EXPLORING JAPAN'S EVOLVING INVESTMENT LANDSCAPE: EUROPEAN FUND STRUCTURING OPTIONS

January 2025

Exploring Japan's Evolving Investment Landscape: European Fund Structuring Options

This article forms part of a series of articles examining the opportunities Japan presents for investment managers and investors. Our previous articles[1] explored fund structuring options in the Cayman Islands, principally focusing on the Cayman Island Unit Trust and Exempted Limited Partnership. In this article, we focus on the key advantages of structuring a fund in Ireland and Luxembourg as well as considering the different fund structuring options that these jurisdictions offer.

Japanese investors are progressively increasing their exposure to private equity, infrastructure, real estate and other alternative asset classes. This move towards alternative investments is influenced by a combination of factors, including the reemergence of inflation in Japan, the pursuit of higher yields and the implications of a declining population.

When seeking exposure to alternative assets in Europe, Japanese institutional investors are continuing to look to Ireland and Luxembourg for a variety of fund structuring options. Ireland and Luxembourg are the two largest fund domiciles in the European Union ("EU"), allowing Japanese institutional investors access to the EU internal market.

Structuring Funds in Ireland and Luxembourg – The Key Advantages

Ireland and Luxembourg are at the forefront of the investment funds industry in the EU, the numerous advantages they offer include:

- Investor familiarity – a vital consideration when fundraising. Both jurisdictions have proven track records in fund structuring for the past 30 years and Japanese investors have invested in Irish and Luxembourg funds for decades.
- Flexibility – Ireland and Luxembourg have expertise in establishing the widest possible range of international funds allowing investment managers to design product ranges with reference to their own and their clients' needs.
- Internationally recognised, open and tax efficient jurisdictions.
- Full market access to Europe including access to the AIFMD marketing passport which allows Alternative Investment Funds ("AIFs") to be marketed freely across the European Economic Area. In addition, Irish

[1] Exploring Japan's Evolving Investment Landscape: Opportunities for Asset Managers - Maples Group
Exploring Japan's Evolving Investment Landscape: Private Equity Funds - Maples Group

and Luxembourg domiciled AIFs may be distributed globally and used to gain access to the main Asia-Pacific markets, subject to local marketing requirements.

- Experienced professional service providers with expertise in the investment funds space.
- Innovative products and technology. Both the Irish and Luxembourg asset management industries recognise that technology is the key to remaining at the forefront of the European investment fund industry.
- Commercial and flexible legislation with long traditions as leading fund domiciles. The regulatory environment for investment funds in Ireland and Luxembourg is founded on the principles of openness, transparency and investor protection and both countries are recognised as leading fund domiciles.
- Well-established, respected and sophisticated legal systems.

IRELAND

Ireland offers a range of vehicles that can be used for investment fund structuring including the Unit Trust, Irish Collective Asset-Management Vehicle ("ICAV"), Investment Limited Partnership ("ILP") and Common Contractual Fund ("CCF"). The legal structure of choice in Ireland for Japanese managers has traditionally been the Unit Trust which is very similar in nature to the domestic Japanese investment trust. There has also been an increasing number of Japanese managers opting for the ICAV and ILP.

Each of the Irish fund structures discussed above may be authorised by the Central Bank of Ireland as a qualifying investor alternative investment fund ("QIAIF"), pursuant to the Alternative Investment Fund Managers Directive ("AIFMD"). QIAIFs are generally not subject to any regulatory, investment or borrowing restrictions and can facilitate the widest range of investment strategies.

In each of the below options, the alternative investment fund manager ("AIFM") may delegate discretionary portfolio management to a regulated overseas (including a Japanese) investment manager, subject to certain requirements.

Unit Trust

Japanese institutional investors have found that an Irish unit trust structured as a QIAIF has the ability to accommodate the range of alternative investments they are seeking to allocate capital towards.

A unit trust is created by way of a trust deed entered into between a management company (in the case of a unit trust as a QIAIF), an AIFM and an Irish regulated depositary which acts as trustee. A unit trust does not have separate legal personality under Irish law and, instead, contracts are entered into in respect of the unit trust by its AIFM or, in certain cases, by its depositary. Unlike traditional trust structures which vest the powers of the trust exclusively in the trustee, the powers of the Irish unit trust are split between the AIFM and the depositary, with ultimate management authority held by the board of directors of the AIFM.

