in order to act as investment manager to a QIAIF.

In relation to investment advisors, the Central Bank does not apply an approval process but does require a confirmation from the management company or the QIAIF's directors that the investment advisor will only act in an advisory capacity and has with no discretionary powers over any of the assets of the QIAIF.

12. Depositary Requirements

One of the AIFMD's means of achieving greater levels of investor protection is to require the appointment of a depositary to carry out specific functions including the monitoring of cash flows and safekeeping of assets as well as general regulatory oversight responsibilities and to impose stringent liability provisions on depositaries.

AIFMD requires every AIFM to ensure that, for each AIF it manages, a single depositary has been appointed and that the appointment is formalised in a written contract regulating at least the flow of information necessary to enable the depositary to perform its functions.

As the focus of this Guide is on the QIAIF, we have simply summarised below some of the relevant eligibility criteria, duties and responsibilities and liability provisions applicable to a depositary to a QIAIF. These matters are dealt with in greater detail in a specific chapter in our "Guide to AIFMD in Ireland".

12.1 Criteria for Appointment of a Depositary

For a QIAIF, the depositary must be one of the following:

(a) an EU credit institution;

(b) a MiFID investment firm authorized to provide custodial services and which meets certain capital requirements;

(c) other entities subject to prudential regulation and ongoing supervision which are eligible to act as UCITS depositaries.

The depositary is required to be either incorporated in Ireland or to have a registered branch in Ireland, being the home Member State of the QIAIF.

12.2 Particulars of Contract of Appointment

The written contract pursuant to which the depositary is appointed (by the QIAIF or by the AIFM on behalf of the QIAIF) must include at least the following:

(a) a description of the services to be provided by the depositary and the procedures for each type of asset which will be entrusted to the depositary;

(b) a description of how safekeeping and oversight functions are to be performed depending on the types of assets and the geographic regions in which the AIF plans to invest, to include country lists and procedures for adding to, and withdrawing countries from that list;

(c) a statement that the depositary's liability shall not be affected by any delegation of custody functions unless there has been an express discharge of liability;

(d) duration (term) of contract, conditions for amendment and termination of the contract and procedures to give effect to termination;

(e) confidentiality obligations applicable to both parties;

(f) processes and procedures for communications as between depositary and the AIFM;

(g) information on the extent to which the depositary or its sub-custodian may re-use assets which have been entrusted to it and the conditions attached to any such re-use;

(h) procedures to be followed when there is an amendment to the QIAIF documentation, detailing situations when the depositary needs to be informed or where the prior agreement of the depositary is needed to proceed with the amendment;

(i) all necessary information that needs to be exchanged between the QIAIF, the AIFM, a third party acting on behalf of the AIF or the AIFM and the depositary relating to the performance of the depositary's oversight and control functions;

(j) where the parties envisage the appointment of third parties to carry out parts of their respective duties, a commitment to provide, on a regular basis, details of any third party appointed and, upon request, information on the criteria used to select the third party and the steps envisaged to monitor the activities carried out by the selected third party;

(k) information on the tasks and responsibilities of the parties to the contract in respect of obligations relating to the prevention of money laundering and the financing of terrorism;

(l) information on all cash accounts opened in the name of the QIAIF and the procedures which ensure that the depositary will be informed when any new account is opened in the name of the AIF;

(m) details regarding the depositary's escalation procedures;

(n) a commitment on the part of the depositary to notify the AIFM when it becomes aware that segregation of assets is not sufficient to ensure protection from insolvency; and

(o) procedures ensuring that the depositary, in respect of its duties, has the ability to enquire into the conduct of the AIFM or the QIAIF and to assess the quality of information transmitted including by way of having on site access to the books of the AIF and/or AIFM.

Note that the details of the means and procedures referred to above must be described in the contract.

12.3 Duties of Depositary

The depositary is required to carry out the following functions:

(i) monitoring of cash flows;

The depositary must ensure that the AIF's cash flows are properly monitored and in particular that all subscription payments have been received and that cash belonging to the AIF is booked correctly in cash accounts opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF or in the name of the depositary acting on behalf of the AIF.

(ii) safe-keeping of assets.

