

Considerations when starting a hedge fund in Europe

Shane Coveney, of Dillon Eustace, identifies the key considerations for those starting a hedge fund in Europe



When seeking to start a hedge fund, some of the many initial questions which will require consideration will be the potential strategy to be utilised by the product, the potential structure of the product, and the jurisdiction in which the product will be established. Hedge fund managers are now having to be increasingly aware of regulatory matters, such as the Mifid II regime, and the ongoing developments in the tax universe, such as the introduction of Beps which has had unforeseen impacts on the hedge fund universe and the changes in the double tax treaties in place between jurisdictions such as the adoption of a 'principle purpose test'. In addition to these considerations, hedge fund managers in an ever more fiercely



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competitive market are striving to differentiate themselves from their competitors to raise capital.

Prior to the advent of the Alternative Investment Fund Managers Directive (AIFMD), many hedge funds would have been established in the Cayman Islands or other offshore jurisdictions. However, since 2013, we have seen an increasing number of hedge fund managers look at regulated investment fund jurisdictions with robust regulatory oversight, such as Ireland, as the preferred location to establish their hedge fund

product. Many hedge fund managers who do not seek to use leverage in their strategy have sought to examine the potential to use an alternative undertakings for collective investment in transferable securities (alt-Ucits), which commonly employ hedge fund-like strategies in the highly regulated parameters of a Ucits product. Notwithstanding the initial interest, the use of alt-Ucits as a product in which to house hedge fund type strategies has lessened in popularity in recent years.

A key determinate in deciding where to set up a hedge fund structure will be tied to where the promoter of the hedge fund foresees asset raising being most effective. This will require a strong business plan being produced in the initial phase which lays out all aspects of the

business that are required to achieve the objectives in the most efficient and cost-effective manner. Should the asset raising and investor base be located in Europe, it is common for start-up hedge fund managers to establish structures within the EU and seek to avail of the EU wide marketing passport which is provided under AIFMD and the Ucits regime.

Ireland as a jurisdiction of choice

Although each jurisdiction will have its merits and can offer various attractive propositions, certain jurisdictions provide more beneficial conditions for starting a hedge fund and other investment products. For budding hedge fund managers in common law jurisdictions with their eyes focused on EU investors, Ireland is usually the jurisdiction of choice due to its membership of the European Union, the robust regulatory framework, varied forms of flexible structures available for the establishment of an investment fund, and the strength of the transparent tax framework in the investment funds universe.

Ireland as a jurisdiction and the very successful regulatory regime for alternative investment funds (AIFs) continue to be attractive options for international hedge fund managers wishing to set up investment fund vehicles due to a number of factors. In Ireland, hedge funds are typically authorised by the Central Bank of Ireland (Central Bank) as qualifying investor alternative investment funds (QIAIFs). QIAIFs benefit from a fast-track authorisation process with the Central Bank which provides investment managers significant speed to market, which is clearly of great importance when seeking capital from investors. In addition, hedge fund managers have the benefit of engaging with an understandable regulatory regime with stable rules and a clear and practical authorisation process. Additional benefits of setting up in Ireland include:

- Flexible and familiar legal structures with differing levels of investment and borrowing restrictions, investment mechanics, minimum subscription requirements, service provider

requirements and authorisation timeframes depending on the proposed portfolio composition and targeted investor profile for a particular project

- Extensive experience of funds industry professionals and service providers
- Access to EU member states via AIFMD passport combined with wider international recognition of Irish fund structures
- Transparent tax framework
- Globally recognised jurisdiction for investment funds and asset servicing
- Speed to market thanks to the Central Bank's QIAIF fast track self-certification based authorisation process.

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Legal structures in Ireland

There are currently five different regulated legal structures which can be utilised to house hedge fund strategies – variable capital companies (VCCs), unit trusts, Irish collective asset-management vehicles (Icav), common contractual funds or investment limited partnerships (ILPs). Each vehicle has their own distinct benefits and the selection of one vehicle over another will typically come down to the need for a tax-transparent vehicle or whether a corporate entity is more conducive to the potential investor base. All available Irish legal structures, with the exception of ILPs currently, can be established as either umbrella structures with multiple sub-funds or standalone entities. VCCs and Icavs are corporate entities which have their own boards of directors, two of whom must be Irish resident. The Icav has become the most readily used form of legal structure for QIAIFs owing to its flexibility, ease of establishment. Ireland is in a unique position in being able to offer multiple tax transparent vehicles such as the Icav, which was created to

meet the needs of the international funds industry and permit hedge fund managers to 'check the box' to be treated as a partnership or disregarded entity for US federal tax purposes, if desired.

At the time of writing, Ireland is in the midst of the regeneration and re-configuration of the investment limited partnership structure. Changes to the investment limited partnership legislation are anticipated with the goal of modernising the investment limited structure and align the features of Ireland's investment limited partnership structure with those of other leading jurisdictions. Amongst the proposed changes which have been mooted is a proposal that investment limited partnerships be established as an umbrella fund with segregated liability between sub-funds and the ability to create different classes of interest which convey different rights on limited partners. Should this come to bare, Ireland will have an investment limited partnership which would be both tax transparent but also more akin to the traditional Delaware limited partnership, which is common in both the hedge fund and private equity industry.

Oversight & service providers

As with any new venture, the strength and expertise of the service providers selected is paramount. The service provider and legal counsel selected need to be client-focused and a partner in your journey from start-up to, hopefully, successful hedge fund. As at the end of January 2019, Ireland was the domicile of choice for alternative investment funds with over 2,800 AIFs (including sub-funds of 7,350 sub-funds domiciled in Ireland) which managed over €633bn in assets (total including Ucits of over €2.5trn) and over 40% of global hedge funds administered from Ireland.

It appears that following the implementation of AIFMD and the looming uncertainty over the continued participation of the United Kingdom in Europe, Ireland remains the jurisdiction of choice for hedge fund managers seeking access to European investors as this will position such funds optimally to be marketed to professionals within the EU. **HFM**