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The Irish ICAV:
The dawn of a new era for the Irish funds industry

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The dawn of a new era for the Irish funds industry

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Since the establishment of the International Financial Services Centre in Ireland in 1988, Ireland has become a domicile of choice for asset managers seeking to establish regulated funds for distribution worldwide.

Over 430 global fund promoters have used Ireland as a fund domicile in order to establish regulated funds. As of 31 December 2013, there were 5,599 Irish domiciled funds with assets of approximately EUR1.344trn[1]. Such funds are regulated by the Central Bank of Ireland (the "Central Bank"), which is the competent authority with responsibility for the authorisation and supervision of funds established in Ireland.

In addition, in recent years Ireland has been the fastest growing international fund administration centre. As of 31 December 2013, Irish administrators serviced 12,889 Irish and non-Irish domiciled funds with assets under administration in excess of EUR2.7trn[2]. Ireland is also the largest hedge fund administration centre in the world with over 43% of global hedge fund assets serviced in Ireland[3].

The setting of the first ICAV seeds

The Irish Government acknowledged in 2011 in its Strategy for the International Financial Services Industry 2011-2016[4] that despite the success of the Irish funds industry, there were challenges that needed to be addressed. One of the challenges identified was product competitiveness.

Although Irish domiciled funds may be structured in many legal forms, depending on whether they are structured as UCITS funds or non-UCITS funds ("AIFs") (e.g. common contractual funds, unit trusts, variable capital companies or investment limited partnerships), it was noticeable that Ireland as a leading international fund domicile did not offer a corporate fund structure similar to the SICAV in other EU jurisdictions.

In this regard, the Government undertook in its 2011 strategy paper to introduce a legal framework for a corporate fund structure which is a not a company required to be incorporated under the Irish Companies Acts. Currently Irish domiciled funds structured as companies (such as variable capital companies) are incorporated under the Irish Companies Acts and are consequently established as public limited companies which are distinguishable by the words "public limited company" or "Plc" appearing at the end of the name of the company.

ICAV – the beginning

In keeping with the Irish Government's commitment, the Irish Minister for Finance, Michael Noonan, published on the 20th December 2013 the General Scheme of the Irish Collective Asset-management Vehicle (ICAV) Bill ("General Scheme of the ICAV Bill"), which provides for a new corporate fund structure to be known as the Irish Collective Asset-management Vehicle or "ICAV".

On the publication of the General Scheme of the ICAV Bill, the Minister of Finance commented: "This is a significant milestone in delivering a new corporate vehicle for investment funds which will be more suited to the needs of the global funds industry. The ICAV will help the Irish funds industry to compete for new sources of business. I intend to push ahead with the drafting of the Bill as a matter of priority."

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The rationale

The principal rationale for introducing a legal framework, to facilitate fund promoters / asset managers who wish to establish an Irish regulated ICAV, is to enhance Ireland's competitiveness. However it is acknowledged that such enhancement will only be realised if the ICAV presents tangible benefits to global fund promoters / asset managers. In this regard, the following benefits are notable:

- The ICAV will not be required to be incorporated as a public limited company under the Irish Companies Acts 1963-2013 and therefore will not be subject to the full rigours of the Companies Acts which are quite comprehensive and more applicable to Irish trading companies than Irish funds. It is expected that this will result in reduced administrative obligations and costs for the ICAV; and
- It is intended that the ICAV will be structured so that it can "check-the-box" to be treated as a partnership or disregarded entity for US federal tax purposes and therefore will facilitate investment by US taxable investors and/or US taxable and tax-exempt investors in a master feeder fund structure. This is distinct from the treatment of Irish corporate funds incorporated as public limited companies under the Irish Companies Acts ("Corporate Fund PLCs") which cannot check-the-box to be a flow-through for US tax purposes. Further information on this is set out below.

Features of the ICAV[5]

It is envisaged that the ICAV will have some common features with Corporate Fund PLCs:

- Authorisation and supervision by the Central Bank;
- Establishment as a UCITS fund or an AIF;
- If established as an AIF, it may be structured as open-ended, closed ended or with limited liquidity;
- Possible establishment as an umbrella fund with segregated liability between sub-funds;
- Multiple share classes;
- The assets of the ICAV must be entrusted to a depositary;
- The paid up share capital of the ICAV must be equal to the net asset value of the ICAV;
- Registered office in Ireland;
- Board of directors and a minimum of two directors;
- A secretary must be appointed;
- The name of the ICAV must be approved by the Registrar of Companies;
- Minimum of two shareholders;

- Shareholders' liability under the Instrument of Incorporation will be limited to the amount unpaid on their shares;
- Annual accounts in accordance with accounting standards must be published;
- The ICAV will be subject to the same attractive Irish tax regime that currently applies to the Corporate Fund PLC i.e. no Irish tax at the fund level, no Irish withholding taxes on distributions where shareholders are not Irish resident or ordinarily resident in Ireland and an attractive indirect tax regime whereby many services provided to a fund are VAT exempt and the issue, redemption or transfer of shares are not subject to any transfer taxes. It is expected that the ICAV (like the Corporate Fund PLC) should have the same access to many of Ireland's double taxation agreements (Ireland has signed comprehensive double taxation agreements with 70 countries, of which 68 are in effect) so as to minimise the possible effect of foreign withholding taxes on returns on its investments.