The Directive requires that the assets of the AIF shall be <u>entrusted to the depositary for safekeeping</u>. In respect of the safekeeping function, the Directive distinguishes between "financial instruments that can be held in custody" and "other assets" as follows:

(a) Financial instruments to be held in custody

The Directive provides that the depositary shall hold in its custody all financial instruments that can be registered in a financial instruments account opened in the depositary's books and all financial instruments that can be physically delivered to the depositary. These instruments must be registered in segregated accounts within the depositary's books so that they can be clearly identified as belonging to the AIF at all times.

(b) Other Assets

In the case of "other assets", the depositary's duty is to verify the AIF's ownership of such assets and to maintain a record of those assets for which it is satisfied that the

AIF (or the AIFM acting on behalf of the AIF) holds ownership of such assets. The assessment of ownership must be based on information or documents provided by the AIF or the AIFM and, where available, on external evidence. The depositary must also keep its records up-to-date.

As to the meaning of "other assets", ESMA advices state that all financial instruments that do not comply with ESMA's criteria for "assets in custody" should be considered as 'other assets' and be subject to record keeping duties.

(iii) *Oversight Responsibility*

In addition to the tasks referred to above, the Directive provides that the depositary has certain oversight responsibilities (similar to those set out in the UCITS Directive) as follows:

(a) to ensure that the sale, issue, re-purchase, redemption and cancellation of shares/units are carried out in accordance with the applicable national law and the AIF rules;

(b) to ensure that the value of the shares/units is calculated in accordance with the applicable national law, the AIF rules and the valuation procedures set down in the Directive;

(c) to carry out the instructions of the AIFM, unless they conflict with the applicable national law or the AIF rules;

(d) to ensure that in transactions involving the AIF's assets any consideration is remitted to the AIF within the usual time limits;

(e) to ensure that an AIF's income is applied in accordance with the applicable national law and the AIF rules.

(iv) *Duty to act honestly and fairly / Conflicts*

In its role, the depositary must act honestly, fairly, professionally, independently and in the interest of the AIF and the investors of the AIF.

A depositary is not permitted to carry out activities with regard to the AIF or the AIFM on behalf of the AIF which may create conflicts of interest between the AIF, the investors in the AIF, the AIFM and itself, unless the depositary has separated the performance of its depositary tasks from its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF.

12.4 Delegation

Subject to compliance with a strict set of conditions (summarised in our Guide to AIFMD in Ireland), the depositary can delegate its safe keeping functions but not any of its oversight responsibilities. However, there can be no delegation of safekeeping with the intention of avoiding the requirements of the Directive and the depositary must be able to demonstrate that there is an "objective reason" for the delegation and that it exercises all due skill, care and diligence in the selection and the appointment of any third party and in the periodic review and ongoing monitoring of such third party.

12.5 Liability

The depositary liability regime is a central issue of the Directive and probably one of the most controversial. The Directive distinguishes between the "loss of financial instruments held in custody" (in which case, a near-strict liability standard is imposed) and any "other losses" (in which case a negligent / intentional failure standard applies).

12.6 Depositaries and Prime Brokerage

The Directive expressly recognises and contemplates the continued use of prime brokers in the provision of services to AIFs, particularly hedge funds. A "*prime broker*" is defined by the Directive as 'a credit institution, a regulated investment firm or another entity subject to prudential regulation and ongoing supervision, offering services to professional investors primarily to finance or execute transactions in financial instruments as counterparty and which may also provide other services such as clearing and settlement of trades, custodial services, securities lending, customised technology and operational support facilities"

(i) Appointment of a Prime Broker.

The Directive requires that an AIFM must exercise due skill, care and diligence in the selection and appointment of prime brokers. Furthermore where a prime broker is to be appointed the terms of any such appointment shall be set out in a written contract. In particular the contract must include contractual provisions relating to any potential transfer and reuse of an AIF's assets which such use or transfer must be in accordance with the rules applicable to the AIF. The contract shall provide that the depositary be informed of the contract

(ii) Custody of Assets

As discussed in some detail above, a key requirement of the Directive is that a depositary is appointed with responsibility, inter alia, for the custody of assets of an AIF. The Directive permits a prime broker which is acting as a counterparty to an AIF to act as depositary provided that it has functionally and hierarchically separated the performance of its depositary functions from its tasks as prime broker and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF. The rationale for this is provided in Recital 43 to the Directive namely it is not possible for a prime broker which acts as counterparty to also act in the best interests of an AIF as is required by a depositary. However, the Directive expressly provides that a prime broker which acts as counterparty to an AIF may custody the assets of an AIF where it has been delegated such custody tasks by the relevant AIF's depositary.

