

Ticking all the Right Boxes! Irish Collective Asset- management Vehicles Act 2015 Signed Into Law

A Legal Update from Dechert's Financial Services Practice

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Ticking all the Right Boxes!

Irish Collective Asset-management Vehicles Act 2015 Signed Into Law

The eagerly anticipated Irish Collective Asset-management Vehicles Act 2015 (the "ICAV Act") was signed into law in March 2015 and the first Irish Collective Asset-management Vehicles ("ICAVs") have been authorised by the Central Bank of Ireland (the "Central Bank").

The ICAV is a new Irish corporate vehicle designed specifically to be constituted as an investment fund, either as a UCITS or an AIF.

Background to the introduction of ICAVs

The funds industry in Ireland has always sought to be innovative in terms of the availability of fund structures.

The longest established fund structure has been the unit trust; however, when the Irish funds industry was established in the late 1980's, a key innovation was the introduction of the variable capital investment company ("VCC"), structured as a public limited company ("PLC").

The investment limited partnership was subsequently introduced in 1994, followed by the common contractual fund in 2003.

Since the introduction of the VCC, the underpinning legislation has been updated on a number of occasions, principally to disapply some of the more onerous company law provisions that apply to PLCs whose shares are publicly traded. The most notable change was the introduction of segregated liability between sub-funds of PLCs in 2005.

However, whilst the PLC has served the Irish funds industry well since its introduction and has become established as the structure of choice for funds domiciled in Ireland, the ICAV offers a number of enhancements and is likely to replace the PLC as the preeminent structure of choice.

The ICAV edge

(i) Ticking the right boxes — an Irish master feeder structure

Facilitating investment by US taxable investors is a key objective of many fund promoters and the PLC has suffered in that regard because PLCs are considered to be "per se" corporations for US tax purposes and, as a consequence, come within the scope of the US Passive Foreign Investment Company ("PFIC") regime.

The main competing structures — the Luxembourg SICAV (in a form other than a Société Anonyme) and the Cayman Islands exempt company do not have the same "per se" corporate designation and may elect, by "checking the box", to be treated as a partnership for US tax purposes. Such an election allows US taxpayers the benefit of a pass-through vehicle that is not subject to the more onerous PFIC and "controlled foreign corporation" anti-deferral regimes applicable to shareholdings in non-US corporate fund vehicles.

The ICAV will be able to "check the box" and be treated as a partnership for US tax purposes, thereby enhancing the attractiveness of Ireland as a fund domicile for promoters targeting US taxable investors.

Prior to the ICAV, promoters looking for a tax transparent vehicle to offer to US taxpayers, whether on a standalone basis or as the master in an Irish master feeder structure, have tended to use a unit trust. However, corporate master funds (together with limited partnerships) are a more recognisable vehicle and the ICAV will have substantial attractions in this regard. An ICAV, similar to a PLC, will also be available for use as a feeder vehicle for investment by US tax-exempt investors and non US investors.

(ii) The tax analysis

In considering whether to establish an Irish fund as an ICAV or converting an existing PLC to an ICAV, promoters need to consider the tax and structuring consequences in detail, especially if the structure contemplates having US taxable investors and/or US tax exempt investors.

