A Guide to Establishing UCITS in Ireland

KB Associates
Fund Consulting

Independence - Commitment - Expertise

KB Associates ("KBA") is an independent consulting firm dedicated to enabling managers successfully establish and operate investment funds.

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Introduction

UCITS offer investment managers a unique opportunity to significantly expand their distribution. UCITS are entitled to passport throughout the EU and have been approved for distribution in over eighty five countries.

UCITS offer investors a product which operates within a well-defined regulatory framework where significant checks and balances exist.

Given the appetite of investors for such well-regulated products and the distribution opportunities which UCITS offer to investment managers, UCITS represent over 60% of the overall investment fund market in Europe.

Benefits of Launching a UCITS in Ireland

Leading funds domicile

Ireland is a leading domicile and administration centre for both UCITS products and alternative investment products. Assets under administration are €3.7 trillion. Irish domiciled funds amount to €1.8 trillion. Over 75% of all Irish domiciled funds are UCITS.

Expertise in alternative and complex strategies

In excess of 40% of global hedge funds are administered in Ireland. Ireland's history of providing administration services to alternative investment products has led to significant expertise in administering complex financial instruments and strategies. Ireland is the leading domicile for alternative UCITS. Assets in alternative UCITS have grown by more than 30% per annum since 2008.

Efficient regulatory approval process

The Central Bank of Ireland (the "Central Bank") provides a pragmatic and efficient regulatory approval process. The timeframe for gaining UCITS approval generally ranges from ten to twelve weeks.

Favourable taxation regime

- Irish UCITS are not subject to Irish taxation on any income or gains
- No Irish tax applies to the net assets of UCITS
- Distributions may be made to non-Irish shareholders without the application of withholding taxes
- Wide ranging VAT exemptions are available on services to Irish UCITS (administration expenses, depositary expenses and investment management expenses)
- Irish UCITS may access Ireland's double taxation treaty network with over seventy countries

Choice of fund structures

The most common legal forms which UCITS may take are:

- Open-ended Unit Trust with appointed management company
- Common Contractual Fund ("CCF") (tax transparent fund) with appointed management company
- Irish Collective Asset-management Vehicle ("ICAV") with appointed management company
- Self-managed ICAV

Allowable Investment Strategies

UCITS may use derivatives as part of a fund's investment strategy as well as for hedging purposes.

UCITS must provide twice monthly liquidity to investors. The liquidity of assets held in UCITS must not compromise a fund's ability to do so.

The following list sets out strategies that are currently acceptable under the UCITS guidelines:

Traditional strategies

- Equity
- Fixed income
- Convertible bond
- Money market

Alternative strategies

- Equity long/short
- Credit long/short
- Fixed income long/short
- Absolute return
- Convertible arbitrage
- Commodity index
- Hedge fund index
- Funds of UCITS funds
- Managed futures/CTA
- Global macro

How to Launch a UCITS in Ireland

To successfully launch UCITS the key steps are:

1. Choose an appropriate structure

Unit Trust with appointed management company (an external management company such as that of KBA or a proprietary management company)

- Generally used where there is a particular taxation or marketing benefit to using a trust structure (The Unit Trust has traditionally been an attractive option for taxable US investors as it can “check the box” for US tax purposes)
- A trust may be set up as an umbrella structure with segregated liability between sub-funds
- A trust requires an appointed management company which will need to comply with minimum capital requirements as set out by the Central Bank
- The entity establishing a Unit Trust may utilise an external management company such as that of KBA to transfer risk and the capital requirement to an external entity and to facilitate speed of establishment
- Alternatively, the entity establishing a Unit Trust may choose to utilise a proprietary management company.

