

Changes to the Irish Qualifying Investor Fund Regime

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CHANGES TO THE IRISH QUALIFYING INVESTOR FUND REGIME

Introduction

The Central Bank of Ireland (“Central Bank”) and the Irish Funds Industry Association (“IFIA”) have engaged in a consultation process which has resulted in the release by the Central Bank on October 20, 2010 of a revised non-UCITS Notice NU24 which includes two significant positive changes for Qualifying Investor Funds (“QIFs”), namely:

- reducing the minimum initial investment per investor to €100,000; and
- replacing the high net worth/AUM investor criteria with three new qualifying categories, focused on the investor's knowledge, expertise and understanding.

These changes will enable promoters of QIFs to broaden the distribution base for their QIFs.

QIFs - Background

A QIF is a non-UCITS fund regulated in Ireland by the Central Bank. QIFs can be structured as investment companies, unit trusts, investment limited partnerships or common contractual funds and can take the form of single portfolio funds or multi-portfolio umbrella funds, with segregated liability between funds/portfolios.

QIFs can also accommodate a wide range of liquidity options, from open-ended to limited liquidity to closed-ended.

Because of their flexibility (they have few investment and no borrowing restrictions and can be authorised by the Central Bank on a fast track basis), QIFs have been favoured by alternative investment managers, particularly for products such as hedge funds, funds of hedge funds, venture capital/private equity funds, real estate funds, loan funds, distressed assets products and commodities funds.

Summary of Changes

Minimum Initial Investment

The Central Bank has reduced the minimum initial investment per investor in a QIF to €100,000.

Investor Criteria

The new QIF investor criteria (replacing the previous net worth/AUM test) focus on the knowledge, expertise and understanding of the investor.

The new criteria are that an investor in a QIF must either be:

- (a) an investor who is a professional client within the meaning of Annex II of Directive 2004/39/EC (Markets in Financial Instruments Directive); **or**
- (b) 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 QIF; **or**
- (c) an investor who certifies that they are an informed investor by providing the following:
 - 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
 - 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 QIF.

It will remain a requirement for all QIF investors to certify in writing to the QIF that they (i) meet the minimum initial investment per investor and appropriate expertise/ understanding tests; and (ii) 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.

Knowledgeable Investor Exemption

Certain types of investors will continue to be able to avail of an exemption from the minimum subscription requirement and criteria listed above where they are:

- (a) the management company or general partner of the QIF; or
- (b) the promoter or an entity within the promoter's group; or
- (c) a company appointed to provide investment management or advisory services to the QIF; or
- (d) a director of the promoter, management company, investment company or general partner or a director of a company appointed to provide investment management or advisory services to the QIF; or
- (e) an employee of the promoter, management company, investment company or general partner, or an employee of a company appointed to provide investment management or advisory services to the QIF, where the employee;
 - (i) is directly involved in the investment activities of the QIF, or
 - (ii) is a senior employee of the company and has experience in the provision of investment management services.

In the case of investments by employees, the management company, investment company or general partner, as appropriate, must be satisfied that prospective investors fall within the criteria outlined above and certify to the fund that they are availing of the exemption provided for in this sub-paragraph and that they are aware that the scheme is normally marketed solely to qualifying investors who are subject to a minimum subscription of €100,000.

QIFs v UCITS

As the two main fund products used in Ireland today are the QIF and the UCITS, you may find of assistance the table in the Appendix which summarise the key differences between QIFs and UCITS.

For further information on QIFs, please contact any member of our Asset Management and Investment Funds team.

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APPENDIX

UCITS v QIFs A Comparative Summary

We have compared the UCITS and QIF fund products across the following series of headings:

- Legal Structures,
- Distribution Issues,
- Liquidity Requirements,
- Permitted Investments,
- Borrowings and Leverage;
- Governance,
- Authorisation Process, and
- Irish Taxation.

We have summarised the comparison over the next pages.

