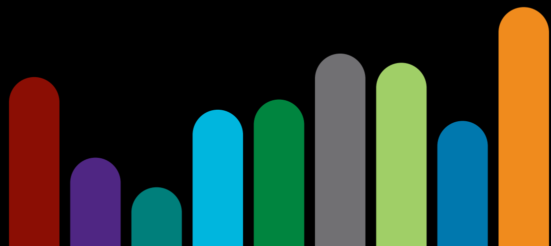

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Ireland Fund Services 2018

Updated structure attracts new wave of PE managers

Ireland prepares to fortify fund governance regime

New flexible Loan Origination QIAIF scheme

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Updated Irish structure set to attract new wave of PE managers

By James Williams

Ireland's investment funds industry shows no sign of slowing with total AUM reaching EUR2.4 trillion by end of 2017. That's a 16 per cent growth year-on-year and represents a new high watermark for the jurisdiction, as alternative fund managers continue to set up UCITS and QIAIFs.

That growth was underpinned by an exceptional year of net sales into Irish funds.

"There was EUR298 billion of net sales in 2017, more than twice the 2016 number. Some EUR242 billion net sales went into UCITS and EUR56 billion into AIFs. The overall aggregate AUM of QIAIFs is now EUR476 billion, which represents a 14 per cent annual increase," says Kieran Fox, Director of Business Development at Irish Funds, which promotes the attractiveness of the jurisdiction to global fund managers.

According to the Central Bank of Ireland, in terms of breakdown every sub-category of AIF attracted net sales last year and as Fox remarks, the QIAIF is very much the "flagship fund type for alternative strategies".

Fox confirms that the large majority of new fund launches are ICAVs.

"Pre-existing funds, which were launched as corporate structures, will often wait until a convenient time i.e. when planned changes are being made to the fund that require shareholders' approval. At that time, they may look to convert the structure to an ICAV.

"We always expected interest in the ICAV to be strong. There was a lot of demand for that type of structure. The ICAV came on stream in March 2015 and since that time assets have grown to EUR97 billion, of which EUR32.3 billion are in UCITS and EUR64.7 billion are in non-UCITS. In fact, ICAVs have had positive net flows every month since inception," says Fox.

What is particularly encouraging for Ireland is that the number of PE/RE funds being set up is rising. This is no longer a jurisdiction that hedge fund managers turn to for a European regulated fund solution.

It helps that the Investment Limited Partnership is being enhanced through amendments to the Investment Limited Partnership Act, 1994. This will be referenced in more detail later in the report, but in effect this 2.0 version of the ILP should, once the amendments have been approved by the Irish Government, make Ireland even more competitive, from a PE/RE perspective.

"I think that is going to make a big difference to the attractiveness of Ireland as a jurisdiction," comments Donnacha O'Connor, Partner at law firm Dillon Eustace.

"In the interim, there are some partnership structures being set up but in the main managers are choosing to use the ICAV. Alternative funds in a non-UCITS format are being established at a greater rate than UCITS and there is particular growth in the PE/RE area. We think that there is a lot of opportunity and that there will be a lot of growth in those areas over the next couple of years."

"I haven't established a single Irish Plc structure since the ICAV came out," confirms Gayle Bowen, Partner, Pinsent Masons (Ireland). "The ICAV is the structure that everybody now tends to use. It has a legal personality, everybody understands it and it's more flexible.

"If you are selling it into the US, it checks the box for US investors. Where someone will deviate from the ICAV is if an investor has a very specific tax requirement; then

"The ICAV came on stream in March 2015 and since that time assets have grown to EUR97 billion, of which EUR32.3 billion are in UCITS and EUR64.7 billion are in non-UCITS."

Kieran Fox, Irish Funds

they might set up a common contractual fund (CCF) or a unit trust. But otherwise it's the ICAV."

In many respects the Irish Plc, which would have been the only corporate legal structure prior to the ICAV, has died a death. The ICAV is a corporate fund, it has limited liability and it doesn't come with the added corporate law complications that a Plc has.

"The ICAV is definitely the default legal structure for regulated funds in Ireland at the moment. Over 450 have been established since the ICAV legislation was enacted in March 2015," remarks O'Connor.

O'Connor confirms that he is seeing more European real estate focussed funds being set up in Ireland than funds focussed on the Irish property market, referencing a number of ICAVs that Dillon Eustace recently established that invested in commercial properties in Italy, UK brownfield sites, healthcare facilities and in "alternative" residential sub-sectors such as student accommodation and social housing.

"The ICAV can access some double tax treaties or can get the benefit of some domestic tax exemptions where the properties are located which can reduce tax leakage," he says.

REITs are enjoying some good success in Ireland, with new announcements such as Core Industrial REIT plc, backed by York Capital, one of the first such REITs in Ireland aimed at capitalising on investment opportunities in the Irish industrial property sector.

Existing REITs, such as Green REIT, announced a 9 per cent increase in NAV for its full year results in June 2017.

Pat Gunne, chief executive of Green REIT, said asset values were up to EUR1.4 billion, which was a good achievement given that

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Inside the mind of a fund administrator

Interview with Barry O'Brien

Interest in Ireland among private debt and private equity fund managers remains strong, especially with the highly anticipated amended Irish Investment Limited Partnership (ILP), scheduled to be formally approved later this year.

This is good news for Ireland's asset servicers. U.S. Bancorp Fund Services, has continued to grow its market share in not only the familiar long/short equity, credit and managed futures segments but also private equity and private debt funds and reinsurance funds.