CCF with appointed management company (an external management company such as that of KBA or a proprietary management company)

- Generally used where there is a requirement for a tax transparent vehicle
- Investors in a CCF are treated as if they directly own a proportionate share of the underlying investments of the CCF and therefore profits and dividend income are treated as accruing or arising to the investors as if they had not passed through the CCF
- The relevant double tax treaties (“DTT”) are those applying between the country of each investor and the countries into which investments are made. The CCF is treated as tax transparent in over twenty markets including Australia, Canada, Germany, Italy, Netherlands, Switzerland, UK and USA
- A CCF is an unincorporated entity established by a deed of constitution between a manager and a depositary who enter into agreements on behalf of the CCF
- A CCF may be set up as an umbrella structure with segregated liability between sub-funds
- A CCF requires an appointed management company
- The entity establishing a CCF may utilise an external management company such as that of KBA to transfer risk and the capital requirement to an external entity and to facilitate speed of establishment
- Alternatively, the entity establishing a CCF may utilise a proprietary management company.

Irish Collective Asset-management Vehicle (ICAV) with appointed management company (an external management company such as that of KBA or a proprietary management company)

- The most popular fund structure in Ireland is the ICAV
- An ICAV can elect to be treated as a tax transparent entity for US federal income tax purposes
- An ICAV is a bespoke corporate structure that reduces the need for compliance with certain Irish company law requirements, e.g. no requirement to hold an AGM

- An ICAV is not subject to the risk spreading/diversification requirements which apply to investment companies
- An ICAV may be set up as an umbrella structure with segregated liability between sub-funds
- ICAV sub-funds may produce their own sub-fund financial statements. Sub-funds in an umbrella ICAV may have different year ends and may adopt different accounting standards. There is no requirement for consolidation
- Generally an ICAV with a management company such as KBA is used to ensure that there is significant demonstrable substance to a fund structure
- A management company must comply with minimum capital requirements as set out by the Central Bank
- The entity establishing an ICAV may utilise an external management company such as that of KBA to transfer risk and the capital requirement to an external entity and to facilitate speed of establishment
- Alternatively, the entity establishing an ICAV may utilise a proprietary management company.

Irish Collective Asset-management Vehicle (ICAV) with no management company (self-managed ICAV)

- A self-managed ICAV is a corporate entity which is directly responsible for appointing its administrator, depositary and investment manager. It is responsible for and performs the UCITS business plan (governance) functions
- A self-managed ICAV avails of the same regulatory advantages as an ICAV with a management company.

2. Select and appoint service providers

Administrator

UCITS must appoint an administrator incorporated in Ireland and authorised to provide administration services by the Central Bank.

The administrator is responsible for:

- Processing fund subscriptions and redemptions
- Calculating the net asset value (NAV)
- Preparing financial statements.

The choice of administrator is a critical decision since it is the administrator that interacts with investors.

There are circa forty administration companies operating in Ireland.

Depositary

UCITS must appoint a depositary which may be:

- A credit institution
- An institution authorised by a national competent authority under the UCITS Directive.

The depositary is responsible for:

- Safekeeping the assets and settling trades
- Cash monitoring
- Overseeing the activities of the administrator and investment manager

There are circa eighteen specialist depositaries operating in Ireland.

The administrator and the depositary are required to be separate legal entities but may be part of the same economic group.

Investment Manager

An investment manager must be regulated in its home country, which must be a country recognised by the Central Bank as having equivalent regulatory oversight.

Legal advisor & listing agent

There are eleven firms with dedicated investment funds practices in Ireland.

If a fund wishes to be listed on the Irish Stock Exchange, a listing agent is required. Many of the legal advisors offer listing agent services as do a number of stockbroking firms.

Auditor

UCITS need to appoint an auditor. The 'big four' and a number of other firms provide audit services to funds.

Tax advisor

UCITS may appoint a tax advisor to advise on disclosures relating to taxation in the prospectus, on accessing double taxation treaties and general tax compliance. The appointment of a tax advisor is particularly important when establishing a CCF.

Irish resident directors

There is a regulatory requirement to appoint two Irish resident directors. Best practice is to appoint directors who are independent of each other. The directors of a fund (both Irish resident and non-Irish resident) are subject to the approval of the Central Bank.

