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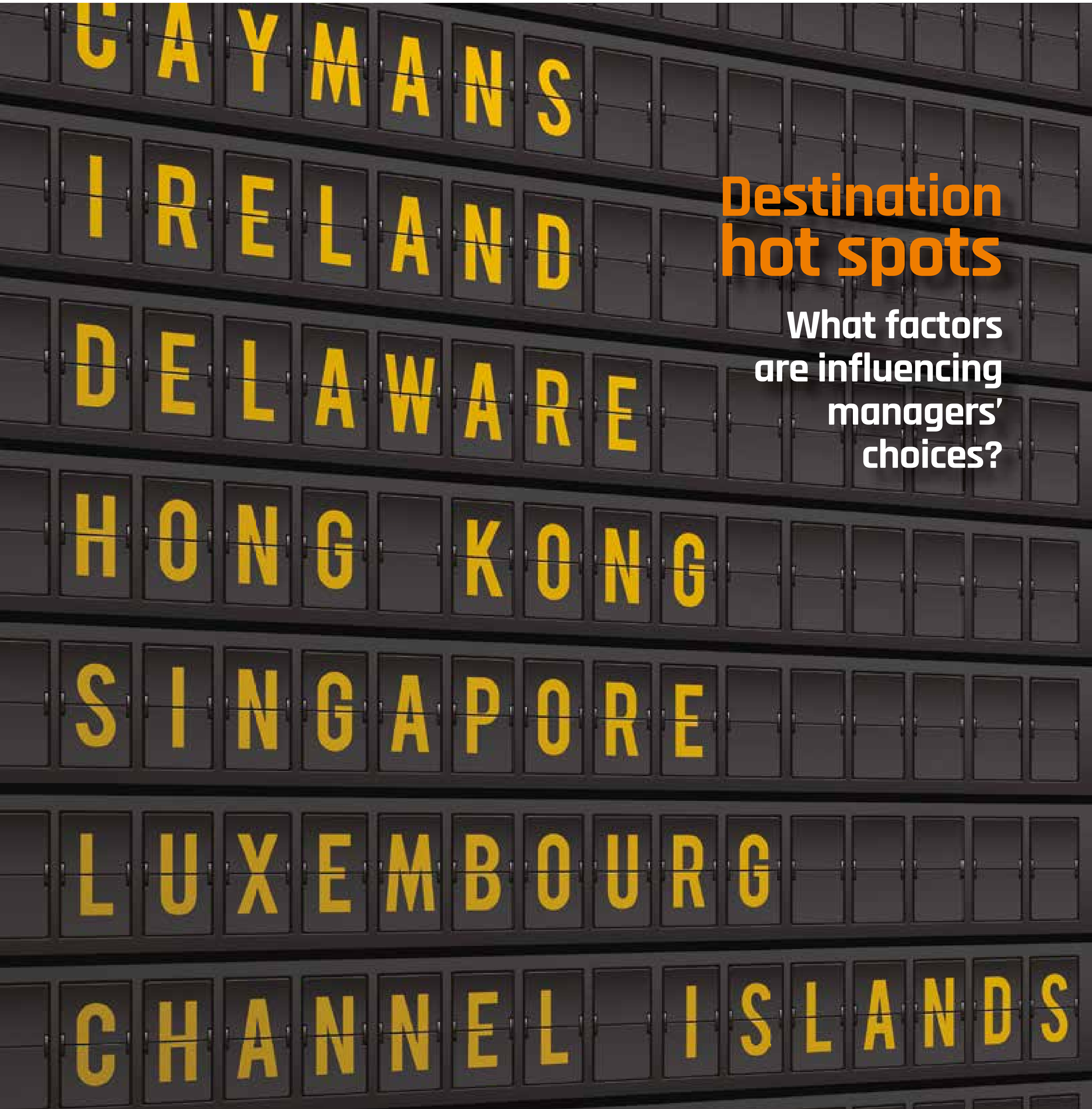
Fund Domiciles and Regulation

July/August 2021 • perenews.com



Destination hot spots

What factors are influencing managers' choices?

KEYNOTE INTERVIEW

Ireland opens the door for funds growth

A new funds regime will enable the domicile to compete for business in post-Brexit Europe, suggest Alter Domus's Anita Lyse and Ronan O'Donoghue

Managers of international capital in Europe with fund vehicles in the UK were forced by Brexit to search for an EU domicile for their funds in order to maintain their ability to market to the continent's investors. Ireland was perhaps an obvious choice but did not see the momentum expected with many going to Luxembourg.