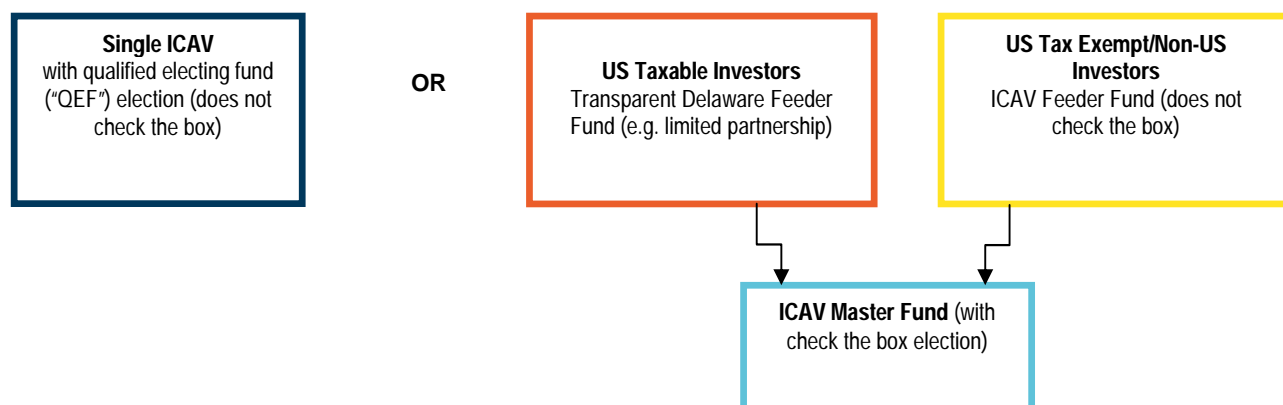
In some instances, an ICAV will not be necessary and, in other instances, a master feeder structure involving an ICAV may be required.

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

Set out below are some of the structuring options (as a starting point to obtaining detailed jurisdiction specific advice). It should be noted that where a check the box election is not required, the existing PLC works just as well as the ICAV in terms of US tax equivalence.

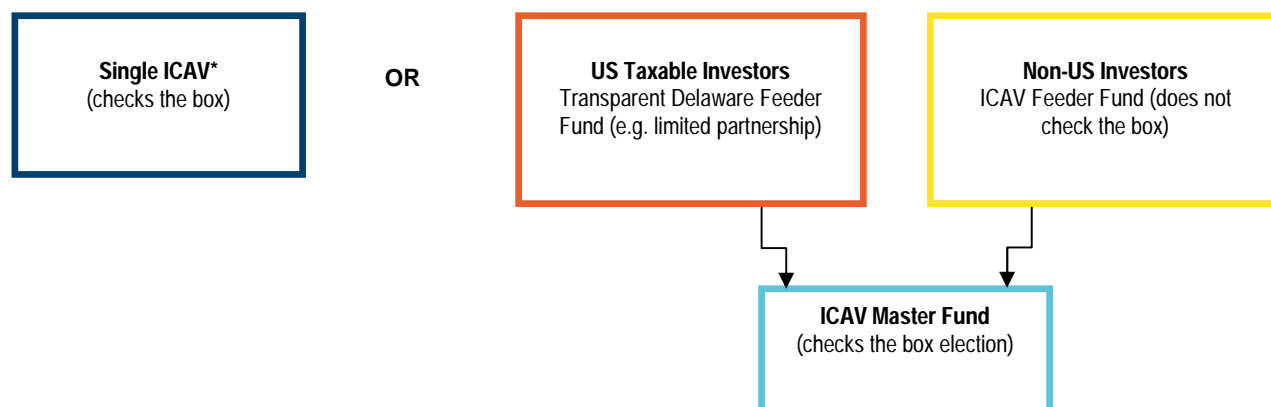
Some of the structuring options are:

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



While establishment costs will be much reduced with the single ICAV with a QEF election option, it does not offer the same tax advantages or “brand” recognition for US taxable investors, making it less attractive to them. Reduced establishment costs for the single ICAV with a QEF election may be offset by extra ongoing accounting costs linked to the QEF election. A master ICAV and a feeder ICAV should not be part of the same umbrella.

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



* The option of a single ICAV (which checks the box) is subject to the proviso that 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).

A master ICAV and a feeder ICAV should not be part of the same umbrella.

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



(iii) Company law compliance burden

In common with most European countries, Ireland has a complex company law code, particularly with regard to public companies. As indicated, many of the more onerous provisions have already been disappplied in the case of PLCs, but this process has proven to be burdensome over the years and PLCs remain exposed to certain company law requirements which should not really apply to fund vehicles.