Consultant

For a self-managed structure or where a proprietary management company exists, UCITS may require the services of a consultancy firm to advise on the eligibility of investment strategies and to prepare a business plan (governance) and risk management document. The consultant may project manage the UCITS set-up which may include advising on the appointment of a suitable administrator, depositary and other service providers.

On an ongoing basis, the consultant may provide individuals to perform the six managerial functions set out in the business plan/governance document and to provide operational and compliance support.

Management Company

UCITS may decide to appoint an external management company such as that of KBA. This transfers risk and the capital requirement to an external entity. Reliance is placed on the existing infrastructure in place at a management company in respect of the launch and operation of a fund. Reliance is also placed on the management company's existing UCITS compliant business plan/governance regime.

Money Laundering Reporting Officer

An Irish investment fund is required to appoint a Money Laundering Reporting Officer ("MLRO"). The MLRO is potentially subject to fines or imprisonment under the relevant legislation. There is no requirement that this position be filled by an Irish resident.

Company Secretary

Irish Company Law requires every company to have a company secretary.

3. Obtain Central Bank approval of investment manager

The Central Bank must approve the investment manager. If the investment manager is not an Irish entity, it is not itself subject to authorisation or supervision by the Central Bank but the Central Bank must satisfy itself that the entity is appropriately regulated in its home state which must be a country recognised by the Central Bank as having equivalent regulatory oversight.

There is no Central Bank imposed minimum capital requirement for a UCITS investment manager.

4. Draft the UCITS business plan

Where a management company is appointed, it is the management company that is required to comply with the UCITS business plan (governance) and capital requirements.

Where a UCITS is self-managed, the UCITS entity itself is required to prepare a business plan and comply with the UCITS governance requirements.

Each UCITS (or its management company) requires a governance document known as a business plan. It addresses the following functions:

- Investment management
- Fund risk management
- Operational risk management
- Regulatory compliance
- Capital and financial management
- Distribution

The business plan sets out how the UCITS will perform the above six functions, who will perform them and the lines of reporting that will be set up to achieve this. The performance of the operational and risk management functions must be segregated from the performance of the investment management function.

Additionally, UCITS are required to put in place an organisational effectiveness role which is segregated from the performance of all managerial functions and must be performed by an independent director. The role includes reviewing board composition, reviewing organisational structure and ensuring that adequate resources are available to carry out all managerial functions.

The directors of UCITS (or a management company) may carry out the functions specified in the business plan or delegate these to named individuals/designated persons. The individuals must be approved by the Central Bank to undertake such tasks.

It is necessary for UCITS to have either directly or through their service providers, written policies and procedures in respect of a number of areas including:

- Risk management*
- Complaints handling*
- Accounting policies and procedures*
- Conflicts of interest/related party transactions*
- Exercise of voting rights*
- Valuation*
- Remuneration**
- Due diligence on investments
- Best execution
- Order handling
- Inducements
- Subscriptions/redemptions
- Late trades and market timing
- Cyber security
- Business continuity planning
- Recordkeeping
- Whistleblowing
- Anti-Money Laundering ("AML") and Counter Terrorist Financing ("CTF")
- Personal transactions

* These policies and procedures must be explicitly referred to in the business plan.

** Remuneration is included in the business plan but the policy itself is maintained as a separate policy on the website of the UCITS, in the UCITS prospectus and in the UCITS annual report. An overview of the remuneration policy is also included in the KIID ("Key Investor Information Document").

5. Draft the Risk Management Process ("RMP") Document

If a UCITS intends to use derivatives, it must prepare an RMP document for submission to the Central Bank.

An RMP details the staff, procedures and systems utilised by the investment manager to manage the risks associated with the use of derivatives. It is necessary to complete such a RMP even where derivatives are utilised exclusively for hedging purposes.

An RMP should cover the following:

- The manner in which the investment manager measures global exposure, leverage, issuer concentration, position cover and counterparty exposure
- The limits that apply to each exposure (e.g. counterparty exposure and global exposure)
- The monitoring and maintenance of limits
- The reporting and escalation of breaches

UCITS must monitor and measure global exposure at least daily. Global exposure is the incremental risk generated by the use of Financial Derivative Instruments ("FDIs").

