Launching a hedge fund in Cayman, Luxembourg and Ireland

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The jurisdiction your fund vehicle is established in, otherwise known as the fund domicile, will have significant implications on the fund's operations and success throughout its existence and needs careful consideration. While similar commercial outcomes can be achieved in each of the jurisdictions considered here, a key requirement for a new fund is the ability to raise investment. The preferences of seed and target investor groups should therefore be considered from the outset.

Choosing the right jurisdiction

The Cayman Islands is one of the most frequently used jurisdictions for non-retail open-ended funds raising capital from investors based in multiple different jurisdictions, and is widely accepted internationally as a fund domicile by investors.

Luxembourg and Ireland are the largest funds domiciles in the European Union (**EU**) and both are used extensively by mangers establishing funds sold in the EU and globally.

Luxembourg and Ireland are particularly popular with investment manager groups wanting to market into EU countries using the professional investor "passport" under the Alternative Investment Fund Managers Directive (**AIFMD**). Distribution of non-EU funds under each EU country's "national private placement regime" may also be possible.

This briefing summarises key features of the most common non-retail open-ended fund structures [1] in the Cayman Islands, Luxembourg and Ireland. However, fund domicile should always be considered carefully based on the full facts of any fund launch.

Fund vehicles: the main considerations

The fund vehicle is the entity in which investors will invest their capital, which will carry out the investment activities and which will legally hold all fund assets. The features of this entity are therefore clearly important and the benefits, or limits, of the fund vehicle chosen will be important to its success. Each of the three jurisdictions considered here – Cayman, Ireland and Luxembourg – have particular strengths as jurisdictions and legal frameworks providing different options in terms of fund vehicle. The types of vehicle offered cannot always be directly compared between jurisdictions, but there are some key elements that should be considered in deciding on the optimal vehicle for your fund:

Terms

How flexible is the vehicle? Can you tailor the features and terms to meet your investment strategy needs and target investor groups?

Liability

Does the vehicle provide limited liability to investors? Most investors will be reluctant to invest in a fund vehicle that does not allow them to restrict their liability to an agreed amount, and most fund vehicles allow for this.

Tax

Is it tax efficient? There is, unfortunately, no single straightforward answer to this question as both investor domicile and investment asset class need to be considered. Fund vehicles established in Cayman, Ireland or Luxembourg are generally able to achieve no or minimal tax leakage at the fund level but specific advice should also be taken in the planning phase.

Regulation

What regulations will apply to the fund vehicle? This is in part a jurisdictional question – different countries impose different regulatory requirements – but within a single jurisdiction there are often a number of regulatory categorisations which will impact the fund's operations and costs. The most commonly used of these in each of Cayman, Ireland and Luxembourg are explored below.

Structure

Does one size fit all? Different investor groups may have different, and possibly incompatible, requirements; you may need to consider establishing more than one fund vehicle (possibly in more than one domicile) as a "master-feeder" structure or parallel fund. The cost and effort of doing so is greater than for a stand-alone vehicle and this may be a deferred to after the first launch – however, there are steps that may be taken at initial set up which could make this easier to implement.

The Cayman Islands

The Cayman Islands has long been the domicile of choice for open-ended funds seeking international investment capital. Cayman's historical ties to the United Kingdom, its stable, common law based judicial system along with its geographical (and time zone) proximity to the United States give Cayman a natural appeal to the hedge fund industry. Onto this frame the Island has built a strong and deep offering of service providers and a regulatory environment which is responsive to the needs of the fund industry. Cayman has built a strong reputation as, and remains, one of the most cost effective and tax efficient domiciles for investment funds.

Cayman Islands legislation provides for a number of legal entity types suited to use as fund vehicles. In this guide we focus on the most common vehicle for open-ended funds: the Exempted Company.

Exempted Company

Exempted Companies are formed under the Cayman Islands Companies Act (Revised) (**Companies Act**) with separate legal personality. Exempted Companies are not permitted to carry on business within the Cayman Islands and are consequently exempted from certain requirements that locally operating companies must adhere to.

An Exempted Company is required to have a registered office in the Cayman Islands and, if carrying out relevant financial business, must comply with Cayman's Anti-Money Laundering Regime. The constitutive documents and share registers are not publicly available, providing significant commercial privacy. The Companies Act allows a high degree of flexibility when drafting company articles (including allowing for shares which are voting or non-voting and whose economic rights may be determined in the articles).

Shareholders in an Exempted Company enjoy limited liability up to the value of their (fully paid) shares. An Exempted Company can be formed in a short period of time with minimal filing requirements and initially need only have a single director and shareholder (neither or which need to be resident in Cayman).

