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Ireland

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Overview of the Irish funds industry

<u>Overview of the Irish regulated funds market</u>

Ireland is regarded as a key strategic location by the world's investment funds industry. Investment funds established in Ireland are sold in 90 countries across Europe, the Americas, Asia, Africa and the Middle East. A total of 986 fund promotors have funds domiciled and/or serviced from Ireland.

As of June 2019, there were 7,500 Irish domiciled funds (including sub-funds) with net assets of over €2.71 trillion. While the majority of these fund assets are held in UCITS, Irish-domiciled alternative investment funds ("**AIFs**") had in excess of €681 billion in net assets as of June 2019 (representing an increase of 12% from June 2018). Ireland is also the largest hedge fund administration centre in the world.

Given the scale of the funds industry in Ireland and the global reach of its distribution network, it is not surprising that the vast majority of the investment in these regulated investment funds comes from non-Irish, predominantly institutional, investors.

<u>Regulatory framework</u>

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.

Common fund structures

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

<u>Regulated structures</u>

There are four main types of regulated fund structure in Ireland (as described below): (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 pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2011, as amended (the "**UCITS Regulations**") or as AIFs pursuant to the EU (Alternative Investment Fund Managers) Regulations 2013 (the

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"**AIFMD Regulations**"). 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**").

- *Investment Companies*

  An Investment Company is established as a public limited company under the Irish Companies Acts 2014. They have a separate legal identity and there is no recourse to the shareholders. There is a requirement to spread risk if the fund is established as an Investment Company. It is typically the board of directors of the Investment Company which will approve any decision to borrow, grant security or enter into derivatives, although it will be important in each case to review the Investment Company's constitutional documents, including its memorandum and articles of association, prospectus and/or supplement thereto, and any management agreements that have the authority to execute the necessary agreements.

- *ICAVs*

  The ICAV is an Irish corporate investment fund which was introduced to meet the needs of the global funds industry, pursuant to the Irish Collective Asset Management Act 2015 (the "**ICAV Act**"). Since its creation, the ICAV has replaced the Investment Company as the most commonly used structure for newly established funds in Ireland. The ICAV is a bespoke corporate structure that is specifically designed to give more administrative flexibility than an Investment Company. For example, the ICAV may:

  - amend its constitutional documents without shareholder approval in respect of changes that do not prejudice the interest of shareholders and do not come within certain categories of changes specified by the Central Bank;
  - where established as an umbrella fund, prepare separate financial statements for each sub-fund;
  - issue debenture stock, bonds and any other securities; and
  - allow directors to dispense with the holding of an AGM by giving written notice to all shareholders.

  In addition and unlike Investment Companies, the ICAV may also be eligible to elect to be treated as a transparent entity for US federal income tax purposes.

  UCITS and AIFs established in Ireland as Investment Companies may convert into an ICAV subject to compliance with the conversion process specified by the Central Bank. Importantly, this conversion process does not affect the legal existence of the fund or any pre-conversion rights or obligations. The ICAV Act also contains a mechanism for existing corporate collective investment schemes established in the Cayman Islands, the British Virgin Islands, Bermuda, Jersey, Guernsey and the Isle of Man, to migrate or redomicile to Ireland as an ICAV by operation of law. As the ICAV is a separate legal entity, the analysis in relation to who has authority to contract, e.g. borrow, grant security, enter into derivatives, for an ICAV is the same as for an Investment Company.

- *Unit Trusts*

  Unlike an Investment Company, a Unit Trust is not a separate legal entity but rather a contractual fund structure constituted by a trust deed between a trustee and a management company. In a Unit Trust, the trustee or its appointed nominee acts as legal owner of the fund's assets. As the Unit Trust does not have a separate legal personality, it cannot contract for itself. Managerial authority is exercised by the directors of the

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management company which, in the context of an AIF, may also perform the role of alternative investment fund manager ("**AIFM**"). While in many cases it is the directors of the management company who execute contracts, the trust deed and other relevant documents, such as the management agreement, should be carefully reviewed to confirm who has signing authority. For example, if assets are registered in the name of the trustee, the trustee will need to execute security over the assets of the Unit Trust and in some Unit Trusts, the trust deed may, for example, require joint execution by the trustee and the management company.

