

Dechert LLP response to the Department of Finance's Funds Sector 2030 Public Consultation

Authored by: Dechert LLP

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About Us

By way of background, Dechert is a global law firm with over 200 financial services lawyers across 17 offices, with an investment funds practice (including private fund formation) in all key European fund domiciles, including the UK, Ireland, Luxembourg, Germany, and France, as well as the U.S., the Middle East and Asia. We were the first international law firm to establish a presence in Ireland, over 12 years ago.

Introduction

We would like to thank the Department of Finance (the "**Department**") for reaching out to industry, via its Public Consultation Paper (the "**Consultation**"), to explore how Ireland might maintain and futureproof its position as a leading fund domicile in the EU.

We also welcome the remarks of the Department's representative at the recent Irish Funds webinar that the Funds Sector review will be ambitious, opportunity-focused, and open to proposals for legislative and regulatory changes.

Response to Questions 15 & 16 of the Consultation¹

While Ireland is, without question, a leading fund domicile for regulated investment funds (including, in particular, UCITS, UCITS-based exchanged traded funds (ETFs) and money market funds) as the Consultation notes, it has been less successful in establishing itself as a pre-eminent domicile for alternative investment funds ("**AIFs**") and, since the introduction of AIFMD², has lost ground with regard to these alternative asset classes to other jurisdictions, notably Luxembourg.

The purpose of our submission is to propose changes that we believe are needed to Ireland's existing funds offering in order for Ireland to become a domicile of choice for private funds in the future. This is particularly important given the expectation that public markets will offer reduced returns in the future and the increasing focus of institutional investors and pension funds (among others) on gaining exposure to private markets via private equity, private debt/credit (including loan origination), infrastructure, real estate, and venture capital funds ("**private funds**")³.

In our view, the best way to make Ireland attractive to private fund managers is for Ireland to offer managers a fund product that aligns with international standards and existing market practice for private funds. We would propose that this be a product which constitutes an AIF for AIFMD purposes (and which therefore has a regulated alternative investment fund manager ("**AIFM**") and Irish-based depositary) but which is not itself subject to additional product-level regulation.

We believe that such a product would assist in meeting the expectations of private fund managers with regard to product offering and support the continued growth of the investment funds sector in Ireland with the consequential positive impact on Ireland's real economy (including the addition of skilled jobs and tax revenues).

In responding to this Consultation, not only did we draw on our own experience in structuring and launching private

¹ Q15: "Are there any updates or changes needed to the current legislation governing the legal structures used to establish investment funds?"; Q16: "How do the Irish legal structures compare to the vehicles available in other jurisdictions?"

² Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 ("**AIFMD**").

³ By way of example, at its current growth rate the global private credit market is on track to reach \$3 trillion by 2030.

funds in Europe (including in Ireland, Luxembourg, Germany, France and the UK), the US, the Middle East and Asia, we also sought input from our contacts in managers, institutional investors, service providers and allocators across the funds industry (via a survey) when preparing our response to ensure that our response and proposals reflect current market views, trends and concerns.

A few notable takeaways from our survey were that:

- the most important factor for respondents when selecting a domicile for their private fund was a tie between: (1) the availability of flexible fund structures (including an AIF which is not itself subject to additional product-level regulation); and (2) tax (followed thereafter by (3) investor familiarity, (4) speed to market, (5) service provider expertise, and lastly (6) regulatory oversight);
- while Ireland rated highly as a private fund domicile for regulatory oversight, its lowest rating was in respect of the availability of flexible fund structures; and
- while Luxembourg appears to be the current domicile of choice for private funds in Europe, 86% of respondents stated that they would consider Ireland as the domicile for their next private fund if there were significant changes in the availability of flexible fund structures.

Background / Existing Structures

A key distinction between Ireland and the other jurisdictions with regard to AIFs, which has impeded the development of the private funds industry in Ireland, is Ireland's approach to fund or product-level regulation.

Although the AIFM of an Irish AIF will in any case always be subject to AIFMD (including in respect of each fund it manages), the framework in Ireland essentially requires that **both** the fund and the AIFM must be regulated. Of the six potential AIF structures which can be established in Ireland⁴, five of these can only be used if the fund itself is regulated by the Central Bank of Ireland (the "CBI"). The only product which is currently capable of being an AIF for the purposes of AIFMD and not regulated by the CBI is a limited partnership formed pursuant to the Limited Partnerships Act, 1907 (a "1907 LP"), which is registered with the Companies Registration Office (the "CRO") as opposed to the CBI.

While the 1907 LP is not itself a regulated fund structure, it is effectively indirectly regulated because if it wishes to be categorised as an AIF and to avail of the pan-European marketing passport pursuant to AIFMD, it must have an EU AIFM who must either be authorised by or registered with the CBI and subject to the rigorous manager-level obligations of AIFMD (and its associated regulations). In such circumstances, the 1907 LP must also appoint an Irish-based depositary, which will be authorised by the European Central Bank as a credit institution and regulated (in its capacity as a depositary) by the CBI, and AIFMD Annex IV reporting must be submitted by the AIFM to the CBI on behalf of the 1907 LP on a quarterly basis.

To date, from an investment funds perspective, the 1907 LP has predominantly been used in the venture capital and private equity industries. However, as the 1907 Act was not drafted specifically for the funds industry⁵, there are a number of difficulties with using the structure for private funds (including the lack of a VAT exemption in respect of fees relating to management services (which is currently only available to funds regulated by the CBI), limits on the number of investors in the 1907 LP and effectively requiring 1907 LPs to be funded via debt / loans)

⁴ The six potential AIF structures are: (i) Irish collective asset-management vehicles (ICAVs); (ii) Investment Companies (under Part 24 of the Companies Act 2014); (iii) Unit Trusts (under the Unit Trusts Act 1990); (iv) Common Contractual Funds (CCFs) (under the Investment Funds, Companies and Miscellaneous Provisions Act 2005); (v) Investment Limited Partnerships (ILPs); and (vi) 1907 LPs.

