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Country chapters

Ireland

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Overview of the Irish funds industry

Ireland is regarded as a key strategic location by the world's investment funds industry. Investment funds established in Ireland are sold in over 70 countries across Europe, the Americas, Asia, Africa and the Middle East. As of July 2016 there were 6,284 Irish domiciled funds with net assets of over €1.9trn. While the majority of these fund assets are held in UCITS funds[1], Irish-domiciled AIFs[2] had in excess of €460bn in net assets as of July 2016 (representing significant growth in the size of alternative investment funds since the introduction of AIFMD in 2013). The majority of the investment in these regulated investment funds comes from non-Irish institutional investors.

General introduction to the regulatory framework

The Central Bank of Ireland ("Central Bank") is responsible for the authorisation and supervision of regulated financial service providers in Ireland, including regulated investment funds and investment managers. The powers delegated to the Central Bank are set out in the laws and regulations applicable to the relevant financial services sector. In addition, the Central Bank issues guidance in relation to various aspects of the authorisation and ongoing requirements applicable to financial service providers and investment fund products in Ireland.

Common fund structures

Ireland as a domicile provides a variety of potential fund structures, which can be broadly categorised as regulated by the Central Bank or unregulated.

(i) Regulated structures

There are four main types of regulated fund structure in Ireland (as described below): (i) variable capital investment companies ("Investment Companies"); (ii) Irish collective asset management vehicles (or "ICAVs"); (iii) unit trusts; and (iv) common contractual funds (or "CCFs"). Each of these regulated fund structures may be established as UCITS pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2011, as amended (the "UCITS Regulations" [3]) or as an alternative investment fund ("AIF") pursuant to the EU (Alternative Investment Fund Managers) Regulations 2013 (the "AIFMD Regulations")[4]. An AIF may also be established as a regulated investment limited partnership (pursuant to the Investment Limited Partnership Act 1994). These structures may be organised in the form of umbrella schemes with segregated liability between compartments ("sub-funds").

- *Investment Companies*

  An Investment Company is established as a public limited company under the Irish Companies Acts. They have a separate legal identity and there is no recourse to the shareholders. There is a requirement to spread risk if the fund is established as an Investment Company. It is typically the board of directors of the Investment Company who will have to approve any decision to borrow, grant security or enter into derivatives, although it will be important in each case to review the Investment Company's constitutional documents including its memorandum and articles of association, prospectus and/or supplement thereto and any management agreements that have the authority to execute the necessary agreements.
- *ICAVs*

  The ICAV is an Irish corporate investment fund which was introduced in 2015 to meet the needs of the global funds industry, pursuant to the Irish Collective Asset Management Act 2015 (the "ICAV Act"). Since its creation, the ICAV has replaced the Investment Company as the most commonly used structure for newly established funds in Ireland. One of the main advantages of the ICAV is that it may be eligible to elect to be treated as a transparent entity for the US federal income tax proposes by "checking the box". This would allow US taxable investors to avoid certain adverse US tax consequences that would normally apply to "passive foreign investment companies". Most Irish funds have historically been authorised as Investment Companies and, as such, are required to comply with many of the rules applicable to Irish companies which may not be relevant or appropriate to an investment fund. The ICAV is a bespoke corporate structure that is specifically designed to give more administrative flexibility than an Investment Company. For example, the ICAV may:

  - amend its constitutional documents without shareholder approval in respect of changes that do not prejudice the interest of shareholders and do not come within certain categories of changes specified by the Central Bank;
  - prepare separate financial statements for sub-funds;
  - issue debenture stock, bonds and any other securities; and
  - allow directors to dispense with the holding of an AGM by giving written notice to all shareholders.

  UCITS and AIFs established in Ireland can convert into an ICAV subject to compliance with the conversion process specified by the Central Bank. However, it is not possible to use the ICAV conversion procedure in respect of an existing UCITS or AIF unit trust, investment limited partnership or common contractual fund. Importantly, it does not affect the legal existence of the fund or any pre-conversion rights or obligations. The ICAV Act contains a mechanism for existing corporate collective investment schemes established in the Cayman Islands, the British Virgin Islands, Bermuda, Jersey, Guernsey and the Isle of Man to migrate or redomicile to Ireland as an ICAV by operation of law. The migration process is the same as the fund redomiciliation process that was introduced in Ireland in 2009, pursuant to which non-Irish funds can move to Ireland and become subject to Ireland's regulatory regime for investment funds. The main difference with the ICAV migration process is that the application for migration is made solely to the Central Bank and not to the Irish Registrar of Companies. The analysis in relation to who has authority to contract e.g. borrow, grant security, enter into derivatives, for an ICAV are the same as for an Investment Company.

