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ICAV - the New Irish Collective Asset-Management Vehicle

By Mark Browne

Legislation was recently enacted in Ireland providing for a new type of corporate fund – the Irish Collective Asset-management Vehicle (ICAV). ICAVs are new Irish legal structures specifically designed to constitute investment funds. They feature a number of specific advantages when compared to previously available structures. This article seeks to outline the salient features of the ICAV, its differentiating characteristics and to highlight the instances where it is most likely to be of assistance to fund promoters and the manner in which it can be used to best effect in this regard.

Background

Ireland is one of the world's leading centers for fund servicing, with over €3.2 trillion in assets currently being administered in this jurisdiction[1]. It is also one of the key European fund domiciles, currently playing host to over 5,800 funds, including entities authorized both as Undertakings for Collective Investment in Transferable Securities (UCITS) and also as alternative investment funds (AIFs), including the most popular Irish authorized AIF, the Qualifying Investor Alternative Investment Fund (QIAIF).

The pan-European passport available to UCITS, and more recently AIFs, means that Ireland has become one of the primary centers for domiciling funds targeting European distribution over the past 25 years. In addition, as such funds have become recognized further afield in regions such as Asia, South America and the Middle East, it has become a global fund hub. As a result Irish funds are now distributed in over 70 countries globally.[2]

The attraction of Irish domiciled funds lies in their efficiency, legal certainty and flexibility, as well as the depth of dedicated service providers catering to these products. Apart from the regulatory categorizations mentioned of UCITS and AIFs, a wide range of legal vehicles has existed for some time within which funds may be structured in Ireland including the variable capital investment company (the VCC), unit trust, common contractual fund (CCF) and investment limited partnership.

The Irish funds industry has always sought to be innovative in terms of the availability of fund structures and the underpinning legislation has been updated on a number of occasions to ensure a better fit for purpose and to reflect evolving industry requirements. Previous examples of this have included development of the CCF and enacting of relevant primary legislation, which in that case is the Investment Funds, Companies and Miscellaneous Provisions Act 2005. The introduction of the ICAV is the latest reflection of this pattern.

The relevant legislation providing for ICAVs, the Irish Collective Asset-management Vehicles Act 2015 (the ICAV Act) was signed into law in March 2015 and the first ICAVs have already been

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registered as entities and authorized as funds by the relevant regulatory authority in Ireland, the Central Bank of Ireland (the Central Bank).

The ICAV- an Overview

The VCC has been the most popular choice of legal structure for funds domiciled in Ireland to date and comprises over 70 percent of the total. However, while the VCC structure has served the Irish funds industry well since its introduction and has become established as the structure of choice for funds domiciled in Ireland, because the VCC is based on general company law, rather than legislation specifically tailored to meet the needs of the funds industry, there are a number of applicable provisions which may be viewed as being inappropriate in the funds context so it has been possible to optimize the position in this regard when designing this new legislation. The ICAV structure, therefore, offers a number of enhancements to the VCC as a form of corporate vehicle and is likely to replace the VCC as the structure of choice for newly established funds.

Advantages of the ICAV

In enacting legislation providing for the ICAV, the legislature was able to remove all references to general company provisions that were deemed inappropriate in the funds context. Having a separate piece of legislation applicable to funds has also eliminated the risk of unintended consequences for funds where any changes are made to general companies legislation and has the benefit of ensuring that one piece of discrete and relatively straightforward legislation covers the structure. The opportunity was also taken to amend certain applicable provisions to ensure that they were more advantageous and appropriate to this environment. Some examples are set out below.

VCCs are subject to a requirement to ensure risk spreading or diversification under existing company law. There are therefore difficulties regarding the use of such structures to be used to hold single assets, such as a single specific building in the context of a property fund. This concern also applies to the use of such structures as feeders in master-feeder structures, although the Central Bank has issued clarification that it would accept that observance of this requirement would be subject to directors' discretion to look through to the level of diversification carried on by an underlying master in satisfaction of such requirement, which has afforded comfort in this regard.

