Ireland eyes opportunities in global regulation focus

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For Ireland, the headlines over the past three years may have screaming about crashing property prices and floundering domestic banks, but beneath the country's genuine economic difficulties one of its biggest success stories, international financial services, has survived the financial crisis and economic downturn in good shape. Now, for the fund services sector in particular, the pendulum seems to be swinging back from threat to opportunity.

True, the industry has had to grapple with the sharp fall in capital markets in 2008 that depressed the level of fund assets and in consequence the fee income of service providers, but hedge fund managers made up much of their performance losses the following year. Investor capital, so skittish in the weeks and months following the crash of Lehman Brother and the uncovering of Bernard Madoff's multi-billion-dollar fraud, has been coming back over the past 12 months, at first at a trickle, later in more substantial flows.

It might still be too early to declare the crisis successfully weathered, but fund industry professionals in Ireland are already identifying trends that they believe will reinforce the country's position as the world's leading service centre for alternative funds – most importantly the impetus for improved fund regulation and governance that already is strengthening its position as a fund domicile within the European Union.

From the G20's initiative last year to force tax compliance on offshore financial centres to the EU's planned Directive on Alternative Investment Fund Managers, a number of converging factors are pushing institutional investors in particular to consider where their funds are domiciled and the extent to which investment managers and/or fund vehicles are regulated. Similarly, managers are now having to consider whether and under what conditions they may be able to access European investors in the future with funds established in traditional offshore jurisdictions.

Ireland promises to be an important beneficiary of any switch in focus from offshore to onshore vehicles because it not only has a couple of decades' experience in servicing mostly offshore funds, the majority domiciled in the Cayman Islands, British Virgin Islands and Bermuda, but it has the tried and tested Qualifying Investor Fund regime designed specifically for hedge fund vehicles.

In addition, as one of Europe's two principal centres for cross-border retail funds governed by the EU's Ucits legislation, it is ideally placed to accommodate the new trend among managers to offer hedge fund strategies via Ucits vehicles, taking advantage of the greater leeway offered by the 2001 Ucits III Directive to use (within limits) leverage and financial derivatives to replicate alternative investment techniques such as short selling.

"Ireland is largely a servicing centre for alternative funds as most of the products are still domiciled outside the jurisdiction, but there is a trend toward setting up more regulated hedge fund products here," says Gerry Brady, country head of Northern Trust Ireland. "For a considerable time, this has been the jurisdiction of choice for the servicing of alternative investment funds, with about 40 per cent of global hedge assets administered in Ireland."

Now the country is becoming increasingly attractive as a fund domicile as well. "Everyone is more risk-averse in this new world and they're looking for more transparency in the fund products they invest in," he says. "There's a perception that greater rather than lesser regulation is a good thing. Cayman, the BVI and Bermuda are still doing well, but there is certainly interest from investors and from managers who are at the least hedging their bets and looking at more regulated centres.

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The change of mood in the marketplace can be seen in a shift in business flows for Irish administration firms. “Historically we predominantly serviced offshore funds along with a smaller proportion of Irish-regulated products, but over the past year as much as 75 per cent of new business has consisted of Irish funds,” says Karl McEneff, managing director of Daiwa Securities Trust Europe.

“The traditional model involved a Cayman fund with an Irish-regulated administrator, a prime broker in London or the US, and a listing on the Irish Stock Exchange. All this gave investors the comfort they needed when the fund itself was unregulated. At the time speed to market at competitive pricing was crucial, but the sentiment now from fund promoters, driven by their investors, is that they don’t seem to be so concerned by these issues. Regulation, transparency and liquidity are the drivers at present.”

Industry members believe that a significant volume of additional business for Dublin may flow from the redomiciliation to onshore (read EU) domiciles of existing funds that were originally established in jurisdictions in and around the Caribbean, and perhaps to a lesser extent in the UK’s Crown Dependencies. At the end of last year Ireland approved legislation designed to allow the continuation of existing funds that opt to switch domicile to Ireland, rather than oblige their promoters to wind up the offshore structure and transfer its assets to a completely new corporate vehicle.