- *Unit Trusts*

  Unlike an Investment Company, a Unit Trust is not a separate legal entity but rather a contractual fund structure constituted by a trust deed between a trustee and a management company. In a Unit Trust, the trustee or its appointed nominee acts as legal owner of the fund's assets. As the Unit Trust does not have a separate legal personality, it cannot contract for itself. Managerial authority is exercised by the directors of the management company which, in the context of an AIF, may also perform the role of the so-called alternative investment fund manager (or "AIFM"). While in many cases it is the directors of the management company who execute contracts, the trust deed and other relevant documents such as the management agreement should be carefully reviewed to confirm who has signing authority. For example, if assets are registered in the name of the trustee, the trustee will need to execute security over the assets of the Unit Trust and in some Unit Trusts, the trust deed may, for example, require joint execution by the trustee and the management company.

- *CCFs*

  A CCF, similar to a Unit Trust and investment limited partnership, does not have a separate legal existence. It is a contractual arrangement established under a deed of constitution, giving investors the rights of co-owners of the assets of the CCF. As co-owners, each investor in a CCF is deemed to hold an undivided co-ownership interest in the assets of the CCF as a tenant in common with other investors. A CCF may be treated as transparent for tax purposes, which is a key distinguishing feature from other types of Irish fund structures.

- *Investment Limited Partnership ("ILP")*

  An ILP is established pursuant to the Investment Limited Partnership Act 1994. An ILP is a partnership between one or more general partners and one or more limited partners and is constituted by a partnership agreement. As with a Unit Trust, an ILP does not have an independent legal existence. It has one or more limited partners (which are similar to shareholders in an Investment Company or ICAV, or a unitholder in a Unit Trust) and a general partner who can enter into contracts on behalf of the ILP, which would include any loan agreement or security document. It is proposed to introduce a number of changes to the ILP structure, which should make the ILP more broadly appealing to promoters of venture capital, and private equity funds in particular.

(ii) Unregulated structures

- *Limited partnerships*

  The limited partnership established pursuant to the Limited Partnership Act, 1907 is the favoured structure for unregulated investment funds in Ireland.

  A limited partnership is a partnership between one or more general partners and one or more limited partners, and is constituted by a partnership agreement. To have the benefit of limited liability, the limited partners are not permitted to engage in the management of the business of the partnership or to contractually bind the partnership – these functions are carried out by the general partner.

There is a general limit of 20 partners in a limited partnership, although this limit can be raised to 50 where the limited partnership is formed 'for the purpose of, and whose main business consists of, the provision of investment and loan finance and ancillary facilities and services to persons engaged in industrial or commercial activities'.[5] The analysis in relation to who has authority to contract, e.g. borrow, grant security or enter into derivatives for an unregulated limited partnership, is similar to that for an ILP.

Regulation of Irish funds

Investment funds in Ireland can be established as either UCITS or AIFs.

<u>UCITS</u>

UCITS were first introduced in 1985 in the European Union with the introduction of the UCITS Directive[6]. Although UCITS are regulated retail investment product, subject to various liquidity constraints, investment restrictions (both in terms of permitted investments and required diversification), borrowing and leverage limits, nevertheless UCITS are predominantly held by institutional investors and are firmly established as a global investment fund product (being widely distributed both inside and outside of the EU). Irish UCITS may avail of the UCITS passport regime which allows for UCITS to be marketed publicly across the EU subject to limited registration requirements.

<u>AIFs</u>

AIFs are defined under AIFMD as "any collective investment undertaking [...] which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors", and that does not require an authorisation under the UCITS Directive. Therefore, all non-UCITS funds may be considered AIFs.

Irish AIFs are established pursuant to the AIFMD Regulations which implement AIFMD in Ireland. AIFMD regulates both EU AIFMs who manage AIFs in the EU and Non-EU AIFMs that manage AIFs in the EU or market AIFs in the EU. The main types of AIFs in Ireland are Qualifying Investor Alternative Investment Funds ("QIAIFs") and Retail Investor Alternative Investment Funds ("RIAIFs"). AIFs must also comply with the rules set out in the Central Bank's AIF Rulebook. QIAIFs can be marketed to professional investors and there is a minimum subscription requirement of €100,000 (which may be disapplied in respect of certain categories of investor). They can avail of the right to market across the EU using the AIFMD passport. A QIAIF can be managed by an EU or non-EU AIFM and can also be internally managed (see below). A QIAIF is not subject to any investment or borrowing limit but it is obliged to spread risk if established as an Investment Company.