The ICAV Act provides for a customised corporate fund vehicle, meaning that legislators will no longer need to consider unintended consequences for fund vehicles when drafting company law legislation and ICAVs will be governed by one piece of discrete and relatively straightforward legislation.

Although the ICAV Act has simplified the applicable regime, most company law provisions relating to the appointment, removal and conduct of directors remain and, furthermore, such provisions are overlaid by the Central Bank's fitness and probity and administrative sanctions regime. The ICAV Act contains in the region of 64 sections that give rise to an offence. The ICAV Act includes a specific prohibition on tax free payments to Directors.

(iv) Risk-spreading

One significant consequence of a PLC operating within the scope of European company law rules is the requirement for PLCs to observe the principle of risk-spreading. This requirement does not arise for other existing fund structures, such as unit trusts, and the absence of this requirement under the ICAV Act will assist managers in terms of product structuring.

(v) Accounts may be prepared on a sub-fund by sub-fund basis

It will not be necessary to prepare consolidated accounts at umbrella fund level. This flexibility is particularly attractive to managed account/fund platforms and multi manager funds that may open sub-funds as sleeves for different underlying managers.

(vi) Redomiciliation

One of the most significant changes to Irish company law relating to fund vehicles was the introduction of redomiciliation legislation enabling fund companies in specific offshore jurisdictions to change their domicile to Ireland from another fund domicile by way of a "continuation", helping the company to preserve its track record and contractual arrangements.

The redomiciliation legislation did not succeed in attracting large numbers of overseas companies to redomicile and one of the key reasons for this was the fact that the redomiciled Irish company was unable, as a PLC, to facilitate a "check the box" election. The ICAV Act remedies this.

Other novel features of the ICAV

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| <p>▶ Fund mergers and amalgamations are to be put on a statutory footing.</p> | <p>▶ No shareholder vote required for alterations of the Instrument of Incorporation provided the depositary certifies changes are non prejudicial or have not been specified by the Central Bank as requiring approval (this consent should not be taken for granted).</p> |
| <p>▶ No longer a requirement to maintain subscriber or non-participating shares – an ICAV is required to have subscribers but they are not required to be shareholders.</p> | <p>▶ Provision to prepare a revised Director's report to correct errors or non-compliance.</p> |
| <p>▶ Directors may dispense with requirement to hold an AGM on 60 days notice to shareholders subject to the right of 10% of shareholders or the auditor to require one to be held.</p> | <p>▶ Central Bank is the relevant authority for registration purposes rather than the Companies Registration Office.</p> |

Establishing an ICAV

As outlined above, an ICAV may be structured as a UCITS or an AIF.

There is now a two-stage Central Bank process:-

- (i) Registration of the ICAV as a legal entity with the Central Bank - this is the registrar role which is undertaken by the Irish Companies Registration Office with regard to PLCs. All company related filings will be made to the ICAV registration section of the Central Bank. The Central Bank will issue a Registration Order for an ICAV within two weeks from the date of receipt by the Central Bank of a complete application for registration; and
- (ii) Authorisation of the ICAV as a UCITS or AIF – this is a separate process conducted through the funds authorisation section of the Central Bank.

The constitutional document for an ICAV is the “Instrument of Incorporation”, a document which can be considered to be a cross between the instrument of incorporation of a UK OEIC and the Articles of Association of a PLC.

Converting to an ICAV

Given the significant advantages of the ICAV, the decision to establish as an ICAV will be relatively straightforward for promoters of new fund vehicles.

The ICAV Act also permits existing PLCs to convert to ICAV status. The process is relatively straightforward and somewhat similar to the process for redomiciliation of companies (and as such it has been tried and tested). Shareholder approval and a declaration of solvency (necessitating an audit engagement, but not a full audit) will be required for such a conversion.

