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ICAV - the New Irish Collective Asset-management Vehicle

Mark Browne
Dechert LLP

Ireland enacted legislation earlier this year which provides for a new type of corporate fund – the Irish Collective Asset-management Vehicle (ICAV). The ICAV is an innovative corporate structure specifically designed for use as an investment fund. It features a number of specific advantages when compared to previous corporate structures available for use as funds in Ireland, one of the primary jurisdictions for domiciling investment funds in Europe. This article outlines the salient features of the ICAV, highlights its differentiating characteristics and explores the instances where it is most likely to be of assistance to fund promoters in both the traditional and alternative spaces.

Background

Ireland is one of the key European fund domiciles; currently playing host to over 5,800 funds, including entities authorised both as Undertakings for Collective Investment in Transferable Securities (UCITS) and also as Alternative Investment Funds (AIFs) under the Alternative Investment Funds Managers Directive (AIFMD), including the most popular Irish authorised 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 centres for domiciling funds targeting European distribution over the past 25 years. However in addition, as such funds have become recognised 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[1].

Irish domiciled funds are deemed attractive because of the efficiency with which they can be established (including a 24 hour approval process for QIAIFs), legal certainty and flexibility, as well as the depth of dedicated service providers catering to these products. Ireland is one of the world's leading centres for fund servicing, with over €3.2 trillion in assets currently being administered in this jurisdiction[2], including almost 40% of Cayman hedge funds, giving it a specific competency in relation to alternative strategies.

A wide range of legal vehicles has existed for some time within which Irish domiciled funds may be structured, including the variable capital investment company (the VCC), unit trust, common contractual fund (CCF) and investment limited partnership. However, 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 that it a better fit for purpose and to reflect evolving industry requirements.

Previous examples of this have included development of the CCF through new primary legislation[3]. The introduction of the ICAV is the latest reflection of this pattern.

The Irish Collective Asset-management Vehicles Act 2015 (the ICAV Act) was signed into law in March 2015. Over 30 ICAVs have already been registered and authorised as funds by the Central Bank of Ireland (the Central Bank), with Dechert acting in relation to a number of such registrations for both UCITS and QIAIFs.

Overview of the ICAV

The most popular choice of legal structure for funds domiciled in Ireland to date has been the VCC, which is used by over 70% of all Irish funds. However, whilst the VCC structure has become established as the structure of choice for funds domiciled in Ireland, issues with this vehicle have been identified. In particular as the VCC has its origins in general company law, rather than legislation specifically tailored to meet the needs of the funds industry, there are a number of provisions applicable which may seem inappropriate in the funds context. The ICAV structure therefore offers a number of enhancements to the VCC as a form of corporate vehicle because it has been possible to omit such items and is likely to replace the VCC as the structure of choice for newly established funds.

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[1] http://www.ifiaevents.ie/distribution/
[2] See http://www.irishfunds.ie/statistics/
[3] Investment Funds, Companies and Miscellaneous Provisions Act 2005

Advantages

The new legislation providing for the ICAV has omitted all of the general company law provisions which were deemed inappropriate in the funds context. The use of bespoke legislation aimed at funds has also eliminated the potential for any changes to general company legislation having unintended consequences for funds. It also has the benefit of ensuring that one piece of discrete and relatively straightforward legislation completely addresses the structure.

Some specific changes were also provided for in the new legislation. 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 in the context of single asset funds, which are relatively common in the context of property funds, for example. This concern also applies to the use of such structures as feeders in master-feeder structures (although the Central Bank did clarify that it would not object to observance of this requirement, at the discretion of directors, by adopting a look through to the level of diversification carried on by the underlying master in satisfaction of such requirement).

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

Alterations of the Instrument of Incorporation of an ICAV will not require a shareholder vote provided the depositary certifies the changes are non-prejudicial or have not been specified by the Central Bank as requiring approval.

An umbrella ICAV will be able to determine to prepare separate accounts with respect to each sub-fund rather than being obliged to prepare a single combined set of accounts for the entire corporate umbrella. 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. The growth of platforms appointing third party managers has been a key trend in recent years.

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

The Central Bank of Ireland is the relevant authority for registration purposes of an ICAV, 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 ICAV rather than a 'certificate of incorporation' as would be the case for a company. The "Instrument of Incorporation" of an ICAV is similar in many respects to that of a UK OEIC. 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).

The ICAV: a corporate entity

While emphasising the advantages which an ICAV offers when compared to a VCC it is important to note that it is a form of corporate structure and accordingly does also have many similarities with existing corporate funds, such as the VCC. As such the ICAV does not represent a re-inventing of the wheel, merely an improvement on the existing structure, which should reassure investors, service providers and counterparties who will be pleased to see many of the features they are familiar with in a VCC still applying.

Some of the common features which are probably worth noting in this regard that both forms of structure share can be categorised under the headings of governance, potential regulatory authorisations, 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.

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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.

