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Privcap/ Report

IRELAND:

Launch Point for European Fundraising Success

An expert discussion about the new opportunity to domicile alternative investment funds in Ireland, including a comparison of fund structures, tax and operational implications, advice for U.S. GPs new to European fundraising, and the impact of Brexit.

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Expert Discussion

IRELAND:

Launch Point for European Fundraising Success

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An expert discussion about the new opportunity to domicile alternative investment funds in Ireland, including a comparison of fund structures, tax and operational implications, advice for U.S. GPs new to European fundraising, and the impact of Brexit.

The Panelists

Karina Stahl
Managing Director, CFO
Monroe Capital

Lindsay Trapp
Senior,
Dechert

Marie Coady
Partner, EMEA ETF Leader
PwC Ireland

James McEvoy
Country Executive
Alter Domus

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Privcap: In general, why is Ireland increasingly attracting attention now as a domicile for U.S. GPs eyeing a European fundraising?

James McEvoy, Alter Domus: Ireland has a lot of alignment with the U.S., which is not seen to the same degree in other E.U. countries. We're aligned on a language, culture and common law basis. In addition, Ireland is a firmly committed member of the E.U., so managers can access investors across the union using a marketing passport under the fund management directive. Another key element is experience and expertise. Irish-domiciled funds have grown to over €3 trillion. There's a huge network of advisors and service providers with deep expertise supporting this. This brings a lot of value to managers entering the market for the first time. Importantly, Ireland has a reputation for its clear and practical legal and regulatory framework, and support for the funds industry. It's got an experienced and internationally respected regulator. Some of the more recent developments there are great examples of how there's a willingness to ensure the Irish regime is fit for purpose, if not best in class.

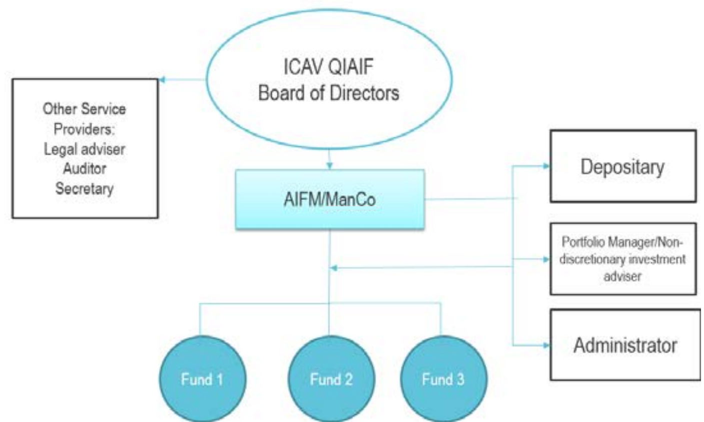
Privcap: Lindsay, please walk us through the three basic fund structuring options in Ireland.

Lindsay Trapp, Dechert: We can discuss three categories of investment vehicles that are available in Ireland [see charts]. These three are: first, fully regulated by the Central Bank of Ireland; second, not fully regulated but AIFMD-compliant; and third, not regulated nor AIFMD-compliant.

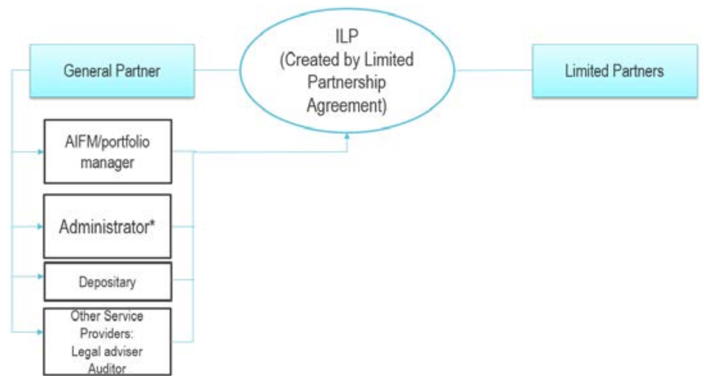
The first includes five possible structures that are fully regulated by the Central Bank of Ireland. They are AIFMD compliant. Two structures are illustrated: (I) the most common is the ICAV, and (II) the investment limited partnership (ILP) which has recently undergone statutory changes and we expect to become the vehicle of choice for illiquid asset classes.