Alter Domus's Anita Lyse, head of real estate, and Ronan O'Donoghue, head of AIFM Ireland and real estate leader for Ireland, explain how regulatory changes are forcing a reassessment of the domicile's appeal, and why alternative investment industry service provision businesses such as theirs are now expanding their operations in Ireland.

Q How has Ireland fared so far in winning post-Brexit business from private real estate funds?

Anita Lyse: Ireland, as an English-speaking country with many cultural and legal similarities to the UK, is well positioned at a high level. But in the wake of Brexit, we didn't see significant volume in private real estate funds outside of those investing in Irish real estate. This was principally owing to the local funds regime lacking alignment with typical strategies and mechanics seen in private funds. However, the Irish Limited Partnership (ILP) regime and some associated regulatory changes for private funds have now made Ireland a real contender in Europe as a fund domicile when compared with the Luxembourg SCSp, and with the partnership structures available in the UK and Cayman.

Ronan O'Donoghue: Those changes came into force in February this year, so the tools they provide were not available to managers while they were planning their post-Brexit arrangements over the past four years.

Before Brexit, many managers had established fund structures in Luxembourg, so it was natural to move their Alternative Investment Fund Managers

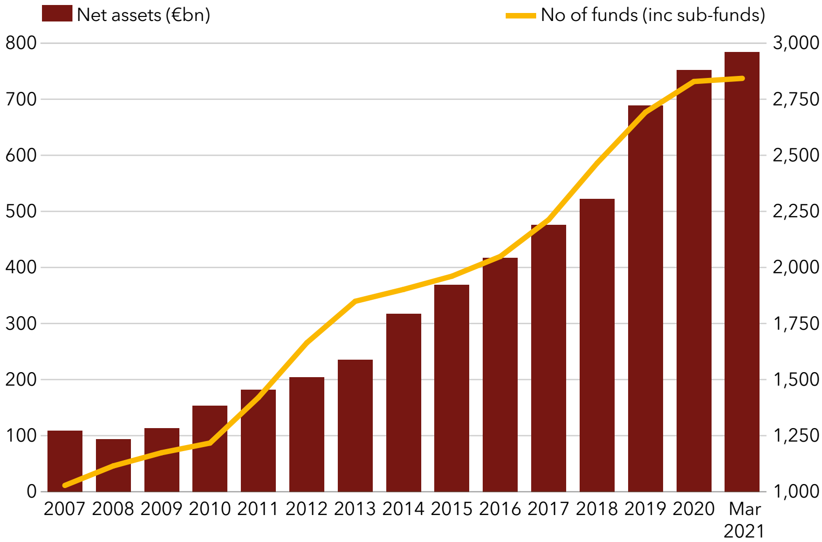
Directive (AIFMD)-regulated management companies from the UK to Luxembourg, too. Meanwhile, Ireland's Partnership Act was quite restrictive. Managers were unable to set up partnerships of the kind commonly used in private real estate investment, and regulatory rules didn't allow for funds with features like multiple closings, allowing investors to come in at values different to NAV, and the normal incentive structures. That made Ireland uncompetitive as a domicile in a European context.

AL: When the UK left the EU, it became a third-party country, so managers could no longer use their UK-domiciled AIFM to manage an EU fund. And those AIFMs are no longer able to use the AIFMD passport to market their fund to EU investors.

That's problematic because there are a lot of very large insurance companies and pension funds based in the EU that many UK-based managers rely on as sources of capital. During the period following the 2016 referendum on EU membership, managers increasingly set up their own AIFM in the EU to ensure their EU operations could continue uninterrupted post-Brexit.

At the same time, there's been a significant initiative under ESMA to ensure AIFMs have sufficient substance, so we see it's become quite costly and time-consuming for managers to set up their own AIFM. Consequently, lots of them chose to use third-party AIFMs managed by specialist administrators like Alter Domus, and we've likewise just established our second third-party AIFM outside of Luxembourg in Ireland to support this.

Growth of Irish-registered Qualifying Investor Alternative Investment Funds



Source: Irish Funds

Q What difference will those changes to Irish partnership law make to its attractiveness as a domicile?

RoD: There's a lot of excitement about the impact going forward. They've created a tax-transparent Irish partnership, which can exist as an umbrella with segregated sub-funds. It's a regulated product which can receive 24-hour regulatory approval from the Central Bank of Ireland, subject to some exceptions depending on the strategy.

The ILP is very comparable with the limited partnerships available in the UK, Cayman and Delaware, or Luxembourg. In addition, the Central Bank of Ireland issued updated guidance on closed-ended AIFs in late 2020. The new regulations are a game-changer because they provide a toolkit for private equity partnerships domiciled in Ireland in real estate, debt, infrastructure and other alternative asset classes.

