

Maximising International Restructuring opportunities under UCITS IV

A primary aim of the regulatory amendments included in UCITS IV was to facilitate the creation of more efficient structures within the UCITS framework.

The three key aspects of UCITS IV designed to assist in achieving this result are the new management company passport, provisions permitting the creation of master-feeder structures and the terms specifically enabling cross border fund mergers.

Now that the implementation date of UCITS IV has passed and the necessary updates to ensure on-going compliance have been met, increased attention is focusing on how best to capitalise on the international restructuring opportunities available for UCITS in this new environment. This article seeks to explore these opportunities and in particular to examine the potential advantages posed by the use of Ireland as a hub domicile in any such restructuring.

Background

UCITS, or Undertakings for Collective Investment in Transferable Securities, are investment vehicles established pursuant to pan European legislation.

UCITS have their legislative origin in a 1985 European Directive (85/611/EEC). The objective was to introduce a pan-European mutual fund product, which, once authorised in one EU member state (a "Member State"), could be sold in all other Member States, without the need to be separately authorised in each target jurisdiction. To achieve this, UCITS are required to meet a common European standard in terms of authorisation, investment restrictions, risk diversification and investor protection.

Because of the necessity to comply with this common European standard, UCITS are regarded as highly-regulated funds and operate on the basis of their potential for availability to the retail investor (although many are, in fact, targeted at institutional investors).

Following the initial success of the UCITS product, developments in financial products and the increasing popularity of new and alternative investment strategies highlighted the limited range of assets in which UCITS were permitted to invest and there was growing recognition that, despite its considerable success, the UCITS framework needed to adapt. This was largely accomplished by the implementation of "UCITS III" as two new directives, being Directive 2001/107/EC (the "Management Company Directive") and Directive 2001/108/EC (the "Product Directive") are normally collectively referred to as. UCITS III significantly widened the range of investment possibilities for UCITS funds.

Having successfully addressed concerns with the UCITS product under UCITS III, the next challenge to be addressed was to improve

the environment in which that product operates by means of further European regulatory amendments. Key changes were provided for in this legislation to facilitate the creation of more efficient structures.

Accordingly Directive 2009/65/EC (known as "UCITS IV") was adopted by the Council of the European Union in mid 2009 and was required to be fully implemented in each Member State by 30 June 2011, in order to come into force on 1 July 2011. It was implemented in Ireland on time by means of the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2011 (S.I. 352 of 2011) (the "UCITS Regulations"). This has addressed these structuring concerns by providing for the creation of master-feeder UCITS structures, cross border mergers of existing UCITS and the potential use of a single centralised management company.

The Management Company Passport

UCITS IV provides for a new form of EU passport whereby a management company domiciled and authorised in one Member State may manage UCITS established and authorised in other Member States (the "Management Company Passport"). It can be noted that there is no requirement to establish a branch or other physical operations in the other jurisdictions where the UCITS are based as services may be offered under the freedom to provide services on a passported basis. The Management Company Passport enables investment management groups to avoid the costs involved in maintaining multiple duplicate management companies in different Member States.

Availing of this passport requires that the management company first notifies the regulatory authority of the Member State where it is domiciled (the "Home State") that it intends to offer management services under the freedom to provide services into another Member State (the "Host State") together with a programme of operations citing the activities and services prescribed in the legislation which it intends to provide, together with a description of its risk management process and investor complaints handling procedures. This information is communicated by the management companies' Home State regulator to the regulatory authority of the Host State together with details of any restrictions on the types of UCITS which the management company is authorised to manage.

In the event that it is decided to establish a branch in the Host State this cannot be subject to more onerous restrictions than are applicable to management companies authorised in that Member State. However, the management company will be required to comply with the key rules relating to the constitution and functioning of the UCITS (as prescribed in the legislation) of the Home State of the UCITS, rather than the Home State of the management company (the "Rules").

The management company will also be required to furnish the Home State regulatory authority of the UCITS with a copy of the custody agreement of the UCITS and information on any delegation arrangements relating to investment management and administration. The UCITS Home State regulatory authority may request clarifications, if it feels this is necessary, but is required to give a decision on whether or not to approve the applicant management company within 10 working days of the initial request. Requests may only be turned down by the UCITS Home State regulator in very limited circumstances, such as where the management company does not comply with the Rules, it does not have the relevant authorisation in its Home Member State or relevant documentation has not been provided. The regulatory authority in the UCITS Home State is obliged to consult with the regulatory authority of the Home State of the management company before refusing an applicant.