The ICAV is a corporate vehicle that was established under its own implementing legislation. It is not a company under the Companies Act—it is a bespoke fund vehicle. You have a board of directors, which is subject to certain composition requirements and each director must be approved by the Central Bank of Ireland. It is capable of appointing a full-scope AIFM or a non-EEA AIFM. It will have an Irish-based, a depositary and administrator. Oftentimes you will have a portfolio manager domiciled elsewhere, like the U.S., that is appointed as a delegate of an E.U. AIFM, allowing full E.U. market access to non-E.U. managers. This can be an umbrella structure, so you are able to have different compartments or, in U.S. parlance,

Fund Regulated by the Central Bank of Ireland



If an EU Authorized AIFM is appointed, Fund may "passport" for sale in any EEA country



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you call them series structures. These can be quite useful as an ongoing structure for open-ended funds, but also useful for closed-ended funds where you have different strategies.

The ILP has been in existence since 1994, but for the past several years has been undergoing a legislative update to bring it into a more modern age and stylish package. We've been working on it as an industry, and this is now making its way through the Irish parliament [*the legislation was implemented in late December 2020]. The ILP structure will be able to be an umbrella or a series structure once the new legislation has passed. You can actually have different compartments. This is a typical partnership structure in that the general partner will be the entity that appoints the AIFM and, if desired, the AIFM can appoint a delegate portfolio manager.

Because these structures are fully regulated at the product level, not just at the manager level, that means they are subject to the Central Bank of Ireland's AIF Rulebook. That is typically in the structure of a Qualifying Investor Alternative Investment Fund, which is for sophisticated investors.

Ireland also has structures that are unregulated but are fully AIFMD compliant. (Some people might be familiar with a similar structure in Luxembourg.) Typically this is a limited partnership structured under the 1907 Act—similar to the ILP, there is a general partner, limited partners—and you can appoint a fully authorized AIFM to this entity. It cannot be a series structure, but it is not regulated by the Central Bank of Ireland.

Finally, there is the Section 110 Company, which is not a typical fund structure. It is a corporate vehicle that is funded by debt through profit participating notes and is often used as an SPV. It's a great securitization vehicle as well. Many people are still interested in this. Though it is not AIFMD compliant, you can do private placements throughout Europe.

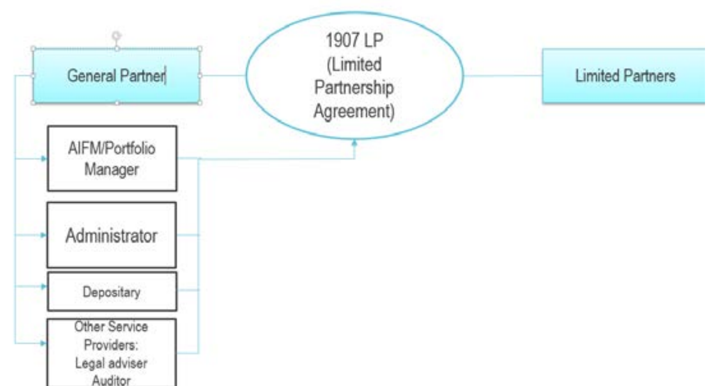
Marie Coady, PwC: From a tax perspective, the ICAV is very similar to a Cayman corporate. It is exempt from Irish tax on income and gains. It has no subscription or net wealth tax which differs from Luxembourg which does apply a subscription tax in certain instances, based on the net asset value of the fund. Also, it is possible for the ICAV to get treaty benefits. Ireland has in excess of 70 treaties around the world which reduce or eliminate withholding taxes or capital gains taxes.

One very important treaty we have is with the U.S. Irish regulated funds are viewed as "residents" for the purposes of the U.S./Ireland Tax Treaty. This means that in certain instances where the Irish fund is investing in U.S. assets and where certain activities are performed in the U.S., U.S. tax treaty entitlement can be really important to ensure that end investors are not subject to an additional layer of taxation. This is quite unique for globally distributed funds..

Another important feature is that you can check the box and elect to treat the ICAV as a transparent or flow-through entity for U.S. tax purposes. That's something that we didn't historically have in Ireland with the PLC structure, but the ICAV makes that possible.

> "Ireland is a firmly committed member of the E.U., so managers can access investors across the union."
>
> –James McEvoy, Alter Domus

AIFMD Compliant but not Regulated by the Central Bank of Ireland



If an EU Authorized AIFM is appointed, Fund may "passport" for sale in any EEA country

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There is obviously an unprecedented level of tax change around the world. And, because the ICAV is tax-exempt and not reliant on deductions to achieve tax neutrality, we would view it as a hugely positive, future-proofed vehicle for the investment industry.