(iii) Delegation of Custody by a Depositary to Prime Brokers – Operating Models

The conditions which must be met in respect of a delegation of custody tasks to a third party are set out in some detail above. Such conditions will apply equally to any proposed delegation of custody functions to a prime broker.

12.7 Depositary Requirements and Private Placement

Under the Directive, Member States may allow <u>an authorised EU AIFM</u> to market a non-EU AIF to professional investors on a private placement basis without the need to comply with the depositary requirements provided that it ensures that one or more persons is appointed to carry out the cash monitoring and safekeeping of assets functions together with the regulatory oversight responsibilities set out in the Directive. Strict liability does not apply. This is often referred to as "<u>Depositary Lite</u>".

Regulated EU AIFs managed by non-EU AIFMs that are marketed within the EU on a private placement basis might already be in compliance with the Depositary Lite requirements given that many EU Member States require AIFs established in their jurisdictions to appoint a local depositary. Non-EU AIFs managed by non-EU AIFMs that are marketed within the EU on a private placement basis are not required under the Directive to comply with the depositary requirements, however, it should be noted that it is in the discretion of each Member State to allow marketing by private placement to investors in its territory and to impose additional requirements over and above the minimum requirements set out in the Directive. In that regard certain EU Member States (notably, Germany and Denmark) impose depositary requirements in respect of non-EU AIFs managed by non-EU AIFMs (as well as AIFs managed by EU AIFMs) being privately placed in their jurisdictions. Bear in mind also that marketing by private placement and the associated rules under the Directive may be discontinued by the European Commission some time after 2018.

It is also important to note that any marketing of AIFs to professional investors under the AIFMD marketing passport <u>will require</u> compliance with the depositary requirements.

12.8 Irish Depositary Requirements

In its AIF Rulebook, the Central Bank has imposed the following additional rules for Irish depositories:

(i) Eligibility criteria

The depositary must have appropriate expertise and experience to carry out the functions as set out in the AIF Rulebook, the AIFMD Regulations and the Level 2 Regulation. It must have sufficient resources to effectively conduct its business and it must organise and control its internal affairs in a reasonable manner with proper records and adequate arrangements for ensuring that employees are suitable, adequately trained and properly supervised.

(ii) Capital requirements and financial reporting

The depositary must have at all times the initial capital of at least €125,000 ("Initial Capital Requirement") or one quarter of its total expenditure taken from the most recent annual accounts ("Expenditure Requirement"), whichever is higher ("Minimum Capital Requirement").

It must calculate its Minimum Capital Requirement in accordance with Annex I of the AIF Rulebook, must have financial resources at least equal of its Minimum Capital Requirement ("Financial Resources") and must hold its Minimum Capital Requirement in the form of Eligible Assets. It must also prepare and submit half-yearly financial and annual audited accounts to the Central Bank. The half-yearly accounts must be submitted within 2 months of the half-year end and the annual accounts within 4 months of the financial year-end. Both must be accompanied by the Minimum Capital Compliance Report.

Annual audited accounts of the corporate shareholder(s) of the company must also be submitted.

(iii) Directors/Shareholders

The depositary must have at least two directors that are Irish resident and must notify the Central Bank immediately of the departure of a director. It must not have directors in common with the board of directors of the AIFM or the management company, the fund administrator, the investment company or the general partner.

Approval by the Central Bank is required in respect of any proposed change in ownership or in significant shareholdings. A significant shareholding for the purpose of this condition is defined as a shareholding of 10% or more.

(iv) Operational Controls

A depositary must establish, implement, document and maintain accounting policies and procedures that enables the depositary to deliver a timely manner to the Central Bank financial accounts which reflect a true and fair view of its financial position and which comply with all applicable accounting standards and rules.