Regulation

Entities (of any type) established in Cayman and operating as investment funds are subject to regulation by the Cayman Islands Monetary Authority. (**CIMA**). Open-ended funds (meaning funds allowing investors to withdraw at their option) are regulated under the Mutual Funds Act (Revised) (**Mutual Funds Act**). Closed-end funds (meaning funds which do not allow investors to choose their exit timing) are regulated under the Private Funds Act (Revised). This guide focuses on open-ended funds and as such will only discuss the Mutual Funds Act.

There are four categories of registrable mutual funds, a fund registered under section 4(3) of the Mutual Funds Act (a **s4(3) Fund**), a limited investor fund registered under section 4(4) of the Mutual Funds Act, an administered fund or a licensed fund.

A fund may qualify for registration as a s4(3) Fund if it restricts the minimum initial investment it will accept from each investor to KY$80,000 (US$100,000). This is by far the most common regulatory option used by hedge funds. Registration for a qualifying fund is made by filing the offering document and certain prescribed details with CIMA. Once registered certain ongoing obligations exist but there are no investment or leverage restrictions applicable and the fund generally can determine its terms.

If the minimum initial investment requirement cannot be met, either limited investor funds (which may not accept more than 15 investors who must have the power to change the operator) or administered funds (which must have a Cayman licensed mutual fund administrator providing its principal office) may be used though either the limited number of investors or the added cost of the principal office make these less common. Licensed funds are designed to be suitable for retail investors and are generally not appropriate for hedge fund structures.

In addition to required filings, CIMA has published a number of rules relating to the operation of regulated mutual funds, including certain requirements regarding net asset value calculation policies, segregation of assets, the content of offering documents, corporate governance and internal controls. A regulated (corporate) fund must also have two directors who must register with CIMA.

Oversight

Regulated funds must make filings with CIMA of changes to offering documents and other prescribed information and must file their audited accounts annually with CIMA. CIMA has broad powers to inspect the operation of regulated funds but funds are not inspected on a routine basis.

Taxation

Exempted Companies (and other relevant types of fund vehicle) are not subject to any income, withholding or capital gains taxes in the Cayman Islands. Shareholders will not be subject to any income, withholding or capital gains taxes in the Cayman Islands with respect to their shares and dividends received on those shares, nor will they be subject to any estate or inheritance taxes in the Cayman Islands. Certain government registration fees are payable by an Exempted Company and by a mutual fund. Where the fund is seeking investment by US taxable investors an Exempted Company can "check the box" to be treated as a pass-through entity for US federal income taxes.

Ireland

The Republic of Ireland benefits from a young, well-educated workforce along with a common-law based, well respected, legal system and is the only English speaking country in the EU. These advantages have enabled Ireland to develop into a one of the EU's most successful financial centres and fund jurisdictions.

Ireland is the third largest global investment fund centre and the second largest in Europe. 1,053 fund managers from 54 countries have assets administered in Ireland. 40% of the world’s alternative investments fund assets are administered in Ireland and 17 of the top 20 global asset managers have

Irish domiciled funds. The assets under management of Irish domiciled investment funds is in the region of €4 trillion, distributed among nearly 9,000 different Irish domiciled funds.

As with the Cayman Islands, Irish law offers a broad range of fund vehicle types, however, this guide will focus on the most commonly used vehicle for open-ended alternative investment funds, the QIAIF ICAV, and the QIAIF ILP.

QIAIF ICAV

The Irish Collective Asset Management Vehicle (**ICAV**) is a corporate vehicle for investment funds. ICAVs may be created as "umbrella structures" with multiple funds under the same legal entity and an ICAV is permitted to produce audited accounts on a sub-fund basis. Whilst there is no requirement than an ICAV have Irish resident shareholders, an ICAV's board must include at least two Irish resident directors. An ICAV's board may determine to not hold annual general meetings of shareholders.

Establishing an ICAV is done by way of an application to the Central Bank of Ireland (**CBI**), the regulatory authority responsible for investment funds. Qualifying investor alternative investment funds (**QIAIF**) ICAVs are subject to a 24 hour CBI approval process. The QIAIF ICAV is fast to market and highly flexible.

QIAIF ILP

The QIAIF Investment Limited Partnership (**ILP**) offers the flexibility of a QIAIF (speed to market and flexibility) coupled with a limited partnership structure. The GP to the ILP may be a non-Irish corporate or non-corporate entity and the ILP may incorporate the usual provisions applicable to limited partnerships operating in the hedge fund space (for example capital accounting, excuse and exclude provisions, capital commitment and contributions, drawdowns, defaulting investor provisions, carried interest, distribution waterfalls and advisory committees). An ILP which appoints an EU alternative investment fund manager (**AIFM**) under AIFMD may avail of the pan EU marketing passport.