- *CCFs*

  A CCF, similar to a Unit Trust and investment limited partnership, does not have a separate legal existence. It is a contractual arrangement established under a deed of constitution, giving investors the rights of co-owners of the assets of the CCF. As co-owners, each investor in a CCF is deemed to hold an undivided co-ownership interest in the assets of the CCF as a tenant in common with other investors. The CCF was developed initially to facilitate the pooling of pension fund assets efficiently from a tax perspective and a CCF may be treated as transparent for tax purposes, which is a key distinguishing feature from other types of Irish fund structures.

- *Investment Limited Partnership ("**ILP**")*

  An ILP is established pursuant to the Investment Limited Partnership Act 1994. An ILP is a partnership between one or more general partners and one or more limited partners and is constituted by a partnership agreement. As with a Unit Trust, an ILP does not have an independent legal existence. It has one or more limited partners (which are similar to shareholders in an Investment Company or ICAV, or a unitholder in a Unit Trust), and a general partner who can enter into contracts on behalf of the ILP, which would include any loan agreement or security document. It is proposed to introduce a number of changes to the ILP structure which, subject to necessary changes to existing legislation, would make the ILP more broadly appealing to promoters of venture capital, and private equity funds in particular. These changes are discussed further in the "Regulatory and market update" section below.

Unregulated structures

- *Limited partnerships*

  The limited partnership established pursuant to the Limited Partnership Act, 1907 (the "**1907 Act**") is the favoured structure for unregulated investment funds in Ireland.

  A limited partnership is a partnership between one or more general partners and one or more limited partners, and is constituted by a partnership agreement. To have the benefit of limited liability, the limited partners are not permitted to engage in the management of the business of the partnership, or to contractually bind the partnership – these functions are carried out by the general partner.

  There is a general limit of 20 partners in a limited partnership, although this limit can be raised to 50 where the limited partnership is formed 'for the purpose of, and whose main business consists of, the provision of investment and loan finance and ancillary facilities and services to persons engaged in industrial or commercial activities'. The analysis in relation to who has authority to contract, e.g. borrow, grant security or enter into derivatives for an unregulated limited partnership, is similar to that for an ILP.

- *Section 110 companies*

  Section 110 is a reference to Section 110 of the Taxes Consolidation Act 1997 (as

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amended) which provides for a specific tax regime for certain qualifying companies. They are most commonly used in structured finance deals but we also see them being used as vehicles for loan book transactions and being dropped under regulated fund structures as an investment vehicle. To qualify for the beneficial tax treatment, certain conditions must be satisfied. It would be common to include certain representations and covenants in a loan agreement to give a lender comfort that the relevant conditions are being satisfied. Section 110 is commonly, but not always, established as a "bankruptcy remote" vehicle, and a common ask from borrowers is that recourse is limited to the secured assets, and a "non-petition" clause is included.

Regulation of Irish funds

Broadly speaking, regulated investment funds in Ireland can be established as either UCITS or AIFs.

UCITS

UCITS were first introduced in 1985 in the European Union with the introduction of the UCITS Directive. Although UCITS are a regulated retail investment product, subject to various liquidity constraints, investment restrictions (both in terms of permitted investments and required diversification), borrowing and leverage limits, nevertheless UCITS are predominantly held by institutional investors and are firmly established as a global investment fund product (being widely distributed both inside and outside of the EU). Irish UCITS may avail of the UCITS passport regime which allows for UCITS to be marketed publicly across the EU subject to limited registration requirements.

AIFs

AIFs are defined under AIFMD as "any collective investment undertaking [...] which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors", and that does not require an authorisation under the UCITS Directive. Therefore, all non-UCITS funds may be considered AIFs. Irish AIFs are established pursuant to the AIFMD Regulations which implement AIFMD in Ireland. AIFMD regulates both EU AIFMs who manage AIFs in the EU and Non-EU AIFMs that manage AIFs in the EU or market AIFs in the EU. The main types of AIFs in Ireland are Qualifying Investor Alternative Investment Funds ("**QIAIFs**") and Retail Investor Alternative Investment Funds ("**RIAIFs**").