UCITS may elect to use either the commitment approach for measuring global exposure and leverage, or may use an advanced risk management technique (e.g. Value at Risk ("VaR")). The commitment approach requires each FDI position to be converted into the market value of an equivalent position in the underlying asset of that derivative.

Commitment approach rules

Using the commitment approach to measure global exposure, FDI exposure is measured as the positive market value of the equivalent underlying position. FDI and security positions may be netted to reduce total global exposure as long as the following conditions are met:

- Between FDIs, provided they refer to the same underlying asset, even if the maturity dates of the FDIs are different
- Between an FDI (whose underlying asset is a transferable security, money market instrument or a collective investment undertaking) and that same corresponding underlying asset

The calculation of global exposure is always presented as an absolute positive number and does not allow for the calculation of negative commitments. UCITS using the commitment approach must ensure that the global exposure from the use of FDIs does not exceed total NAV.

Advanced risk measurement technique rules

UCITS must use an advanced risk measurement technique to measure global exposure where:

- The UCITS engages in complex investment strategies and/or
- The UCITS has more than a negligible exposure to exotic derivatives and/or
- The commitment approach does not adequately capture the market risk of the UCITS portfolio.

When measuring global exposure using VaR, UCITS may use Absolute VaR or Relative VaR.

Absolute VaR is the VaR of UCITS as a percentage of the NAV. Absolute VaR must not exceed 20% of the NAV.

Relative VaR is the VaR of UCITS divided by the VaR of a UCITS eligible benchmark or reference portfolio. Relative VaR must not exceed two.

The VaR model must comply with the following requirements:

- The confidence level must be 99%
- The maximum holding period is twenty days
- The minimum historical holding period is one year

The VaR model may use a different confidence level and/or holding period, provided the confidence interval is not below 95% and the holding period does not exceed twenty days. In such instances the VaR limit must be adjusted accordingly.

6. Draft required legal documentation

The following key legal documents (in addition to the business plan and RMP) must be drafted by the UCITS' legal advisor and filed with the Central Bank as part of the UCITS approval process:

- Constitutive documents (Trust Deed for a Unit Trust/ Deed of Constitution for a CCF/Instrument of Incorporation for an ICAV)
- Prospectus
- KIID
- Depositary agreement
- Administration agreement
- Investment management agreement
- Distribution agreement (if applicable)
- Management agreement (if applicable)

Ongoing Requirements of a UCITS

The following ongoing requirements must be satisfied:

- ❖ UCITS must monitor monthly, or on a more frequent basis where required, the reporting required by the business plan in meeting the requirements of the six management functions
- ❖ UCITS must submit, via the administrator, monthly statistics to the Central Bank, to include gross assets, net assets, units in issue, net asset value per unit, subscription and redemption amounts
- ❖ UCITS must hold quarterly board meetings at which reports from the administrator, depositary and investment manager must be produced
- ❖ UCITS must receive and review quarterly reporting that covers all requirements set out in the UCITS' business plan
- ❖ UCITS must produce audited annual and unaudited semi-annual financial statements for filing with the Central Bank and for distribution to investors
- ❖ UCITS must submit an annual FDI report on the use of derivatives and any breaches of exposure limits
- ❖ UCITS must submit a revised RMP document to the Central Bank should any material amendments be made to the document
- ❖ UCITS must obtain prior Central Bank approval of any board appointments
- ❖ UCITS must maintain an up-to-date prospectus and KIID. An updated KIID must be produced at least annually and where there is a material change to the UCITS
- ❖ UCITS must ensure that the prospectus, KIID and annual report include an up-to-date remuneration policy and that remuneration details of professional staff are included in annual reports.

Solutions Offered by KB Associates

KBA is an independent provider of management company and consulting services. KBA is dedicated exclusively to meeting the needs of managers promoting investment funds.

KBA is independent of the various service providers to UCITS (administrators, depositaries, auditors, legal advisors etc). As it offers services solely to funds, KBA is well positioned to monitor the performance of service providers as required by the UCITS management directive. This ensures that KBA avoids potentially significant conflicts of interest.