Management Restructuring Opportunities using Ireland

Given that this new regime enables a management company to be established in the most attractive jurisdiction in the EU and to provide management services to each of the UCITS it manages from this central location, regardless of where they are located, it is appropriate to identify the jurisdiction best suited to play this role. Ireland has considerable advantages which make it a prime choice for selection as the jurisdiction in which to locate this central European management company, as detailed below.

Ireland is currently ranked in the top ten places in the world in which to do business by the World Bank¹. As an English speaking, common law jurisdiction with highly developed infrastructure it is frequently chosen as the location for European headquarters of international corporations². Ireland's 12.5% tax corporate rate, which would be applicable to profits of a management company, is one of the most attractive in the EU. Furthermore, the recession in Ireland has had a marked effect on its competitiveness in recent years, with rents falling by around 50%, staff costs dropping significantly and a greater pool of skilled potential employees becoming available, in particular due to consolidation and job losses in the financial sectors outside the Irish funds industry.

However, in addition to these general factors, as one of the key European fund domiciles with over 11,000 professionals working in the funds industry, Ireland presents this industry in particular with specific advantages. These include, a large established network of fund administrators and depositaries, the availability of comprehensive fund focussed international legal, tax and auditing expertise and a tax code which has been tailored to maximise the potential advantages afforded by UCITS IV, for example by clearly providing that a foreign UCITS will not be regarded as having a taxable presence in Ireland due to being managed by an Irish management company.

It can be noted that at present over 50% of the funds administered in Ireland (comprising 6,258 funds holding €828 billion in assets) are foreign funds, which illustrates the existing experience available in Ireland to administer international schemes³.

While the Management Company Passport enables economies to be realised where existing fund management companies are consolidated into a single entity, investment groups that currently have management companies and UCITS in multiple EU Member States may also wish to simultaneously take advantage of the other new provisions of UCITS IV to also restructure their existing fund structures to achieve greater efficiencies there as well as at the management level- for example by availing of the ability to create master-feeder UCITS structures.

Master-feeder structures

UCITS IV has provided for an exemption from the generally applicable UCITS investment restrictions in order to permit the creation of master-feeder UCITS structures. The relevant provisions provide that:

- the feeder fund is required to have at least 85% of its assets in a single master fund (with the remainder being held in either liquid assets, financial derivative instruments used for hedging or property used to carry on the business);
- the master UCITS may not be a feeder UCITS or invest into feeder UCITS; and
- the investment policy of the feeder UCITS must be approved by the competent authorities of the Home State of the feeder UCITS.

It can be noted that the establishment of cross-border master-feeder structures is specifically contemplated by the revised UCITS Regulations. The creation of such structures is subject to the prior approval of the Home State regulator of the feeder UCITS but where certain prescribed conditions are met such regulatory authorities are required to provide this authorisation under the provisions of UCITS IV. Feeder UCITS are required to provide specific information in their prospectus in order to ensure transparency, including in relation to the tax implications of an investment by the feeder UCITS into the master, remuneration or costs payable by the feeder and a summary of the agreement between the master and feeder.

There are also specific new provisions to facilitate the transformation of an existing UCITS into a feeder UCITS. The relevant requirements include providing relevant information to existing investors in the UCITS which is to convert into a feeder (in a language approved by the regulator of the feeder) and granting its unit holders the right to request the redemption of their holdings without any charges (other than the divestment costs of the UCITS).

The primary reasons for availing of the master-feeder structure are to ensure that the opportunity to avail of any advantages afforded by having a local feeder in specific Member States, which may arise due to marketing considerations or due to the application of local withholding or other taxes, for example, can be combined with the advantages afforded by using the most advantageous domicile in which to base a UCITS in Europe. The pooled structure will be able to achieve greater economies of scale and consequent cost efficiencies as well as other general advantages of the domicile chosen for the master vehicle, all to the advantage of investors. Considerations in regard to choosing the domicile for the establishment of the master fund would include, the tax treatment of the UCITS in each Member State, the distribution network of UCITS domiciled in that country and the availability of a broad network of service providers offering services with cost benefits for larger funds. The key advantages which Ireland poses for master-feeder structures under these headings are detailed below. However, before exploring these it would be appropriate to first examine the opportunities available under UCITS IV to streamline existing funds even further by simply merging them into a single entity, another of

¹ See *The World Bank, International Finance Corporation*, <http://www.doingbusiness.org/rankings>

² See *Industrial Development Authority statistics*: <http://www.idaireland.com/why-ireland/>

³ See *latest Irish Fund Industry Association statistics*: <http://www.inshfunds.ie/statistics.htm>

the efficiencies specifically provided for under UCITS IV for the first time, as the advantages which Ireland offers in both such restructuring scenarios are similar.