Directors of an ICAV will be able to determine to dispense with the general requirement to hold an AGM on providing 60 days notice to shareholders (subject to a right of 10 percent of shareholders or the auditor to require such a meeting to be held, as a safeguard).

An umbrella ICAV will be able to determine to prepare separate accounts with respect to each sub-fund. This will be particularly useful for platform structures with multiple sub-investment managers and would permit the adoption of separate financial year ends for different sub-funds.

No shareholder vote will be required for alterations of the Instrument of Incorporation of an ICAV provided the depositary certifies that the proposed changes are non-prejudicial or have not been specified by the Central Bank as requiring approval.

Specific statutory provisions are included which will apply to fund mergers and amalgamations.

Provision has been made for the preparation of a revised Director's report to correct errors or with respect to aspects of non-compliance.

The ICAV will be able to "check the box" and be treated as a partnership for US tax purposes. This is a primary attraction of this new product for some promoters and is addressed in detail below.

Distinguishing Features

Further distinguishing features of the ICAV when compared to the VCC are that the Central Bank of Ireland is the relevant authority for registration purposes, rather than the Companies Registration Office, and there is no requirement to have subscriber shareholders. The name of the constitutional document is the instrument of incorporation, rather than the memorandum and articles of association; and once registered, a "registration order" is issued for an

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ICAV rather than a "certificate of incorporation" as would be the case for a company. The "Instrument of Incorporation" of an ICAV can be considered to be a cross between the instrument of incorporation of a UK Open Ended Investment Company and the Articles of Association of a VCC. Each ICAV will feature the word "ICAV" as a suffix in its name (instead of public limited company or plc, as appropriate, for the VCC).

Similarities

While emphasizing the advantages which an ICAV offers when compared to a VCC it is important to note that it is a form of corporate structure that does also have many similarities with existing corporate funds, such as the VCC. Accordingly the ICAV does not represent a re-inventing of the wheel in that regard and investors, service providers and counterparties can be assured that many of the features they are familiar with in a VCC still apply.

Some of the common features that are probably worth noting in this regard that both forms of structure share relate to governance, potential regulatory authorizations, liability, and structure. The following provisions apply to both by way of example in respect of these headings:

- Governance: Responsibility for governance is carried by a board of directors. An external management company may be appointed or the structure may exist as a self-managed entity. Corporate directors are not permitted in either case. Most of the current company law provisions relating to the appointment, removal and conduct of directors remain. Furthermore such provisions are overlaid by the Central Bank's fitness and probity and administrative sanctions regime.
- Structures: Umbrella structures comprising multiple sub-funds may be established and in such cases segregated liability will apply between sub-funds;
- Enforcement: the (Irish) Director of Corporate Enforcement may exercise powers over both structures (as well as the Central Bank);
- Regulation: they may be established as UCITS or AIFs (including QIAIFs); and
- Listing: both VCCs and ICAVs may, but are not required to, be listed on a stock exchange (including, but not limited to, the Irish Stock Exchange which is the world's leading stock exchange for listings of investment funds).

Partnership Treatment

As noted above, the ICAV will be eligible to "check the box" to be treated as a partnership for US tax purposes. The VCC is established in Ireland as a public limited company (plc) and such entities are specifically prohibited from electing to be treated as partnerships for US tax purposes. Accordingly the VCC may not be treated as a partnership for US tax purposes.

Corporate structures used for funds in competing jurisdictions such as Luxembourg and the Cayman Islands (being the SICAV and exempt company, respectively) are not subject to this prohibition. This has allowed them to be used by US taxpayers as pass-through vehicles not subject to the more onerous "passive foreign investment company" and "controlled foreign corporation" anti-deferral regimes applicable to shareholdings in non-US corporate fund vehicles.

Prior to the ICAV, promoters seeking a tax transparent vehicle in Ireland to offer to US taxpayers tended to use the unit trust structure, as this is eligible to check the box. However, there is a general preference for corporate master funds due to investor and counterparty familiarity with corporate entities.