KBA is entirely independent of all potential service providers and professional advisors.

KBA offers a range of solutions to UCITS including the following:

Project management of set-up

KBA can provide a complete turnkey set-up service or provide assistance with elements of the set-up process to include:

Administrator and Depositary selection

KBA has significant experience in service provider selection. KBA maintains a database detailing the product offering of each service provider based in Ireland. KBA also oversees service providers on behalf of our clients. This allows us to monitor the actual quality of service against the stated capabilities.

Professional advisor selection

KBA can advise on the selection of the auditor, legal advisor and listing agent.

Development of operational model and service level agreement

KBA can establish operating procedures between the various service providers to UCITS, principally between the investment manager, administrator and depositary. KBA can also establish service level standards with the service providers and set in place reporting procedures to monitor actual performance against agreed standards.

Preparation/Review of Business Plan

Where the business plan of UCITS is prepared by the legal advisor to a fund, KBA will review the business plan. Alternatively KBA can prepare the business plan. KBA has a team of consultants with expertise in risk, investment management, compliance, finance and operations, and is well placed to prepare a pragmatic business plan meeting the Central Bank's requirements without placing unnecessary burden on a fund or its investment manager. Where the KBA management company is appointed, the business plan used will be the existing KBA management company business plan.

Advise on eligible investment strategies and preparation of the RMP document

KBA advises on the eligibility of specific investment strategies under the UCITS investment restrictions. KBA has particular experience in the preparation of RMP documents.

Review of fund documents

KBA can review all legal documents (prospectus, KIID, supplements, depositary agreement, administration agreement and investment management agreement) from an operational perspective.

KBA Management Company

KBA management company is authorised by the Central Bank to support both UCITS and AIFMD compliant funds. It allows asset managers to establish funds without incurring the costs of incorporating and operating a proprietary management company. It also significantly reduces the time commitment and administrative burden placed on asset managers. KBA management company assumes legal responsibility for overseeing the investment management, distribution and fund administration activities performed by its appointed agents. KBA management company's directors have expertise in investment management, risk management, depositary responsibilities and fund operations.

Performance of business plan functions

KBA currently supports a number of UCITS by providing consultants to undertake the management functions which the business plan requires a fund company to fulfill. The consultants to whom the board of directors delegates performance of the business plan functions must be identified in the business plan and approved by the Central Bank. KBA consultants have been approved to perform this role.

Operational and compliance support

The UCITS business plan identifies a number of specific functions defined by the regulations, which KBA undertakes for its clients.

KBA provides operational and compliance support to its clients beyond the functions specified in the business plan. This may entail a range of activities including KBA completing on-site reviews of the depositary and administrator, identifying opportunities for UCITS to reclaim VAT, reviewing compliance with the Irish Funds corporate governance requirements and acting as fund system administrator for Central Bank reporting. Where appointed to provide services to UCITS, KBA acts as a fund's and the investment manager's operations and compliance partner in Ireland.

Directors

KBA provides professionally qualified directors with many years' experience in the investment funds industry.

Money Laundering Reporting Officer

The MLRO is responsible for overseeing the adequacy of the work undertaken by the administrator in relation to compliance with anti-money laundering legislation. At KBA, this function is performed by professionally qualified consultants who are members of the Association of Compliance Officers in Ireland.

Company Secretary

Irish Company Law requires every company to have a company secretary. KBA provides a dedicated company secretarial service to UCITS investment companies and UCITS management companies.

Distribution Support and Fund Registration

KBA assists asset managers with the implementation of their fund distribution strategies. KBA has in-depth expertise in this area and provides advice on distribution trends and share class design. KBA also advises on the appointment of distribution partners in many markets.

KBA provides a fund registration service to assist clients with the marketing of UCITS and AIFMD compliant funds on a cross-border basis. This service includes:

- Managing the initial registration of funds
- Maintaining the registration status on an ongoing basis
- Monitoring the registration jurisdictions for changes to local regulations

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