The uncertainty surrounding the marketing restrictions proposed by the draft AIFM Directive, and the growth in popularity of the UCITS wrapper, has lead many hedge funds to consider redomiciliation within Europe. But is talk of an onshore diaspora premature? HFMWeek asks professionals from EU jurisdictions to outline the case for redomiciliation, and find out how much the discussions are becoming a reality.

What are the key issues that will drive hedge funds to consider redomiciliation?

Kenneth Farrugia (KF): “There are various issues which are leading the boards of directors of hedge funds to redomicile a fund from an offshore jurisdiction to an onshore one. The possibility of converting the hedge fund into a UCITS scheme opens up distribution opportunities. This is facilitated by the retention of the track record (versus the option of setting up of a new onshore fund structure). In addition, institutional and high-net-worth investors may also be exerting pressure on the board of directors to move the fund to an onshore jurisdiction. Undoubtedly the UCITS directive affords significant investor protection by way of the inbuilt restrictions in the directive itself coupled with the ability to passport such funds into Europe with greater ease. Taxation of fund managers in non-EU jurisdictions and on investors holding non-EU-EU domiciled funds may also be a factor leading to redomiciliation considerations.

Paul Govier and Peter Stapleton (PG/PS): Although funds are considering whether it might become necessary to redomicile few have actually done so as yet. At this stage it is a case of ‘be prepared’, largely in the event that the EU AIFM Directive makes it necessary to have an EU-domiciled fund in order to access EU investors. It is too early to make that call yet and we are still hopeful that it will not be required, because redomiciliation of existing funds is sufficiently complex (and costly) to be avoided unless necessary.

Having said that, there is increased investor interest, particularly from EU institutions, in EU-domiciled funds and, provided that the many legal, tax and regulatory issues can be resolved, redomiciling a fund may make sense in a ‘worst-case scenario’ under the draft Directive for certain managers who rely on those investors. The interest in UCITS funds is remarkable, but redomiciling an offshore hedge fund into a UCITS fund is unlikely to be the way to access that market. We are seeing UCITS funds being set up by managers as an alternative to, not a replacement for, their existing offshore hedge funds; principally to attract investors who may find it more difficult to invest in the offshore version. For that reason, and because of the characteristics of most offshore hedge funds, redomiciliation is unlikely to be used to launch a UCITS fund.

How can you help a hedge fund to redomicile – what do they need to consider?

KF: “There are a number of matters that need to be taken into consideration when a decision to redomicile has been taken. Firstly, fund managers must assess the legislation covering the continuation of companies in both the home jurisdiction and the jurisdiction in which the fund is to be redomiciled. Equally important is the need to ensure that the hedge fund structure has a fit with the regulatory framework in the new jurisdiction, particularly insofar as the investment policy of the fund is concerned, with regard to leverage issues, concentration restrictions and similar matters. Tax implications are also important at both the fund and shareholder level and equally important are any regulatory requirements in the new jurisdiction as to whether shareholders’ consent is required. The process through which the existing structure is mapped into the continued structure under the rules of the host member state, especially where there are segregated subfunds and side-pocket classes, must also be taken into consideration.

PG/PS: The principal way in which we can help is by providing a single point of contact for both the Irish and Cayman/BVI legal advice. We are the only Irish law firm providing a single point of contact for both the Irish and alternative investment funds, hedge funds, cFos and fund-linked products.
that can do so. Since most sophisticated fund managers will already have expert UK or US counsel advising them generally, a single Irish/Cayman firm will help streamline the process.

Once they have selected who will assist them in the process, hedge funds need to consider the existing fund rules to obtain investor and supervisory consent to redomicile; and also the onshore requirements which will apply once the fund is authorised in the target jurisdiction.

**How important has investor pressure been for redomiciliation – how has the rush to Ucits-style products been instrumental in this?**

**KF:** Pension funds and other institutional investors have been putting pressure on managers to set up Ucits-type structures, which in themselves offer more transparency and diversification requirements than the conventional hedge funds. Suffice to say the requirement for the custodian to monitor the manager in a Ucits structure is also an important consideration for institutional investors as this affords a high degree of comfort.

**PG/PS:** The interest in Ucits is not really linked to queries in relation to redomiciliation; Ucits tend to complement existing offshore fund offerings, not replace them.

**How much interest from hedge funds in redomiciliation actually results in a concrete move?**

**KF:** Quite a high percentage so far. As with every new development, there are those enquiries that remain at the enquiry stage and do not go any further. However, it is clearly very evident that redomiciliation to European domiciles is in fact taking place and the momentum is gaining traction.

**PG/PS:** To date there have been very little concrete moves. Typically, we are approached by clients who are considering all available options following recent market volatility and forthcoming legislation. Redomiciliation tends to be one of the options which are considered. The next stage involves a detailed analysis of whether a redomiciliation is legally possible and also what changes need to be implemented to achieve it.

**What are the prime locations for redomiciliation at present? Will this change in the future?**

**KF:** Within an EU context, Luxembourg, Ireland and Malta are the prime jurisdictions. However, allow me to be parochial in confirming that Malta is strongly coming to the fore due to the presence of a legal framework that has been in force since 2002 and which allows for exit routes. Maltese service providers have extensive experience in the continuation of funds and other companies considering the continuation framework has been in place for eight years, while other jurisdictions have just introduced continuation rules, so the experience in the implementation of the continuation process is limited, thus increasing the continuation risk. Moreover, Malta is highly cost-competitive in this regard, with the costs for a turn-key solution for the whole redomiciliation process in the €20,000 to €25,000 range, coupled with the presence of a meticulous yet highly responsive regulator.

**PG & PS:** Within the EU, Ireland, Luxembourg and Malta are the most widely considered locations and each has its own distinct merits. However, Malta, at this stage, is probably not well enough established and tends to suffer in comparison to the experience, distribution networks and service capabilities offered in Ireland and Luxembourg. Between these two, Ireland is better suited to most alternative fund products, which represent the majority of potential redomiciliations. Many managers will already be familiar with the Irish regime from a listing of their offshore fund on the ISE, use of an Irish administrator or the use of Irish legal and audit services.

“Ucits has become a quality mark and its acceptance has markedly increased, even in non-EU jurisdictions. This means that redomiciliation itself and the change to a Ucits structure increases the marketability of the fund.”

KENNETH FARRUGIA, VALLETTA FUND SERVICES