

Irish Loan Origination Funds - Rules Update February 2018

Background

As a result of the 2007-2008 financial crisis, lending from traditional sources such as banks has reduced mainly as a result of Basel III capital ratio regulations which were imposed on banks in relation to their lending activity. In Europe, the majority of Small to Medium Enterprise (“SME”) loans have traditionally come from banks. As a result of the reduced lending appetite by banks, credit funds including loan origination funds are increasingly a source of finance for SMEs. European regulators have increasingly encouraged SME lending by fund managers and the Alternative Investment Management Association (“AIMA”) estimates that by 2022 up to 20% of SME lending in Europe will come from alternative lending sources such as loan origination funds.

On October 1st 2014, Ireland became the first EU jurisdiction to introduce a specific regulatory framework for loan originating investment funds. The product is referred to as a Loan Origination Qualifying Investor Alternative Investment Fund (“LQIAIF”).

LQIAIF Rules Summary

An LQIAIF is a QIAIF and as such is required to comply with the general criteria for QIAIFs as set out in AIFMD and the AIF Rulebook by the Central Bank of Ireland (“CBI”). However, there are a range of additional requirements which LQIAIFs need to adhere to. A summary of the main rules is detailed below.

- In January 2017, the CBI made an update to the LQIAIF rules which stated that an LQIAIF must limit its investments to the debt and equity securities of entities/groups to which it lends and that it is not permitted to invest in other non-loan debt instruments. In order to meet these requirements but also provide for wider loan/credit investment strategies, LQIAIFs have been established as sub-funds of umbrella structures whereby non-direct lending activity and direct lending activity is segregated in separate sub-funds. The CBI has recently given notice of its intention to relax these rules as noted in the recent developments section below.
- LQIAIFs need to be closed-ended.
- There are restrictions on the types of entities an LQIAIF may lend to.
- A specific diversification requirement prescribes exposure to any one issuer or group to be limited to 25% of the fund’s net assets.
- An LQIAIF may not be leveraged more than one times its assets – a gross assets limit of 200%.
- The CBI requires LQIAIFs to maintain effective credit management processes and to have comprehensive stress-testing procedures in place.
- The prospectus, marketing materials and investor communications of an LQIAIF must include a number of disclosures to investors. These disclosures include information on the risk and reward profile of the LQIAIF, concentration levels of the LQIAIF and details of the LQIAIF’s credit assessment monitoring process.

Recent Developments

It is estimated that just under 30 LQIAIFs were authorised by the CBI in 2017. It is believed that the number of new LQIAIF structure launches has been limited by the inability to offer a mixed portfolio of credit assets and the associated costs of operating umbrella structures with multiple sub-funds to segregate loan origination and non-loan origination investments.

After extensive consultation with market participants, the CBI announced on February 7th 2018 that it intended to relax the investment restrictions that apply to LQIAIFs. From March 7th 2018, the CBI will permit LQIAIFs to offer a more wide-ranging credit-focused strategy that is not just focused on direct lending. The rule change will enable LQIAIFs to

invest in debt/credit instruments without being required to also lend to these issuers. The expansion in the permissible activities of LQIAIFs is likely to result in an increase in the popularity of this fund type.

How can KB Associates Assist?

KB Associates provides a range of services to LQIAIFs including:

- The provision of LQIAIF and proprietary AIFM establishment services
- The provision of third party AIFM services to LQIAIFs
- The provision of designated persons to perform AIFMD PoA functions
- The provision of operational and compliance support services to AIFMD compliant structures.

If you would like to discuss any issues raised in this paper, please feel free to contact any of the contacts below:

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