"Over the last 18 months our assets under administration have grown from USD117 billion to USD187 billion. A considerable portion of that growth has been in these strategies," comments Barry O'Brien, Head of Fund Client Relations at Quintillion, the Europe-based affiliate of U.S. Bancorp Fund Services.

Barry O'Brien, Head of Fund Client Relations at Quintillion

To support such strategies requires leading-edge technology, not to mention automation. This has been a cornerstone of Quintillion's operations "and continues to be so", says O'Brien. "We utilise Advent Geneva globally as our core accounting platform and Geneva World Investor as our private equity accounting platform, in conjunction with HWM ManTra on the investor services side."

Technology, is only as good as the people supporting it. In that respect, Quintillion's motto, *'smart technology with the power of experience'*, is as true today as it has been since its inception. Quintillion has always maintained an enviable service reputation combined with a robust and heavily automated IT infrastructure, "with unmatched staff tenure and staff experience", opines O'Brien.

O'Brien confirms that fund managers are looking for the most effective, automated back and middle-office capabilities. To that end, Quintillion has always had in place well established automation and STP, integrating several licensed and in-house designed applications for this purpose.

"These applications provide firm oversight and operational control as well as workflow exception management. Companies tend to forget we are in the service industry and that people are at the core. Strong talent should be combined with an automated and controlled product delivery. Superior service and a personal touch are key differentiators," states O'Brien.

A noteworthy development in Ireland for Quintillion is its Bank Depositary solution, which will trade as U.S. Bank Depositary Services. The firm has had a depositary lite solution in place to support non-EU funds being marketed into Europe since 2014 and currently has some USD14 billion under depositary lite custody. The wider group has over USD11 billion in AUA for PE funds.

"This will be a fully authorised Irish depositary solution and it is due to launch mid-2018. It will put us on par with our peers in terms of breadth of services offered and will be further progression of an institutional footing for Quintillion as part of U.S. Bank.

"Regulated EU fund products require a full depositary solution taking care of cash monitoring, oversight and safekeeping obligations. Moving forward, hedge fund administrators, backed by custodian banks, will become leading edge in terms of the range of services they are able to offer clients. We have one of the strongest balance sheets of any of our peers in the US," explains O'Brien.

Quintillion has also enhanced its regulatory reporting services and added collateral administration services as well as enhanced OTC reconciliation in direct response to changing client demands, confirms O'Brien.

With a continued commitment to broadening its service offering, Quintillion is a good illustration of what today's administrators are expected to do. ■

4 ▶ the REIT has only been in operation for four years. "That's up 11 per cent year on year. One of the key components is rental income and dividend flows," Gunne was quoted as saying by RTE.

REITs are Irish Limited Companies that are publicly listed. As such, they aren't regulated. While they generally fall within the definition of an alternative investment fund, they do need to have an appointed AIFM.

Michele Foley is Head of Alternative Investment Services (Ireland), Northern Trust. She says that Ireland has been a particular focus for real estate launches from both new and existing clients. "We have noted a recent increase in the use of Real Estate Investment Trusts (REITs) with some funds re-designating their status to this tax-efficient vehicle. REIT structures offer investors a gross dividend (without deduction of tax) so long as the fund continues to comply with certain conditions.

"Structures aside, there is also a general trend to invest in strategies with an environmental and/or a social governance theme, such as alternative energy developments like wind farms or solar energy. This may be held as a direct investment, or in the case of solar energy, held as part of a physical building as an alternative investment stream," says Foley.

As the global surge in real estate investing continues to build, Northern Trust is busy driving new products and capabilities to support a diverse mix of real estate asset manager clients. The bank has been supporting RE fund launches from managers across the globe, seeking a European hub for their European real estate structures.

"We view ourselves as a strategic operations partner to our clients; providing the operational expertise and infrastructure to enable our clients to focus their time and resources on their strategy and investors," says Foley.

The continued global focus on alternative asset investment has propelled inflows from both existing and new clients, helping Northern Trust achieve a 50 per cent increase in global real estate assets under administration over the past 12 months.

On the private equity front, Ireland has been a focus for technology investing over the last 12 months, with PE managers

"Structures aside, there is also a general trend to invest in strategies with an environmental and/or a social governance theme, such as alternative energy developments like wind farms or solar energy."

Michele Foley, Northern Trust

choosing to use Ireland as a tech hub for their investment strategies.

"There are a lot of international PE managers active here and there are some fast growing domestic PE firms. They are investing in a variety of sectors but particularly in tech companies. We see them funding a lot of M&A activity here. They are also using Irish funds to house their PE and loan origination strategies," adds O'Connor.

Since mid-July 2014, EU-based PE fund managers have fallen within the scope of the European Alternative Investment Fund Managers Directive ("AIFMD"). This has made it a bit more difficult for fundraising in Europe for non-EU structures, though it is possible to use depositary lite solutions to address the brass plating requirements of Germany and Denmark; notably even where there is a non-EU Manager and non-EU PE Fund.

"As a result, many private equity houses are increasingly looking to Qualifying Investor AIFs (QIAIFs), as a potential solution to capital-raising issues within the European Union. Once you have a QIAIF you don't need to go down the route of meeting the requirements of individual countries like Germany and Denmark; it's a readymade solution," explains Barry O'Brien, Head of Fund Client Relations, Quintillion.

The Central Bank has made some positive changes recently to facilitate the establishment of PE funds within the context of the Irish funds regime. PE funds in Ireland are able to:

- have different asset allocations between share classes;
- have multiple and longer initial closings;

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New loan origination QIAIF regime – finally a viable option?