More detailed information can be obtained from our **Guide to UCITS in Ireland** and our **Guide to QIFs in Ireland** which are available on our website or from your usual Dillon Eustace contact

Other Guides are available covering Hedge Funds, Private Equity Funds, Real Estate Funds, Multi-Manager Products and many more fund related topics.

A. Legal Structures

Matter	UCITS	QIFs
Legal Structures	(a) Variable Capital Investment Company (b) Unit Trust (c) Common Contractual Fund	(a) Variable Capital Investment Company (b) Unit Trust (c) Common Contractual Fund
Can you have umbrella structures?	Yes	Yes
Can you have different classes within a single Fund or Sub-Fund?	Yes	Yes
Is cross-investment (one Sub-Fund of umbrella investing in a sister Sub-Fund) permitted?	Yes. But maximum of 20% of net assets can be invested in another fund. May increase when UCITS IV implemented in mid-2011.	Yes. No investment limit.
Use of Subsidiaries	Generally not permitted. Very limited capacity to use non-EU subsidiaries but Directors need to certify compliance matters (often too uncertain to certify).	Permitted. QIFs may use underlying subsidiaries to improve treaty access and/or to support segregation of liability.
Feeders	UCITS cannot be structured as feeder funds. Will change mid-2011 upon implementation of UCITS IV.	QIFs can be set up as feeders. A QIF becomes treated as a feeder when it invests more than 50% of net assets in

		<p>another fund.</p> <p>A QIF can invest up to 100% of net assets in regulated or unregulated funds but cannot invest more than 50% of net assets in any one unregulated master unless it obtains a specific derogation. Limited availability / high threshold for such a derogation.</p>
Fund of Funds	<p>UCITS can be a fund of funds but:</p> <ul style="list-style-type: none"> (a) maximum exposure to a single fund is 20% of net assets; (b) maximum exposure to non-UCITS funds is aggregate 30% of net assets; (c) cannot take more than 25% of underlying fund; (d) underlying fund must limit its own investment in other funds to 10% of net assets and must state that in its own prospectus. 	<p>QIFs can be fund of funds and, for example, many QIFs are funds of hedge funds or funds of private equity funds.</p> <p>Can invest up to 100% of net assets in regulated or unregulated funds, provided not more than 50% in any one unregulated fund.</p> <p>Very flexible.</p>

B. Distribution Issues

Matter	UCITS	QIFs
EU Distribution	<p>EU retail passport. This means that once authorised in one EU Member State, a UCITS can be sold in all other Member States (ie. without further authorisation required).</p> <p>Note: Certain local filings still have to be made and certain UCITS fund documentation has to be translated.</p> <p>Can also use private placement.</p>	Private placement only.
Distribution Outside EU	Many non-EU jurisdictions give favourable inward marketing approvals to UCITS (eg. Hong Kong, Japan, Chile, Switzerland, etc.).	<p>Private placement only.</p> <p>Many jurisdictions have straightforward private placement regimes, particularly for QIFs targeting HNW / institutional investors.</p>
Minimum Subscription per Investor	<p>None imposed by regulation.</p> <p>Can self-impose (often to distinguish retail from institutional money).</p>	Euro 100,000 per investor (across umbrella).
Investor Criteria	None.	<p>MiFID "professional client";</p> <p>or</p> <p>Appraisal from an EU credit</p>

		<p>institution, a MiFID firm or a UCITS management company;</p> <p>or</p> <p>Investor self-certification.</p>
Irish Stock Exchange Listing	Available.	<p>Available.</p> <p>[If QIF is closed-ended and seeks listing, it must also comply with Prospectus Directive and several other EU Directives.]</p>

