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Ireland is regarded as a key strategic location by the world's investment funds industry. Investment funds established in Ireland are sold in over 70 countries across Europe, the Americas, Asia, Africa and the Middle East. As of August 2017 there were 6,672 Irish domiciled funds with net assets of over €2.25 trillion. While the majority of these fund assets are held in UCITS,[1] Irish-domiciled AIFs[2] had in excess of €521 billion in net assets as of 2017 (representing significant growth in the size of alternative investment funds since last year and, in particular, since the introduction of AIFMD in 2013). The majority of the investment in these regulated investment funds comes from non-Irish institutional investors.

Regulatory framework

The Central Bank of Ireland ("Central Bank") is responsible for the authorisation and supervision of regulated financial service providers in Ireland, including regulated investment funds and investment managers. The powers delegated to the Central Bank are set out in the laws and regulations applicable to the relevant financial services sector. In addition, the Central Bank issues guidance in relation to various aspects of the authorisation and ongoing requirements applicable to financial service providers and investment fund products in Ireland.

Fund structures

Ireland as a domicile provides a variety of attractive fund structures, which can be broadly categorised as regulated by the Central Bank or unregulated.

There are four main types of regulated fund structure in Ireland: (i) variable capital investment companies ("Investment Companies"); (ii) Irish collective asset management vehicles (or "ICAVs"); (iii) unit trusts; and (iv) common contractual funds (or "CCFs"). Each of these regulated fund structures may be established as UCITS or as AIFs. An AIF may also be established as a regulated investment limited partnership (pursuant to the Investment Limited Partnership Act 1994). These structures may be organised in the form of umbrella schemes with segregated liability between compartments ("sub-funds"). The limited partnership established pursuant to the Limited Partnership Act, 1907 is the favoured structure for unregulated investment funds in Ireland.

In the 2017 1st Edition of this book we provided a detailed description of the above structures as well as information on the regulation of Irish funds established as either UCITS or AIFs. As such we do not propose to detail these structures again in this current Edition but instead to provide an update on certain regulatory and market developments affecting the Irish funds sector, with a particular focus on developments with a potential impact on fund finance arrangements.

Regulatory and market update

Brexit

Brexit remains the most significant market development impacting the financial services sector in Ireland and across the European Union ("EU"). Britain triggered the Article 50 mechanism to exit the EU on 29 March 2017 and, at the time of writing, over eight months later, it remains to be seen what form Brexit will take. With negotiations continuing on the "Brexit Bill", it would appear that either a hard Brexit (with no passporting rights) or a soft Brexit (with some form of third country equivalency rights) remain possible outcomes. Notwithstanding this uncertainty, UK-based financial services firms have been busily planning for business in a post-Brexit world, with some already having relocated activities to the remaining EU countries. Ireland and other EU countries have received and continue to receive more and more queries from UK-based financial service providers seeking to explore options to relocate some or all of their business, and Ireland is well-positioned to offer an EU solution for UK-based financial services firms.

To the backdrop of a potential raft of relocations by UK-based financial services firms, ESMA has published three sector-specific opinions to promote supervisory convergence in this area. Two of the opinions relate separately to investment management and investment firms and focus on how national regulators in the EU should deal with MiFID investment firms, UCITS management companies, self-managed investment companies and authorised AIFMs that are currently based in the UK and are looking to relocate to within the EU. The third opinion issued in July addresses the perceived regulatory and supervisory arbitrage risks arising from third country trading venues relocating to the EU and looking to outsource investment activities back to their jurisdictions of origin.

In September this year, the EU Commission published draft regulations proposing to give ESMA enhanced supervisory powers in relation to reviewing the delegation arrangements of investment management firms (such as MiFID firms, AIFM, and UCITS management companies). It is difficult not to link these proposals to Brexit and UK-based investment management firms looking to establish similar firms within the EU. At the time of writing, it would appear that the EU Commission's proposed regulations have upset a number of EU member states so it remains to be seen whether the proposals as presented by the EU Commission will be implemented as drafted, but it does seem unlikely at the time of writing.