The RIAIF replaces the previous retail non-UCITS regime and has no minimum subscription requirement, but there is a restriction on it borrowing more than 25% of its net assets. As the RIAIF is a retail fund it cannot use the AIFMD passport which is available to QIAIFs marketing to professional investors. Unlike a QIAIF, RIAIFs cannot be managed by a non-EU AIFM.

AIFs are required to appoint an AIFM which can be either an external manager of the AIF or, where the legal form of the AIF permits, such as in the case of an Investment Company or ICAV, and the AIF chooses not to appoint an external AIFM, the AIF itself.

Recent developments

Loan origination funds

The Central Bank's rules for loan origination funds are set forth in a dedicated chapter of the Central Bank's AIF Rulebook on loan origination QIAIFs ("LO-QIAIF") which represents the first dedicated regulatory regime in the EU for loan origination funds. AIFMs that meet the additional conditions relating to LO-QIAIFs will be able to manage the new LO-QIAIF and market it within the EU using the AIFMD passport. The additional conditions applicable to LO-QIAIFs include the requirement that the LO-QIAIF:

- be closed-ended;
- must not have gross assets of more than 200% of its net asset value;
- must achieve a diversification of its exposures to any one issuer or group to 25% of its assets within a time frame specified in its prospectus;
- does not lend to certain categories of borrower; and
- that certain 'skin in the game' is maintained in respect of loans acquired from a bank under arrangements that involve the retention by the bank or an affiliate of an exposure correlated with the performance of the loan.

EU long-term investment funds

The EU regulation on long-term investment funds (ELTIF) came into force on 9 December 2015 and was implemented into Irish law by the EU (European Long-term Investment Funds) Regulations (ELTIF Regulations). The ELTIF is a new type of regulated investment fund that invests in long-term investment opportunities and may be marketed to both professional and retail investors across the EU. ELTIFs have been designed with the intention of increasing the level of long-term investment in the European economy by facilitating investment in asset classes that are too illiquid to be served by existing fund structures. An ELTIF must be an EU AIF and must be authorised by the regulator in its home jurisdiction (the Central Bank having been designated as the competent authority in Ireland). Further, an ELTIF may only be managed by an EU AIFM. ELTIF managers will therefore be required to comply with the requirements under AIFMD as well as the ELTIF Regulations. The ability to market an ELTIF on a passported basis to retail investors across the EU is a significant advantage over other types of AIFs. However, as the ELTIF is subject to significant limitations in terms of the types of assets that it may invest in and the diversification limits that apply, it remains to be seen whether, from a marketing perspective, the potential benefits are considered by promoters to be worth the additional investment constraints and compliance burdens.

Fund financing and security

Overview

Lending to Irish funds is typically structured as either a bilateral or syndicated facility, a note issuance agreement whereby the issuer (the fund) issues a note in favour of the note holder or a derivative contract, typically documented through an ISDA Master Agreement. Lending by AIFs is restricted although (as discussed above) it is possible to establish an AIF which is focused on loan origination, including investing in loans. In the last number of years capital call, subscription and equity bridge facilities have become much more commonplace. Irish fund structures, particularly Investment Companies, ICAVs and ILPs, are also commonly used as property investment vehicles.

The lenders and governing law

At present the majority of deals in the Irish market are being financed by international financial institutions. Reflecting the international nature of the financiers, the relevant loan agreements for such transactions are commonly governed by the laws of New York or England and Wales, although there is no legal reason why they could not be governed by Irish law. The terms of the loan agreement will very much depend on the type of facility being advanced.

While many lenders in Irish fund financings hold a bank licence or have "passport" rights to lend into Ireland, it should be assessed on a case-by-case basis whether a bank licence or passporting rights are required on a particular transaction, particularly where the relevant lender(s) do not have either a banking licence or passporting rights and the transaction involves "banking business" as a matter of Irish law.

