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Irish Private Funds – A New Era

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Introduction

There has been much excitement for those in and connected with the Irish funds industry over recent weeks, with the introduction of new legislation that updates and re-purposes the Irish Investment Limited Partnership ("ILP") for use by fund managers with a focus on illiquid asset classes.

This milestone has been a long time coming and is the result of extensive work by the Irish industry, Government and regulator, the Central Bank of Ireland ("CBI"). There has undoubtedly been a perception that Luxembourg has, for a number of years, been better positioned to serve private market managers but Ireland is now finally a viable option.

In that time, Ireland has continued as the fastest growing fund domicile in Europe, despite focussing almost exclusively on UCITS and liquid alternatives until now.

Ireland as a fund domicile enjoys a global reputation for excellence, with an approach to doing business which US and UK managers in particular find familiar. Ireland's prudent but pragmatic regulator, clear and transparent tax regime and very deep market of fund service providers copper-fastens this reputation. In terms of available service providers, all the leading names have a presence in Ireland as do an array of smaller and potentially more nimble players, with over 40% of the world's alternative assets serviced through Ireland. International law firms have also begun to set-up in Ireland which helps to drive global standards in the local market.

Assets under management in Irish funds have nearly doubled since 2016 and now sits at EUR3.2 trillion, with the expectation that this figure will rapidly grow to exceed EUR5 trillion. Ireland is already home to over 1,000 promoters from over 50 countries.

Given its position as one of the world's leading fund domiciles, many managers will naturally have Ireland as their first choice for the establishment of a private fund. This means increased competition and greater choice for managers, both of which will be a catalyst for new industry innovation, technology and product solutions.

Although a long time coming, the enhanced Irish framework comes at a time when the growth in private markets and illiquid alternative investments has never been stronger or more sustained.

As outlined in this report, the enhanced framework is now fit for purpose, but it is also new. So what are the key considerations for managers now looking at Ireland as a domicile for their next fund raise?

This report provides an overview of the enhanced framework, both practical and objective, from a legal and commercial standpoint, highlighting opportunities but also exploring a number of points worth considering by those potential early adopters.

Overview

Ireland has taken a multi-pronged approach to formulating a competitive private funds regime.

Update to the Investment Limited Partnerships Act

Firstly, the ILPs Act, 1994 has been modernised and updated significantly including to permit the establishment of umbrella ILPs with segregated liability between sub-funds, to permit the migration of non-Irish limited partnerships into Ireland as an ILP by way of continuation, the use an alternative foreign name and perhaps most significantly, to expand and modernise the list of "safe-harbour" actions which a limited partner in an ILP can undertake without risking loss of limited liability.

Update to the regulatory framework for closed-ended funds

ILPs are required to be regulated and it is expected that the vast majority will be authorised as Qualifying Investor Alternative Investment Funds or "QIAIFs" which can avail of a 24 hour approval process by the CBI, without any review of the fund documentation. Certain requirements applicable to the GP of an ILP, which were out of step with other leading private fund domiciles and which negatively impacted on the speed to market of an ILP, were removed when the CBI updated its AIFMD Q&A document document in November 2020. The CBI's previous approach with classes of interests in an Irish fund also meant that certain market standard provisions for private funds such as providing for excuse and exclude rights, stage investing and also a standard carried interest and distribution waterfall proved challenging. The CBI no longer applies this approach to closed-ended funds which was confirmed by way of updated guidance issued in February 2021.

"Real Asset" Depositaries

Finally, the number of specialist service providers available to private fund managers establishing a fund in Ireland will further increase with the availability of a new licence for depositaries providing services to closed-ended funds, or so-called "real asset depositaries". Until now, depositaries licensed in Ireland needed to be part of a banking group, which meant that choice of service provider was somewhat limited where there was a preference for both fund administration and depositary services to be provided by the same group. Real asset depositaries are not required to be part of a banking group, which means that specialist private equity fund administration groups will also be able to apply for authorisation as a depositary for Irish closed-ended funds. The guidance for this new licence type was issued in February 2021 but the CBI has been accepting applications for authorisation since late 2018. There are a number of applications which are at a very advanced stage with the first of such providers expected to be authorised before the end of Q1 2021.