It must also establish, implement, document and maintain an adequate business continuity policy aimed at ensuring, in the case of an interruption to its systems and procedures, the preservation of essential data and functions, and the maintenance of services and activities, or where that is not possible, the timely recovery of such data and functions and the timely resumption of its services and activities. The business continuity policy must be subject to annual testing.

(v) Depositary tasks

Where the depositary is acting as a depositary for a QIAIF, the depositary must enquire into the conduct of the AIFM and the management company, investment company or general partner in each annual accounting period and report thereon to the investors. This report shall be delivered to the AIFM in good time to enable the AIFM to include a copy of the report in the annual report of the authorised AIF. This report shall state whether in the depositary's opinion the authorised AIF has been managed in that period:

(a) in accordance with the limitations imposed on the investment and borrowing powers of the authorised AIF by the constitutional document and by the Central Bank under the powers granted to the Central Bank by the investment fund legislation;

(b) otherwise in accordance with the provisions of the constitutional document and the investment fund legislation.

If the AIFM, management company, investment company or general partner has not complied with (i) or (ii) above, the depositary must state why this is the case and outline the steps which the depositary has taken to rectify the situation.

Where there has been a change of depositary during the accounting period, the annual report must include a depositary report from both the retiring and new depositary to cover their respective periods of appointment.

A depositary must also notify the Central Bank promptly of any material breach of the investment fund legislation, the AIFMD Regulations or Level 2 Regulation, or of the requirements imposed on the AIF or the depositary by the Central Bank or provisions of the AIF's prospectus.

Where a QIAIF proposes to invest more than 50% of net assets in another investment fund (and a Euro 500,000 minimum subscription does not apply), the depositary must, prior to the investment being made, (a) confirm in writing to the Central Bank that the authorised AIF has procedures in place to ensure that the underlying investment fund meets the requirements imposed by the Central Bank; and (b) confirm that the depositary will regularly review the operation of these procedures to ensure that the underlying investment fund continues to meet the requirements imposed by the Central Bank.

The depositary must not permit performance fees to be paid by or on behalf of the authorised AIF unless the calculation of the fee has been verified by the depositary or by a competent person appointed by the AIFM and approved for the purpose by the depositary.

Additionally, subscriptions and redemptions of units of AIF on an in specie basis may only be accepted if the depositary is satisfied that the terms of the exchange will not be such as are likely to result in any material prejudice to the AIF unitholders.

(vi) Delegation

The depositary must not delegate to third parties its functions, except in accordance with the AIFM Regulations. The functions which the depositary has not delegated must be carried out in the Ireland.

(vii) Acting as depositary to AIF not authorised by Central Bank

Where a depositary provides services to an AIF not authorised by the Central Bank, it must be satisfied that the prospectus issued by the AIF does not imply, in any way, that the AIF is regulated by the Central Bank and it must submit a quarterly return containing the following aggregate information, for all investment funds not authorised by the Central Bank to which services are provided, within each base currency category: domicile of the investment funds; number of investment funds; number of unitholders; and total net asset value.

13. Listing of QIAIFs on the Irish Stock Exchange

A listing on the Irish Stock Exchange ("**ISE**") offers a number of advantages, including the potential to increase distribution capacity. For example, a listing on a "regulated market" such as the ISE may allow fund sponsors to market the QIAIF to pension funds and institutional investors who may require securities they invest in to be listed on a regulated market. An ISE listing also increases transparency and allows a fund sponsor to profile the listed fund, the AIFM and fund performance on its professional investor portal "**ISE FundHub**".

The ISE has developed a listing regime for QIAIFs which fits within the requirements of AIFMD, automatically accepting the suitability of investment policy, strategy and investment parameters, service providers, including the AIFM and depositary, and operational aspects of the QIAIF, as approved by the Central Bank. This results in a smooth listing process that is largely disclosure based. The ISE listing application is made concurrently with the Central Bank application, using in most cases, a single set of documentation with the prospectus also serving as listing particulars.

The ISE listing is quick and cost effective and sits easily within the Central Bank regulatory approval timetable, with most QIAIF listings completed within a 1-2 week period. An ISE annual listing fee is charged on a per subfund (rather than per security) basis.