C. Liquidity Requirements

Matter	UCITS	QIFs
Liquidity Requirements	<p>Must provide full redemption facilities <u>at least</u> once every fortnight.</p> <p>Portfolio liquidity is a <u>core</u> UCITS requirement.</p> <p>Need to examine liquidity at portfolio and instrument level.</p>	<p>Full range of liquidity options to include:</p> <p>(i) open-ended: quarterly redemptions;</p> <p>(ii) open-ended with limited liquidity: at least annual redemptions;</p> <p>(iii) limited liquidity: allow redemptions at least once during life of fund;</p> <p>(iv) closed-ended: no redemptions allowed.</p>
Instrument Liquidity	Transferable securities and money market instruments	Full range of options for liquid or less liquid or illiquid

	<p>must be listed/traded on regulated markets.</p> <p>Max. of 10% money market instruments in transferable securities / not so listed or traded.</p> <p>Need to examine liquidity at portfolio and instrument level.</p>	<p>instruments.</p> <p>Will allow, for example:</p> <ul style="list-style-type: none"> - underlying funds with long lock-up periods; - private equity; - venture capital; - real estate; - unusual assets (e.g. shipping vessels, toll roads, etc.)
Redemption Payments	<p>Max. 14 days between redemption deadline and payment date.</p>	<p>Max. 90/95 days between redemption deadline and payment date.</p> <p>Can be <u>much</u> longer for limited liquidity funds.</p>
Gates	<p>Yes, 10% threshold.</p>	<p>Yes, 10% threshold (depends on dealing frequency).</p>
Side Pockets	<p>No</p>	<p>Yes</p>

D. Permitted Investments

Matter	UCITS	QIFs
Permitted Investments	<p>UCITS can invest in:</p> <ul style="list-style-type: none"> (i) transferable securities (e.g. shares, debt securities) (ii) money market instruments (iii) other UCITS and highly regulated funds (iv) cash (v) currencies (vi) exchange traded and OTC derivatives where underlying exposure is to any of (i)-(v) above <u>or</u> to financial indices, interest rates. <p>Reference to "financial indices" will allow for derivative exposure to be taken to certain hedge fund indices and certain commodities indices.</p> <p>Transferable securities and money market instruments must be limited to those listed or traded on regulated markets.</p> <p>10% aggregate "trash" basket would allow investment in other assets.</p>	<p>No prohibited investments (other than under, for example, UN sanctions).</p> <p>Can invest in <u>full asset spectrum</u> from listed securities to exotic derivatives, private equity, real estate, development land, hedge funds, unregulated funds, precious metals, ships, etc.</p> <p>Basic rule – if it can be custodied/safekept, then a QIF can normally invest.</p>

	No direct investment in precious metals or commodities.	
Issuer/Diversification Limits	<p>(i) 5%/10%/40% rule for issuer diversification. Applies at issuer and <u>group</u> level;</p> <p>(ii) Max. exposure to another fund = 20% of net assets;</p> <p>(iii) Max. <u>aggregate</u> exposure to funds that are not UCITS = 30% of net assets;</p> <p>(iv) No legal or management control;</p> <p>(v) Aggregate limits on exposures to single issuer / group (issuances, cash and derivatives counterparty);</p> <p>(vi) 5% + 10% OTC counterparty limits;</p> <p>(vii) Max. 20% of net assets exposure to a single credit institution for deposits.</p>	<p>No issuer diversification rules apply, <u>save</u> that investment company type QIF has obligation to spread risk.</p> <p>Where required (e.g. private equity/venture capital) QIF can take legal/management control.</p> <p>No counterparty limits.</p> <p>No cash deposit limits.</p>
Use of Derivatives	UCITS can use exchange traded or OTC derivatives provided:	QIFs have full freedom in using exchange traded and OTC derivatives.