The updates are comprehensive and well thought through. The activity and excitement around the enhanced framework is justified, but there are a number of items which managers need to bear in mind when considering any new fund product.

Closed-Ended Fund and Limited Partnership Expertise

Limited Partnerships differ, quite markedly, from vehicles traditionally used as open-ended funds, such as the ICAV, including in terms of legal and tax status, constitutive documentation, capital accounts, investor rights and liability provisions, profit-sharing (or waterfall model), closing mechanics, capital contributions and distributions, amongst others.

Limited partnerships also require a particular process in terms of formation and a slightly different approach in terms of governance given that limited partnerships have no legal personality.

Managers rely heavily on a number of service providers to ensure the smooth launch and ongoing operation of their fund vehicles, in particular:

- Lawyers who will drive and be central to the fund launch from a documentary perspective. It is essential to select a law firm with extensive experience of market standard terms, the formation process and parties and the regulatory approval framework.
- A fund administrator who can manage investor, accounting, pricing, operational and reporting requirements, leveraging appropriate technology systems in those areas, and are staffed with teams who understand and can effectively address potential issues that may arise.
- An AIFM with experience of (and an oversight model tailored to) the closed-end limited partnership structure, asset classes, risks, distribution strategy and other requirements.
- A tax adviser who can guide managers on the complexities associated with tax transparent vehicles, including double taxation treaty eligibility, assessment of investor tax status, mitigation of underlying tax risk and use of blocker and aggregator entities.

Substance

When considering a new domicile, in particular an onshore domicile such as Ireland, increasingly managers need to consider what level of substance is required.

Substance is certainly one of the main topics of discussion for fund managers operating in Europe, and with Brexit it appears that regulators across the continent are increasingly seeking more boots on the ground than a manager would perhaps like, with local regulators acutely conscious of the potential scenario whereby small outposts are established by managers in the EEA with major functions delegated back to third countries, including the UK. Each jurisdiction will likely require different levels of substance, minimum capital and functions to be undertaken locally by people with the required skills and technical resources to undertake management activities.

The substance required for the ILP itself is limited to having two Irish resident directors at the GP level but only where the GP of the ILP is an Irish company. In the case of a non-Irish GP, Irish resident directors will not be required.

Separately each ILP will need to appoint an AIFM. When considering who should act as AIFM of an ILP or indeed any Irish alternative fund, there are a number of options.

The first option is for the manager to establish its own proprietary EEA AIFM, something which makes sense for managers of a certain scale. In order to establish an Irish AIFM, a minimum of 3 full-time equivalents will be required but that figure is "only relevant to the smallest and simplest of entities" in the words of the CBI. It is also an option for an ILP, and any alternative Irish fund, to designate a non-EEA manager as its AIFM, but this comes with the loss of the EEA AIFM marketing passport.

Consequently, by far the most popular option is to appoint a third-party EEA AIFM.

For new market entrants, this gives rise to a whole host of questions which will shape the optimal business and service provider model. The question arises as to what is the most efficient route to achieving the substance threshold and if that is the appointment of a third party AIFM, it is essential to select a provider with sufficient systems, controls, knowledge and expertise to oversee a limited partnership structure. It should be considered as to how a third-party model would affect the portfolio or risk management framework as well as the delegation of decision-making. Cost implications should be considered, and whether there is merit in considering establishment of a proprietary AIFM and at what level of assets under management does that option begin to make sense. Is the EEA marketing passport required? If not is a non-EEA AIFM an option and if so can that entity comply with the minimum AIFMD requirements which the CBI requires for non-EEA AIFMs?

Managers with an AIFM elsewhere in the EEA may passport services to Ireland and act as an AIFM to an ILP but this raises a different set of questions – Is the AIFM operating model fit for cross-border supervision of portfolio or risk management, administration and distribution? Is it a tried and tested model? Does the AIFM have connectivity in place with designated advisers and service provider partners to discharge their direct and oversight responsibilities? Do individuals with functional responsibility at the AIFM have the requisite level of skill and competence to effectively perform their roles in respect of the new ILP?