Once listed, a QIAIF will be subject to additional ISE reporting obligations and the Market Abuse Directive. These obligations include reporting of NAV, annual financial statements, the announcement of changes to service providers and operational matters and notification of controlling interests or interests of the AIFM in the listed shares. It is worth noting that the ISE and Central Bank ongoing requirements differ in many respects, with the ISE imposing additional reporting requirements. Certain proposed changes require prior ISE approval, although in practice changes approved by the Central Bank will be usually be accepted by the ISE.

The Market Abuse Directive, which applies to all securities which are listed on an EU regulated market, requires all listed entities to report interests of directors or persons closely associated with them in the listed shares and has specific requirements for the publication of inside information.

An AIF which offers no capacity for investors to request redemption on a voluntary basis for the life for the fund is considered *closed-ended* under the Prospectus Directive. Where a closed-ended fund makes application to list on the ISE (or on any other EU regulated market), or wishes to make a public offer in the EU, the prospectus must be approved under the Prospectus Directive and, on an ongoing basis, the AIF and its investors must comply with the additional reporting requirements of the Transparency Directive. In reality, many open ended funds operate significant lock-ups during the life of the Fund, with limited redemption offered prior to maturity, without being classified as closed-ended. Closed-ended AIFs are subject to a different prospectus approval mechanism, involving both the Central Bank and the ISE but the approval can still be achieved within 2-3 weeks at a reasonable cost. AIFs which are approved as closed-ended vehicles under the Prospectus Directive can avail of an EU passport allowing public offer and admission to trading on other EU regulated markets.

It should, of course, be noticed that because of their high minimum subscription per investor, closed-ended QIAIFs will normally fall outside the ambit of the Prospectus Directive unless they apply for a listing.

A Listing Sponsor is required for the listing application and for the duration of the listing. Dillon Eustace has a dedicated Listing Team which works together with the Legal Team to provide a seamless and cost-effective service.

14. Taxation of QIAIFs in Ireland

All Irish QIAIFs, no matter what their legal form, are subject to the same taxation regime so long as they are designated as Investment Undertakings under Section 739B of the Taxes Consolidation Act, 1997 (as amended) (the "**TCA**").

All Irish regulated funds (other than CCFs and Investment Limited Partnerships – which are both treated as Irish tax transparent) are Investment Undertakings.

14.1 Irish Direct Tax and Withholding Tax

Investment Undertakings ("fund" or "funds") are not subject to Irish taxation on any income or gains they may realise from their investments. In addition, there are no Irish withholding taxes in respect of a distribution of payments by funds to unitholders or any encashment, redemption, cancellation or transfer of units in respect of unitholders who are neither Irish resident nor ordinarily resident in Ireland and who have provided the fund with the appropriate relevant declaration of non-Irish residence. The same is also true for certain categories of exempt Irish investors (e.g. approved pension schemes, charities, other investment undertakings, etc.) who have also made the appropriate declaration to the fund.

In the absence of a non-resident declaration, there is a presumption that an investor is Irish resident or ordinarily resident in Ireland. However, measures exist whereby the requirement for non-resident declarations is removed provided that appropriate *equivalent measures* are put in place by the fund to ensure that such unitholders are not Irish resident or ordinarily resident in Ireland <u>and</u> the fund is not actively marketed to such unitholders. The prior approval of the Irish Revenue Commissioners is required in order to operate the equivalent measures regime as an alternative to the non-resident declarations. The *equivalent measures* regime when availed of can significantly reduce the administrative burden for funds.

When, however, a distribution is made by the fund to Irish resident unitholders (or to an ordinarily Irish resident unitholder) who do not fall within any of the exempt Irish investor categories, or such a unitholder disposes of units and realises a gain, tax must be deducted by the fund at a rate of 41% (25% where the unitholder is a company and an appropriate declaration is in place) on distributions (where payments are made annually or at more frequent intervals). Similarly, tax at the rate of 41% (25% where the unitholder is a company and an appropriate declaration is in place) will have to be deducted by the fund on any other distribution or gain arising to the unitholder. Ireland introduced in 2006 legislation to counteract Irish investors being able to roll-up (indefinitely) their share of the underlying income and gains of an Investment Undertaking for more than 8 years. Therefore, every time an Irish investor invests in a AIF, an 8 year clock will start running in relation to that particular investment in the AIF and if that investment is not returned before the 8^{th} anniversary of making (or acquiring) that investment (being shares/units) in the AIF, then certain Irish investors will be taxed as if they had made a redemption or disposal (at market value) of their investment (being shares/units) in the AIF.