By Gayle Bowen & Aongus McCarthy

Under new rules implemented by the Central Bank of Ireland ("Central Bank") last month, Irish Loan Originating Qualifying Investor AIFS ("L-QIAIFs") are now permitted to adopt broader credit focussed strategies. Previously L-QIAIFs were prohibited from engaging in any activities other than lending and ancillary related operations. This restriction was generally viewed by industry as the main obstacle to their growth in the Irish market.

These new changes are widely anticipated to create new interest in the L-QIAIF product among asset managers.

Gayle Bowen, head of Pinsent Masons' Asset Management and Investment Funds practice in Ireland

What is loan origination?

The funding gap which followed the global financial crisis, highlighted the need to create alternative sources of finance outside of the banking sector. L-QIAIFs can provide borrowers with alternative and viable credit lines, whilst offering an attractive risk versus return profile, when compared against other more traditional asset classes. However, due to the fact that loan origination is treated as 'shadow banking' by the Central Bank, L-QIAIF are subject to more onerous requirements when engaging in direct loan originating activities, which we set out in more detail below.

L-QIAIFs are funds that source loan assets for their investment portfolio by directly originating loans, acting as the primary sole or primary lender rather than confining themselves to investing via loan assignments or participations.

The Central Bank has confirmed that funds that acquire credit or debt instruments, without directly originating loans (e.g. through loan participations and loan assignments) are not subject to the L-QIAIF regime.

The background to the L-QIAIF regime in Ireland

In October 2014, Ireland became the first EU Member State to establish a specific domestic regulatory framework for loan originating investment funds. However, the initial regime applied quite stringent rules, in particular, L-QIAIFs were prohibited from engaging in activities other than originating and participating in loans, which was widely regarded as an overly-restrictive approach by the Central Bank.

Further enhancements were introduced in January 2017 to permit L-QIAIFs to also hold investments connected to the loan origination strategy, including investing in debt and equity securities of entities or groups to which the L-QIAIF originated loans, which was helpful but did not address the issue of having a broader multi-credit focus.

As a result of these restrictions, L-QIAIFs that wished to invest in other assets, such as debt or equity securities (other than those of the borrower the L-QIAIF had lent to), typically needed to establish as an umbrella fund and create a separate sub-fund for non-loan strategies. As a consequence, the take up of the L-QIAIFs regime in Ireland to date has been lower than initially anticipated.

Under the new regime, the Central Bank now permits L-QIAIFs, as part of their core investment strategy to hold a broad range of debt or credit instruments and to mix assets within the same fund.

- **AIFMD compliant AIFM** – L-QIAIFs must designate a fully authorised AIFM, which can be external or the L-QIAIF itself, ie, internally managed (sub-delegation of investment management is permitted).
- **Liquidity and Distributions** – L-QIAIFs must be closed-ended and established for a finite period, however distributions and redemptions may be permitted in certain circumstances.
- **Prohibited Loans** – L-QIAIFs may not originate loans to any of the following: (a) natural persons; (b) the AIFM, management company, general partner, depositary, or to delegates or group companies of these; (c) other collective investment undertakings; (d) financial institutions or related companies of these, except in the case where there is a bone fide treasury management purpose which is ancillary to the primary objective of the L-QIAIF; or (e) persons intending to invest in equities or other traded investments or commodities.
- **Diversification** – L-QIAIFs must apply a risk diversification strategy to achieve a diversified portfolio of loans and limit exposure to any one issuer or group to 25% of net assets within a specified period of time.
- **Leverage** – L-QIAIFs must not have gross assets of more than 200% of net asset value.
- **Stress Testing** – L-QIAIFs must have a comprehensive stress testing programme in place, which identifies possible future economic changes that could have an unfavourable effect on the L-QIAIF's credit exposure and which assesses the ability of the fund to withstand such events.
- **Credit Assessment, Granting and Monitoring Processes** – L-QIAIFs must establish and implement appropriate, documented and regularly updated procedures, policies and processes in the following key areas: a risk appetite statement; assessment, pricing and granting of credit; credit monitoring, renewal and refinancing; collateral management; concentration risk management; valuation, including collateral valuation and impairment; credit monitoring; identification of problem debt management; forbearance, delegation of authority; and documentation and security.
- **Disclosure Obligations** – L-QIAIFs must adhere to additional disclosure obligations in the prospectus, financial statements and /or sales marketing materials, in relation to credit assessment and monitoring processes, supplementary risk warnings and information on the L-QIAIF's risk and reward profile and anticipated concentration levels.

L-QIAIF regime: applicable requirements

In addition to the general rules applicable to QIAIFs and AIFMs pursuant to Alternative Investment Fund Managers Directive ("AIFMD"), Irish law and the Central Bank requirements, L-QIAIFs must also comply with additional Irish requirements.

Under the new rules, L-QIAIFs must limit their operations to the business of:

- issuing loans;
- participating in loans;
- investment in debt/credit instruments;
- participations in lending; and
- to operations relating thereto, including investing in equity securities of entities or groups to which the L-QIAIF lends or instruments which are held for treasury, cash management or hedging purposes.