As for ILPs, there is no tax at the limited partnership level. They are viewed as transparent, which means that the tax treatment of the structure will be dependent on what's above the partnership and what's below the partnership. And, for investors who hold underlying assets directly, this can be really beneficial because you can access the treaty between the investor country and the underlying assets. We do often see blockers used in limited partnerships, interposed to manage various tax leakages within the structure. Sometimes blockers are above the limited partnership, sometimes below the limited partnership.

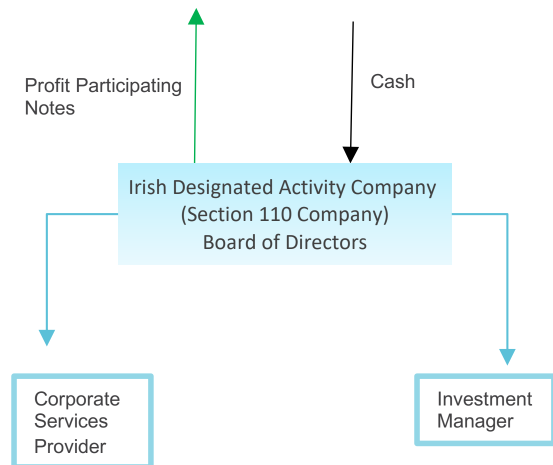
And then Section 110: the unregulated structure. Section 110 is a taxable entity subject to Irish tax at a rate of 25 percent. But, when structured correctly, the profit participating interest payments are deductible. Typically, you end up paying minimal or no tax in Ireland. It is possible to exit the Section 110 on a tax-free basis – no withholding on distributions or redemptions. And, because it is a taxable entity, it is entitled to the treaty network that I just touched on, which the ICAV is similarly entitled to. We do see it used quite a lot in practice – CLOs, CDOs, capital bond issuances, and indirect investments.

McEvoy: We often find managers' first foray into Ireland can be with something like Section 110, especially on the credit side. They're hugely popular and have their genesis in pure securitization transactions – for example, CLOs and other ABS transactions. Managers may later wish to set up a regulated AIF. In many cases, the Irish entity will be part of a larger global structure. So, from the outset, it's usually helpful to consider looking to the service provider side to ensure you have solutions across multiple products, multiple jurisdictions.

If we look at Section 110, it's a corporate entity, an Irish limited liability company. So, you need a board of directors, usually all or majority being Irish residents for substance to ensure having the mind and management locally, as well as a company secretary and a registered office in Ireland. Your 110 will need to prepare annual financial statements, which are independently audited, and file various returns including with the local regulator, the Central Bank of Ireland.

You would typically expect to have periodic board meetings, likely quarterly, depending on the level of activity of the SPV. We're seeing more and more of a drive for substance – robust discussions reviewing company performance, with submis-

Not Regulated or AIFMD Compliant



Typically privately placed

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> –Karina Stahl, Monroe Capital

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sions from the investment manager. For all of this, you tend to rely significantly on a service provider who works closely with auditors and advisers day to day, keeping everything running smoothly.

Not surprisingly, a regulated fund product brings with it more requirements. Common across any European funds set up for marketing under the AIFMD, you need your E.U.-authorized AIFM, who carries all of the responsibilities for managing the fund across distribution, portfolio management, risk and compliance. The agent can be sponsor-owned or independent. Increasingly, these days, we're seeing the manager appoint a service provider – a third party agent – to fill that role. The agent can then delegate the portfolio management to the client asset manager if they meet regulatory criteria. If not, the firm can retain that portfolio management function. It may appoint the manager as more of an investment advisor to the AIFM.

On a non-discretionary basis, your Irish fund, whether ILP or ICAV, will also need to appoint an Irish regulated fund administrator, as well as a depository. The depository oversees the activity of the fund and the existence of assets on behalf of investors. You would also have an MLRO appointed. You can have all of those provided together or separately per function.

In the case of an ICAV, the board members of the fund will be at the level of that ICAV entity. In the case of a limited partnership, an ILP, it will be at the GP. Those individuals need to get approved by the Central Bank as well. You'll need an independent director within the mix of the board – usually an Irish resident in terms of setup.

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>
> –Lindsay Trapp, Dechert

Getting parties lined up and getting fund docs prepared, etc., can take some time, but it is a clear path. The authorization itself is actually quite efficient. Your typical closed-ended fund strategy is set up as a non-retail, or so-called Qualifying Investor AIF (QIAIF). With some exceptions, these can receive a 24-hour authorization from the regulator, which is really helpful.

The non-regulated 1907 partnerships that Lindsay described offer a viable alternative. These offer less regulatory burden.