Security package

A key consideration in every fund financing is the security package. This will vary depending on the type of financing involved. For example, on many financings, the security package will consist of a fixed charge over the funds rights, title and interest in and to the securities and/or cash account recorded in the books and records of the Depositary (or Trustee in the case of a Unit Trust, as such any references hereafter to a Depositary should be read to include Trustee in the context of a Unit Trust) and an assignment of the funds rights in the Depositary Agreement (or Trust Deed, in the case of a Unit Trust). Such a security package is also commonly coupled with a control agreement which will give the lender or its security agent control over relevant rights or assets either on a "day-one" or more commonly "springing lien" basis on the occurrence of a future enforcement event.

A properly drafted and structured Irish law security document should also be able to obtain the benefits of being considered a "financial collateral arrangement" pursuant to the European Communities (Financial Collateral Arrangements) Regulations 2010 (as amended). Relevant bank mandates should be reviewed and where necessary amended to be consistent with the terms of the control agreement. It is very important in this context to also verify where the account is located, and whose name the account is opened in. In many cases the account holder may be a Depositary or sub-custodian, and the cash account for an Irish fund may not be located in Ireland, particularly where cash is held by a sub-custodian. Equally in structures where the connection with Ireland is only that the Depositary is Irish incorporated, it is not uncommon that one or more cash accounts may also be held by sub-custodians outside Ireland.

As with any financing, there is no "one size fits all". In this regard, the typical security package for a capital call/subscription facility is quite different, commonly consisting of security over the right to call on investors for further contributions, security over the account into which such subscriptions monies are lodged, and coupled with a robust power of attorney either prepared on a stand-alone basis or forming part of the relevant security document. The fund's constitutional documents, prospectus, as well as the administrative services agreement and the subscription agreement, need to be carefully reviewed to verify who actually makes the subscription call; for example, in the context of a corporate fund such as an Investment Company or ICAV, most commonly it is the directors of the fund that make the call, but sometimes the constitutional documents also give the manager (where the corporate fund is externally managed) the power to make the call. The Administrator also plays an important role in processing subscriptions, and recording and registering the subscriptions. Depending on the extent of the role performed by the Administrator, consideration could be given to taking specific security over the rights of the fund in and to the administrative services agreement, which would afford the lender "step-in" rights *vis-à-vis* the Administrator in any further enforcement. However, in practice we do not see this, and more usually a side letter addressed to the Lender/Agent is obtained from the Administrator in relation to the performance of their duties under the administrative services agreement.

Over the last number of years we have also seen a steady growth in financings involving Feeder Fund structures. From an Irish law regulatory perspective, this can require careful structuring of the security package. One of the issues which requires consideration in this regard is that an Irish regulated fund cannot give "guarantees" to support the obligations of a third party (which may include another sub-fund within the same umbrella fund structure). Unfortunately, the term "guarantees" is not defined and it would be prudent to take it that this term also captures "security" to support the obligations of a third party. In Feeder Fund structures where, for example, the Feeder Fund is the borrower and the Master Fund is an Irish fund and expected to guarantee the obligations of the Feeder Fund, the rule against giving third party guarantees is very relevant and the structure and security package will need to be carefully considered and tailored to ensure that this rule is not infringed. The use of "cascading pledges" can also, depending on the structure, be a useful tool in the security package.

<u>Governing law of security package</u>

Irish law does not strictly require that the security package be governed by Irish law. We commonly see transactions where security is taken under the laws governing the relevant financing agreement, e.g. New York or England & Wales law. However, where the relevant secured assets are in Ireland, e.g. the securities or cash account or, for a subscription call deal, the governing law of the subscription agreement is Irish law, we would always also take Irish law-governed security. Typically, any control agreement would be governed by the laws of the country where the account is located, however, if this not the case, local law guidance and preferably a legal opinion should be obtained to ensure that the use of a different governing law will be enforceable in the relevant jurisdiction.

<u>Security agent</u>

As a common law jurisdiction, there is no issue as a matter of Irish law with security being granted in favour of a security agent or security trustee and, subject to the bank licensing considerations referred to previously, it is not necessary under Irish law for the security agent to be licensed in Ireland to enforce its rights. A point to note in relation to the enforcement of Irish security is that on enforcement typically it is a receiver appointed by the lender/security agent who will be appointed over the secured assets and realise same on behalf of the secured parties. One advantage of this from a lender/security agent perspective is that the Irish security document will contractually provide that the receiver is the agent of the borrower rather than the lender(s)/security agent, thereby insulating the lender/security agent from potential claims arising from the actions of the receiver as part of any enforcement.