QIAIFs can be marketed to professional investors and there is a minimum subscription requirement of €100,000 (which may be disapplied in respect of certain categories of investor). They can avail of the right to market across the EU using the AIFMD passport. A QIAIF can be managed by an EU or non-EU AIFM and can also be internally managed (see below). A QIAIF is not subject to any investment or borrowing limit, but it is obliged to spread risk if established as an Investment Company.

The RIAIF replaces the previous retail non-UCITS regime and has no minimum subscription requirement, but there is a restriction on it borrowing more than 25% of its net assets. As the RIAIF is a retail fund, it cannot use the AIFMD passport which is available to QIAIFs marketing to professional investors. Unlike a QIAIF, RIAIFs cannot be managed by a non-EU AIFM. AIFs are required to appoint an AIFM which can be either an external manager of the AIF or, where the legal form of the AIF permits, such as in the case of an Investment Company or ICAV, and the AIF chooses not to appoint an external AIFM, the AIF itself.

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Real Estate Investment Trusts ("REITs")

REITs were first introduced in Ireland in 2013 under the Irish Finance Acts with the purpose of attracting capital and thereby improving the stability of the Irish property market. Irish REITs are established as companies under the Companies Act 2014 and can gain classification as a REIT when notice is given to Irish Revenue and applicable conditions are met. REITs are not collective investment undertakings and so are not subject to regulatory provisions that apply to regulated investment funds in Ireland. However, the Central Bank has indicated that REITs are *prima facie* AIFs for the purpose of AIFMD (requiring the appointment of an AIFM) unless the REIT can demonstrate otherwise.

Regulatory and market update

Brexit

At the time of writing, 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 with the initial proposal to leave the EU by 29 March 2019. However, following a series of extensions to this deadline, the current "Brexit" date is set for 31 January 2020.

As such, we are no closer to knowing with certainty what final shape Brexit will take than we were this time last year. However, from a funds perspective, Ireland has already taken a number of measures to help mitigate against the disruption that Brexit would likely cause in the event of a "no-deal" Brexit – for example, permitting UK AIFMs to manage Irish authorised AIFs (subject to certain conditions being met and without the availability of the AIFM marketing passport).

At an EU level, there were also a number of positive initiatives, for example, ESMA agreed a Memorandum of Understanding on behalf of the EU 27 regulators with the Financial Conduct Authority of the United Kingdom (the "**FCA**"), ensuring that the delegation of portfolio management from EU funds to UK-based portfolio managers could continue, even in a hard-Brexit scenario. The UK has also played its part with the implementation of the FCA's temporary permissions regime ("**TPR**") which facilitates the continued marketing of investment funds into the UK in the event of a "hard Brexit".

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 and has seen its share of UK firms seeking to establish operations here over the last number of months.

Investment Limited Partnerships ("ILPs")

The Irish government has recently published the Investment Limited Partnership (Amendment) Bill 2019 (the "**ILP Bill**") which provides welcome reforms to the Irish investment limited partnership ("**ILP**"). The changes are aimed at modernising the ILP to bring the structure in line with other leading jurisdictions. Some of the main changes include:

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(i) *The establishment of umbrella ILPs*

The ILP Bill introduces the possibility of establishing "umbrella" ILPs that are divided into sub-funds with segregated liability. The principle of segregated liability means the assets of one sub-fund belong exclusively to that sub-fund and that the liabilities attributable to a sub-fund may only be discharged out of the assets of that sub-fund. The umbrella structure is attractive because it allows separate strategies or investor types to be accommodated in different sub-funds of the same umbrella rather than having to establish stand-alone ILPs for each. This would allow certain economies to be achieved in terms of costs and time to market.