In terms of day-to-day operations, look to design and implement the most efficient delivery solution across the investment structures: blockers, feeders, etc. We always recommend good engagement with your provider to get this operating model right the first time, while respecting the regulatory requirements, be it in Ireland or in other jurisdictions. This is a helpful workshop discussion to be having early on.

Privcap: Karina, your firm, Monroe Capital, is based in Chicago. Why did Ireland make sense as a base from which to raise capital?

Karina Stahl, Monroe Capital: We first entered the Irish space from a fund management perspective in 2015. Previous to that, our offshore structures have been primarily Cayman structures. The majority of our investment base has been U.S. investors. As we grew, we started to see fundraising pick up in Europe as well as in the Asian and Australian markets. It became apparent that we needed to have a fund structure that was AIFMD (Alternative Investment Fund Manager Directive) compliant, with which to accept capital from at least the European investors. You get a lot of respect from that structure outside of Europe as well. At that point, the Luxembourg partnership structure was not in place. So, we started with our second large commingled fund structure as an ICAV. We chose the regulated ICAV as our delivery vehicle to our offshore investors.

We are a private debt manager, so with this first fund structure, we actually did not rely on the treaty capabilities. We used the ICAV structure in order to deliver our product to our investors. And we structured that in a bit of a fund-of-funds product.

Being a first-time manager in Ireland was really interesting and we learned a lot. There's a great group of service providers out there, many of them being represented on this phone call today. It is very important to get yourself off on the right foot with your service provider groups and really understand

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the differences between managing a Delaware fund structure here in the U.S. versus a regulated fund structure in Ireland. I happen to sit on the board for the ICAV. I am the Monroe representative, joined by an independent in Ireland, as well as a representative from our AIFM. We structure ours in a way so that we have an AIFM across our fund structures, and then they delegate investment management authority.

We do our best to try to coordinate depository and fund admin together. But the oversight and reporting functions were a little bit foreign, as well as the unitization structure of the Irish ICAV.

James talked earlier about the Irish experience being very commercial and the lack of language barriers. The service model in Ireland seems to be pretty consistent with what we see in the U.S. service provider model. That's been a really welcoming environment for new U.S. managers entering the Irish space.

IMPROVED STRUCTURES

McEvoy: If you're a U.S. GP, you and your investors are very much used to working with partnership structures. So, there's been a lot of effort on the part of industry to improve the investment limited partnership structure. We're very pleased to see that come through. That gives us a much more fit-for-purpose model for this market. In the meantime, we're seeing good engagement with the local regulator, looking to make some amendments to its own rules not just in respect to partnerships, but across the full suite of fund products that are available in Ireland that will better reflect your typical private equity-type strategy. In terms of how investors are brought into the fund – how carry and management fees are handled – there were some components that were not prohibitive for establishing funds in Ireland, but were a little troublesome and created some hoops to jump through.

We've also seen, over the last year, the local regulator agree to the concept of what we call a specialized depository that allows firms like ourselves and others dedicated to the space to provide depository services in the market.

We've seen such strong sentiments from not just the U.S. but also the UK and other markets to establish in Ireland, and some of those components have prevented that. So [the changes] lay solid groundwork for a real growth market.

Coady: It is increasingly complex for some of the multi-tiered private equity structures to remain tax efficient with various tax reform taking place globally. It has meant that it is increasingly difficult for multi-tiered structures to now structure tax efficiently. We're going to see a trend toward an unraveling of some of those complex structures. The Irish ILP is coming to market at the right time in that private equity is going to play a huge role in the recovery of distressed parts of economies globally. Private credit will be a core asset that will facilitate the growth and the recovery of a lot of markets as well. I'm quite excited about 2021 from an ILP perspective. Ireland will close a gap that we have had for some time.

Privcap: Karina, please talk further about the U.S.-Irish tax treaty and why it is important for U.S. managers to understand.

Stahl: The treaty-based structure has been really important for us from a fundraising perspective. The Irish ICAV in our structure is able to take advantage of the resident status. You can bring into the structure U.S. as well as non-U.S. investors that may not have a treaty in their own rights. And, to the extent that there are not more than 50 percent non-treaty investors within the structure, the entire structure gets treated as a good structure from an Irish tax perspective.

So, when we're trying to figure out the best way to deliver a vehicle to as many investors as possible, this treaty structure is really fantastic. You're able to bring in U.S. taxables and super tax-exempts, and it gets to be treated as a partnership all the way through. For U.S. tax-exempt investors, you can block UBTI for those investors. Then, you can bring in non-U.S., non-treaty investors directly through the structure. It allows you to equal the playing field for investors in terms of offering one structure versus separate vehicles for your on- and off-shore investors.