⁵ 1907 LPs are also used for development finance, syndicated ownership structures (such as in the horseracing industry), estate planning, and the holding of family businesses.

meaning that it has not attracted widespread use as an AIFMD-compliant product.⁶

The other two existing fund structures which are most commonly used for private funds in Ireland⁷ are the Irish collective asset-management vehicle (“**ICAV**”) and the Investment Limited Partnership (the “**ILP**”), each of which were introduced by fund-specific legislation (being the Irish Collective Asset-management Vehicles Act 2015 (the “**ICAV Act**”) and the Investment Limited Partnership Act 1994 (as amended, the “**ILP Act**”), respectively). Under existing legislation however, the ICAV and the ILP must be regulated by the CBI and subject to the CBI’s additional fund or product-level regulation. While this additional product-level regulation has not impacted the popularity of the ICAV structure in the more traditional / liquid fund space (where it has been hugely successful), it has led to a much slower than hoped for uptake of these structures for private funds.

These additional CBI rules often impose additional requirements beyond those required by AIFMD which do not reflect the developed market practice in the private funds industry and limit the flexibility required by a private fund. Some examples include: (1) the broad application of the prohibition on granting loans (unless authorised by the CBI as a loan originating Qualifying Investor AIF) or acting as a guarantor on behalf of third parties, which is not consistent with how typical private equity strategies operate and the typical fund financing arrangements (such as bridge financing) put in place by private funds; and (2) the rules and requirements in the CBI’s AIF Rulebook in relation to investment through subsidiary companies which are burdensome and go beyond what AIFMD requires (which itself provides adequate protection).

To be competitive with other European jurisdictions in the private funds space (including Luxembourg (in particular) and the UK), Ireland needs to offer fund structures which are designed specifically for funds (such as the ICAV and the ILP) and are AIFs, but which are not subject to additional product-level regulation.

As the Consultation itself notes in respect of 1907 LPs, while the AIFM of a 1907 LP that is categorised as an AIF must either be authorised by or registered with the CBI, this does not bring the 1907 LP, as a vehicle, within the regulatory purview of the CBI. We see no reason that this approach could not be adopted for other fund structures. In particular, following its update in late 2020, the ILP Act now presents managers with a partnership structure that reflects market practice and expectations for private funds structured as partnerships, and we would expect an exponential increase in the use of the ILP for private funds if the CBI’s additional product-level regulation did not apply to the structure.⁸

Proposals

We would propose that Ireland introduce a version of the ICAV and the ILP that is an AIF, but which is not itself subject to additional product-level regulation, *i.e.*, the introduction of an indirectly regulated AIF product, through the regulation of the AIFM by the CBI, which has proved very popular with both managers and investors as a structure for private funds in other European jurisdictions.

Such an indirectly regulated AIF would only be sold to professional investors (as defined in AIFMD) and would be fully compliant (through the obligations of its AIFM) with AIFMD. In our view, AIFMD itself provides sufficient investor protection for and transparency to professional investors, particularly as the AIFM and the depositary of the AIF will themselves be regulated and have ongoing reporting obligations under AIFMD to their national competent authority.

Consideration could be given to amending the ILP Act and the ICAV Act to include sections permitting the establishment of these indirectly regulated AIFs where they are subject to management by an AIFM, and allow the AIFM to elect whether the ILP / ICAV it is establishing will be directly regulated by the CBI (*i.e.*, in the same way

⁶ Other fund structures not regulated by the CBI include: (1) exempt unit trust structures that are sold only to pension funds/charities; and (2) the fixed capital company (*i.e.*, a private company or designated activity company, limited by shares), each of which have a number of significant limitations as an investment vehicle for private funds.

⁷ Note that there are just 39 Unit Trusts and 18 CCFs authorised in Ireland (both UCITS and AIFs). Note also that since the introduction of the ICAV Act, Investment Companies are almost never used for new structures.

⁸ As of 16 August 2023, the total number of ILPs was 42.

that ILPs and ICAVs are currently regulated) or only be indirectly regulated via AIFMD and not subject to additional CBI product-level regulation. The fund offering document would be required to make it clear to investors whether the AIF is directly regulated or unregulated by the CBI. In order not to create a nexus or presumption of regulation, these sections would also need to provide (as is the case with 1907 LPs) that the CRO (as opposed to the CBI) would be the entity with whom the indirectly regulated AIFs are registered and ensure that the tax exemptions that apply to funds regulated by the CBI are also extended to these AIFs.

Alternatively, a new section could be added to the Investment Funds, Companies and Miscellaneous Provisions Act 2005 to provide for the establishment of ILP and ICAV structures which are not regulated by the CBI (but are AIFs) and incorporating the provisions of the ILP Act and the ICAV Act with appropriate amendments (to provide that such structures will not be regulated by the CBI).

We would also support Irish Funds' proposals in their response to question 15 of the Consultation in relation to the establishment of a separate unregulated product regime that can be applied in respect of all existing regulated products and the proposed new limited partnership regime modelled on the 1907 LP (amended as suggested).

Stakeholder Engagement

We would welcome the opportunity to discuss our views and proposals with the Consultation team when it begins its stakeholder engagement. If it would be of assistance, our colleagues across our global offices (including in Luxembourg and the UK) are also at the Department's disposal to answer any questions the Consultation team may have in relation to the private funds' regimes in those jurisdictions.

This submission was authored by:



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