UK-based lenders are an important source of finance for Irish investment funds. From a fund financing perspective it is important for Irish funds that whatever deal (or indeed no deal) scenario plays out, that Brexit does not impact on the ability of UK-based lenders to continue to provide finance to Irish investment funds and, on a broader basis, to investment funds established within the EU post-Brexit. While the solutions available to lenders post-Brexit will vary depending on their particular circumstances, there is a continuing trend towards lenders exploring the establishment of lending operations in one of the remaining EU countries. Ireland is well placed to benefit from this trend.

Loan origination funds

In the 2017 1st Edition we advised on some of the key features of the Irish loan origination fund (i.e. the loan originating qualifying investor alternative investment fund or "LO-QIAIF") which represents the first dedicated regulatory regime in the EU for loan origination funds. The Central Bank's rules for loan origination funds are set forth in a dedicated chapter of the Central Bank's AIF Rulebook. AIFMs that meet the specific conditions relating to LO-QIAIFs will be able to manage the new LO-QIAIF and market it within the EU using the AIFMD passport. The specific conditions applicable to LO-QIAIFs include the requirement that the LO-QIAIF: (i) be closed-ended; (ii) must not have gross assets of more than 200% of its net asset value; (iii) must achieve a diversification of its exposures to any one issuer or group to 25% of its assets within a time frame specified in its prospectus; (iv) does not lend to certain categories of borrower; and (v) that certain 'skin in the game' is maintained in respect of loans acquired from a bank under arrangements that involve the retention by the bank or an affiliate of an exposure correlated with the performance of the loan.

At the inception of this regime, the AIF Rulebook prohibited LO-QIAIFs from engaging in activities other than lending and directly related operations. However, in a welcome development, and following a number of submissions from industry, the Central Bank updated the AIF Rulebook in early 2017 to permit other investments linked to the loan origination strategy and, more specifically, debt and equity securities of entities or groups to which the LO-QIAIF lends or which are held for treasury, cash management or hedging purposes. This added flexibility has meant that the LO-QIAIF is now a much more practical and attractive product for managers and we have seen growth in the numbers of LO-QIAIFs established during the year (particularly in relation to the use of a LO-QIAIF as part of a blended credit allocation).

EU long-term investment funds

The EU regulation on long-term investment funds ("ELTIF") came into force on 9 December 2015 and was implemented into Irish law by the EU (European Long-term Investment Funds) Regulations ("ELTIF Regulations"). In the 2017 1st Edition we advised that the ELTIF has been designed with the intention of increasing the level of long-term investment in the European economy by facilitating investment in asset classes that are too illiquid to be served by existing fund structures. The fact that an ELTIF can be marketed on a passported basis to retail investors across the EU is a significant advantage over other types of AIFs. While the uptake on the establishment of these products has been slow, we have seen indications of interest from some managers and there is certainly potential for growth in this area.

Irish real estate funds (IREFs)

The Irish tax rules changed, with effect from 1 January 2017, to apply a new tax regime in respect of investment funds that invest in Irish real estate and related assets. In effect, where a regulated investment fund derives at least 25% of its value from certain Irish property assets (Irish real estate, shares in unquoted real estate companies, Irish REITs and certain debt securities issued by Irish securitisation companies), then the investment fund is considered to be an "Irish Real Estate Fund" (or "IREF"). An IREF may be required to impose a 20% withholding tax on a percentage of the distribution and redemption payments to investors (other than in respect of certain exempt classes of investors, most notably, Irish taxable investors). As a consequence of these changes many investment funds, assisted by their tax and legal advisers, investing in Irish property assets, had to re-examine their structuring and financing arrangements. As a result of the tax changes, the advantages in using a regulated fund structure to acquire Irish property assets has been somewhat eroded. As such it is possible that the use of Irish AIFs to purchase Irish property will decline going forward in favour of the use of non-regulated corporate structures.

Indeed, the new tax rules provided for two restructuring options which appeared to encourage such transactions. The first was a provision which exempted from stamp duty the transfer of the property rental business of an IREF to an Irish REIT (which are generally exempt from tax on rental income and gains), provided this was done before 31 December 2017. Further, transfers of land/business of an IREF to a non-regulated corporate structure prior to 1 July 2017 were also deemed exempt from stamp duty provided the transferee company issued shares to the shareholders in the IREF as consideration for the transfer.