Benefits of the L-QIAIF regime in Ireland

The following are some of the key benefits of the new L-QIAIF regime in Ireland:

Fast-track Regulatory Authorisation	L-QIAIFs can avail of **a fast track twenty four (24) hour** authorisation process
Transparent Regulatory Framework	L-QIAIFs are fully regulated by the Central Bank in accordance with AIFMD
EEA Marketing Passport	L-QIAIFs can avail of the AIFMD pan-European passport and be sold under a quick notification process across the EEA to professional investors
Choice of Multiple Legal Structures	L-QIAIFs may be established using a variety of legal structures, including an Irish Collective Asset-management Vehicle (ICAV), a public limited company (PLC), a unit trust, a common contractual fund (CCF) or an Irish Limited Partnership (ILP). L-QIAIFs may be established with segregated liability between sub-funds

Proposed changes to Irish ILP legislation will further enhance the L-QIAIF regime

The Investment Limited Partnership (Amendment) Bill (the "ILP Bill") proposes to modernise and update the partnership law in Ireland to create a more flexible vehicle that can be used by L-QIAIFs.

The proposed new ILP structure offers many enhanced features over the existing partnership

structures, which includes permitting the creation of umbrella partnership structures with segregated liability, which is currently not permitted within Irish partnership structures.

The purpose of the ILP Bill is to ensure that there are viable limited partnership structures in Ireland for asset managers to consider when structuring their fund products; in particular, for L-QIAIFs, private equity and venture capital funds, as well as infrastructure funds. To date, many asset managers have domiciled such products within their fund ranges in other European jurisdictions given the absence of an appropriate Irish structure.

It is envisaged that the proposed changes will become law in Ireland during the course of 2018.

What might the future hold for the L-QIAIF?

Notwithstanding the fact that Ireland was the first European member state to establish a domestic framework for loan originating funds, due to the initially conservative approach adopted by the Central Bank, there has to date been a low uptake in this product in Ireland.

However, the new rules combined with the strong legal and regulatory environment in Ireland, the settled and transparent requirements applicable to L-QIAIFs and the fast track authorisation process have already attracted increasing interest in L-QIAIFs among asset managers. In addition, the availability of the AIFMD marketing passport and proposed changes to the ILP structure further enhances the attractiveness of L-QIAIFs to managers looking to raise capital in Europe, particularly with Brexit on the horizon.

While the recent changes are a welcome development, Pinsent Masons and Irish Funds will continue to engage with the Central Bank to make even more enhancements to the L-QIAIF regime, including more flexible leverage and liquidity provisions, however, the new changes most significantly have removed what was generally viewed as the largest obstacle to the growth of L-QIAIFs in Ireland. ■

Gayle Bowen is the head of Pinsent Masons Asset Management and Investment Funds practice in Ireland. Gayle has extensive experience advising asset managers on licensing options, the establishment of Irish regulated UCITS & AIFMD compliant alternative products and in relation to the global distribution and marketing of Irish funds. Gayle also has particular expertise in relation to cross border mergers. Gayle is a member of the Irish Funds Brexit Steering Group and is the outgoing Chair of the Irish Funds Legal & Regulatory Committee, which liaises with the Central Bank, the Irish Government and European bodies to represent the interests of the Irish funds industry. Gayle has received ratings as a leading lawyer from Chambers, Legal 500 and IFLR.

Aongus McCarthy is an associate in Pinsent Masons' Asset Management and Investment Funds practice in Ireland. Aongus advises primarily in the area of investment funds and has advised on a wide range of legal and regulatory matters. Aongus has particular experience in the structuring, establishment and operation of all types of investment funds including UCITS and alternative investment funds as well as the establishment and operation of UCITS management companies and alternative investment fund managers (AIFM).

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- provide for carried interest and waterfall mechanisms (which wasn't in place before);
- have unlimited amounts of borrowing or leverage;
- have either open-ended or closed ended structures;
- provide for partly paid shares, capital commitments and drawdown provisions;
- invest through wholly owned subsidiaries;
- provide for flexible valuation provisions which permit the Irish Venture Capital Association.

"These changes, together with the introduction of the ICAV structure, have sparked a lot of interest among PE houses looking for solutions to increasing their capital base and distribution network in Europe. This is evidenced by the number of QIAIFs established by PE and RE houseswhich include some rather well-known firms such as LGT, KKR, Old Mutual, Kennedy Wilson and Blackstone," outlines O'Brien.

Investment Limited Partnership 2.0

Current amendments to the Irish Investment Limited Partnership – Investment Limited Partnership (Amendment) Bill, 2017 (the "ILP Bill") – are a key legislative development for Ireland. They are a necessary update in the eyes of many Irish fund practitioners, given that the original Limited Partnership Act in Ireland dates back to 1907.

On 18th July 2017, the Minister for Finance announced that the Government had approved the legal drafting of the amendment to the ILP legislation and the Heads of Bill (Heads) was published in early March 2018.

"The goal of the ILP Bill will be to update and modernise the current investment limited partnership legislation, further enhancing Ireland's suite of legal structures available for fund formation, and in particular Ireland's offering for global private equity, venture capital, infrastructure, loan origination and other asset-focused investment funds," explains O'Brien.

The original Irish ILP was designed to be attractive to US managers at the time. The idea was that by being tax transparent, it would be favoured by US taxable investors to whom managers were selling their offshore funds.

"The ICAV is definitely the default legal structure for regulated funds in Ireland at the moment. Over 450 have been established since the ICAV legislation was enacted in March 2015."

Donnacha O'Connor, Dillon Eustace

"In reality, in the mid-1990s, a regulated Irish limited partnership structure was probably a bit too niche. At the time, as a domicile, Ireland was best known for UCITS and hedge funds. Ireland also had other fund legal structures that were achieving more or less the same results under US tax rules and that were also being used by UCITS and hedge funds. So, the ILP wasn't featuring that much.

"The ILP legislation didn't get updated for some years as a result and now it is being generally refreshed," remarks O'Connor.