	<p>(i) comply with eligible assets/permitted exposure rules;</p> <p>(ii) comply with counterparty criteria and counterparty exposure limits;</p> <p>(iii) comply with UCITS cover and position exposure rules;</p> <p>(iv) covered in derivatives Risk Management Procedure:</p> <ul style="list-style-type: none"> - VaR limits; - cover + position exposure; <p>(v) specific OTC valuation rules apply.</p> <p>Does allow long / short positions, where covered.</p>	<p>No restriction on underlying exposures.</p> <p>Standard counterparty criteria apply, but no other limits.</p> <p>Very flexible.</p>
<p>Prime Broker</p>	<p>UCITS cannot appoint PB.</p> <p>Other financing arrangements possible.</p>	<p>All leading PBs can be used/are in QIF market.</p> <p>Full re-hypothecation allowed (normally limited commercially)</p> <p>.</p>

E. Borrowing and Leverage

Matter	UCITS	QIFs
Borrowing	<p>Max. 10% of net assets and only on temporary basis.</p> <p>Cannot be used for investment purposes.</p> <p>Really only to cover timing mismatches.</p>	<p>No borrowing limit.</p> <p>Disclose in Prospectus to what extent QIF will borrow or that no limit.</p> <p>Can be used for investment purposes.</p> <p>Can issue debt securities as borrowings.</p>
Leverage	<p>Limit is unclear. Global exposure cannot exceed NAV but leverage via derivatives can be multiple of NAV.</p>	<p>No limit.</p> <p>Disclose in Prospectus to what extent QIF will be leveraged or that no limit.</p>

F. Governance

Matter	UCITS	QIFs
Promoter	Must be pre-approved by Financial Regulator (regulated and Euro 635 k in shareholder funds).	Must be pre-approved by Financial Regulator (regulated and Euro 635 k in shareholder funds).
Directors	Must be pre-approved by Financial Regulator.	Must be pre-approved by Financial Regulator.
Discretionary Investment Manager	Must be pre-approved by Financial Regulator.	Must be pre-approved by Financial Regulator.
Business Plan	<p>Detailed Business Plan required:</p> <ul style="list-style-type: none"> - minimum 4 Boards per annum; - appoint Chairman; - set out reporting; - imposes <u>8 core management functions</u>; - designated individuals (at least 2). - 	<p>Not required.</p> <p>No rules imposed.</p> <p>There is an expectation that a Fund Governance Code will apply in the future.</p>
Liability of Management Company	Liable for delegates.	Not required / provided for.
Derivatives Risk Management Process ("RMP")	<p>Detailed RMP required:</p> <ul style="list-style-type: none"> - types of derivatives; - why / how used; - how risks managed; - VaR systems used; - in-house expertise 	Not required.

	must be explained.	
Custodian Liability	UCITS Directive imposes strict liability. Unclear if can exclude liability for sub-custodians.	Can exclude liability for sub-custodians.
Accounts	Annual Audited Accounts <u>and</u> Semi-Annual Unaudited Accounts required.	Annual Audited Accounts required. <u>No</u> Semi-Annals required.

G. Authorisation Process

Matter	UCITS	QIF
Promoter and Investment Manager pre-approval	Required.	Required.
Fund Authorisation Process	<ol style="list-style-type: none"> 1. Initial filing of draft: <ul style="list-style-type: none"> - Prospectus; - Simplified Prospectus; - UCITS Business Plan; - Custody Agreement; - Derivatives RMP. 2. Regulator reviews / comments; 3. Client addresses comments and re-files; 4. May go through further round of review/comments; 5. Objective is to reach "no comments" stage. 	<p>Fast-track authorisation.</p> <p>No pre-filing (unless derogation from already very flexible QIF regime required).</p> <p>File executed documentation and QIF authorised next day.</p>
Timing	<p>6-8 weeks from initial filing.</p> <p>Can only start once promoter approved.</p>	<p>Solely dependant on client / advisers.</p> <p>Could be done in 2 weeks – more normally 3-4 weeks.</p>

H. Irish Taxation

Matter	UCITS	QIF
Irish Tax Status	Tax exempt (save for Irish residents).	Tax exempt (save for Irish residents).
Tax Treaty Access	Very limited (if any).	QIFs may use underlying subsidiaries to improve treaty access in certain circumstances.

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