Security update

In the 2017 1st Edition of this publication we referenced the typical security package(s) that we would most commonly see being used in Irish transactions. Before deciding on the final lending and security structure, it is of critical importance that the requisite due diligence is undertaken. In this update we focus on some issues which lenders should bear in mind in undertaking their due diligence for subscription facilities.

(a) *Power and authority to borrow and give security*

Subject to any leverage limits, as mentioned below, most non-UCITs funds will have broad powers, in their constitutional documents, to borrow and create security. For a subscription call facility, it is preferable that the constitutional documents, when describing the assets over which security can be taken, explicitly refer, for example, to "unfunded capital commitments". But even where they do not, the lender should be satisfied if the constitutional documents refer to the fund's ability to create security over all of its "assets", as the unfunded capital commitments will constitute an asset of the fund.

Borrowing and leverage limits

As referenced above, there are a variety of available fund structures in Ireland, ranging on the regulated side from Investment Companies, ICAVs, Unit Trusts and CCFs to Limited Partnerships on the unregulated side. The constitutional documents of each type of fund, while bearing similarities to each other, can be quite different and need to be carefully reviewed to establish who has the authority to borrow and provide security on behalf of the fund. Such authority should reflect the legal structure of the fund and should be set out in the relevant constitutional document. Typically, the following parties will have authority to borrow and provide security on behalf of a fund:

- **Investment Company**: The directors of the Investment Company.
- **ICAV**: The directors of the ICAV.
- **Unit Trust**: The Manager commonly has the power to borrow and frequently also has the power to create security, although this varies and sometimes requires execution by the Trustee.
- **CCFs**: As per Unit Trust above.
- **Limited Partnership**: The General Partner.

Regulated Irish funds may be established as umbrella funds with one or more sub-funds and segregated liability between sub-funds. Importantly, the sub-funds do not have a separate legal personality so the finance documents are typically entered into by the corporate entity itself in the case of a corporate fund such as an Investment Fund and ICAV; the Manager in the case of Unit Trusts and CCFs; and the General Partner in the case of the Limited Partnership. In each case, the relevant entity is acting for and on behalf of the relevant sub-fund and this should be reflected in the finance documents. Segregation of liability means that the assets of one sub-fund cannot be used to satisfy another sub-fund's liabilities or *vice* *versa*. This is achieved by statute in the case of Investment Companies and ICAVs, and by contract in the case of Unit Trusts, CCFs and Limited Partnerships. While statute implies the concept of segregated liability in every contract entered into by Investment Companies and ICAVs, it is customary practice to include segregated liability language into any finance document to which the Irish fund is a party, irrespective of its legal form.

(b) *The constitutional documents – Due diligence*

Irish funds may be open-ended, open-ended with limited liquidity, or closed-ended. In the context of a capital call facility (in the case of closed-ended funds or limited liquidity funds with a capital commitment structure), it is crucial to understand: (i) the subscription process, including who can make calls on investors; (ii) who determines the price at which units or shares are issued and by what means; (iii) when capital calls can be made on Investors; (iv) what an investor can be asked to fund; (v) the implications of an Investor not funding a capital call; and (vi) what account are subscription proceeds paid to?

(i) The subscription process, who can make calls?

The agreement between the fund and the investor in relation to subscription is typically enshrined in a subscription or capital call agreement. This tends to be a relatively short document, but must be read in conjunction with the constitutional documents. Most commonly it is the fund through its directors who will be authorised to make the calls on investors, although this is sometimes a role which is delegated by the directors to the Administrator. For entities such as a Unit Trust or a CCF, which are constituted by deed between the Manager and the Trustee/Depositary, it is usually the Manager who is authorised to make calls.

(ii) How and who determines the price at which units or shares are issued?

For Irish regulated funds it is not just the fund itself acting through its directors that has a role. Other service providers such as the Administrator of the fund also play a crucial role. The Administrator in an Irish regulated fund assumes, for example, the role of calculating the Net Asset Value ("NAV") of the fund and its units/shares. This calculation is crucial in determining the number of units/shares that will be issued to the investor in return for their subscription/capital call proceeds. Once the proceeds are received, the Administrator will then issue all of the relevant shares/units to each relevant investor. In Irish regulated funds, the constitutional documents commonly provide that physical unit/share certificates are not issued but rather the unit holder/shareholder register is evidence of ownership. Due to the important role played by the Administrator, it is common that an Administrator side/control letter is obtained as part of the security package.