This is an area that's really exciting for investors, as long as you're an investor of a certain size. There's an independent agent test here that's really important in order to make this structure work. But, if you're a manager of a certain size, this really does provide a great way to build one vehicle that a lot of different investors can come into. It ensures that you don't have differing returns for on- and off-shore investors.

Coady: A lot of our clients in this space are dealing with U.S. assets and are having to manage complex U.S. exposures. Particularly where you are originating loans back into the U.S., it does give rise to either effectively connected income for your foreign fund or UBTI ("unrelated business taxable income"). So, from a technical perspective, Ireland's treaty is quite unique. Ireland's tax treaty with the U.S. includes a "collective investment scheme" (i.e. Irish regulated fund) in its definition of "tax resident."

So, where we are looking for U.S. treaty benefits for the underlying assets to minimize the leakage in the structure, the Irish vehicle really does work well. You have to be a resident of Ireland and you have to meet good ownership requirements,

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which is called a limitation on benefits provision in the Ireland-U.S. treaty. Where you are originating in the U.S., you need to make sure that you qualify as an independent agent. It's possible to meet those criteria and to put policies, procedures and protocols in place to make sure that it's a robust structure.

Privcap: Let's say you're a U.S. GP about to raise capital in Europe for the first time. What are some considerations in setting up an Irish structure?

Stahl: It's really important to designate an operational, tax and legal team in-house that's going to be working with your service provider groups. It is going to look and feel different from what you're used to in a Delaware or even a Cayman structure. Your in-house team is going to learn and get comfortable with the new environment that you're operating in. You also need to ensure that you are very thoughtful about selecting your service providers. It's really important to have very strong legal counsel from both the document-drafting side, but also the tax consulting side who can consider the tax consequences for various types of investors and is able to assist you in explaining all of this to your investors.

Then, operationally, your selection of the AIFM is important. If you're new to the overall concept of oversight of the depository in Europe, it all feels a bit foreign the first time through. So, you need to be unafraid to ask questions and place a good amount of reliance on your service provider group to teach you along the way.

Privcap: One big question is around Brexit. James, with the monkey wrench of Brexit thrown into the equation, how does that affect the Irish opportunity?

McEvoy: It's astonishing that, four-odd years since the vote, we're still talking about uncertainty when it comes to Brexit. When it comes to Irish funds, one of the key things that we've seen is around substance. Obviously, a lot of funds and managers are based out of London. And a lot of those have needed to set up an AIFM in Ireland, or elsewhere in Europe so that they can continue to distribute within the E.U.. Of course, they continue to have operations in London. But this has really driven regulators across Europe to place significant focus on substance. They want to ensure a firm setting up in Europe can stand on their own feet without significant reliance on their UK colleagues. So, that substance drive doesn't just impact Brexit cases.

Broadly, we're seeing a higher barrier for establishing and running an AIFM. We think that the third-party AIFM is a model that will grow and allow managers to focus on their core business.

Coady: Ireland has a very competitive corporate tax rate. We've seen over 180 authorizations by the Central Bank in the last 18 months for firms who have decided to move from the UK and have chosen Ireland as a domicile for their AIFM or UCITS management company. The Irish tax code has a number of attractive regimes supporting innovation such as the R&D (research and development) tax credit and the IP regime. Many managers are considering Ireland as an innovation for their business particularly around technology given the skillset of talent available in Ireland as a result of the leading global technology firms located there. The competitiveness of Ireland from a corporate tax perspective is also overlapping with the substance play.

From a practical standpoint, there will be greater focus from source countries on treaty entitlements, and the way to future-proof your structure is to put substance around your products.

Ireland is a changed location as a result of Brexit, with a lot more corporate substance.

Privcap: Is there a minimum amount of capital that needs to be raised to justify the costs of establishing a domicile in Ireland?

Stahl: There are baseline costs that are going to be different than running your Delaware LP. Having a depository, an AIFM and independent directors that you'll need to pay does add cost and burden to the overall vehicle, and to your average expense ratio. It is going to be a bit more expensive, from an establishment perspective, than a domestic structure. Each manager needs to think about their return profile and what level of expense load any of their structures can take on. That's certainly a question that we ask ourselves every time we launch one of these fund structures, to ensure that the structure will have enough capital to take on this burden. ■

This report is based on a recent Privcap webinar.

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