It should be noted that neither a *relevant declaration* nor the *equivalent measures* should be required in relation to units held in an ETF, as any transactions (which might otherwise be a chargeable event) in relation to units held in a recognised clearing system as designated by order of the Irish Revenue Commissioners is not a taxable event.

14.2 Stamp Duty

No stamp duty is payable in Ireland on the issue, transfer, repurchase or redemption of units in an AIF. Furthermore, no stamp duty is payable by the AIF on the conveyance or transfer of stock or marketable securities provided that the stock or marketable securities in question <u>have not</u> been issued by a company registered in Ireland and provided that the conveyance or transfer does not relate to any immovable real estate situated in Ireland or any right over or interest in such real estate or to any stocks or marketable securities of a company (other than a company which an Investment Undertaking) which is registered in Ireland. Where Irish securities or land is involved, Irish stamp duty will apply.

Where any subscription for or redemption of units is satisfied by the in specie transfer of securities, real estate or other types of assets, consideration should be given to whether Irish stamp duty may arise on the transfer of such assets.

14.3 VAT

There are wide ranging VAT exemptions with regard to the provision of services to funds (e.g. administration, transfer agency, investment management, etc.) and to the extent that a fund suffers Irish VAT on certain services it receives (e.g. audit and legal fees) the fund may recover this VAT based on its recovery rate. Under current practice the recovery rate will be based on either (i) the extent that the investments of the fund are located outside the EU or (ii) the extent that the investors in the fund are located outside the EU. The Irish Revenue Commissioners prefers to rule on the fund's VAT recovery position by reference to where the investments of the fund are located, rather than where the investors in the fund are located. Nevertheless, whichever basis is used, it must be applied consistently from one period to the next.

Certain services received from abroad (e.g. the service of non-Irish lawyers or accountants) will require a fund to register and self-account for VAT in Ireland under the general reverse charge rules. Such foreign services giving rise to a VAT registration obligation on the part of a fund are commonly referred to as Business to Business services. However, depending on the fund's VAT recovery rate the fund may be able to recover some or all of this Irish VAT.

14.4 Compliance requirements

Investment Undertaking Tax: Funds have an obligation to register with the Irish Revenue Commissioners to obtain a tax reference number as each fund must file bi-annual investment undertaking tax returns. These tax returns should be accompanied by the payment of appropriate tax (if applicable) for the period in question. On the basis that there are no Irish resident or ordinarily resident unitholders (or such unitholders are exempt Irish investors) the appropriate tax should be nil.

Payroll Taxes: The current position of the Revenue Commissioners is that under Irish tax law remuneration arising from the office of director of an Irish incorporated company (such as an Irish incorporated corporate fund) is subject to the Pay As You Earn ("**PAYE**") system of deductions at source and that this is the position irrespective of either the tax residence of the director in question or where the duties of the office are performed. Generally, the only exception to the requirement to operate the PAYE system is where the director in question has obtained a PAYE Exclusion Order. Where the directors of a corporate fund are partners in an Irish law firm or accountancy firm then it may be possible for them to obtain a PAYE Exclusion Order from the Revenue Commissioners (subject to certain conditions being satisfied).

VAT: Once required to register for VAT, an Irish fund will have certain VAT filing and annual return obligations with the Revenue Commissioners. Any VAT refund claims are included with any VAT returns required to be made.

14.5 FATCA

The foreign account tax compliance provisions ("**FATCA**") of the Hiring Incentives to Restore Employment Act 2010 represent an expansive information reporting regime enacted by the United States ("**US**") aimed at ensuring that Specified US Persons with financial assets outside the US are paying the correct amount of US tax. FATCA will generally impose a withholding tax of up to 30% with respect to certain US source income (including dividends and interest) and gross proceeds from the sale or other disposal of property that can produce US source interest or dividends paid to a foreign financial institution ("**FFI**") unless the FFI enters directly into a contract ("**FFI agreement**") with the US Internal Revenue Service ("**IRS**") or alternatively the FFI is located in a IGA country such as Ireland (please see below). An FFI agreement will impose obligations on the FFI including disclosure of certain information about US investors directly to the IRS and the imposition of withholding tax in the case of non-compliant investors.