Fund Mergers

UCITS IV provides for pan-European mergers of UCITS, regardless of the legal structure of either of the merging entities. It outlines procedures and requirements for such fund mergers and competent regulatory authorities may only refuse merger applications if these have not been observed. This is intended to facilitate the consolidation of European fund products, enabling UCITS to benefit from greater economies of scale and consequent lower operating costs. Furthermore it can be noted that there is a requirement for a decision on whether to approve a proposed merger of UCITS to be reached by the regulatory authorities of the merging UCITS within 20 working days so the process is reasonably expeditious. A range of merger options exist to cater for different practical scenarios including merger by absorption, merger into a new fund and amalgamation.

Consequently, where a group has a number of UCITS, either in the same or multiple Member States and this situation has arisen due to legacy or marketing reasons it may be preferable to take advantage of the opportunity to streamline the product range into a single UCITS platform through a merger or series thereof.

UCITS IV has also revised the passporting regime through which UCITS can be registered for sale in other Member States. The new streamlined regulator-regulator filing process is considerably more efficient than the pre-existing notification regime so this improvement has further reduced any arguments in favour of having separate UCITS in different member states

It can be noted that it is also possible for a fund established as a non-UCITS to later convert to a UCITS so any such consolidation of existing products could also be carried out simultaneously in conjunction with the conversion of non-UCITS structures, to the extent that their strategies were compatible with the UCITS restrictions, and their amalgamation into a single platform structure, hence assuring even greater potential efficiencies.

Investment Managers with offshore funds may also consider taking advantage of availing of the separate legislation enabling the redomiciliation of offshore funds to onshore jurisdictions such as Ireland, thereby potentially enabling the complete restructuring of a diverse international range of onshore and offshore funds, structured in various legal forms and authorised under a variety of regulatory regimes into a single fund platform in one jurisdiction which, in UCITS, has an internationally respected form of authorisation and unsurpassed potential for international distribution.

Restructuring Opportunities using Ireland in Consolidated UCITS Structures

Both the master-feeder and fund merger types of restructurings facilitate fund promoters to select the optimal jurisdiction to act as domicile to their primary consolidated UCITS platform independently of legacy issues which might previously have set the agenda and meant that they ended up employing a disparate range of funds spread across multiple Member States to the detriment of efficiency and cost control. In any such analysis of the optimal jurisdiction the prerequisites of the jurisdiction of choice will be defined in terms of its regulatory framework, tax efficiency, distribution network and servicing ability.

- Legal and Regulatory Framework

A common law jurisdiction, Ireland's legal system can offer the full range of corporate, trust and contractual vehicles within which UCITS can be structured.

Over 3,000 UCITS funds or sub-funds, with combined total assets of almost €800 Billion, currently operate under the authorisation of the relevant Irish regulatory body, the Central Bank of Ireland (the "Central Bank"), ensuring that it has a strong track record of prudential supervision of Irish investment funds and the regulated firms providing services to them⁴.

The Central Bank has set out clear timeframes for fund authorisations and currently meets 100% of its approval deadlines. Comments are received within three weeks for new UCITS launches. In addition to UCITS Notices, which supplement the relevant legislation in Ireland, its regularly issues topical Guidance Notes to ensure clear regulatory standards and guidance on key issues.

At the same time the Central Bank has proven to be adaptable in amending its regulations to ensure these remain appropriate and operates an 'open door' policy in dealing with fund promoter issues. For example, UCITS IV was fully implemented on time in Ireland following a lengthy consultation process between representatives of the funds industry and the Central Bank.

Ireland is a member of the Organisation for Economic Co-operation and Development (OECD) and the Financial Action Task Force (FATF), as well as the EU.

