Fund Structuring: Why the importance of fund domicile selection has increased.

In this article (first published in Finance Dublin Yearbook 2016), **Dirk Holz, Director at RBC Investor & Treasury Services**, explains why domicile selection is a critical strategic decision for global private equity and real estate fund managers.

Alternative fund managers are only too aware that potential investors carefully review their prospectuses for key differentiating factors before making an investment decision. However, alongside more usual considerations, the fund's proposed domicile is also increasingly being evaluated. While investors have always had an interest, the investment and compliance parameters in which many institutional investment houses now operate has resulted in closer scrutiny of this area.

Investors are looking for assurances that the chosen fund location and its regulatory framework are aligned with their own investment and compliance requirements. Among their key considerations are whether the selected domicile has a strong, positive reputation, and whether it can provide the appropriate fund management services with specialist expertise.

Choosing a domicile that meets the necessary criteria at an optimum price is therefore a critical consideration during fund structuring. Traditionally, large US fund houses have selected Delaware or the Cayman Islands when their distribution is primarily targeted in North America. However, an increasing trend towards a European location is emerging to target international investment. As a result, some funds have been established as parallel structures. Delaware and/or the Cayman Islands continue to be the choice for North American distribution, while Ireland is among one of the favoured locations of US fund managers for distribution across Europe and beyond.

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Ireland has worked diligently over the years to ensure that it is well positioned to support a range of international fund houses. As one of the leading fund jurisdictions, it has been proactive in listening to the concerns of the fund management community to deliver solutions to meet their challenges. The introduction of the Irish Collective Asset-management Vehicle (ICAV) is testament to this.

In addition, following the introduction of the Alternative Investment Fund Management Directive (AIFMD), private equity firms in Europe indicated that fundraising had become more difficult for non-EU vehicles. In response, Irish regulators adapted the Alternative Investment Fund (AIF) vehicle and created Qualifying Investor AIFs (QIAIF) as a potential solution to capital-raising issues within the internal market. The Irish QIAIF provides private equity / real estate managers with the ability to leverage the AIFMD distribution passport it permits the marketing of units to institutional investors across the EU with relative flexibility.

Ireland is not the only European country attracting international fund houses. The United Kingdom, the Channel Islands, and Luxembourg have also established themselves as leading jurisdictions in terms of the number of funds domiciled there. Each boasts an impressive number of fund administrators, depositaries, transfer agents, law firms, management companies and directors to choose from. Although Luxembourg's legal structure is based upon the Continental European system, and Ireland, Channel Islands and the United Kingdom leverage the Anglo-Saxon model, the principles of all the jurisdictions are very similar.

Nevertheless, the choice of domicile for private equity/real estate funds requires a significant amount of due diligence in ensuring it meets the objectives of a particular fund manager and their potential investors.

On deciding upon the domicile, the choice of service provider is equally important. US fund houses have traditionally performed back office functions in-house but as the trend for parallel fund structures increases, they are starting to turn towards the European model of outsourcing in order to consolidate and increase their operational efficiency. This trend was further strengthened by AIFMD. Prior to its introduction, firms in Europe were not required to appoint a depositary; under AIFMD, it is a mandatory requirement. As a consequence, some have concluded that economies of scale must be considered. Increasingly a bundled administrative solution from the depositary is often delivered which encompasses fund accounting, transfer agency, trade settlement, FX, as well as the governance and safekeeping of assets.

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The importance of the depositary bank has evolved significantly. Fund managers are increasingly turning to them to bring external perspectives that may aid their distribution strategies while leveraging their capacity as a bank to provide value-added services, like finance and lending products.

Some fund managers may suggest that understanding the nuances of investor appetite and decision-making is more of an art than a science. Whatever the metier required, it is imperative that Ireland and its service providers continues to innovate and enable fund houses to operate effectively and efficiently if they are both to continue to enjoy the growth they have seen over the past 25 years.

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In the News

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