VISTRA

Europe Is Calling: Considerations of Alternative Investment Opportunities in Luxembourg and the Channel Islands

In a low-interest-rate environment, there's a greater imperative for European investors to seek exposure to alternative investments. With pension funds, insurance firms, high-net worth and private banking customers increasingly casting the net more broadly for long-term investment opportunities that align with their long-term liabilities, alternatives make a good fit.

This has driven a steady flow of capital into that asset class over the last decade and a half, creating opportunities for new and established fund managers to create new investment vehicles in private equity, real estate, and infrastructure that cater to this demand.

Creating a European footprint for managers coming from outside Europe (such as North America and Asia) can be a daunting prospect, with a new set of regulatory and market practices to understand and options galore for structure and domicile. However, alternatives managers who get it right can seize on the opportunity to raise new capital from patient investors with a long-term perspective, diversify their investor pool geographically, and create a platform to reach other investor pools worldwide. A European fund platform can provide the starting point to build knowledge and expertise necessary to take advantage of investment opportunities beyond the home market of some managers in the alternative asset class.

European Domiciles: Choices, Choices, Choices

European jurisdictions have long established themselves as leading hubs for alternative investment fund structures globally, offering mature regulatory regimes to protect all parties, economic and political stability, as well as expert and scalable infrastructure in fund administration and legal and audit support. In particular, Luxembourg and Dublin stand out, but many other centers such as Guernsey and Jersey in the Channel Islands have compelling stories, too.

Because each domicile has its unique advantages and challenges, US managers must weigh their options carefully, taking into account target investor acceptance, tax and regulatory implications, cost, time to market, service providers, and accessibility practicalities. Working with an on-the-ground partner with practical operational, regulatory, and legal expertise can smooth the way through the myriad of options and support a successful entry into the lucrative European market.

Luxembourg: Growth in Alternatives at the Heart of Europe

Already established as a frontrunner in private equity, Luxembourg is also a very popular choice for US managers seeking to raise capital for real asset funds. As a multilingual domicile, Luxembourg has always had cross-board inclinations, making it a natural destination for distribution into other European markets, especially continental Europe as well as Asia.

Of course, it's hard to ignore Luxembourg's tax-friendly status. First, its double-taxation treaties enable investors to avoid multiple layers of taxes. Additionally, investment firms can achieve tax efficiency through subsidiary structures and seeking out pre-approved tax rulings. Establishing appropriate and compliant structures can have a material performance benefit for the funds investors.

Luxembourg is at the forefront of implementing the Alternative Investment Fund Managers Directive, the pan European regulation that governs investment funds and their managers in Europe. Significantly it enables the passporting of funds across Europe. With the launch of the Reserved Alternative Investment Fund (RAIF) in 2016, managers now have the option of a fast time-to-market option measured in days rather than months.

More recently, Luxembourg has emerged as an oasis of stability. Since the Brexit vote in 2016 and the lack of certainty over passporting UK funds and AIFMs into Europe, an increasing set of private equity, real estate firms, insurance companies, and other financial institutions are choosing Luxembourg to meet their European substance requirements and ensure access to Europe's single market.

Despite the many positives, Luxembourg can present some challenges to managers who are unused to operating within its borders. Firstly, as with all AIFMD compliant locations, investment companies can expect an added layer of regulation and transparency reporting in understanding and complying with the AIFMD regime. Next, the costs can be higher than some less regulated domiciles and with its rapid growth, resources across the market are being challenged.

Nonetheless, the access to Europe's sophisticated institutional investor community, its tax friendly nature, and the availability of a wealth of solid, experienced, professional service providers can help to tip the balance in Luxembourg's favor.

Dublin: Hedge Funds and More

Ireland, and Dublin especially, has already established itself as a leading center for alternative funds, especially hedge funds. Ireland now administers nearly $5 trillion of assets, only half of which are funds domiciled in Ireland. It's estimated that this represents 40% of the world's alternative investment funds.

In recent years Dublin has expanded that capability and expertise. In particular, structured finance deals can be domiciled in Ireland, making it a center for global aviation finance worldwide. In turn, Ireland has seen an increase in popularity for some infrastructure and private credit structures along with debt-based property funds.

Ireland is working hard to enhance its regulatory regime to better fit the needs of private equity structures. Like Luxembourg, Ireland has been an early adopter of the AIFMD regulations and has also enhanced its capabilities for tax efficient fund structures.

For US managers, practicalities such as language, a familiar legal system, and frequent flights help to smooth the path to selecting Ireland as the domicile of choice for European funds.

Guernsey and Jersey: European Proximity, but With Independence

The financial hubs of Guernsey and Jersey in the Channel Islands offer proximity to the European market—relying on a combination of private placement regime and proposed passporting laws that allow managers to distribute their investment vehicles in multiple European jurisdictions.

Despite the proximity, Guernsey and Jersey fall outside the EU and, therefore, are not subject to the AIFMD regime. That relieves fund managers of the regulatory complexity and expense under which managers within in the EU operate. That can be an attractive feature for managers not seeking to raise funds from across mainland Europe, but who are instead looking to the UK capital markets and other selected European jurisdictions. This can be achieved through a fully AIFMD compliant opt-in regime for those who market to European investors under national private placement regimes (NPPRs). The different regulatory approaches give US managers the flexibility they need to design products tailored for their specific investor base demands.

And because of the potential for a reduced regulatory burden in Guernsey and Jersey, costs can be significantly less than in other jurisdictions. Without the regulatory hurdles, the time to market is significantly reduced at just two to three days. In addition, the islands are located within the European time zone, have English as their official language, and boast a deeply entrenched financial infrastructure.

These jurisdictions also offer tax-efficient structures for many investment types and locations. These domiciles are seeing lots of activity in response to the newly imposed Global Intangible Low-Tax Income (GILTI) tax in their home country. As of January 2018, shareholders of Controlled Foreign Corporations (CFC) must include their pro rata share of GILTI in their gross income. The tax is levied on GILTI income of 10% of more.

Malta and Cyprus: The Newcomers

In recent years, Malta and Cyprus have made significant inroads to being recognized as suitable domiciles for alternative funds. Both are putting in place regulatory frameworks to fit the AIFMD regime, by improving administration, legal, and audit support. At the same time, the jurisdictions are mindful of potential roadblocks and are working to improve speed to market, access to a flexible regulator, lower costs and a broader base of global fund administrators and service providers.

To set themselves apart from more established centers, Malta and Cyprus have focused on establishing a first-mover advantage in emerging sectors such as cryptocurrency and blockchain.

Bottom Line

The current interest in alternatives among European investors creates a compelling opportunity for US managers to raise additional capital. Not only can managers expect greater revenues from the potential asset growth, but the capital flows also allow them to be more responsive to market opportunities. In the process, they can gain a new set of long-term investors willing to support their investment strategy.

When the opportunity is so favorable, going the extra mile can pay off. However, there are still likely to be challenges to consider. Working with an experienced partner with capability across many of the options and locations available can help you avoid potential roadblocks. Vistra has the knowledge and experience in local markets, regulation, operations, and accounting to smooth the way for your European success.

If you would like to discuss how Vistra can support your launch of funds in Europe or any one of our supported locations, please contact Malcolm Pobjoy using the details below.

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