Regulation

An ICAV must be regulated as a UCITS, RIAIF or QIAIF. Undertaking for collective investment in transferable securities (**UCITS**) are principally retail focussed products and are unlikely to be the regulatory regime of choice for a hedge fund targeting sophisticated investors (an ILP must be regulated as a RIAIF or QIAIF). Retail investor alternative investment funds (**RIAIF**) may be marked to retail investors (like UCITS) but with fewer restrictions on their eligible investments; however, such structures cannot be passported to other EU jurisdictions.

QIAIFs by contrast are eligible for EU passporting and have very few investments restrictions (thought the CBI does require that significant disclosures are made). The minimum permitted investment in a QIAIF is €100,000 and the categories of investor such a fund may be marketed to is restricted.

The majority of hedge funds selecting Ireland as a fund domicile have been structured as ICAVs regulated as QIAIFs. An increasing number of hedge funds are being structured as QIAIF ILPs.

Oversight

The CBI is the regulatory body with oversight over all fund vehicles established in Ireland. A QIAIF (both QIAIF ICAV and QIAIF ILP) may be authorised by the CBI within 24 hours of the submission of final documents (including the dated PPM or prospectus and executed service provider contracts). The directors and service providers must be pre-approved prior to the 24 hour filing. A non-EU investment manager is subject to a clearance process with the CBI which is generally completed within two weeks (and one-to-two days for an EU investment manager). An ICAV must have at least two Irish resident directors and all directors of an ICAV, or directors of an Irish corporate GP to an ILP, must be approved by the CBI pursuant to its Fitness and Probity regime.

Taxation

An ICAV is fully exempt from Irish taxes on its income and profits and there are no Irish taxes on distributions or redemptions to non-Irish resident investors or Irish tax exempt investors. Certain taxes may exist in relation to distributions arising from Irish domiciled real estate assets. An ICAV is not subject to any form of Irish subscription tax or tax on its assets under management. For non-Irish resident investors, no Irish transfer taxes apply to the transfer, exchange or redemption of shares in an ICAV. No capital duty is payable on the issue of shares. ICAV's benefit from an exemption to certain VAT charges, including VAT on fund management and administration services. ICAVs are generally able to benefit from Ireland's extensive double tax treaty network.

Ireland has one of the most developed and favourable tax treaty networks in the world including double taxation treaties with 74 countries, minimising the effects of withholding taxes at the asset level. Unlike certain other Irish fund vehicles, ICAVs are eligible to "check the box" in relation to US federal income taxes (an important consideration if US taxable investors are expected).

The ILP is tax transparent for Irish tax purposes. All income, gains or losses of an ILP are treated as accruing to each limited partner for Irish tax purposes as if such income, gains or losses had accrued to the limited partners without passing through the ILP. There is no Irish stamp duty on the transfer, exchange or redemption of units in ILPs. As is the case with ICAVs, management and administration services to an ILP are VAT exempt.

Luxembourg

Luxembourg is one of the world's largest global financial centres, benefiting from flexible and attractive legal, regulatory and tax regimes and a significant concentration of professional service providers to the financial services industry.

Luxembourg's investment funds industry ranks as the largest EU fund domicile jurisdiction and the second largest fund domicile jurisdiction globally.

Luxembourg's legal system provides a wide range of potential fund vehicle structuring options and regulatory regimes including UCITS, regulated and unregulated alternative investment funds. Fund vehicles in Luxembourg will frequently be subject to the requirements of the rules governing the relevant corporate form and, as the case may be, the specific "product" law applicable to investment fund structures.

This guide will focus on the most popular form applied in the open-ended alternative investment fund context: the S.A. SICAV-RAIF.

Société Anonyme (**SA**) – Société d'investissement à Capital Variable (**SICAV**)

An SA is a Luxembourg public limited liability company formed under the Luxembourg Law of 10 August 1915 (as amended) which, if formed as an investment fund subject to a product law providing for such possibility, may also benefit from the feature of having a variable capital and thus qualify as an investment company with variable capital – SICAV. This means its share capital will, at all times, be equal to the value of its assets and may be increased without recourse to a meeting of shareholders. An SA-SICAV is incorporated in front of a notary and must have an initial capital on incorporation of €30,000.

An SA-SICAV is usually managed by a board of directors issuing shares to investors. Considerable flexibility exists in terms of what can be provided to different share classes. When governed by a specific "product law", such as the Law of 23 July 2016 on reserved alternative investment funds (**RAIF Law**), an SA-SICAV may also be formed with "compartments" allowing for the creation of an umbrella structure The board of directors must have a majority of Luxembourg residents in order to maintain Luxembourg substance for tax purposes, though it is possible to allocate voting decisions such that the approval of directors associated with the initiator of the fund is needed.