US taxable investors will generally have a preference for investing through a partnership structure.

One of the most significant changes to Irish company law relating to fund vehicles in recent years was the introduction of redomiciliation provisions contained in the Companies (Miscellaneous Provisions) Act 2009 (the 2009 Act), which enabled fund companies in specific offshore jurisdictions, such as the Cayman Islands or British Virgin Islands, to change their domicile to Ireland from their existing country of domicile. Key advantages of effecting a redomicile rather than simply incorporating a new entity in

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Ireland are that this permits the company to preserve its track record and contractual arrangements.

However, the redomiciliation legislation did not succeed in attracting large numbers of overseas companies and one of the key reasons for this was the fact that the redomiciled Irish company would be unable, as a VCC, to effect a "check the box" election. The ICAV Act has remedied this.

Master- Feeder Considerations

ICAVs are not subject to a requirement to diversify and therefore represent an appropriate vehicle to be used as a corporate feeder. It is appropriate to note that while, as mentioned above, they may elect to "check the box" to be treated as partnerships they are not subject to a requirement in this regard and therefore a master-feeder combination involving two ICAVs could involve one checking the box and a second one, the master, refraining from doing so and hence act as a corporate blocker. Utilizing two ICAVs in such a master-feeder structure, rather than an ICAV and a VCC, for example, has the advantage of simplicity from an investor perspective and also ensures consistency.

Umbrella ICAVs are also permitted to cross invest between sub-funds so it is possible to have a single ICAV comprising the feeder and master in one legal entity. Unfortunately, however, it is not yet clear that the US tax authorities will accept such a scenario where one sub-fund elects to be treated as a partnership and a second does not. Accordingly this is not currently recommended and separate entities should be used for master-feeder structures.

Any decision to establish any such master-feeder would primarily be driven by the target investor base for the fund and would only be necessary in certain specific circumstances.

Practical Considerations: How to Establish an ICAV

Where a new entity is to be established as an ICAV this will entail a two stage process, both of which are conducted with the Central Bank.

(i) Registration of the ICAV - this is similar to the registrar role, which is undertaken by the Irish Companies Registration office with regard to VCCs. The Central Bank will issue a Registration Order for a new ICAV within ten business days from the date of receipt by it of a complete application for registration duly signed by two of the proposed directors and subscribers. The prospectus and service provider agreements will not need to be submitted at this time. All company related filings will be made to the ICAV registration section of the Central Bank post registration.

(ii) Fund authorization - this is a separate process conducted through the funds authorization section of the Central Bank. As outlined above, an ICAV may be structured as a UCITS or an AIF and the standard new fund authorization process will apply. In the case of a QIAIF this can be the 24 hour approval process.

Directors of a proposed new ICAV will need to be approved by the Central Bank under its fitness and probity regime before it is authorized as a fund. This documentation is submitted after the initial registration stage is complete and a file reference number can be obtained for the Central Bank's Online Reporting System. The directors should be approved prior to the fund approval application being completed.

Converting to an ICAV

Where an existing corporate fund structure exists it is possible to convert this to an ICAV rather than requiring the formation of a new structure. This applies to both Irish and non-Irish entities.

The ICAV Act also permits existing VCCs to convert to ICAV status. The process is straightforward and somewhat similar to the existing process for redomiciliation of companies provided for by existing Irish company law (and as such it has been tried and tested). Shareholder approval and a declaration of solvency (necessitating an audit engagement, but

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not a full audit) will be required for such a conversion. It can be noted that a number of the first funds to be registered as ICAVs are effective redomiciliations of existing funds from the offshore domiciles to Ireland.

Going Forward

More than three quarters of Irish funds are currently structured as VCCs. It is now expected that the ICAV structure will replace the VCC as the default option for fund structuring going forward, due to suitability for funds and flexibility. It will be possible for existing VCCs to undertake a conversion into an ICAV and accordingly to take advantage of its benefits outlined above.