The answer to each of these questions will, of course, depend on a manager's own circumstances.

Managers must also be aware of the evolving picture, for example the recent update to the CBI fund management company guidance which has cast doubt on the viability of self-managed funds in Ireland which were once the norm and also recent letters from ESMA to the European Commission as well as the AIFMD II consultation, which appears to indicate that the focus on substance will continue including the rules around delegation of portfolio management to third countries which now, post-Brexit, includes the UK.

Governance

The AIFM bears overall responsibility for many functions, but who then oversees the overseer? Technically, that duty sits with the GP, who is empowered to select, appoint and manage the vendors which support the ILP.

As outlined above, a GP to an ILP which is an Irish company is required to have two Irish-resident directors. If an Irish AIFM is used, either proprietary or third party, it is usual for the AIFM to provide at least one Irish resident director, which can reduce the overall cost of operating an ILP.

But does complying with the minimum truly serve the business from a governance standpoint? Good governance is no longer just a luxury in the fund management world. It is a pre-requisite, as a line of defence, and for institutional investors in their due diligence assessment of a firm's business model.

The appointment of independent directors undoubtedly strengthens governance, with certain investors insisting on there being a majority of independent directors. But selecting an independent director cannot be a tick-box exercise and managers should examine the experience and credentials of potential candidates, in particular when considering the establishment of an ILP given Ireland to date has focussed more on UCITS and liquid alternatives.

When issues arise, including those particular to the private funds space such as an investor failing to meet a capital call resulting in a failed transaction, or a portfolio company falling into a distressed scenario necessitating a work-out solution from the manager in short order, or where there is a default on a facility leading to the lender seeking to enforce security – the independent directors need to be ready and prepared to act.

Regulatory Pragmatism

The risk based regulatory approach of the CBI has long been considered a great advantage for any firm operating in the Irish market. The level of engagement and leadership from the CBI in formulating the enhanced private funds framework only serves to highlight the importance of the CBI in maintaining Ireland's position as one of the world's leading fund domiciles.

As noted above, careful consideration is needed when choosing local advisors and service providers in order to ensure the required level of knowledge and experience but a reasonable concern which may also arise on the part of the manager is that the regulator itself may be tested with the expected surge in the volume of fund applications, time pressures and commercial drop-dead dates, technical submissions, complex product terms, a significant number of which will involve a new fund vehicle.

As outlined above, generally ILPs authorised as QIAIFs will be able to avail of the CBI 24 hour approval process. Pre-submissions to the CBI have recently been required for certain assets classes, including real estate and loan origination funds. Whilst pre-submission is potentially a temporary requirement, managers may need to take this into account in the planning stage and engage with advisors early on in the process to understand whether such a process is required for the proposed asset class.

Private fund managers are used to having near absolute control over the launch timeframe in other jurisdictions given that the fund vehicle itself will usually be unregulated. The ILP is a regulated fund and although some offshore jurisdictions (such as Cayman) are moving towards regulating private funds, for now at least regulated private funds remain a bit of an outlier. That being said, the 24 hour approval process is smooth and seamless and has no impact on speed-to-market which makes it a compelling aspect of the regime as some investors take comfort from an additional layer of regulation.

Operations Without Borders

We've already noted what new entrant managers with first vintage funds must bear in mind when selecting local advisors and vendors to support their new ILP.

The picture for managers with established operations and products elsewhere in Europe is naturally more complex. There can be many reasons for (and benefits of) contemplating the launch of funds in a new market. With product innovation, and the availability of new investment structures, firms will always consider whether they represent an opportunity for their business. Such will inevitably be the case with the ILP.

The most obvious example would be a manager with existing closed-end SCSp funds in Luxembourg deciding to use the ILP as the default fund vehicle going forward. What do they need to consider? They will already have met the substance standard, either with their own AIFM or a third party AIFM. Nearly all service providers and auditors will have operations in both Luxembourg and Ireland although there remains very few law firms which can provide a seamless service across the main fund domiciles.