An alternative legal form would be the SCA-SICAV. As a corporate partnership limited by shares (societe en commandite par actions or SCA), an SCA-SICAV allows organised dissociation between the management and the holding of the capital. It could be compared to a partnership issuing two classes of shares: the management shares where the holders have unlimited liability towards third parties but are ensured to keep guaranteed to retain control of the vehicle, and the participating shares where the holders' liability is limited to the amount paid for the shares.

Regulation - Reserved Alternative Investment Funds (**RAIF**)

An important feature of the continued success of Luxembourg as an investment fund domicile is the existence of the RAIF within the suite of regulatory options. Whilst a RAIF qualifies as an alternative investment fund (**AIF**) under AIFMD, and is therefore eligible for marketing passporting in the EU via its AIFM, it is not subject to direct supervision by Luxembourg’s financial regulator – the 'Commission de

Surveillance du Secteur Financier' (**CSSF**). A RAIF must appoint a full scope AIFM (either based in Luxembourg or in another EU jurisdiction) as its alternative investment fund manager, responsible for risk and portfolio management.

The AIFM may delegate portfolio management to another entity – allowing for portfolio management by a non-EU manager subject to certain regulatory requirements (including eligibility of the delegate) and the supervision by the AIFM. Besides the appointment of the authorised AIFM, RAIFs are required to appoint certain Luxembourg based service providers including their fund administrator, auditor and depositary.

A RAIF is required to have a minimum invested capital of €1,250,000 (though this amount is subject to a 24 month ramp up period during which the capitalisation can be below this).

As RAIFs are not directly supervised by the CSSF, pre-launch regulatory applications are not required (though the AIFM needs to make certain regulatory notifications (management and marketing notification) in connection with the RAIF's launch).

Shares or interests in RAIFs can only be offered to "well-informed investors" which includes professional and institutional investors as well as investors who have confirmed in writing that they adhere to the status of "well-informed" investor and either commit to at least €100,000 or whose expertise and knowledge has been assessed as adequate by a credit institution or an investment firm.

Oversight

As a RAIF is not itself regulated by the CSSF, it does not come under its direct supervision. However, whilst RAIFs are routinely described as "unregulated" it may be more accurate to say that regulation of a RAIF takes a "hybrid" form in that it is required to appoint an authorised AIFM, which is subject to supervision by a European regulator, and indirect regulatory oversight is therefore provided. For AML / CFT purposes, the supervision of the RAIF is supervised by the Luxembourg's Registration Duties, Estates and VAT Authority ('Administration de l'enregistrement, des domaines et de la TVA′ – **AEDT**).

Taxation

Depending on their legal and regulatory status, most Luxembourg funds will generally either not be subject to or be exempted from corporate income tax, net wealth tax, withholding tax on distributions and not be subject to non-resident capital gain taxation in Luxembourg. Depending on whether a product law such as the RAIF Law applies, Luxembourg funds may however be subject to a subscription tax (often 0.01% rate of the fund's net asset value). Benefit from the extensive network of Luxembourg double taxation treaties (**DTT**) would need to be analysed on a case-by-case basis. Management services rendered to Luxembourg funds are usually VAT exempted. Luxembourg VAT may however be payable on certain other service provider fees.

Cayman, Ireland or Luxembourg?

The range of potential fund domiciles and fund vehicle structuring options can make the decision as to the optimal choice for your fund feel challenging. It can often therefore be helpful to focus on the most popular jurisdictions and structures in the first instance in discussion with your advisers and (if possible) key initial investors.

For managers seeking an EU domiciled fund, Ireland and Luxembourg both provide regimes tailored to the fund industry, while Cayman's longstanding position as a major fund domicile provides a well-trodden path for non-EU structures. Considering how these vehicles can provide similar outcomes, and where they differ, can assist new managers in clarifying your options.

Please contact one of the Ogier lawyers listed below to discuss. A high-level summary table is set out below to assist your review.

	Cayman s4(3) fund	**Irish QIAIF ICAV or QIAIF ILP**	**Luxembourg**

	Cayman s4(3) fund	Irish QIAIF ICAV or QIAIF ILP	Luxembourg
		Auditor Depository Administrator	Auditor Depository Administrator
			No local tax save where subscription tax applies. DTT access to be reviewed case-by-case. Broad VAT exemption on management services.
			No AEDT supervision for AML / CFT purposes

[1] UCITS are the most common form of EU domiciled open-ended fund targeting retail investors, the Luxembourg or Ireland contacts listed here are able to discuss any UCITS enquiries.

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