(iii) When can calls be made on investors?

Calls are typically made on a Dealing Day, which will be a defined term in the constitutional documents. It is important to check this definition accommodates calls being made by the lender, if they need to, on a future enforcement. The definition of Investment Period is also relevant in this regard. Many constitutional documents only permit calls to be made during the Investment Period, subject to limited exceptions, for example where the call is made to satisfy sums due for an acquisition which has contracted but did not complete prior to the expiry of the Investment Period. As noted above, one of the key first steps in making a call is for the Administrator to determine the NAV and how many units/shares will be issued. The constitutional documents must be carefully reviewed to determine what events are specified, the occurrence of which gives the directors the right to suspend calculation of the NAV. The concept of suspension is an important safeguard for the fund to deal with, for example, *force majeure* market events which prevent the fund from valuing a substantial portion of the assets of the fund, or generally where it is deemed in the best interests of the investors in the fund. However, in practice, while the NAV is suspended, calls cannot be made. A suspension of the NAV where enforcement is necessary is not ideal!

(iv) What can an investor be asked to fund?

As you would expect, investor calls are primarily made to fund the acquisition of investments. Preferably the constitutional documents should also explicitly permit calls to be made to repay sums due to the lenders. Importantly, most Irish funds will operate on the basis that *pro rata* calls are made on investors. This may not be explicit in the constitutional documents, and sometimes may be reflected in an investor side letter.

(v) What are the implications of an investor not funding a subscription call?

The constitutional documents and/or the Subscription Agreement will usually provide for a period of time in which the investor must remit the call proceeds. If they are not received in that period, the documents will commonly provide that the fund may then issue a default notice and if the default is not remedied within any applicable remedy period, the fund will have the right to charge default interest and ultimately to realise the defaulting investors shares/units to meet the call. From a lender perspective, the constitutional documents need to be checked to determine if they contain "overcall" provisions. Such provisions permit the fund to call on the other investors to fund another investor's defaulted call, subject of course to the investors' maximum commitment not being exceeded. As noted above, this needs to be carefully considered in the context of any potential conflict with any "*pro rata*" call provisions in the constitutional documents, any side letter or the commercial practice of the particular fund. The constitutional documents should also be checked to determine if the investor has any right of set-off in respect of unpaid calls against amounts that may be owed by the fund to the investor.

(vi) What account are subscription proceeds paid to?

A key part of the security package for this type of facility is security over the Subscription Proceeds Account. There can be some variation between funds as regards how and in whose name their bank accounts are established. For example, it may be in the fund's name, which is the most straightforward position from a lender's perspective, but may also be in the Administrator's or the Depositary's name. The bank account mandates should also be checked to see who has signing rights. Appropriate control arrangements should also be considered, to include the above-referenced service providers, where necessary.

(c) *The Subscription Agreement, Investor Side Letters and Notice of Security*

As mentioned above, the typical Subscription Agreement is quite short but it is a crucial document. As part of the security package, security is taken over the fund's rights therein by way of security assignment. The Subscription Agreement and any side letters need to be checked to ensure there are no prohibitions or restrictions on such assignment. Upon execution of the security, an equitable assignment is created as a matter of Irish law. From a priority perspective, however, it is better to convert this to a legal assignment. There can be some reluctance on the part of the fund to have notices of assignments sent to investors and relevant acknowledgments obtained, particularly where there are a large number of investors. In this regard, some lenders will agree that notices are not served until a future Event of Default. One possible compromise between these two positions is that the relevant notice of creation of security is communicated in the next investor communication.

The year ahead

In the coming year, Brexit, whether a hard or softer version, and its consequences, will continue to loom large over the financial services sector (and beyond) throughout the EU. As the negotiations of Brexit have progressed and continue to progress over the coming year, Ireland, which has close strategic links with the UK, is watching developments closely, and will need to adapt and be ready for the likely outcome of these negotiations. From a fund financing perspective, it is important that UK-based lenders put appropriate arrangements in place to ensure that they maintain and can continue to grow their lending to Irish and other EU-based investment funds post-Brexit.

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Endnotes

1. Established pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, as amended.
2. Alternative Investment Funds established pursuant to the EU (Alternative Investment Fund Managers) Regulations 2013.
3. AIF Rulebook, March 2017.

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