In recognition of both the fact that the stated policy objective of FATCA is to achieve reporting (as opposed to being solely the collecting of withholding tax) and the difficulties which may arise in certain jurisdictions with respect to compliance with FATCA by FFIs, the US developed an intergovernmental approach to the implementation of FATCA. In this regard the Irish and US Governments signed an intergovernmental agreement ("Irish IGA") on the 21st December 2012 and provisions were included in Finance Act 2013 for the implementation of the Irish IGA and also to permit regulations to be made by the Irish Revenue Commissioners with regard to registration and reporting requirements arising from the Irish IGA. In this regard, the Revenue Commissioners (in conjunction with the Department of Finance) have issued Regulations – S.I. No. 292 of 2014 which is effective from 1 July 2014. Supporting Guidance Notes (which will be updated on an ad-hoc basis) were issued by the Irish Revenue Commissioners on 1 October 2014.

The Irish IGA is intended to reduce the burden for Irish FFIs of complying with FATCA by simplifying the compliance process and minimising the risk of withholding tax. Under the Irish IGA, information about relevant US investors will be provided on an annual basis by each Irish FFI (unless the FFI is exempted from the FATCA requirements) directly to the Irish Revenue Commissioners. The Irish Revenue Commissioners will then provide such information to the IRS (by the 30th September of the following year) without the need for the FFI to enter into a FFI agreement with the IRS. Nevertheless, the FFI will generally be required to register with the IRS to obtain a Global Intermediary Identification Number commonly referred to as a GIIN. Under the Irish IGA, FFIs should generally not be required to apply 30% withholding tax.

14.6 Common Reporting Standards ("CRS")

Ireland and a number of other jurisdictions have announced that they propose to enter into multilateral arrangements modelled on the Common Reporting Standard for Automatic Exchange of Financial Account Information published by the Organisation for Economic Co-operation and Development ("**OECD**"). If implemented into Irish law, this may require a QIAIF to provide certain information to the Irish Revenue Commissioners about unit holders resident or established in the jurisdictions which are party to such arrangements (which information will in turn be provided to the relevant tax authorities).

14.7 Irish Collective Asset Management Vehicle (ICAV")

As explained above in Chapter 4 "Available Legal Structures for QIAIFs", the ICAV is a new type of corporate structure which can be used for UCITS and AIF corporate funds.

One of the more significant advantages, indeed a driving force behind the introduction of the ICAV, its treatment for US tax purposes where it can "check-the-box" to be treated as a partnership or disregarded entity for US federal tax purposes. Therefore, an ICAV should be able to facilitate investment by US taxable investors and/or US taxable and tax-exempt investors in a master / feeder fund structure. This is different to the treatment of Irish corporate funds incorporated as public limited companies under the Irish Companies Acts (PLCs) which cannot check-the-box to be a flow-through for US tax purposes.

In terms of its domestic tax treatment, the ICAV will be subject to the same attractive Irish tax regime that currently applies to the other corporate funds (i.e. no Irish tax at the fund level, no Irish withholding taxes on distributions where shareholders are not Irish resident or ordinarily resident in Ireland and an attractive indirect tax regime whereby many services provided to a fund are VAT exempt and the issue, redemption or transfer of shares are not subject to any transfer taxes).

Furthermore, the ICAV (like other corporate funds) should have the same access to many of Ireland's double taxation agreements. Ireland has signed comprehensive double taxation agreements with 72 countries, of which 68 are in effect, so as to minimise the possible effect of foreign withholding taxes on returns on its investments.

14.8 AIFs in the form of a CCF or Investment Limited Partnership

Essentially CCFs and Investment Limited Partnerships are treated as tax transparent from an Irish tax perspective. So no withholding taxes will arise on distributions made by them. There is no need for any non-resident declarations or AEM. Other than that primary difference, most of the tax measures explained above which apply to corporate and unit trust AIFs equally apply to AIFs in the legal form of a CCF Investment Limited Partnership.

14.9 PAYE

Directors fees are subject to Irish PAYE unless a PAYE Exclusion Order is obtained.

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