“A series of company law changes initiated late last year will enable offshore fund companies to redomicile funds to Ireland while maintaining their history and track record,” says Tony McDonnell, head of business development at HSBC Securities Services Ireland. “In the light of the draft AIFM Directive, managers of offshore funds will see Ireland as a very strong contender in which to redomicile their funds. The legislation will enable managers to bring over a lot of the characteristics of their offshore funds to a regulated onshore structure, which is clearly beneficial for investors, and the company history remains intact.”

McEneff notes: “The new Irish redomiciliation rules provide a clear framework to address and minimise the challenges currently experienced when redomiciling a fund. The legislation has been drafted specifically to allow a fund structured as a corporate entity in another domicile to re-register in Ireland with its original corporate identity retained, ensuring continuity of activity and continuation of arrangements. There is an approval process for the promoter and service provider, and assets and liabilities move across once the regulator gives approval.

“There is a widespread expectation of a surge in fund redomiciliation driven not just by investors but promoters anticipating how investors will react. We are aware of international managers who have decided to redomicile no matter what the outcome of the AIFM Directive. They believe their products could be domiciled in any jurisdiction, but having a regulated fund ticks the box for the suite of products they offer, and they reckon that their fund should be equally competitive on price in Ireland.”

Admiral Administration (Ireland), whose parent company is based in Grand Cayman, has seen an increase in enquiries about the redomiciliation of funds from jurisdictions such as Cayman, according to managing director David Whelan. He says: “The legislation last year to facilitate the redomiciliation of funds is one of the developments that has helped to position Ireland as the centre of choice for managers looking to redomicile their funds onshore. Investors and managers are focusing more on the fund domicile, with some managers choosing to set up an onshore product as part of an existing master-feeder structure, with some further investigating the use of the Ucits passport for distribution within the EU.”

Uncertainty about the AIFM Directive and the potential for attracting new capital from EU institutional investors are other factors that have driven the enquiries Admiral has received, Whelan believes. “We’re hearing from US-based managers looking to build their assets back up with a focus on attracting European institutional investors,” he says. “Some managers, who have historically operated within the alternative funds space, have now taken steps to establish a flexible Ucits structure to access new institutional monies. This trend is partly being driven by the needs of those EU institutional investors that are restricted in their ability to invest in certain investment products.”

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Barry O'Rourke, managing director of SEI's fund services business in Ireland, adds: "Whereas in the past you would have had to close down a fund and set up a new one in Dublin, now you can move the legal entity straight over, which enables managers to demonstrate continuity of performance."

O'Rourke acknowledges that it's still early days for the new provisions, but says the feedback SEI has received is highly positive. "A lot of alternative managers are looking actively at redomiciliation, and the QIF is a very quick-to-market and flexible solution for managers moving funds from an offshore jurisdiction," he says. "It's probably a trickle at this point, but it's gaining a lot of momentum. If existing investors seek a more regulated jurisdiction, managers will consider redomiciliation, although if they are targeting new investors they may want to set up an Irish equivalent alongside existing offshore products."

However, other industry members believe the domiciliation trend will be limited to managers for whom the European market is particularly important, and that other funds will continue to be established in Cayman and other offshore jurisdictions. "If a fund promoter wants to sell to European investors, they will set up a European fund, but where they want to sell outside Europe they'll go to the usual offshore jurisdiction," says Brian Kelliher, a partner in the asset management and investment funds unit at law firm Dillon Eustace.

"Ultimately redomiciliation will make sense for Cayman funds that up to now have been sold into Europe on a private placement basis, and converting them can allow promoters to take advantage of the European passport. But I doubt that redomiciliation will be as big as some people think. At the end of the day, US firms will continue to use Cayman, as well as the BVI and Bermuda."