There's no doubt that when the National Private Placement Rules are phased out in Europe, which should have been this year but will need to be extended because of Brexit, private equity managers with non-EU based funds who wish to access European capital will find the amended Irish Investment Limited Partnership a useful legal structure to consider.

One only has to look at the success of Luxembourg, whose Special Limited Partnership was introduced only a few years ago. If Ireland can compete on a more equal footing by having the new ILP structure in place, we expect that PE/RE managers could favour the English speaking jurisdiction and the speed to market of the Irish regulated product.

"At the moment, while not an ideal route, PE and RE Managers can still access capital in Germany, the UK, the Nordics and the Netherlands via the national private placement regimes. We therefore need the amended Irish ILP in place before those NPPR channels are shut down. That's when I expect to see a lot of traction in these sectors," suggests Bowen.

Alongside the growth in PE/RE funds, Ireland is also enjoying strong interest

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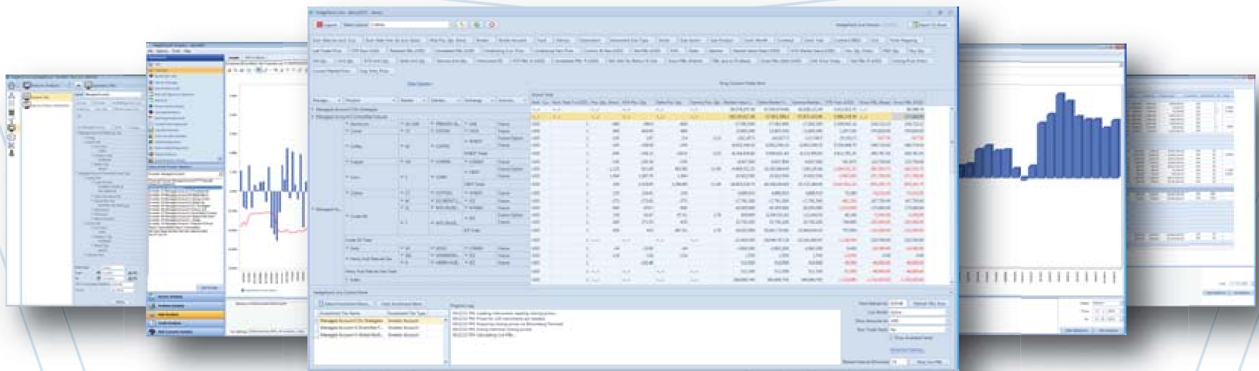

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Reducing the middle- and back-office burden

Interview with John Hynes

Although most institutional investors are comfortable with the idea of fund managers outsourcing middle- and back-office functions while they focus on managing the investment strategy, they are taking great care and attention at the pre-allocation stage, as part of the ODD process.

Whilst they understand that there are numerous cost benefits and efficiencies to be gained using hosted platforms, they want complete confidence in who the platform provider is.

John Hynes is CEO of HedgeFacts, a leading provider of middle- and back-office solutions to alternative fund managers. He notes that the cloud has become a significant game changer for managers as they seek to use hosted platforms to support their business activities, with disaster recovery of particular import; indeed, investors want to see real evidence of how managers put their DR plans into practice.

"There are a host of reasons that might prevent a manager getting to the office and if they are tied to being in a physical location to do business, that's a limiting factor. Sometimes it could be as simple as a change in the weather; take parts of the East Coast that suffered intense winter storms recently. People don't – and perhaps can't – travel to work in those conditions.

"In that case, people need the flexibility to work from wherever necessary to manage the portfolio. However, the challenge to that is you still need the appropriate level of controls in place to monitor and manage how people are accessing systems in the network. A lot of time and effort goes in to monitoring those key requirements for our clients," explains Hynes.

HedgeFacts can be set up with a hierarchy of controls whereby an individual

John Hynes, CEO at HedgeFacts

user will have pre-set levels of authority to access different parts of the system on a 'need to know' basis. A risk officer, for example, will only have access to risk-related information and reports. They won't have any access to the core accounting system, where they could potentially book trades.

"Using an audit trail we can monitor what access any user has made over a period of time," says Hynes. "We can also set up the system so that people can only log in from specific locations or devices.

"We monitor the traffic that comes in to look for anything that deviates from those approved locations or devices."

Having a platform like HedgeFacts monitor access controls in a night watchman capacity, can go a long way to reassure both managers and their end investors.

Hynes confirms he is seeing a significant increase in fund managers wanting to ensure that all of the internal reports and analyses they use for managing the book are produced on a systematic and automatic basis.

"We've worked over the past 12 months to automate the production of all of that information and reporting analysis.

"We aren't an outsourced compliance officer but one of the things we do for Irish-based managers is to produce the information they require to submit for regulatory purposes. We can reduce the workload that goes into becoming regulatory compliant," explains Hynes.

To illustrate the point, Hynes refers to one particular client who was able to reduce their middle- and back-office team by 60 per cent.

"That's where you see the benefit of utilising an intelligent system that works in tandem with skilled staff," Hynes concludes. ■

12 ▶ among managers – especially US-based managers – wishing to set up AIFMD-compliant loan origination funds; or L-QIAIFs. These are very flexible and very quick to set up, thanks to a 24-hour fast track authorisation process.

As the L-QIAIF is fully regulated by the CBI, a fund manager can benefit from the AIFMD passport to market their fund across the EU to professional investors.

"If you are a US manager, you can try going through a Cayman fund structure but you won't be able to sell that freely across Europe, and you won't be able to sell it to pension funds and insurance companies because they usually require a regulated version of any such product," explains Bowen.