(ii) *Limited Partner Safe Harbours*

As a general rule under Irish partnership law, a limited partner ("**LP**") may lose the benefit of limited liability, thereby becoming liable for the debts of the partnership, if it participates in the management of the ILP. While there are safe harbours under Irish law currently, the ILP Bill clarifies and broadens the safe harbours which allow LPs to undertake certain actions without being deemed to take part in the management of ILPs (e.g., sitting on advisory committees and approving changes to the limited partnership agreement ("**LPA**")).

(iii) *Permitting an LPA to be amended by majority*

The ILP Bill removes the requirement for all LPs to approve an amendment to the LPA. Instead such an amendment would require approval by a majority of the general partners ("**GPs**") and a majority of LPs. The ILP Bill also allows for certain amendments to proceed without LP approval where the depositary certifies that the changes do not prejudice the interests of LPs. This would bring the ILP in line with the flexibility afforded other Irish fund structures. In addition, in line with partnership structures in other jurisdictions, the ILP Bill allows for the LPA itself to make specific provision as to what constitutes a "majority of limited partners" (e.g., a majority by value, by number or by class).

(iv) *Clarifying limited partner obligations*

The ILP Bill includes provisions aimed at removing the risk that, in the event of the insolvency, LPs could be liable to contribute to the partnership. Under the proposals, LPs would not be required to contribute to the capital of the partnership except in the circumstances set out in the LPA.

(v) *Facilitating the replacement of the General Partner*

The ILP Bill streamlines the process for the contribution and withdrawal of capital to and from ILPs and aligns the process with that applicable to other Irish fund vehicles and partnership structures in other jurisdictions.

Unregulated limited partnerships

A public consultation on the 1907 Act took place in early 2019 and legislation is currently being drafted with proposed amendments. The proposed changes are aimed at enhancing and modernising the unregulated limited partnership structure in Ireland. Some of the suggested reforms are, in effect, similar to those contained in the ILP Bill. The proposed reforms of the 1907 Act, which is based on the equivalent English legislation, are also influenced by the recent changes to the English limited partnership regime. The modernisation of the unregulated limited partnership is a welcome development to bring Ireland in line with other leading jurisdictions.

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Fund financing and security

Overview

Lending to Irish funds is typically structured as either a bilateral or syndicated facility, a note issuance agreement whereby the issuer (the fund) issues a note in favour of the note holder or a derivative contract, typically documented through an ISDA Master Agreement, although we have found in the past 18 months that very few deals are still structured as a derivative contract. Lending by AIFs is restricted although (as discussed above) it is possible to establish an AIF which is focused on loan origination, including investing in loans. In the last number of years, capital call, subscription and equity bridge facilities have become much more commonplace. Irish fund structures, particularly Investment Companies, ICAVs and ILPs, are also commonly used as property investment vehicles.

The lenders and governing law

At present, the majority of deals in the Irish market are being financed by international financial institutions, although one of the Irish 'pillar' banks has recently entered the market. Reflecting the international nature of the financiers, the relevant loan agreements for such transactions are commonly governed by the laws of New York or England and Wales, although there is no legal reason why they could not be governed by Irish law. The terms of the loan agreement will very much depend on the type of facility being advanced.

While many lenders in Irish fund financings hold a bank licence or have "passport" rights to lend into Ireland, it should be assessed on a case-by-case basis whether a bank licence or passporting rights are required on a particular transaction, particularly where the relevant lender(s) do not have either a banking licence or passporting rights and the transaction involves "banking business" as a matter of Irish law. Lenders should also assess with local counsel whether they need to register summary details of the loan with the Irish Central Credit Register maintained by the Central Bank of Ireland.

Security package

A key consideration in every fund financing is the security package. This will vary depending on the type of financing involved. For example, on many financings, the security package will consist of a fixed charge over the fund's rights, title and interest in and to the securities and/or cash account recorded in the books and records of the Depositary (or Trustee, in the case of a Unit Trust, as such any references hereafter to a Depositary should be read to include Trustee in the context of a Unit Trust) and an assignment of the funds rights in the Depositary Agreement (or Trust Deed, in the case of a Unit Trust). Such a security package is also commonly coupled with a control agreement which will give the lender or its security agent control over relevant rights or assets either on a "day-one" or more commonly "springing lien" basis on the occurrence of a future enforcement event.

