A Guide to Establishing an Alternative Investment Fund in Ireland

KB Associates
A Waystone Group Company

Commitment - Expertise

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

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Alternative Investment Funds ("AIFs")

AIFs in Ireland may be established as either Retail Investor Alternative Investment Fund ("RIAIFs") or Qualifying Investor Alternative Investment Funds ("QIAIFs").

A RIAIF may be marketed to retail investors and no minimum subscription requirements apply. A RIAIF must utilise an authorised Alternative Investment Fund Manager ("AIFM"). However, as it is a retail product, a RIAIF cannot avail of the automatic right to market across Europe under the AIFMD marketing passport. The marketing passport provides access only to professional investors. The Central Bank of Ireland ("Central Bank") imposes investment restrictions (e.g. limitations on investments in securities which are not traded on a regulated market) and diversification requirements on RIAIFs.

Most AIFs are established as AIFMD compliant QIAIFs. A QIAIF offers an investment manager a structure with virtually no investment restrictions. Strategies adopted by QIAIFs include:

- Hedge funds
- Private equity
- Venture capital
- Property
- Fund of funds
- Direct lending / loan origination
- Infrastructure investment.

Only "qualifying investors", i.e. an informed investor or professional client under MiFID, may invest and a minimum investment of €100,000 is required. There are no limits on subsequent investments.

Benefits of launching a QIAIF in Ireland

Flexibility

A QIAIF offers flexibility which is not available within UCITS or RIAIFs such as:

- The requirements for twice monthly liquidity, diversification of investments and borrowing restrictions that apply to a UCITS fund do not apply to a QIAIF
- A QIAIF may invest in a full range of assets from listed securities to exotic derivatives, hedge funds, ETFs, private equity, real estate, precious metals and infrastructure assets.

Distribution channels

A QIAIF authorised under AIFMD can avail of an EU marketing passport for sale to professional investors within the EU.

Leading funds domicile

Ireland is a leading domicile and administration centre for both AIF and UCITS products. Total assets under administration are approx. €4.3 trillion. Irish domiciled funds amount to over €2.2 trillion. The total assets of Irish domiciled AIFs stand at over €520 billion.

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 complex financial instruments and strategies.

Efficient regulatory approval process

The Central Bank provides a pragmatic and efficient regulatory approval process. A QIAIF utilising the services of an established AIFM can be established within 8-10 weeks. The Central Bank provides a 24 hour approval timeframe once the appropriate documentation has been filed. The speed to market is determined primarily by the time taken to appoint service providers, negotiate contracts and draft the prospectus.

Favourable taxation regime

- QIAIFs are not subject to Irish taxation on either income or gains
- No Irish tax applies to the net assets of a QIAIF
- Distributions may be made to non-Irish shareholders without the application of withholding taxes
- Wide ranging VAT exemptions are available on services to a QIAIF (administration expenses, depositary expenses, and investment management expenses)
- QIAIFs may access Ireland's double taxation treaty network with over 70 countries.

Choice of fund structures

The most common legal forms which a QIAIF may take are:

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

AIFMD Summary

Requirement for an AIFM

It is the AIFM that is regulated by AIFMD, not the QIAIF. A QIAIF may access the EU marketing passport by appointing an AIFMD compliant manager or may be a self-managed structure whereby it acts as both the AIF and the AIFM.

An AIFM with assets of less than €100 million can operate as a "registered" AIFM. Such entities are subject to only limited obligations under AIFMD. AIFMs with assets in excess of €100 million (€500 million where the AIFM does not use leverage and has a five year lock-in period for investors) are "authorised" under AIFMD and must comply with all requirements of AIFMD.

Minimum capital requirements

Self-managed AIFMs are required to have initial capital of €300,000. An external AIFM is required to have initial capital of at least €125,000 in place plus 0.02% of the value of the portfolios of the QIAIFs it manages in excess of €250 million, subject to a cap of €10 million.

There is an additional requirement for external AIFMs to have in place insurance for an amount equal to 0.90% of the Assets under Management ("AUM") or alternatively to hold additional capital equivalent to 0.01% of the AUM.

Delegation of functions

AIFMD identifies portfolio management and risk management as the core functions of the AIFM. An AIFM must notify the Central Bank if it chooses to delegate any of its functions and must have an objective reason to delegate any of these functions. An AIFM cannot delegate so many of its functions that it is deemed to be a "letter box" entity. In reality, most self-managed and third party AIFMs perform the risk management function and delegate the portfolio management function.

Depositary

A depositary must be appointed to each QIAIF to provide services such as safe-keeping of assets, oversight and cash monitoring services. The depositary must be based in Ireland and approved by the Central Bank. An AIFM cannot act as a depositary.

Risk management

The regulations require that an AIFM must functionally and hierarchically separate the risk management function from its operating units, including portfolio management. An AIFM may delegate elements of investment management, which includes both portfolio management and risk management. While a majority of investment management may be delegated the portion delegated should not exceed by a "substantial margin" that portion retained by the AIFM. Therefore it cannot delegate a substantial majority of each of portfolio management and risk management at the same time. There is a requirement to retain a significant element of portfolio management and/or risk management within the AIFM.