"When it was first introduced, managers could only engage in loan origination activities. That meant that they couldn't also invest in equities or other debt instruments with a view to participating in the potential upside. The only way around this was to set a second sub-fund. The problem with this is that they ended up with quite a costly product, as costs, particularly annual minimums are applied on a sub-fund basis.

"Now, managers can hold loan participation debt and other credit strategies not only as collateral but also to avail of the potential upside. These changes will, in my view, greatly increase the uptake in L-QIAIFs by managers."

Brexit and the rise of the Irish ManCo

UK managers must now come up with contingency plans to ensure they can continue to operate their funds and passport them into Europe under the auspices of AIFMD. Come 2019, UK managers will become de facto third country managers, even if they are operating as an FCA-authorised UK AIFM.

"The top-tier institutional managers picked up on the distribution issue straight away following the referendum," says Patrick Robinson, Director, Bridge Consulting, which offers a range of regulatory compliance and governance services and operates its own Irish ManCo, Bridge Fund Management Limited ('BFML').

"A number of firms were receiving a lot of questions from their institutional investors on what these plans might be. As a result, one

or two took the decision quickly to set up a 'contingency' ManCo in an EU jurisdiction like Ireland with a view to wait and see how Brexit works out and whether they would need to use the ManCo or shut it down. By the end of Q1 2017, the next tier of asset managers started considering their plans.

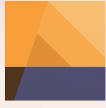
"Some are looking to set up their own license in the EU and extend their regulatory footprint, particularly where they have greater numbers in their own sales team and selling funds to wider range of investors in a larger number of jurisdictions. Managers who are selling into a lower number of EU jurisdictions to a lower number of institutional investors, will look to see whether they can leverage a third party ManCo license and whether that is a feasible model for them.

"We haven't yet seen many managers actually pull the trigger. With a UK exit date of March 2019 and no guaranteed transition process in place, we may see a greater number of applications going in to the CBI towards the end of the summer."

In terms of the delegation of portfolio management, Robinson points out that ESMA appears to have softened its stance and he doesn't expect any real issues with the continuation of discretionary portfolio management on a delegated basis.

As he points out, this is already happening in Ireland with respect to managers in the US and Asia. "UK managers are, however, currently having to consider: How does my distribution work and is it

▶ 19



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Changing times in Irish funds

By Mark Crossan

Irish Funds are on the move again. Every couple of years there is a new product evolution. In 2015 we had the introduction of the ICAV (Irish Collective Asset Management Vehicle) and 2018 is shaping up to be no different. Not only could this year be the year that Ireland gets its eagerly awaited revamped Investment Limited Partnership (ILP) structure, but it looks like other changes are afoot as well.

In years gone by, the majority of new funds travelled down the self-managed fund route. This was the de facto standard fund structure in Ireland. However, a new trend has evolved in Ireland over the last 2-3 years, with more and more asset managers electing to use either a Management Company or a Fund Platform when setting up new funds.

So why the change and what are the drivers behind these new trends? In order to analyse this in more detail, let us take a closer look at the fund structures available;

Mark Crossan, Senior Consultant at Bridge Consulting

1. Self-Managed Investment Company (SMIC)

Of the 6,800+ funds domiciled in Ireland this is still the most common fund structure in the Irish market, mainly because of its historical usage. Whilst Management Companies and Platforms may have taken over as the "new norm" from 2015, the bulk of existing funds came from the previous era of self-managed investments companies. A SMIC can be set up as one of the following:

- A Public Limited Company ("plc") under the Companies Act or
- as an ICAV under the ICAV Act 2015.

Both structures utilise a Board of Directors who are ultimately responsible for the running of the fund. In this case, the level of involvement for the asset manager in running the fund would generally be considered "medium to high", as the increased regulatory 'drag' which comes with running a fund is generally pushed back on the asset manager.

2. The Independent Third Party Management Company

When the fund appoints an independent third party management company the asset manager is effectively outsourcing all of the day to day running, operations and oversight for the fund. Discretionary portfolio management is generally delegated back to the asset manager. The management company becomes the responsible party in the eyes of the Central Bank and the fund's Board of Directors now monitors the activities of the Management Company. The fund Board still maintains overall control. They can select their preferred delegates and they retain the power to hire or fire the Management Company as deemed necessary. The fund retains its own branding. The level of involvement for the asset manager is "low".

3. Fund Platforms

A fund platform comes as a pre-branded package. This is a "plug and play" solution for an asset manager, with fund delegates already selected e.g. administrator / depositary. Time to market should be short e.g. 4 to 8 weeks. The control rests with the platform and they effectively drive the business relationship. The platform should act as a one stop shop for the asset manager. The level of involvement for the asset manager should be "low".

As we can see, the three structures offer different levels of involvement for the asset manager. The structure selected should reflect how involved the asset manager wants to be. Other factors can also influence this decision, so it's best to also consider the market environment and some of the key business drivers that have been impacting companies over the last 2 to 3 years.

Drivers to Change:

CP86: This was a three-year consultation process run by the Central Bank of Ireland and it addresses the substance requirements of Irish regulated funds. It culminated in the publication of "Fund Management Companies – Guidance" in December 2016. In this document, the Central Bank outlines its findings and expectations for effective management and oversight required by Irish fund management companies. It outlines its expectations for the role of the Board and similarly for Designated Persons who can be appointed by the Board to carry out day-to-day oversight of the six specific management functions that apply to both UCITS and AIFs i.e. Investment Management, Fund Risk Management, Operational Risk Management, Regulatory Compliance, Distribution, and Capital & Financial Management.