Peter Stapleton, a partner in the investment funds group in the Dublin office of international law firm Maples and Calder, agrees, saying: "Hedge funds will continue to use Cayman, BVI and other traditional domiciles. Growth statistics in these locations remain impressive, and the key for EU jurisdictions is to be able to adopt some of the flexibility and efficiency of these jurisdictions within a regulated framework.

"As a result, while I expect some European-focused hedge fund managers to build EU-domiciled fund platforms, in many cases it is likely to take the form of complimentary offerings rather than a fundamental shift of existing business, particularly as once the AIFM Directive is finalised non-EU managers and funds are likely to be able to qualify to market funds in the EU under either an adapted private placement regime or some sort of passport."

In the meantime, Stapleton expects the Irish redomiciliation regime to be adapted in due course to cover non-corporate fund structures. "At present specific the redomiciliation law focuses on corporate vehicles, but funds can also take the form of unit trusts, limited partnerships and contractual vehicles," he says. "While it has always been possible to redomicile these vehicles using asset swaps and other traditional techniques, further clarity on the regulatory parameters applicable would be welcome. There has already been discussion on this at industry level and I would expect it to continue for the benefit of managers looking to move."

Industry professionals in Ireland acknowledge the country's rivalry with Luxembourg, which has a larger share of the Ucits domicile and servicing market but is playing catch-up on hedge funds, but say there's as much co-operation as competition. "Ireland and Luxembourg have long been the two pre-eminent jurisdictions for fund domiciliation," Stapleton says. "It's a respectful rivalry and there are ways in which the jurisdictions work together – for example many promoters use both domiciles for different products – but each also keeps a very keen eye on what the other is doing.

"The factors that made Ireland attractive for servicing Cayman and other offshore funds can now be compelling reasons if managers look to redomicile to the EU. For example, Ireland has built up a wealth of expertise in administering the complex instruments used by hedge funds, it has significant experience in the listing of funds on the Irish Stock Exchange, the largest exchange for listed investment funds in the world, and offers expert legal services to funds and their managers."

Stapleton notes that Ireland also benefits from a cultural and linguistic affinity with much of the

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hedge fund management industry, which traditionally has been mostly based in the US and UK, as well as familiarity with its legal system. “Ireland is an English-speaking common law jurisdiction with a very similar business culture to the leading US and UK financial centres,” he says.

“As a result Ireland has developed a lead over other EU jurisdictions in the alternative space. I would anticipate that if some funds move to Europe, managers will be attracted to the Irish framework owing to familiarity with the regime and synergy with existing Cayman and BVI models.”

He is echoed by McDonnell, who says: “Ireland has first-mover advantage over Luxembourg in the hedge funds arena. It became a very attractive proposition because of its attractive tax rate for companies, including administrators, the intellectual capital and skills of staff, plus all the benefits of a quick-to-launch offshore fund with a tightly regulated administrator. That’s what helped the Irish hedge fund industry take off over the 10 years up to 2008, and it will continue to benefit us when regulations change and people are forced to look more onshore.”

Industry members also note that for various classes of funds, Ireland benefits from the fact that it does not levy a tax based on assets, as Luxembourg does with its taxe d’abonnement (subscription tax) of between one and five basis points on funds domiciled in the jurisdiction.

Still, Ireland is ready to learn where necessary from Luxembourg, notably its Specialised Investment Funds, of which more than 800 have been set up since their introduction in February 2007. “There are likely to be developments on the Qualifying Investor Fund to pre-adapt it to some of the final AIFM Directive criteria, and also to increase harmonisation with some elements of Luxembourg’s SIF, which has been very successful,” Stapleton says.

“I don’t think Ireland will necessarily go as far as SIFs in not requiring prior approval of the promoter or investment manager – from our experience that may not be what managers or investors want from a regulated EU jurisdiction, and it would be contrary to current regulatory trends – but we do expect amendment of certain QIF criteria to make it more flexible.”

Please click here to read the full Hedgeweek special report on Ireland Hegde Fund Services 2010 [1]

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