Each AIFM must also implement adequate risk management systems to identify, measure, manage and monitor all risks relevant to each QIAIF it manages or has exposure to. An AIFM must establish and implement risk limits for each QIAIF, covering market risks, credit risks, liquidity risks, counterparty risks and operational risks. These limits must be aligned with the QIAIF's risk profile and take into account the QIAIF's strategies and assets.

Valuation

AIFMs are required to ensure the proper and independent valuation of each relevant QIAIF's assets at least once a year. An AIFM can undertake the valuation itself but only if the valuation function is functionally independent from the portfolio management function. It is also possible for an external valuer to be appointed.

Remuneration

Under AIFMD, an AIFM is required to establish remuneration policies which encourage sound risk management and do not promote excessive risk-taking. Remuneration refers to all payments or benefits paid by the AIFM, any payments by the QIAIF itself or any transfer of shares in the QIAIF to AIFM identified staff (i.e. those staff whose professional activities have a material impact on the AIFM's risk profile).

Marketing

QIAIFs may be distributed to EU professional investors as follows:

- An authorised EU AIFM which can use the AIFMD marketing passport
- National Private Placement Rules ("NPPRs") may be utilised by non-EU managers to market their funds in EU jurisdictions. These NPPRs however vary from country to country and may be phased out after 2018
- The use of reverse solicitation.

Asset stripping

Where a QIAIF acquires control of an EU portfolio company, its AIFM is required to use "best efforts" to prevent asset stripping for 24 months following the acquisition of control. Control generally means acquisition of more than:

- 50% of the voting rights of an unlisted company; and
- 30% of the voting rights, in the case of a listed company with an Irish registered office.

Leverage

Under AIFMD, there is no limit for leverage however an AIFM should establish for each QIAIF a limit on the maximum leverage level it will employ which must be disclosed to investors and regulators (both total leverage employed and maximum allowed). Leverage may be calculated under either the gross or the commitment method. Under the gross method, all positions of the QIAIF are taken into account, and derivative exposures are translated into the market value of equivalent positions. The leverage under this method is the gross sum of all the translated exposures. Under the commitment method, hedged or offsetting positions are netted against each other before the leverage is calculated.

An AIFM must conduct periodic stress tests and scenario analysis to assess the vulnerability of a portfolio to extreme or unusual market events or conditions. An AIFM must also conduct periodic back testing of its own risk management arrangements to assess the robustness and reliability of the models employed within the risk management function.

How to Launch a QIAIF in Ireland

To successfully launch a QIAIF, the key steps are:

1. Choose an appropriate structure

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

- The most popular fund structure in Ireland is the ICAV. The ICAV's key benefits are:
  - 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 certain 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
- 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 AIFMD governance functions
- A self-managed ICAV avails of the same regulatory advantages as an ICAV with a management company.

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

- 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.

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 20 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.

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.

2. Select and appoint service providers

Administrator

An AIFM must appoint an administrator incorporated in Ireland and authorised by the Central Bank for each QIAIF it manages.

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 over 40 administration companies operating in Ireland.

Depositary

A QIAIF must appoint a depositary which may be:

- An EU credit institution
- A MiFID investment firm which satisfies the same minimum capital requirements as an EU credit institution
- An institution entitled to act as a UCITS depositary.

An AIFM cannot act as a depositary and a prime broker acting as counterparty to a QIAIF is only permitted to act as a depositary if it has separated the performance of its depositary functions from its tasks as a prime broker.

The depositary is responsible for:

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

There are over 18 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 12 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

A QIAIF needs to appoint an auditor. The 'big 4' and a number of other firms provide audit services to funds.

Tax advisor

A QIAIF 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 2 Irish resident directors. Best practice is to appoint directors who are independent of each other. The directors of each QIAIF (both Irish resident and non-Irish resident) are subject to the approval of the Central Bank.

Consultant

A QIAIF may require the services of a consultancy firm to prepare a programme of activity ("POA") (governance) document for the relevant AIFM. This is relevant for a self-managed structure or where a proprietary AIFM exists. The consultant may project manage the QIAIF 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 6 managerial functions set out in the POA/governance document and provide operational and compliance support.

AIFM

A QIAIF 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 an AIFM in respect of the launch and operation of a fund. Reliance is also placed on the management company's existing AIFMD compliant POA/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. The investment manager must be an authorised entity, subject to prudential regulation. 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 QIAIF investment manager.

4. Draft the AIFMD POA

Each self-managed QIAIF or AIFM requires a governance document known as a POA. Where a management company is appointed it is the management company that is required to comply with the AIFMD POA (governance) and capital requirements.

Where a QIAIF is self-managed, the QIAIF itself is required to prepare a POA and comply with the AIFMD governance requirements.

The POA addresses the following functions:

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

The POA sets out how the self-managed QIAIF or AIFM will perform the above 6 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, self-managed QIAIFs or AIFMs 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 a self-managed QIAIF or AIFM may carry out the functions specified in the POA or delegate these to named individuals/designated persons. The individuals must be approved by the Central Bank to undertake such tasks.