The rules became effective for all new Fund Management Companies from 1 July 2017 and from 1 July 2018 for existing fund companies.

BREXIT: The UK's scheduled exit from the EU is forcing UK asset managers to examine their current fund structure and reassess whether BREXIT affects their sales strategy in Europe and how they can market their funds. This can directly affect not only UK AIFMs, but it also has the potential to affect a UK-domiciled MiFID subsidiary firm that was established by a global asset manager. If the UK MiFID subsidiary loses its MiFID distribution passport because it is no longer located in the EU, then it too needs to reassess the potential impact.

CP86 is currently generating a number of changes in the Irish market:

- A growing number of asset managers establishing new funds in Ireland only want to focus on core functions such as investment management and /or sales and distribution, and are happy to outsource fund governance and compliance.
- As the costs of regulatory burden continue to grow, asset managers are looking to generate cost efficiencies where possible from companies that already have the relevant technology and regulatory solutions in place.
- In the case of larger firms, a number are contemplating setting up proprietary Management Companies that will allow their sales force to continue to market funds under their own brand. As a Management Company licence can take between 6 to 9 months to establish in Ireland, a number of firms are opting to start the authorisation process in mid-2018 in order to be ready for BREXIT in March 2019.
- For smaller firms there may be greater interest in third party Management Company options as the cost of establishing a management company, implementing the required technology, relocating staff (if required) plus the ongoing cost of regulatory capital can act as disincentives. Leveraging an established third party Management Company should reduce the authorisation time frame.
- We are also seeing a shift within existing self-managed funds where some fund Boards are moving from Designated Directors to Designated Persons due to CP86.

Conclusion

When we consider all of these factors together i.e. the structures available to managers, the burden of new regulation and the emphasis on best practice in fund governance, regulatory compliance and organisational effectiveness, we start to understand why asset managers are choosing a different path to that of old.

Management companies and platforms are offering off-the-shelf solutions to a number of current challenges. These challenges are distracting managers from what is becoming an increasing competitive, fee conscious market. We are now at a junction familiar to other markets and we appear to be leaving the self-managed road and travelling down the Management Company / Fund Platform route.

From the Central Bank's perspective, might this be considered a positive evolution?

Ireland will have enhanced its fund governance model, however, potentially reducing the number of fund entities it will be required to regulate. We will have to wait and see. ■

15 ▶ reliant on a UK license being passported elsewhere in Europe?

"As a result of Brexit, there is likely to be a move towards the use of proprietary or third party AIFMs," adds Mark Crossan, Senior Consultant, Bridge Consulting.

Fox confirms there has been an increase in the number of third party management companies and platforms setting up in Ireland over the last 12 months, in part, no doubt, to Brexit.

"Some have stated that part of the reason for setting up is they anticipate providing solutions to UK-based AIFMs who will be regarded as third country managers from March 2019 onwards.

"Through conversations we have with asset managers, many are thinking about what to put in place as a contingency plan for Brexit. Do I need to have additional structures or authorisations to cover current or planned activity in the EU? Unfortunately, nobody yet knows what the future relationship is going to be between the UK and the EU and uncertainty is never a good situation in which to be making business decisions," comments Fox.

For those launching funds in Ireland to enjoy passporting rights, most choose to set up standalone funds rather than set up sub-funds on platforms. This is because they want it to "look and smell" like their product, says Bowen. If a manager were to go onto someone else's platform, they could keep their name on the fund but they won't get to control the board of directors.

Bowen explains that post AIFMD a lot of US managers established management companies in the UK but now face the realisation that they may not be able to use these for distribution in Europe except by using the various national private placement regimes (to the extent that they still exist) once the terms of Brexit have been finalised and are looking to Ireland as a solution.

"Most of our discussions with US and UK based managers are around distribution – how can they continue to market into the EU?

"Ireland is well placed to benefit from this. It is an English speaking common law country. It is worth noting that the clients I am speaking with are not looking to move everything over from the UK to Ireland. While they are happy to have substance on the ground in Ireland, they are not looking to relocate the day-to-day portfolio management, which will continue to be delegated back to the UK, which is where that expertise lies," says Bowen.

Under CP86, oversight and responsibility of the fund manager has to happen out of Ireland in the eyes of the CBI. The day-to-day portfolio management activities can be performed elsewhere, as Robinson alludes to above, but the Irish AIFM will have to show that they are properly supervising any delegated activity.

O'Brien says he does not see a huge imposition on UK based managers in the short to medium term and rather "a continuation of the status quo".

The prevailing model is Irish regulated products being marketed in the EU with the correct management company structures in place if delegation continues to be possible.

"We see current clients choosing either Ireland, Luxembourg or Malta as viable options; maybe first to use a hosted AIFM solution before deciding whether to set up their own AIFM," says O'Brien. "In Ireland, there are firms that are 'Super ManCos' and have wide European footprints. We see a lot of managers looking to this hosted regulatory solution in both Ireland and Luxembourg. Everyone is hoping that the ▶ 23

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Fund governance changes loom large

By Keith Parker

The Irish funds industry had another bumper year with total assets for 2017 growing by EUR298 billion – a 16 per cent year-on-year increase – to a record high of EUR2.4 trillion[1], a substantial figure and testament to the attractiveness of Ireland as a global funds domicile. Of this total just over 76 per cent represents UCITS funds' assets, the balance representing alternative assets. More than 900 fund managers from 50-plus countries have assets serviced in Ireland.[2]

There are many service providers that form part of the Irish funds industry; these include custodians, administrators, depositories and investment managers. A key participant in the Industry is the Management Company, typically referred to as the ManCo.

