ALG and A&O Selecting your Fund Domicile - Ireland

Hello, and welcome back to the Selecting your Fund Domicile, a series of video podcasts featuring expert law firms and A&O experts covering both onshore and offshore jurisdictions. I am Kamar Jaffer, a funds and asset management partner based in the Middle East, and I will be moderating today's discussion.

Today we will be discussing key regulatory and legal developments in Ireland, another popular fund jurisdiction, and I am delighted to introduce our guest speakers today, Brian McDermott and Stephen Carson, partners at A&L Goodbody.

Brian McDermott is the head of A&L Goodbody's asset management and investment funds group. He has extensive experience in structuring, establishing and authorising all types of investment funds including UCITS, AIFs and non-regulated funds.

In addition to advising the providers and investment managers of such funds, Brian has also advised fund investors, fund directors and service providers on relevant Irish law, regulation and market practice. Brian also advises on all aspects of regulation of asset management and fund service activities in Ireland.

Stephen Carson is a partner at A&L Goodbody, asset management and investment funds group. He advises international asset management funds and investment banks in relation to the establishment and authorisation of all types of investment funds, including UCITS, AIFs, exchange traded funds, money market funds, hedge funds, private equity funds and property funds, as well as the authorisation of UCITS management companies and alternative investment fund managers.

Brian and Stephen, thank you very much for joining us today.

Thanks a lot, Kamar, we're delighted to be here and to have this opportunity to have this chat with you.

So, without further ado, let's kick off with our first question. Brian, Ireland is an established fund establishment jurisdiction. What are the types of funds that you're currently seeing come to markets?

So, we're fortunate in that Ireland is now the only English-speaking common law jurisdiction in the EU, and it's quite a mature funds market. And our client range certainly reflects that maturity in that it spans the gamut between startup managers looking to target the Italian market with a new ETF to very established institutional asset managers adding to their existing suite of investments on products.

We are fortunate in being able to offer a range of products covering both the UCITS and AIFMD world, so the retail and then the more sophisticated investor market. But we also have an unregulated fund offering for more specialized types of private funds.

We are primarily a regulated fund domicile and the majority of promoters of funds in Ireland come from the US or from the UK, but we're fortunate certainly in our practice, but across our industry in Ireland to have promoters really from all over the world, from the Middle East, Far East to the Americas, and then across Europe and closer to home, both in Ireland and in the UK.

And Stephen, what are some of the types of vehicles that are commonly used? Are there any innovative or creative structures you've seen currently in the market?

So, as Brian mentioned, Ireland is primarily a regulated fund domicile and so for regulated funds, whether they're UCITS or AIFs, there are a range of vehicles available.

The main corporate vehicle is the Irish Collective Asset-management Vehicle or the ICAV, and there are non-corporate vehicles such as unit trusts, common contractual funds, and the Investment Division Partnership or ILP.

The most common of those is the ICAV, particularly for UCITS, open-ended hedge funds, many types of credit funds and hybrid structures. The ICAV, while it's a corporate vehicle, it has variable capital and is designed specifically for use as a fund vehicle or as a fund product, so it has the level of flexibility you would need to structure any of those fund types.

For unregulated funds, we see what we call the 1907 Limited Partnership as being that the structure of vehicle choice, particularly for private fund sponsors, it's, I guess, the Irish equivalent to the English Limited Partnership.

And while not particularly innovative, I would like to mention the ILP in particular. this is a regulated limited partnership structure. It was subject to a range of legislature reforms about two years ago, which when combined with new guidance from the Central Bank and the operation of closed-ended funds, has brought that structure into line with comparable partnerships from other fund domiciles.

So, we're increasingly seeing private fund sponsors take interest in that as a structure for raising capital in the EU, whether as the buy-out fund or a credit fund, or maybe as a feeder fund or a co-investment fee. So, we're seeing increased interest from private fund sponsors for that structure in particular.

And Brian, what are the key regulatory structuring considerations?

That's the fun question for a fund's lawyer when you're trying to guide them through the range of products available. And it's very much a case of considering who are your target investors, where are you trying to raise money, where do you want to invest that money, what is the investment strategy you're going to follow.

And once you've established those criteria, and I would throw tax neutrality or tax transparency into that mix. And also, throw into the capabilities of the fund promoter and the service providers they want to use for their product.

When you analyse these factors, you tend to come down to a choice of do you go with a UCITS product or an AIF product? And the most popular AIF product is a qualifying investment fund. And I think we'll come back to that in a later question.

You then need to consider to what extent you are going to outsource the provision of services to that fund, to what extent you as the fund promoter can provide those services within your organisation, or do you need to buy in services from a third party?

Then it is a matter of framing and negotiating the fund documentation, but that key stage is getting the structure right and everything in my experience tends to flow from that.

And Stephen, what are some of the economic substance requirements that apply? Can you also describe the ecosystem in Ireland?

