MAPLES GROUP

UPDATE

CBI's New Enhanced Flexibility for QIAIF Digital Asset Exposure

On 4 April 2023, the Central Bank of Ireland ("Central Bank") published a new AIFMD Q&A[1] ("New Guidance") that increases the limits for a Qualifying Investor AIF ("QIAIF") seeking indirect exposure to digital assets and removes the need for a Central Bank pre-submission under the limits depending on the QIAIF's liquidity.

Background

The QIAIF regime has long been the most popular category of regulated Irish AIF in Ireland. The speed to market of the QIAIF has been a key feature supporting the success of the regime as a result of the Central Bank's 24-hour fast-track authorisation process. No prior regulatory review of authorisation applications is required, except for a number of limited exceptions. Instead, the Central Bank relies on a certification of compliance with the relevant requirements from the investment fund's legal advisers and the AIFM.

In July 2021, the Central Bank in its AIFMD Q&A[2] introduced a formal pre-submission requirement for QIAIFs seeking to take direct or indirect exposure to digital assets. It required the AIFM detail the various risks to be addressed in its pre-submission and provide information on how the digital assets are capable of being appropriately risk managed. However, where a QIAIF proposed to invest no more than 10% of its net asset value ("NAV") in cash-settled Bitcoin futures traded on the Chicago Mercantile Exchange, no pre-submission was required if shareholder approval was obtained. That element of the July 2021 Q&A guidance directly tracked a successful pre-submission[3], advised by the Maples Group, which resulted in the Central Bank approving a QIAIF to invest in digital assets for the first time in Ireland.

In the case of direct investment in digital assets, the pre-submission must include details of how the proposed depositary is satisfied that it can discharge its AIFMD safekeeping obligations.

New Flexibility

The New Guidance provides additional flexibility on the ability of a QIAIF to seek indirect exposure to digital assets and increases the limits, under which there is no pre-submission requirement to the Central Bank (depending on the liquidity profile of the QIAIF). Where a QIAIF is structured as open-ended, it can gain indirect exposure to digital assets of up to 20% of its NAV and where structured as closed-ended or open-ended with limited liquidity, it can gain indirect exposure to digital assets of up to 50% of its NAV.

The New Guidance outlines that a QIAIF seeking exposure to digital assets must comply with the following requirements:

(a) The AIFM must have an effective risk management policy addressing all risks

[1] https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/aifs/guidance/qa/aifmd-qa--edition-47.pdf?sfvrsn=86eb991d_1
[2] https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/aifs/guidance/qa/aifmd-q-a-40th-edition.pdf?sfvrsn=8
[3] https://maples.com/en/news/2022/4/maples-advises-on-first-irish-funds-to-invest-in-crypto-assets

relevant to an investment in digital assets, which must, at a minimum, address: liquidity risk; credit risk; market risk; custody risk; operational risk; exchange risk; money laundering / terrorist financing risk; legal, reputational and cyber risk;

(b) The AIFM must carry out appropriate stress testing on the proposed digital asset investments. The New Guidance outlines the stress testing should be extreme yet plausible, reflecting asset price volatility of digital assets including the potential entire loss of value in the investment;

(c) The AIFM must have an effective liquidity management policy which includes a suite of tools that is sufficient to enable the AIFM to manage liquidity events arising in the QIAIF;

(d) The prospectus / supplement of the QIAIF must contain clear disclosure on the nature of the proposed digital asset investment and a clear articulation of the relevant risks associated; and

(e) The portfolio should be assessed to ensure that there is an alignment between the QIAIF's redemption profile, the level of investment in digital assets as a percentage of the NAV and the likelihood of illiquidity (both in normal and stressed conditions) in the types of invested digital assets. In addition, the New Guidance provides that:

    (i) a QIAIF that proposes to invest up to 20% of its NAV in digital assets may be structured as open-ended, if the portfolio as a whole is determined by the AIFM to be suitable for an investment fund providing open-ended liquidity; and
    (ii) a QIAIF that proposes to invest up to 50% of its NAV in digital assets may be structured as open-ended with limited liquidity or closed-ended.

Where a QIAIF proposes to take either: (a) indirect exposure above the respective 20% and 50% limits mentioned above; or (b) any direct exposure to digital assets, a pre-submission to the Central Bank will still be required. The New Guidance does not change the Central Bank's position on RIAIFs.

Equally, the corresponding revised UCITS Q&A[4] also issued on 4 April 2023, reaffirms the existing Central Bank position that taking into account the specific risks attached to digital assets, the Central Bank is highly unlikely to approve a UCITS proposing any direct or indirect exposure to digital assets.

The increased Central Bank flexibility on QIAIFs is a welcome change. Given the continued growth of digital assets as an asset class, this pragmatic approach draws a sensible balance between maintaining a regulated Irish AIF regime while allowing promoters and investment managers to be able to adapt to the fast-evolving digital asset market environment.

Further, the removal of the time involved in the pre-submission process for QIAIFs under the relevant indirect exposure limits brings a return of predictability of the 24-hour fast-track, which is an extremely positive development for the Irish AIF market.

How the Maples Group Can Help

Our Irish Funds & Investment Management group has extensive experience assisting our clients to navigate the digital asset pre-submission process successfully. We have also been, and remain, engaged with the Central Bank as a firm and at industry level to ensure the regulatory authorisation regime remains fit for purpose, as part of which we can, if appropriate, bring the experiences and views of our clients to bear.

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[4] https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/ucits/guidance/ucits-qa-39-edition.pdf?sfvrsn=9ceb991d_1

Further Information

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The Maples Group's Irish legal services team is independently ranked first among legal service providers in Ireland *in terms of total number of funds advised (based on the most recent Monterey Insight Ireland Fund Report, as at 30 June 2022).*

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