The circumstances for every manager will again be different, but considerations include:

- Whether to migrate or re-domicile existing funds from Luxembourg into Ireland. This is a complex process, with inherent costs, resource demands and risks. Closed-end funds will naturally run off over time, so depending on the maturity profiles, it may be possible to effect a natural transition to the new structure without bearing a heavy operational and cost burden.
- The development of a cross-border operating platform. For any manager with parallel funds in different markets, the ultimate goal will always be a consistent service provider framework and service model. Those with existing funds in Luxembourg or other European markets should engage with their providers, understand to what extent they can (and are authorised to) support ILPs alongside, under the same terms, within the same team, based on the same technology, reporting standards and account platform.
- Regulatory environment. Whilst the CSSF and CBI are both EU regulators and members of ESMA, there can be differences between Ireland and Luxembourg in terms of approach, working styles, regulatory emphasis, culture and, in rare cases, interpretation of prevailing rules, including by different law firms within the same market. Those differences can result in divergent approaches to supporting and engaging with managers. Any firm which manages products in separate European domiciles, such as Luxembourg and Ireland, will essentially duplicate their regulatory footprint, which requires constant oversight of compliance standards and relationships. There are, of course, cost and resource implications, as well as regulatory risks, with any such commitment.

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First Mover Advantage

The most important question that any manager should address when considering a new product structure – is there a greater benefit to leading or following?

Without doubt, the ILP will be a leading investment vehicle and first choice for private markets investment and alternative fund managers in due course but firms do need to consider when the structure will be right for their business.

For example, there are an abundance of global fund service providers with Irish operations, but the CBI has only recently permitted the licensing of so-called "real asset" depositaries. None are authorised as of today although it is expected that a number will come on stream during the course of Q1 2021.

It will also take time for best practice and market conventions to take hold. Selecting service providers, directors, advisors and legal counsel with international strength in depth and knowledge and experience of global private market standards is critical. The ILP is new and choosing partners who are not new to private funds is a very important step in the right direction.

Conclusion

There is no doubt that the updated private funds framework in Ireland is a very positive development, providing another onshore option to private fund managers.

We are here to guide you through the decision-making process, to provide direction in selecting your service providers and/or determining an approach to implementation that will meet your needs and best serve your business.

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James specialises in advising asset managers on the establishment and ongoing maintenance of investment vehicles.

He has significant experience assisting clients with the establishment of a variety of fund types, ranging from broadly offered retail funds to private funds aimed at small groups of sophisticated investors and family offices, across every major asset class, liquid and illiquid, and also in respect of digital assets. James has advised in relation to the establishment of funds structured as companies, unit trusts, limited partnerships, common contractual funds, as well as umbrella fund structures and master feeder structures.

He has advised in relation to the establishment of investment structures domiciled in a number of jurisdictions including Ireland, Luxembourg, the Channel Islands, the Cayman Islands, the British Virgin Islands, Bermuda and Hong Kong and has advised managers based in a variety of jurisdictions including the U.K, the U.S., Ireland, the E.U., Switzerland, Latin America, Hong Kong, the People's Republic of China, Japan, Singapore and Taiwan.

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Benjamin Lamping is the founder and director of Reframe Capital, a new investment solutions firm which supports alternative managers and investor groups with development and implementation of strategic business, product and distribution plans.

He was formerly a director of Global Product Management with Nuveen, responsible for establishing, developing and managing the firm's international product platform. Before joining Nuveen, Benjamin held various product leadership roles, serving as Global Head of Product Development with Winton Capital, Head of Fund Structuring with J.P. Morgan, and as a member of the structuring and solutions teams at Merrill Lynch and HSBC. He started his career as a solicitor with the law firm, Allen & Overy LLP, and holds an LLB undergraduate degree in Business Law from City, University of London.

Benjamin is also a proud patron of the Salmon Centre, a youth charity in Bermondsey, South East London, which empowers young people to fulfil their potential and contribute positively to their community.

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