A properly drafted and structured Irish law security document should also be able to obtain the benefits of being considered a "financial collateral arrangement" pursuant to the European Communities (Financial Collateral Arrangements) Regulations 2010 (as amended). Relevant bank mandates should be reviewed and where necessary amended to be consistent with the terms of the control agreement. It is very important in this context to also verify where the account is located, and whose name the account is opened in. In many cases, the account holder may be a Depositary or sub-custodian, and the cash account for an Irish fund may not be located in Ireland, particularly where cash is held by a sub-custodian. In this context, and to satisfy the Depositary's obligations to maintain control over the assets, consideration should be given as to whether the Depositary also

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needs to be party to the control arrangements. Equally in structures where the connection with Ireland is only that the Depositary is Irish incorporated, it is not uncommon that one or more cash accounts may also be held by sub-custodians outside Ireland.

As with any financing, there is no "one size fits all". In this regard, the typical security package for a capital call/subscription facility is quite different, commonly consisting of: security over the right to call on investors for further contributions; security over the account into which such subscriptions monies are lodged; coupled with a robust power of attorney either prepared on a stand-alone basis or forming part of the relevant security document.

The fund's constitutional documents, prospectus, as well as the administrative services agreement, other fund service provider appointment documents and the subscription agreement, need to be carefully reviewed to verify who actually makes the subscription call; for example, in the context of a corporate fund such as an Investment Company or ICAV, most commonly it is the directors of the fund that make the call, but sometimes the constitutional documents also give the manager (where the corporate fund is externally managed) the power to make the call.

The Administrator also plays an important role in processing subscriptions, and recording and registering the subscriptions. Depending on the extent of the role performed by the Administrator, consideration could be given to taking specific security over the rights of the fund in and to the administrative services agreement, which would afford the lender "step-in" rights *vis-à-vis* the Administrator in any further enforcement. However, in practice we do not see this, and more usually a side letter addressed to the Lender/Agent is obtained from the Administrator in relation to the performance of their duties under the administrative services agreement. Depending on the extent of the role of other fund service providers, further side letters may be required.

Over the last number of years, we have also seen a steady growth in financings involving Feeder Fund structures. From an Irish law regulatory perspective, this can require careful structuring of the security package. One of the issues which requires consideration in this regard is that an Irish regulated fund cannot give "guarantees" to support the obligations of a third party (which may include another sub-fund within the same umbrella fund structure).

Unfortunately, the term "guarantees" is not defined, and it would be prudent to take it that this term also captures "security" to support the obligations of a third party. In Feeder Fund structures where, for example, the Feeder Fund is the borrower and the Master Fund is an Irish fund and expected to guarantee the obligations of the Feeder Fund, the rule against giving third party guarantees is very relevant and the structure and security package will need to be carefully considered and tailored to ensure that this rule is not infringed.

The use of "cascading pledges" can also, depending on the structure, be a useful tool in the security package. It is also possible to apply for an exemption from the Central Bank of Ireland but – even if given – this takes time to obtain. Other structuring solutions do exist, and we would always recommend local advice be sought at term-sheet stage so the solutions can be "baked" into the deal. Guarantees by an Irish regulated fund of the obligations of a 100% owned subsidiary are not captured by the prohibition.

Governing law of security package

Irish law does not strictly require that the security package be governed by Irish law. We commonly see transactions where security is taken under the laws governing the relevant

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financing agreement, e.g. New York or England & Wales law. However, where the relevant secured assets are in Ireland, e.g. the securities or cash account or, for a subscription call deal, the governing law of the subscription agreement is Irish law, we would always also take Irish law-governed security. Typically, any control agreement would be governed by the laws of the country where the account is located, however, if this is not the case, local law guidance (and preferably a legal opinion) should be obtained to ensure that the use of a different governing law will be enforceable in the relevant jurisdiction.