However it is also envisaged that the ICAV will have features which distinguish it from Corporate Fund PLCs:

- Incorporation by the filing of certain prescribed documents with the Central Bank (as opposed to the Irish Companies Registration Office which is the registry applicable to Corporate Fund PLCs);
- Instrument of Incorporation as opposed to a Memorandum and Articles of Association;
- Amendments to the Instrument of Incorporation without the need for proposed amendments to be sanctioned by the shareholders provided that the depositary of the ICAV certifies that the proposed amendments will not prejudice the interests of the shareholders;
- Shares and/or debentures (i.e. bonds, debt securities, etc) may be issued. This contrasts with Corporate Fund PLCs structured as AIFs marketing to qualifying investors which may only issue debt securities on a private basis to a lending institution to facilitate financing arrangements;
- The requirement to hold an AGM may be avoided by giving at least sixty days' written notice to all of the ICAV's shareholders;
- Financial statements may be published on a sub-fund by sub-fund basis in the case of an umbrella ICAV. Currently Irish company law requires the accounts of all sub-funds of an umbrella Corporate Fund PLC to be included in the financial statements of that company;
- More simplified procedure for facilitating schemes of amalgamation, mergers, divisions and other general reorganisations;
- No statutory requirement to diversify investment risk. The Irish Companies Act 1990, as amended currently provides, based on EU company law requirements, that a variable capital company must have the aim of spreading investment risk which may be problematic where a fund is seeking exposure to a single issuer or counterparty. This latter requirement will not apply to the ICAV.

In addition to the above features, existing Corporate Fund PLCs will be able to convert to an ICAV and funds domiciled outside of Ireland will be able to re-domicile into Ireland by continuation as ICAVs.

ICAVs and US Investors

While the introduction of the ICAV will have some welcoming legal features which will distinguish it from Corporate Fund PLCs, the original driver for the introduction of the ICAV is to add an additional choice of legal entity (which a fund can take the form of) for fund promoters to accommodate both US taxable investors and US tax-exempts in the same investment fund without creating a potential US tax disadvantage for either type of US investor. It is expected that non-US investors should be tax neutral as to whether to invest in an ICAV or Corporate Fund PLC.

A US taxable investor investing in an offshore fund that is treated as a corporation for US federal tax purposes, may face certain adverse US tax consequences. Most offshore funds are considered 'passive foreign investment companies' ("PFIC") for US federal income tax purposes. While PFIC classification need not necessarily in all circumstances give rise to adverse US tax consequences for US taxable investors, typically PFIC classification (even in the event of a fund electing to be a "qualifying electing fund") will reduce the attractiveness of the offshore fund for many US taxable investors. For that reason many fund promoters will only distribute an offshore fund to US taxable investors if such a fund can "check-the-box" to be treated as a partnership or disregarded entity for US tax purposes.

A Corporate Fund PLC is by default treated as a corporate entity for US tax purposes and cannot elect (unlike a unit trust) to be treated as a partnership for US tax purposes. This typically puts an onus on fund promoters to use either unit trusts or investment limited partnerships if they wish to attract US taxable investors.

It is expected that an ICAV should by default be treated as a corporate entity for US tax purposes, however (unlike a Corporate Fund PLC) it should have the ability to check-the-box to be treated as a partnership (if more than one investor) or disregarded entity (if only one investor) for US tax purposes. Therefore, the introduction of the ICAV should give fund promoters an additional option as to what legal entity they wish to use when establishing a fund which may have US taxable investors.

Where fund promoters wish to establish a master/feeder fund structure to accommodate both US taxable and US tax-exempt investors, the introduction of the ICAV should provide the option for the master fund to be formed as an ICAV as opposed to a unit trust or investment limited partnership. The feeder fund (for US tax-exempt investors and non-US investors) will be able to be formed as an ICAV, Corporate Fund PLC, unit trust or investment limited partnership as all 4 types of legal entities should be able to be treated as a corporate entity for US tax purposes.

Next steps

Having received feedback on the General Scheme of the ICAV Bill from stakeholders including inter alia the Central Bank, Office of the Director of Corporate Enforcement and the Irish funds industry, the Irish Department of Finance has instructed the parliamentary counsel to draft the full text of the ICAV Bill. Once the ICAV Bill is published, it will be reviewed by the Houses of the Irish Parliament before being enacted into Irish law.

Although there is no prescribed timeframe, it is expected that the applicable legislation will be enacted before the end of 2014 as a result of the priority given to the legislation by the Irish Government to date and the input by relevant stakeholders in the process to date. ■

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Footnotes:

1. *www.irishfunds.ie/fs/doc/statistics/stats-factsheet-december-2013.pdf*
2. *www.irishfunds.ie/fs/doc/statistics/stats-factsheet-december-2013.pdf*
3. *www.irishfunds.ie/fs/doc/statistics/stats-factsheet-december-2013.pdf*
4. *www.fsi.ie/Sectors/FSI/FSI.nsf/vPages/Advocacy_and_Policy_Development~ifsc-strategy-2011-2016/$file/IFS+Strategy+2011.pdf*
5. *Although the principal features of the ICAV are not expected to change given the commitment of the Irish Government and the level of input to date by relevant stakeholders, it should be noted that, as part of the legislative process, a number of reviews will take place by both Houses of the Irish Parliament once the ICAV Bill is published which may result in amendments.*