- Structure: 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: both may be established as UCITS or AIFs (including Qualifying Investor Alternative Investment Funds, QIAIFs); and
- Listing: both may, but are not required to, be listed on a stock exchange (including but not listed to the Irish Stock Exchange which is the World's leading stock exchange for listings of investment funds).

Transparency and partnership treatment

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. However, as noted above, the ICAV will be eligible to 'check the box' to be treated as a partnership for US tax purposes. US taxable investors will generally have a preference for investing through a partnership structure and accordingly the ICAV will be the vehicle of choice for managers seeking to target investors in this market.

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.

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 which enabled fund companies in specific offshore jurisdictions, such as the Cayman Islands or BVI, 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 Ireland are that this permits the company to preserve its track record and contractual arrangements.

However, the redomiciliation legislation did not succeed in attracting the large numbers of overseas companies anticipated for a redomiciliation and one of the key reasons for this was the fact that the redomiciled Irish company would be unable as a VCC to facilitate a 'check the box' election. The ICAV Act has remedied this and we are already seeing evidence of redomciliations occurring to take advantage of this as it can be noted that a number of the first funds to be registered as ICAVs were essentially redomiciliations of existing funds from the offshore jurisdictions to Ireland.

Master-feeder structures

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 acting as a corporate blocker (or a separate feeder refraining to do so and being used as the route for tax-exempt investors to access the structure). Utilising 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 by having one sub-fund elect to be treated as a partnership and a second not. Unfortunately, however, it is not yet clear that the US tax authorities will accept such a scenario and accordingly this is not currently recommended.

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

Establishing an ICAV

Where it is intended to establish a new ICAV this will entail a two stage process, both of which are carried out 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 10 business days from the date of receipt of a complete application for registration, duly signed by 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. And

(ii) Fund authorisation - this is a separate process conducted through the funds authorisation section of the Central Bank. As outlined above, an ICAV may be structured as a UCITS or an AIF (including QIAIFs of course) and the standard new fund authorisation 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. This occurs before fund authorisation, but after the initial registration stage is complete and a file reference number can be obtained for the Central Bank's Online Reporting System.

Converting to an ICAV

Existing corporate fund structures will typically be able to convert to an ICAV rather than requiring the formation of a new structure. This applies to both Irish and non-Irish (offshore) entities and is a straightforward process.

The ICAV Act also permits existing Irish VCCs to convert into ICAVs. This is a somewhat similar process to that relating to the redomicilation of offshore companies and as such it has been tried and tested over recent years. Such a conversion will require shareholder approval and a declaration of solvency (necessitating an audit engagement, but not a full audit).

Going forward

It is expected that the ICAV will be the standard choice for Irish corporate fund structures going forward, replacing the VCC, due to its suitability for funds and general flexibility. As it is possible for existing VCCs to undertake a conversion into an ICAV and accordingly to take advantage of its benefits outlined above, it is expected that, in time, many will do so.

However, promoters may wish to wait before converting an existing entity to this structure until there is greater familiarity with the structure in the industry generally and to ensure that no unforeseen issues arise with this. It is expected that key factors for those considering converting an existing structure to an ICAV will be the extent to which it can ensure added benefits in light of their 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, or the promoter wishes to extend it to include this category, 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.

- Accounts at sub-fund level: Fund platforms and multi manager products will find the flexibility to prepare separate accounts at the sub-fund level particularly attractive, as it will facilitate the use of sub-funds as sleeves for different underlying managers.

- Investor appetite: Converting to the simpler ICAV regime may be viewed as weakening the rights of shareholders (who would have invested into existing structures on the basis of company law protections). Investors may feel the benefits of conversion are not worth the short term expense.

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- Cost: 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

The flexible nature of ICAVs means that they are ideally suited to facilitate master-feeder structures. Some of the structuring options relating to three key target investor scenarios are set out below:

1. Investors are a combination of US taxable investors, US tax exempt investors and the rest of the world;

2. Investors are a combination of US taxable investors and the rest of the world;

3. Investors are a combination of US tax exempt investors and rest of the world.

Where US sales are contemplated, a US wrapper and US subscription documentation are highly recommended. 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).

(a) Combination of US taxable investors, US tax exempt investors and 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 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

(ii) 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 (i.e. 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 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, and therefore will most likely be used by managers which have a separate product range targeting the US market (such as a 40 Act fund), or those that wish to remain ex-US.

Summary

The ICAV is a new corporate structure specifically designed to be used as an investment fund domiciled in Ireland and may be authorised as a UCITS or as an AIF. It has a number of specific advantages when compared to the existing fund structures previously available and is expected to become the default choice for new investment funds domiciled in Ireland going forward. It is already proving popular, including with managers with existing offshore funds wishing to 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.

Mark Browne is a partner in Dechert specialising in the establishment and ongoing operation of investment funds. He has worked in the funds industry in the Cayman Islands, Ireland and Luxembourg for over ten years and has experience of acting both on behalf of fund platforms as well as for asset managers seeking to join them, either directly or as sub-delegates. His experience includes advising, and advising with respect to, a wide range of UCITS, European AIFs and Cayman funds.

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