Common features of ICAVs and PLCs

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| ▶ May be established as an umbrella structure. | ▶ Will have a board of directors. |
| ▶ Segregated liability will apply between sub-funds | ▶ May not have corporate directors. |
| ▶ May be listed on a stock exchange. | ▶ Subject to the powers of the Director of Corporate Enforcement. |
| ▶ May issue and redeem shares. | ▶ Similar depositary requirements. |
| ▶ May either be managed by an external management company or exist as a self-managed entity. | ▶ May be established as UCITS or AIFs (including QIAIFs). |

The arguments in favour of and against the ICAV

More than three quarters of Irish funds are structured as PLCs and, particularly since the introduction of segregated liability between sub-funds, it is the default option for fund structuring. While we expect that the ICAV will now become the default option, there are a number of factors that Boards and promoters will need to consider before deciding whether to use an ICAV.

(i) In favour

The following factors will be relevant for those wishing to immediately establish as or convert to an ICAV.

▶ **Redomiciliation**

As discussed above, fund redomiciliation to Ireland was not as popular as expected because the redomiciled entity was not able to make a “check the box” election. This deficiency has now been addressed.

▶ **US taxable investors**

If the distribution strategy of the fund encompasses US taxable investors, this will be facilitated by the ICAV, but regard will need to be had to structuring to facilitate investment by other investor groups, notably US tax exempt investors. Many early ICAV movers will be those targeting US taxable investors living outside of the US.

▶ **New structures**

We expect that most new Irish funds will be structured as ICAVs and therefore early investor unfamiliarity will soon change.

▶ **Single Asset Funds**

As the principle of risk spreading does not apply, it is possible to establish single asset AIFs as well as using ICAVs as feeder funds without necessitating any “look through” when doing so.

▶ **Accounts may be prepared on a sub-fund by sub-fund basis**

▶ **Reduced costs of company law compliance**

While it is not expected to be a primary driver, the simpler legislative code, particularly with regard to the requirement to hold meetings, should reduce costs over time.

(ii) **Neutral**

▶ **Funds with charges and debentures**

The ICAV Act contains detailed provisions on charges and debentures which mirror the parallel company law provisions. These are complex provisions involving a new registrar being the Central Bank itself. In determining whether to establish or convert to an ICAV, consideration should be given to the mechanics of dealing with charges and debentures and whether the registration process has bedded down. The approach adopted by contracting counterparties (e.g. prime brokers) will be important here.

▶ **Costs of conversion and requirement for shareholder approval**

Shareholder approval and an auditor's report will be required for a conversion. We expect that, unless they have a pressing need, funds that opt to convert might do so as part of the AGM process rather than immediately.

(iii) **Against**

▶ **Issuing debt securities**

The ICAV Act mirrors existing Irish company law with regard to the ability to issue both shares and debentures and this has given rise to some commentary that the long standing regulatory prohibition on the issue of debt securities by funds has been relaxed. The Central Bank has confirmed that this prohibition remains in place. The ability to combine both debt and equity securities in a fund structure is attractive particularly in the real estate and private equity fund space and those managers hoping that the ICAV would herald a new departure in this regard will be disappointed.

▶ **It ain't broke!**

We have set out the factors relevant to the choice of vehicle (including conversion). For many funds,

these factors may not be relevant or important and Boards may opt not to convert to an ICAV. One of the primary drivers for the ICAV Act was the prevailing view that the existing company law code was over engineered for funds. 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.

How can Dechert assist you?

Dechert is happy to advise further regarding the establishment of an ICAV or converting to an ICAV from an existing structure and have already assisted a number of clients in this regard. Please contact your usual Dechert contact for further information.

This update was authored by*:



Declan O'Sullivan
Partner, Dublin
T: +353 1 436 8510
declan.osullivan@dechert.com



Emma McDonnell
Associate, Dublin
T: +353 1 436 8529
emma.mcdonnell@dechert.com

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