So maybe looking at the corporate fund vehicle I mentioned earlier, the ICAV, and there are no minimum substance requirements as such. You need a board of non-executive directors, a minimum of two Irish resident directors, best practice is to have at least three non-executive directors.

So, no minimum substance requirement at a product or at a corporate fund level. But as many of your listeners will know in the EU, whether you're establishing a UCITS or an AIF, you need to have a management company or agent.

And in Ireland, setting up a management company does attract a minimum substance requirement. In Ireland, that's three full-time employees or equivalent, which aligns with the guidance that ESMA issued a number of years ago and aligns with the minimum substance requirements you'd see in most member states.

Now, as a result of that, you tend to see larger asset managers or more established asset managers setting a proprietary managing companies in Ireland or elsewhere in the EU are passporting into Ireland to appoint to their Irish fund structures.

This is particularly the case post-Brexit where, as the managers who had previously managed funds from management companies authorised in the UK, post-Brexit had to find alternative arrangements and many of whom set up management companies in Ireland to be appointed to their Irish and their EU funds.

One point I think we should bear in mind is that the ecosystem in Ireland for the third-party providers of management help and narration services is quite developed and so there is a well-trodden path towards new asset managers or asset managers coming to Europe for the first time using a third-party management company in order to set up their

Irish or the European funds with a view to maybe at a later stage setting up their own proprietary management company.

So, that is an option we see adopted very regularly particularly for asset managers setting up their first team funds or Irish funds. While that addresses the economic substance requirements, maybe to pick up on something Brian mentioned earlier on. There are other service providers you need for an Irish fund, in particular the administrator who calculates the NAV and manages the units over shareholder register, and of course the depository, which is a regulatory requirement to provide safekeeping and oversight services to the fund and its assets.

Ireland, being an established fund domicile, has a full range of administrator and depository service providers ranging from large US and European banks, all the way to more specialist private fund service providers.

And Brian, what are some of the key requirements that apply in relation to private funds specifically?

Yeah, I think as already mentioned, probably the most popular structure for a private fund is our Qualifying Investor AIFs.

So, this is an alternative investment fund, which is authorised by the Irish regulator, the Central Bank of Ireland, for marketing to professional investors and, for that purpose, the professional investor has the meaning ascribed to that term in the MiFID directive at a European level.

The other requirements in order to be a QIAIF is that the minimum investment in the product needs to be 100,000 euros or its equivalent, or the minimum capital commitment needs to be 100,000 euros or its equivalent.

If you are looking at an unregulated structure, you do have then greater flexibility because obviously the Central Bank requirements don't apply. And for any regulated fund, the investment manager of that product needs to be approved by the Central Bank of Ireland.

That's not an authorisation, but it is a separate approval process. And the bank's ability and what the bank takes into consideration in giving its approval is where the investment manager is domiciled, how it is regulated, does the Central Bank have a relationship with that regulator.

And the Central Bank increasingly also looks to the AIFM, so the authorised Alternative Investment Fund Manager for the product to demonstrate to the Central Bank the due diligence which the AIFM has carried out on that investment manager.

Other than that, the tax structuring is a key consideration for infrastructural private funds. For example, debt funds, loan funds, you want to make sure that it's not that there's an Irish tax concern, but it's more that the product is as efficient for the jurisdiction into which it's invested.

And there are various devices and structures which we advise clients on and we've seen been used in the past to, I suppose, optimise the tax treatment, minimise the amount of withholding tax, and ensure the best outcome for investors in that particular product.

So, when it comes to fund structure, you can never get away from tax as a consideration. The other point would be the availability of appropriate service providers with the expertise to provide services to a fund investing in a particular asset class, and that could be patent royalties, for example. We've looked at art funds and various other more exotic asset classes. So, you also do need that service provider capability for those products.

And, Stephen, looking forward, what are some of the legal and regulatory developments on the horizon in Ireland?

I know we'll probably touch more broadly on ESG and sustainable finance later on, but it won't surprise you to hear that those themes dominate the regulatory landscape. And maybe just to step back, first of all, a number of years ago, the EU introduced its action plan for sustainable finance, and a number of regulatory initiatives emerged from the Commission as a result of that, which have a direct impact on the managers of and investment funds themselves.

So, for the last two years, we've been working with our asset management clients to integrate sustainability considerations at the policies or process of their managing companies and also to update their offering documents where relevant to meet the disclosure requirements and sustainable finance disclosure regulations and underpinning that, the EU taxonomy regulation.

Now, while we got through the level one and level two requirements with clients before the deadline at the start of this year, and that was quite a big undertaking, there are a number of areas which require clarification and a number of gaps in the regulatory regime.

The expectation is that over the course of this year that the European authorities and the European Commission will issue further Q&As to provide that clarity and we expect we will have to work further with our asset management clients to further update their offering documents and their policies and procedures to meet some of those clarifications.

One particular regulatory development related to that which we should touch on is ESMA, before Christmas, issued a consultation on some proposed draft guidance on the use of ESG or sustainability terms in the names of funds.