Some promoters may wish to wait before using the structure to ensure that no unforeseen issues arise with it and there is greater familiarity with the structure in the industry generally. Apart from new funds, it is expected that key factors for those considering converting an existing structure to an ICAV will be the target investor base, the nature of the assets to be held, investor preference and cost. Some considerations regarding these options are included below:

- Target Investors
  If the distribution strategy of the fund includes targeting US taxable investors, it is likely that the ICAV will be the appropriate vehicle (see below for further exploration of this point).

- Single Asset Funds
  ICAVs are not subject to a risk spreading requirement so it is possible to establish single asset funds (as well as using ICAVs as feeder funds).

- Sub-Fund Accounts
  The flexibility to prepare separate accounts at a sub-fund level will be particularly attractive to fund platforms and multi manager products who may have sub-funds as sleeves for different underlying managers.

- Investor Appetite
  Fund boards might form the view that converting to the simpler ICAV regime weakens the rights of shareholders who invested on the basis of company law protections or is otherwise not worth the short term expense.

- Cost
  While a conversion would entail incurring the costs of a conversion and related ancillary work (including obtaining shareholder consent), this may be balanced to an extent over time by reduced costs of compliance. For example there will not be a requirement to hold annual general meetings.

Structuring Considerations

As noted above, ICAVs have been designed to facilitate acting in master-feeder structures. A decision to feature an ICAV in such a structure will largely be driven by a decision to target US taxable investors.

Set out below are some of the structuring options on the basis of three key target investor scenarios:

- Combination of US taxable investors, US tax exempt investors and investors from the rest of the world;
- Combination of US taxable investors and investors from the rest of the world; or
- Combination of US tax exempt investors and investors from the rest of the world.

It can be noted that where a check the box election is not required (for example when targeting US tax exempt investors), the existing VCC structure would work just as well as the ICAV in terms of US tax equivalence (but as outlined above the ICAV does have various other advantages). Where US sales are contemplated, a US wrapper and US subscription documentation are highly recommended.

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(a) Combination of US taxable investors, US tax exempt investors and the investors from the rest of the world

This combination of target investor types would be best served by a structure involving either:

(i) a single ICAV with a qualified electing fund (QEF) election (as opposed to a check the box election).

or

(ii) a master feeder fund comprising:
- a transparent Delaware feeder fund into an ICAV master fund (which checks the box) for US taxable investors; and
- a different ICAV (which does not check the box) as a feeder fund into the ICAV master fund for US tax exempt and non-US investors.

Reduced establishment costs for the single ICAV with a QEF election may be offset by extra ongoing accounting costs linked to the QEF election. This option is also less attractive to US taxable investors.

(b) Combination of US taxable investors and investors from the rest of the world

This combination of target investor types would be best served by a structure involving either:

(i) a single ICAV (which checks the box) **provided** the fund administrator can prepare K-1 partnership accounts for US taxable investors and there is no US trade or business risk within the fund (such a risk is unlikely for UCITS strategies but may be a relevant consideration for QIAIFs)

or

(i) if these provisos cannot be met, a master-feeder structure with
- a transparent Delaware feeder fund into an ICAV master fund (which checks the box) for US taxable investors; and
- a different ICAV (that is, not part of the same umbrella and which would not check the box) as a feeder fund into the ICAV master fund for non US investors (this structure will also generally be attractive to US tax exempt investors).

(c) Combination of US tax exempt investors and investors from the rest of the world

This combination of target investor types would be best served by a structure involving a single ICAV (which would not check the box). This is unlikely to be an attractive structure for US taxable investors, however.

Summary

The ICAV is a new Irish corporate structure specifically designed to be used as an investment fund. It has a number of advantages when compared to existing vehicles and is expected to become the default choice for new investment funds domiciled in Ireland going forward. It is also anticipated that managers with existing offshore funds will take advantage of this structure to redomicile such funds into Ireland because it facilitates effectively addressing the needs of a key investor base – US taxable investors.

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NOTES

1 *See http://www.irishfunds.ie/statistics/.*

2 *http://www.ifiaevents.ie/distribution/.*

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