5. AIFMD policies and procedures

An AIFM in Ireland is required to adopt a number of policies and procedures including:

- Accounting policies and procedures
- AIFMD reporting
- Anti-Money Laundering (AML)
- Best execution
- Business continuity planning
- Complaints handling
- Confidentiality of information
- Conflicts of interest
- Counterparty due diligence
- Cyber security
- Delegation
- Due diligence on investments
- Handling of orders
- Inducements
- Internal control
- Late trading and market timing
- Leverage
- Liquidity management
- Monitoring compliance
- Order allocation and aggregation
- Personal transactions
- Portfolio management
- Prime brokers
- Procedures to prevent malpractice
- Record keeping
- Related and connected party transactions
- Remuneration
- Risk management
- Subscriptions/redemptions
- Transparency
- Valuation
- Voting rights
- Whistleblowing

6. Draft required legal documentation

The following list outlines a number of key legal documents which must be drafted by a legal advisor and filed with the Central Bank as part of the QIAIF approval process:

- Constitutive documents (an instrument of incorporation where the QIAIF is established as an ICAV, a trust deed where the QIAIF is established as a Unit Trust and deed of constitution for a CCF).
- Prospectus
- AIFM agreement
- Investment management agreement
- Depositary agreement
- Administration agreement
- Prime brokerage agreement and sub-depositary agreement (if applicable)
- Distribution agreement (if applicable)

Ongoing Requirements of AIFMD

The following ongoing requirements must be satisfied:

- An AIFM must monitor monthly, or on a more frequent basis if necessary, the reporting required by the POA
- A QIAIF must submit, via the administrator, monthly statistics to the Central Bank, to include net assets, units in issue, net asset value per unit, subscription and redemption amounts, profit and loss figures and details of expenses
- An AIFM must hold quarterly board meetings at which reports from the administrator, depositary and investment manager must be produced
- An AIFM board must receive and review quarterly reporting that covers all requirements under the AIFMD POA
- A QIAIF must produce audited annual and unaudited semi-annual financial statements (unit trusts and CCFs only) for filing with the Central Bank and for distribution to investors
- An AIFM must obtain prior approval of the Central Bank of any board appointments
- A QIAIF must maintain an up-to-date prospectus and this prospectus must be made available to all potential investors. The prospectus must include a general risk warning
- An AIFM must ensure that the prospectus and annual report for each QIAIF managed includes an up-to-date remuneration policy and that remuneration details of professional staff are included in annual reports.
- The main reporting obligation under AIFMD is Annex IV reporting. Annex IV reporting is aimed at increasing investor protection and market stability. Annex IV requires AIFMs to disclose to the Central Bank detailed information for each QIAIF managed. This includes:
    - Details of instruments traded
    - A breakdown of instruments by type
    - An overview of portfolio geographic and currency concentration
    - An overview of exposures
    - Details of AUM
    - Details of liquidity profiles
    - Portfolio concentration
    - Details of counterparty risk
    - Details of market risk
    - Details of leverage and borrowing risk

The reporting frequency for Annex IV is determined by AUM. AIFMs with AUM between €100 million and €500 million are expected to file Annex IV on an annual basis, AIFMs with AUM between €500 million and €1 billion are expected to file Annex IV on a semi-annual basis while AIFMs with AUM in excess of €1 billion are expected to submit quarterly reports to the Central Bank.

Solutions Offered by KB Associates

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

As it offers services solely to funds, KBA is well positioned to monitor the performance of service providers as required by AIFMD. This ensures that KBA avoids potentially significant conflicts of interest.

KBA offers a range of solutions to QIAIFs 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 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 a QIAIF, 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 POA

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

Review of fund documents

KBA reviews all legal documents (prospectus, 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 POA functions

KBA currently supports a number of self-managed QIAIFs/ proprietary AIFMs by providing consultants to undertake the management functions which the POA requires. The consultants to whom the board of directors delegates performance of the POA functions must be identified in the POA and approved by the Central Bank. KBA consultants have been approved to perform this role.

Operational and compliance support

The AIFMD POA 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 POA. This may entail a range of activities including KBA completing on-site reviews of the depositary and administrator, identifying opportunities for VAT reclaim, reviewing compliance with the Irish Funds corporate governance requirements, reviewing compliance with Central Bank requirements such as cyber security and fitness & probity and acting as fund system administrator for Central Bank reporting. Where appointed to provide services to a QIAIF, KBA acts as the QIAIF'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. The MLRO is responsible for a number of tasks including performing a detailed review of the AML controls and procedures at the fund administrator and providing AML training to a fund's directors addressing Irish legislative requirements and practical issues. At KBA, this function is performed by professionally qualified consultants who are members of the Association of Compliance Officers in Ireland.

Company Secretary

All corporate funds in Ireland are required to appoint a company secretary. KBA provides a detailed company secretarial service to AIFMD compliant funds and AIFMs.

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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