Security agent

As a common law jurisdiction, there is no issue as a matter of Irish law with security being granted in favour of a security agent or security trustee and, subject to the bank licensing considerations referred to previously, it is not necessary under Irish law for the security agent to be licensed in Ireland to enforce its rights. A point to note in relation to the enforcement of Irish security is that on enforcement, typically, it is a receiver appointed by the lender/security agent who will be appointed over the secured assets, and realise same on behalf of the secured parties. One advantage of this, from a lender/security agent perspective, is that the Irish security document will contractually provide that the receiver is the agent of the borrower rather than the lender(s)/security agent, thereby insulating the lender/security agent from potential claims arising from the actions of the receiver as part of any enforcement.

Consents and stamp duty

No Irish governmental consent or stamp duty is generally required/payable in connection with the execution of security in fund financing. However, where a security assignment is being taken over the funds rights in and to the depositary agreement, the depositary agreement should be carefully reviewed to check that the prior consent of the Depositary and/or the Central Bank is not required. In cases where the assignment is taken by way of security rather than being a true assignment, the consent of the Central Bank will not be required, as it permits funds granting such security in connection with its borrowings, and for receivers appointed by the lenders enforcing such security.

Security over the appointment documents of other fund service providers is not common, but should be assessed on a case-by-case basis, depending on the extent of the relevant role of such fund service providers in relation to the secured assets.

Security filings

Once security has been created, lenders will need to ensure that the security, if created by an Irish entity or an entity required to be registered in Ireland as a branch, whether governed by Irish law or otherwise, is registered against the correct entity in the appropriate Irish registry. For example, (i) security created by an Investment Company will be registered on the file of the Investment Company in the Irish Companies Registration Office ("CRO"), and (ii) security created by a trustee or its nominee as part of a Unit Trust structure will be registered on the file of the trustee/its nominee in the CRO.

Importantly, as ICAVs are established under the ICAV Act rather than the Companies Act, registrations for ICAVs are made on the file of the ICAV with the Irish Central Bank rather than the CRO. Particulars of all such security in the form prescribed by the CRO (Form C1) or the Irish Central Bank (Form [CH1]) must be filed within 21 days of the date of creation of the security, and in the absence of such, filing is void against a liquidator and any creditor.

Property fund financing

Irish funds are also popular vehicles for investment in Irish real estate by both Irish and

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non-Irish investors. In our experience, ICAVs have, since their introduction in 2015, been the most popular platforms used by investors, but some investors have also used Unit Trusts due to their familiarity with same in their home jurisdictions. While many investors establish their own fund platforms, it is also possible to establish a sub-fund as part of an existing platform set up by a service provider, a so-called "rent a fund". This can save on the establishment cost. In some deals, ILPs are also set up under the relevant Investment Company or ICAV sub-fund, for finance structuring reasons.

The loan agreement in financings for such funds is typically based on the LMA Real Estate Finance form of loan agreement. This is commonly governed by Irish law but, if necessary, could equally be governed by the laws of England & Wales (adapted as required). There are a number of key modifications that need to be made to the LMA form, in particular to reflect the role and importance of the relevant service providers in such structures, such as the management company, AIFM and the Depositary, the applicable events of default, regulatory compliance matters, the change-of-control provisions and the security package.

The security package will always consist of security over the relevant property and related assets and in many, but not all, cases security over the shares/units in the fund/sub-fund. Where the fund/sub-fund has invested in real estate through an ILP, security can also be taken over the sub-fund's interest in the ILP, and security is also taken over the shares held by the shareholder of the general partner of the ILP. This is important as, in an ILP, it is the general partner who contracts for the ILP and, on an enforcement, having security over those shares means that the lender can exercise control over the general partner and its contracting powers.

As with all fund financing structures, it is crucial at an early stage of any property fund financing deal to ascertain who has title to the assets and who has contracting power. An additional point to note in this regard is that the Depositary of the fund investing in real estate is obliged to maintain "control" over the property and related assets, such as rental income. Previously, this was interpreted by Depositaries to mean that title to the property had to be registered in their name.