- Taxation Considerations

Ireland is a highly tax efficient jurisdiction for the domiciliation of funds. Irish regulated funds, including UCITS, benefit from the following attractive tax provisions:

- no on-going or yearly tax is charged on the UCITS net asset value;
- they are exempt from Irish tax on their income and gains irrespective of an investor's residency. This allows investors' returns to roll up on a gross basis;
- under Irish legislation, no withholding tax is applied on income distributions or the redemption of units by UCITS to non-Irish resident investors even if the investor is not resident in a country with which Ireland does not have a double tax treaty;
- no Irish stamp duty is applied on the establishment, transfer or sale of units or shares in an Irish regulated fund;
- many of the services provided to UCITS are exempt from VAT, e.g. investment management, administration and custodial services;
- Ireland does not withhold tax under the European Union's Taxation of Savings Directive;
- Ireland is not regarded as a tax haven. and is listed on the OECD's "white list" for internationally agreed tax standards; and
- Ireland is party to more than 60 double tax treaties, the provisions of which may be accessed by funds or structures involving funds.

In addition, the Irish taxation code contains provisions to ensure that no Irish transfer tax applies on UCITS mergers, including funds merging into Ireland.

⁴ See latest Irish Fund Industry Association statistics: <http://www.irishfunds.ie/statistics.htm>

- Distribution Network

Irish domiciled UCITS are currently distributed in over 70 countries, showing it is the ideal hub for international distribution of UCITS. Already over 30% of all cross border UCITS are domiciled in Ireland and following the implementation of UCITS IV in Ireland this percentage seems destined to grow considerably in view of its attractions as a location to domicile the master fund in a master-feeder structure or to be the single domicile following a pan-European merger of existing funds.

- Industry Expertise and Depth

Over 11,000 professionals are directly employed in the funds industry in Ireland. This body of expertise is supported by a large pool of experienced support professionals including lawyers, tax advisors, consultants and auditors. There are over 50 authorised fund administrators in Ireland, the majority of which are subsidiaries of large global firms. Many of these firms also have sister companies offering custody operations, all of which ensure a highly competitive market offering particularly attractive terms for larger funds on a sliding scale due to their inherent economies of scale.

Irish service providers are renowned for their flexible, solution-orientated approach, which has been one of the driving forces behind the growth of the funds industry in Ireland over the last 20 years and is one of the primary reasons why over 6,000 foreign funds are already administered from Ireland⁵. In addition a recent EFAMA survey found that Ireland had the highest trade automation rate in 2010, facilitating greater operational efficiency and proving a further boost to international fund servicing.

The last ten years have also seen a huge growth in the ability to provide international multilingual investor servicing by the funds industry in Ireland.

In Summary

UCITS IV offers fund promoters a variety of mechanisms to increase the efficiency of their management and fund distribution networks. Key considerations in determining which jurisdiction to select to maximise the potential afforded under these new opportunities are the legal and regulatory environment, the relevant taxation provisions, the potential distribution network and the availability of a broad network of relevant service providers. Ireland is already one of the leading international fund domiciles in Europe and has considerable advantages to offer under each of these criteria.

⁵ See latest Irish Fund Industry Association statistics:
<http://www.irishfunds.ie/statistics.htm>

How Mason Hayes & Curran can Assist

The dedicated Investment Funds Practice at Mason Hayes & Curran advises on all aspects of investment funds law and regulation including structuring, establishing and the on-going operation of investment funds in Ireland. In particular, we have significant experience of advising international investment managers and promoters on the authorisation process with the Central Bank and then on establishing Irish domiciled UCITS for international distribution, both within Europe and further afield.

As a full service law firm the Investment Funds Practice is further supported by the broader Investment Funds Group at Mason Hayes & Curran which includes specialist practitioners from the Tax, Corporate, Dispute Resolution, Banking, Intellectual Property, Employment and Financial Services Regulation Practices who have experience of applying their specialisations to the funds industry. This allows us to ensure specialised advice in relation to all relevant matters affecting both funds and their management companies which chose to domicile in Ireland.

In addition to establishing new UCITS structures we have specific experience in converting funds initially established as non-UCITS, including professional investor and qualifying investor funds, into UCITS, changing service providers, amending investment objectives and arranging for the international distribution of UCITS so the funds team at Mason Hayes & Curran are already well acquainted with the types of restructuring operations contemplated under UCITS IV and ideally placed to assist with relevant projects.

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Mason Hayes+Curran is a leading Irish full service law firm with 58 partners, over 270 employees and offices in Dublin, London and New York.

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