<u>Consents and stamp duty</u>

No Irish governmental consent or stamp duty is generally required/payable in connection with the execution of security in fund financing. However, where a security assignment is being taken over, the funds rights in and to the depositary agreement, the depositary agreement should be carefully reviewed to check that the prior consent of the Depositary and/or the Central Bank is not required. In cases where the assignment is taken by way of security rather than being a true assignment, the consent of the Central Bank will not be required as it permits funds granting such security in connection with its borrowings, and for receivers appointed by the lenders enforcing such security.

Security filings

Once security has been created, lenders will need to ensure that the security, if created by an Irish entity or an entity required to be registered in Ireland as a branch whether governed by Irish law or otherwise, is registered against the correct entity in the appropriate Irish registry. For example, (1) security created by an Investment Company will be registered on the file of the Investment Company in the Irish Companies Registration Office ("CRO"), and (2) security created by a trustee or its nominee as part of a Unit Trust structure will be registered on the file of the trustee/its nominee in the CRO. Importantly, as ICAVs are established under the ICAV Act rather than the Companies Act, registrations for ICAVs are made on the file of the ICAV with the Irish Central Bank rather than the CRO. Particulars of all such security in the form prescribed by the CRO (Form C1) or the Irish Central Bank (Form [CH1]) must be filed within 21 days of the date of creation of the security, and in the absence of such, filing is void against a liquidator and any creditor.

Property fund financing

Irish funds are also popular vehicles for investment in Irish real estate by both Irish and non-Irish investors. In our experience, Investment Companies and ICAVs have been the most popular platforms used by investors, but some investors have also used Unit Trusts due to their familiarity with same in their home jurisdictions. While many investors establish their own fund platforms, it is also possible to establish a sub-fund as part of an existing platform set up by a service provider, a so-called "rent a fund". This can save on the establishment cost. In some deals, ILPs are also set up under the relevant Investment Company or ICAV sub-fund, for finance structuring reasons.

The loan agreement in financings for such funds is typically based on the LMA Real Estate Finance form of loan agreement. This is commonly governed by Irish law but, if necessary, could equally be governed by the laws of England & Wales (adapted as required). There are a number of key modifications that need to be made to the LMA form, including in particular to reflect the role and importance of the relevant service providers in such structures, such as the management company, AIFM and the Depositary, the applicable events of default, regulatory compliance matters, the change of control provisions and the security package.

The security package will always consist of security over the relevant property and related assets and in many, but not all, cases security over the shares/units in the fund/sub-fund. Where the fund/sub-fund has invested in real estate through an ILP, security can also be taken over the sub-fund's interest in the ILP, and security is also taken over the shares held by the shareholder of the general partner of the ILP. This is important as, in an ILP, it is the general partner who contracts for the ILP and, on an enforcement, having security over those shares means that the lender can exercise control over the general partner and its contracting powers.

As with all fund financing structures, it is crucial at an early stage of any property fund financing deal to ascertain who has title to the assets and who has contracting power. An additional point to note in this regard is that the Depositary of the fund investing in real estate is obliged to maintain "control" over the property and related assets, such as rental income. Previously, this was interpreted by Depositaries to mean that title to the property had to be registered in their name. However, as registered owner of the property this potentially exposes the Depositary to claims, for example, in relation to environmental liability, but also to being named in court proceedings if, for example, there is a rent dispute. The practice which has emerged in this regard is that either the Depositary has title registered in the name of a nominee company it establishes or, more commonly, it registers a caution on the relevant property title which restricts future disposals, including on any enforcement. It is crucial in this context to obtain a Control Letter/Deed of Control from the relevant Depositary to regulate the rights and duties of the Depositary on any future enforcement by the lenders but also, for example, to regulate how the Depositary operates the fund's bank accounts to ensure compliance with the account control and waterfall provisions of the facility agreement. Commonly, the rent account in such transactions is opened in the name of the Depositary, and it is Depositary signatories who are named on the bank mandate.

Hotel financing can also be accommodated through a fund structure. Particular issues can arise in relation to this type of structure, where a separate OpCo/PropCo structure is used, and advice should be sought at an early stage to optimise the structure and ensure that financing can be put in place.

* * *

Endnotes

1. Described further below.
2. Described further below.
3. The UCITS Regulations implement the UCITS Directive in Ireland.
4. The AIFM Regulations implement AIFMD in Ireland.
5. Companies (Amendment) Act 1982 (Section 13(2)) Order 2004.
6. Undertakings for Collective Investments in Transferable Securities Directive 2009/65/EC.

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