Fund management companies are defined as either a UCITS management company, an authorised Alternative Investment Fund Manager (AIFM), a self-managed UCITS investment company or an internally managed AIF. Legislation also provides for a dual-authorised AIFM/UCITS ManCo, otherwise known as a 'Super ManCo'.

Link Asset Service's Management Company is an example of this type of structure and is Ireland's longest-established 3rd-party ManCo.

This structure is particularly attractive as it opens up additional opportunities for a single legal entity with a single governance structure and with a single capital adequacy requirement to manage UCITS and AIFs across multiple jurisdictions. Capital adequacy is an especially important consideration as ManCos not only need to be capitalised but also need to ensure that they maintain a sufficient buffer in order to accommodate any increases in asset under management.

Keith Parker, Head of Business Development at Link Asset Services

A ManCo can be defined in a number of different ways but essentially it exists to assist fund boards with regulatory and operational challenges associated with underlying investment funds. At its core a ManCo is all about governance; the prudent management of the fund to safeguard and maximise shareholders' interests.

With effect from 1st July 2018 the fund governance regime for Irish authorised ManCos (including self-managed funds) is to be overhauled. Since 2014, the Central Bank of Ireland (CBI) has been engaged in a body of work to examine and enhance fund management company effectiveness (CP86). The result is the Management Company Guidance, a new governance regime predicated on three core principles; governance, compliance and effective supervision.

Central to this new regime is the notion of a Designated Person.

The CBI has distilled the entire fund governance spectrum into six clearly delineated managerial functions. These six key managerial functions (regulatory compliance, operational risk management, capital and financial management, fund risk management, investment management and distribution) are required to be carried out by a Designated Person; an individual that demonstrates the appropriate levels of knowledge and experience to manage and oversee their respective functions.

All Designated Persons will need CBI approval to act in such a capacity. It will be possible for a Designated Person to oversee more than one managerial function, and the same Designated Person may carry out the managerial functions of fund risk management and operational risk management. However, under this scenario

the Designated Person who performs at least one of these risk management functions man not also perform the investment management function.

CP86 goes much further than just Designated Persons however. The CBI has also introduced a new 'Location Rule' which applies to fund directors and Designated Persons. The determining factor is the Bank's Probability Risk and Impact System (PRISM) rating of each individual management company.

The rating will be such that a ManCo will either be rated 'Medium Low or above' or 'Low'. In the case of the former, the requirement will be for three of the fund's directors to be resident in the state or at least two directors to be resident in the state and the same for one of the Designated Persons. Additionally, half of the fund's directors will need to be resident in the EEA and finally half of the fund's managerial function to be performed by at least two Designated Persons resident in the EEA. It is obvious from these requirements that impact on UK fund managers post-Brexit will be considerable.

The Guidance also extends in to the realm of fund record keeping and the retrievability of these records to ensure extensive records are kept (board minutes, policies and procedures, letters of engagement, etc) and for them to be made available on an 'immediate' basis to the CBI. ManCos will also need to set up and monitor a dedicated e-mail address for communications with the CBI.

These varied requirements under the Guidance demonstrate to how seriously the CBI takes fund governance. These enhanced rules bolster Ireland's already-impressive governance regime and further reduces the likelihood of investment funds failing. Importantly, the new guidance was constructed on a consultative basis and therefore the outcome represents an industry-wide desire for supervisory enhancement.

At Link Asset Services we share the CBI's vision and efforts to fortify the fund governance regime. As a leading service provider in Ireland's fund industry we have long championed the idea of a fund governance regime that operates under strict, implementable and achievable rules resulting in a governance methodology that maximises a positive outcome for all participants. CP86 will go a long way to sustain Ireland's enviable reputation as one of the world's premier investment fund domiciles. ■

Footnotes:

1. https://www.irishfunds.ie/facts-figures/irish-domiciled-funds
2. https://www.irishfunds.ie/getting-started-in-ireland/why-ireland

19 ▶ status quo will remain. I don't think it would be in the investors' interests if there is no political agreement on delegation back to FCA regulated fund managers. We know it's already available to US managers and believe it should be made available to UK fund managers."

Currently, there are a large number of self-managed investment companies ('SMICs') in Ireland that need assistance with respect to substance in the form of governance and compliance. This needs to be in place by June this year in order to comply with the CP86 obligation deadline.

Although there's no rush for SMICs to appoint an AIFM or establish a proprietary AIFM, managers who are setting up new funds must choose either option, in order to continue to operate freely under AIFMD.

Robinson says that third party ManCos in Ireland are developing quickly in terms of service standards, in terms of technology, compared to the pre-AIFMD era, when traditionally third party ManCo services were sold on a lighter basis given that most investment managers used the self-managed fund model.

"Now, with CP86, managers are looking for a third party ManCo service which can take on the day-to-day operations of a fund and take away the regulatory burden so that those investment managers can get back to focusing just on managing the portfolio and raising capital.

"We have the infrastructure commensurate with what a third party ManCo needs to deliver in today's regulatory environment.

"In addition, over the next couple of years we will look at how we can best to use our ManCo services as a form of outsourcing to support managers who decide to set up their own ManCo in Ireland. We will be able to help people arrive at the most effective operating model using a mix of our people and their people; what that model looks like, however, will depend on the nature and scale of what they are doing," concludes Robinson. ■

"Now, with CP86, managers are looking for a third party ManCo service which can take on the day-to-day operations of a fund and take away the regulatory burden."

Patrick Robinson, Bridge Consulting