Now assuming this guidance is ultimately adopted in the form it's consulted on, it will represent the first time that the European institutions will introduce a minimum threshold for ESG alignment or minimum threshold for sustainable investments to use those terms in fund names which is a significant step forward and one which we expect will be working very closely with their clients to help them grapple with that over the next 18 months.

Brian, what are some of the trends that you're seeing in the market fund terms changing? We've seen quite a lot of managers having more bargaining power than investors. What are you seeing in this regard?

I think we certainly see a degree of that. Again, it depends on the context of the establishment of the product. What we do see is Irish fund structure is being used as solutions, and that can be from a large manager devising or establishing a range of funds solely for one client, such as a wealth manager or a private bank, and solely for their distribution.

But we also see managers coming up with fund structures as solutions to a particular structure need of an institutional investor. And obviously, if there's a significant enough pipeline or committed capital to the actual fund, it's worth that manager or promoters while in setting up that bespoke structure.

When it comes to the degree of negotiation of the documents, obviously, if it's a tailored structure, there is much more scope for negotiation and being more investor friendly. But particularly the large managers typically have their own hot buttons and areas they won't concede on and are always mindful of their other investors and their other products, and not wanting to be seen to prefer, or even in a bespoke structure, going too far beyond what they would typically permit or allow or, indeed, concede as a matter of negotiation.

More broadly in terms of product trends, we are seeing in the retail space quite a lot of thematic funds, thematic ETFs in particular. We continue to see the development and the increased AUMs of ETFs and being used across portfolios, so you get funds of ETFs from fund-to-fund structures, so that's definitely a trend that's set to continue.

We've already touched on ESG and the influence of ESG, but we are still seeing funds converting either from article 9 to article 8 funds, or a deed from Article 6 to Article 8 funds, and investment managers needing to feel that they have a product that is going to be attractive to investors who are looking to invest in products which they consider to be sustainable.

In the private funds, or the more traditional private fund space, we continue to see a lot of debt funds and debt fund structures, and indeed a number of, probably not a high volume, but a significant number of impact investing funds as well.

And Stephen, what are you seeing on the fund finance side?

As I mentioned earlier on, Ireland is really growing as a domicile and relocation for private funds structuring. So, at this point, perhaps the funds finance space isn't as developed as there might be in other jurisdictions.

With that said, in line with the growth in private funds structuring and those from Northern Ireland, we are seeing a significant amount of subscription line lending. And across broader alternative funds we're seeing asset finance in particular for credit funds and real estate funds. I think the two main structural themes that we see are the lending arrangements or the facility agreements tend to be English law governed, which probably won't surprise you. But actually, this security arrangements would be Irish law governed on the basis that either the assets here in Ireland or accounts in Ireland, or the subscription agreements are signed and subject to Irish law.

So, it's an area of growth and an area where we'll probably see greater trends emerge in the not too distant future, but it is an emerging space in Ireland at the moment.

Stephen, you have touched a bit on ESG. What are you seeing in this space and in sustainable finance?

As you mentioned earlier, Kamar, we've been working closely with our clients on implementing the regulatory aspects of ESG and sustainable finance over the last two years. But sustainable investing and ESG investing is a long-term structural trend in Europe.

It's led by institutional investors across Europe. And as a result, notwithstanding the regulatory burden and the increased regulatory focus, we see ESG funds as being a very significant part of all of the funds that we establish on behalf of our clients.

And that has really increased since the introduction of SFTR in taxonomy. I think many asset managers probably are responding to the fact that there is a framework within which to classify or disclose funds which make an ESG contribution or have a sustainable objective.

And so I think we've seen that trend really accelerate over the last two years. The regulatory burden doesn't seem to have discouraged asset managers and the appetite from investors has continued to increase as well.

I guess one point I think which you're seeing a lot of discussion about and we're starting to see regulators respond to is that the risk of greenwashing, or ESG washing. Last year ESMA issued a supervisory briefing and addressed to the competent authorities of the EU member states setting out a framework for the inspection of how asset managers have implemented their disclosure obligations, how asset managers have implemented their sustainability consideration obligation.

And we expect that the Irish Central Bank and other EU competent authorities will include those themes as part of their thematic inspections over the course of this year.

In parallel to that, ESMA also issued a feedback or a call for evidence to the asset management industry in order to enhance its understanding of what greenwashing is. So, there is this ominous presence of regulatory focus on greenwashing and ESG washing, and I think asset managers are very mindful of that, and you hear asset managers or regulators talk about the risk of green bleaching, which is asset managers disclosing less about the ESG credentials than they actually should.

So, but I think notwithstanding that ominous presence in the background, ESG products and sustainable investment products are a trend that we're going to continue to see being a significant part of fund formation in the EU and in Ireland in particular.

Stephen, Brian, thank you very much for sharing your insights, and to our listeners, thank you for listening. We'll be back with a new podcast for the Selecting your Fund Domicile series very soon. Thank you very much and have a good day.

Thank you.