The changes to Irish partnership law will be more relevant to real estate investors and managers making domiciliation decisions in the future, because now they have more options.

Over the coming months and years, it will be proven to what extent Ireland will work for them in terms of tax efficiency, access to professional support and relationships with the regulator. But Ireland has many ingredients to make it attractive. People talk about the language advantage, but it's not necessarily the biggest factor. And some may point to cultural fit. But one of the biggest attributes Ireland has is its good availability of well-educated labor. We set up a central operations center in Cork, Ireland's second-biggest city, partly because it has two large universities and a good community of financial services firms.

Availability of talent will also influence managers' decisions on where they will set up their own offices. Those that already have well-established operations in Luxembourg will probably remain there because to change that is like turning a supertanker. However, for those starting with a blank sheet of paper, it will be possible to compare Ireland and Luxembourg in the future to see which works best for them. Then factors start to come into play like having existing connections with Ireland, closer cultural fit or being part of a larger company that already has employees working here in other sectors.

Q What impact will the imminent changes to funds marketing in the EU have on domiciliation choices?

RoD: Until now, many non-AIFMD authorized managers have relied on reverse solicitation to market their funds. It's a subtle arrangement where manager and investor have conversations about ideas for potential funds, and then the manager relies on the investor making a proactive request for information about their new fund, so the manager is not marketing. It's the reverse. It's an approach that has been well used by US and UK-based managers.

But the new cross-European marketing rules, being introduced this summer, will restrict it. If a manager accepts a subscription from an investor within 18 months of having a conversation with them, marketing will be deemed to have taken place. Going forward, that will mean more managers setting up European AIFs and appointing EU-authorized AIFMs, which can avail themselves of the AIFMD marketing passport to raise capital. It will now be possible to set up Irish partnerships and Irish AIFMs. In addition, providers like Alter Domus will offer a third-party service, so a manager from the US, for instance, would be able to set up an Irish or Luxembourg partnership, appointing us as their AIFM.

That would allow them to submit their fund to the local regulator in Ireland to be issued with a passport to market that fund around Europe, instead of having to go through the awkward and time-consuming process of using the national placement regime in each individual country. They would not necessarily have to base the whole fund in Europe, just set up a parallel sleeve or fund for raising capital in the EU. Alter Domus already has a significant management company business in Luxembourg, and now we have an AIFM in Ireland authorized by the Central Bank of Ireland, as well as authorization to set up a real asset depositary here.

"The new Irish Limited Partnership regime has now made Ireland a real contender in Europe as a fund domicile"

ANITA LYSE

AL: We can see from our own client base that while many large US investors and managers already operate in Europe, there are still some that don't. For them, it might be worth considering setting up in Ireland instead of Luxembourg. On paper, there's no reason why Ireland should not work well for these types of managers, if they can get their fund structures right and make good connections with service professionals.

In Luxembourg, there's a certain level of resource scarcity in several areas of the financial services sector, which can sometimes lead to constraints on capacity. This is among the reasons why we've set up alternative centers of operation outside Luxembourg, including in Cork.

Q How would you gauge Ireland's future potential as a fund domicile?

AL: The recent enhancements of the Irish funds regime were needed to allow Ireland to compete in private funds generally. Having a fund product, and a legal and tax regime that works for managers and investors is essential. But a domicile also needs skilled people to run these structures day to day.

There are clear differences in the way a real estate fund operates compared to a debt fund, a private equity fund, a hedge fund or a mutual fund, and one should not neglect the importance of asset-specific knowledge and expertise. Ireland has a vibrant domestic real estate investment market, so combining this with its more than 30 years of funds experience means we should seriously consider its growth prospects.

RoD: Alter Domus has just launched depositary and third-party AIFM services in Ireland to provide our clients with fully integrated services, so we're bullish about the potential for Ireland to grow as a domicile. We're very much focused on alternatives, including real estate, and Ireland has the tools to participate in that space going forward.

Real estate is one of the most popular asset classes in Ireland, so there are plenty of experienced professionals in the market who can expand their offering to work with pan-European asset managers.

The number of Irish domestic alternative AIFs has already doubled in the last five years, so the industry is growing rapidly. It will certainly get the attention of US-based managers, and potentially UK-based managers too. That the future is bright is borne out if you look at the corporate activity in our industry. Many of our competitors are making sure they have an operation in Ireland as well as in Luxembourg, because they see the growth in both markets.

Ireland has a history of competing successfully for foreign direct investment in other sectors, such as IT and pharmaceuticals. There's no reason why it can't win a share of the growth we're seeing in the fund services industry. ■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