However, this potentially exposes the Depositary, as registered owner of the property, to claims, for example, in relation to environmental liability, but also to being named in court proceedings if, for example, there is a rent dispute. The practice which has emerged in this regard is that either the Depositary has title registered in the name of a nominee company it establishes or, more commonly, it registers a caution on the relevant property title which restricts future disposals, including on any enforcement.

It is crucial in this context to obtain a Control Letter/Deed of Control from the relevant Depositary to regulate the rights and duties of the Depositary on any future enforcement by the lenders but also, for example, to regulate how the Depositary operates the fund's bank accounts to ensure compliance with the account control and waterfall provisions of the facility agreement. Commonly, the rent account in such transactions is opened in the name of the Depositary, and it is Depositary signatories who are named on the bank mandate. Certain Depositaries also interpret their duty of "control" to extend to limited partnership assets where the relevant Irish regulated fund controls the General Partner and is the sole limited partner.

Hotel financing can also be accommodated through a fund structure. Particular issues can arise in relation to this type of structure, where a separate OpCo/PropCo structure is used, and advice should be sought at an early stage to optimise the structure and ensure that financing can be put in place.

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Due diligence

Before deciding on the final lending and security structure, it is of critical importance that the requisite due diligence is undertaken. A good deal of management time, both on the lender and borrower side, can be saved by clearly setting out the proposed structure, the proposed security structure, including what will be required from all stakeholders, including Investors, and what amendments will be required to constitutional documents.

Identifying and seeking to address issues in relation to any of the above in the course of the transaction will lead to additional costs, tension and potentially, in the worst cases, the deal not completing. In this update we focus on some issues which lenders should bear in mind in undertaking their due diligence for subscription facilities.

Power and authority to borrow and give security

Subject to any self-imposed leverage limits, as mentioned below, most AIFs 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 in terms of regulatory content, can be quite different structurally and will always 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.
- **Section 110**: The directors of the section 110 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

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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. Segregated liability is not important for a Section 110 company, but as previously mentioned, the concepts of limited recourse and non-petition will be key concerns for borrower counsel.

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 subscription proceeds are 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 and the fund service provider 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 either the Investment Manager or 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.

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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 may not be able to be made. This risk can be mitigated by having all shares potentially issuable to an investor being issued on a partly paid basis on day one, but the ability to use this mechanism needs to be assessed on a case-by-case basis. A suspension of the NAV where enforcement is necessary is not ideal! A carefully drafted Investor Consent Letter, or drafting included in the Subscription Agreement, can give lenders additional comfort on this issue.

(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, defences, counterclaim (etc.) in respect of unpaid calls against amounts that may be owed by the fund to the investor. If possible, it should be made explicitly clear that the investor must fund even if the fund is insolvent, and that they will meet calls by the lender upon enforcement.

(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, and it should be checked with the

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Administrator/Depositary whether the proceeds move through any other accounts *en route* to the Subscription Proceeds Account. Appropriate control arrangements should also be considered, to include the above-referenced service providers, where necessary.

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. For subscription into a Section 110 company, commonly investors invest by subscribing for profit-participating notes rather than by subscription for shares, but a security assignment can still be taken over the Section 110's rights therein.

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

Brexit, whether a hard-boiled, poached or "sunny side-up" version, and its consequences, will continue to loom large over the financial services sector (and beyond) throughout the EU. From a fund financing perspective, it has been clearly observable that UK-based lenders have been busy planning and implementing appropriate arrangements to ensure that they maintain and can continue to grow their lending to EU-based investment funds post-Brexit.

Ireland has seen a significant amount of UK-based investment banks (as well as other types of UK-based financial and investment firms) relocating some or all of their business here as part of this response to Brexit. These developments and regulatory measures, coupled with the legislative changes being made to our limited partnership law, give us cause for quiet confidence that 2020 will see further significant growth in the Irish market.

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