It can sometimes be beneficial to Japanese investors to establish an Irish domiciled special purpose vehicle company ("SPV") through which an Irish unit trust will invest. There are a range of options for establishing such an SPV. Typically, it is established as a private limited company or a designated activity company, and can be structured in a tax efficient manner, to act as a "liability blocker" by interposing a separate legal entity between the unit trust and underlying investments, in order to limit the AIFM's personal liability. This is important if the unit trust will invest in private funds to gain exposure to European alternative assets.[2]

A QIAIF unit trust structure investing through a SPV is very similar in nature to the 'PE Type Unit Trust', which is a very popular tried and tested Cayman Islands structure among Japanese investors seeking exposure to alternative assets globally.[3]

ICAV

The ICAV is a corporate vehicle tailored specifically for Irish investment funds, established through registration and authorisation by the Central Bank of Ireland. As a corporate vehicle the ICAV has a distinct and separate legal personality (i.e. it may enter into contracts itself, can own property etc). The ICAV can be structured to suit

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[2] European Alternative Investments for Japanese Investors - The Irish Unit Trust - Maples Group

[3] Exploring Japan's Evolving Investment Landscape: Opportunities for Asset Managers

all major investment strategies and can accommodate traditional as well as alternative investment policies. It can also avail of a full suite of liquidity options making it suitable for hedge funds, real estate funds, infrastructure strategies, lending vehicles, private equity funds, managed accounts and hybrid funds. ICAVs can also be established as part of global master-feeders, co-investment or joint-venture structures and use a full range of underlying SPVs and subsidiaries to hold investments.

The ICAV may also "elect" to "check the box" and be treated as a pass-through entity for US federal tax purposes.

ILP

The Irish Limited Partnership ("ILP") is a regulated common law partnership structure. It is Ireland's flagship partnership vehicle for use as an investment fund and typically selected by managers availing of closed-ended strategies in real estate, private equity, credit, infrastructure, sustainable finance and related asset classes. The ILP is a tax-transparent vehicle in respect of all its income, gains and losses. All of the assets and liabilities of an ILP belong jointly to the partners in the proportions agreed in the partnership agreement. Similarly, the profits are directly owned by the partners, again in the proportions agreed in the partnership agreement.

An ILP is not subject to legal risk-spreading obligations, making them extremely useful for single asset funds and / or funds with very concentrated positions. There are no restrictions on the use of financing by the ILP, its subsidiaries or its alternative investment vehicles with full security packages available to lenders over all assets, including contractual call rights in any master feeder structure. Full flexibility for an ILP to utilise subscription financing, margin lending, NAV and other types of facilities including total return swaps and other derivative arrangements.

ILP may avail of a full suite of liquidity options so may be structured as open-ended, limited liquidity or closed-ended schemes, while redemption gates, deferred redemptions, holdbacks, in-kind redemptions and side-pockets can all be facilitated.

CCF

The Common Contractual Fund ("CCF") is a tax transparent contractual arrangement enabling assets to be pooled in a regulated fund vehicle managed for the benefit of its investors, who share in the property of the fund as co-owners in proportions reflecting the assets or cash subscribed by each investor. Under Irish law, the CCF is an unincorporated body and has no separate legal personality. Instead, not unlike the unit trust, the CCF is formed by a deed of constitution entered into between an Irish-domiciled and regulated management company and an Irish domiciled and regulated depositary.

LUXEMBOURG

The Luxembourg regulatory framework, widely known for its flexibility in fund structuring, offers a wide range of legal forms for AIFs that can meet diverse investor and manager needs. AIFs can be set up in corporate, partnership or common contractual (FCP) form, and may avail of one of a number of different product labels (or 'regulatory regimes'), such as the reserved alternative investment fund ("RAIF") or the specialised investment fund ("SIF"), based on the specific requirements of individual managers and their clients and investors.

Depending on the chosen regulatory regime, an AIF may be directly supervised and authorised by Luxembourg's financial regulator, the *Commission de Surveillance du Secteur Financier* ("CSSF"), or, alternatively, may be unregulated, or regulated indirectly through its authorised AIFM.

In each of the below options, the AIFM may delegate discretionary portfolio management to a regulated overseas (including a Japanese) investment manager, subject to certain requirements.

A) Legal and organisational forms

Limited Partnerships

Luxembourg limited partnerships are formed by one (or more) general partner(s) with unlimited liability and one (or more) limited partner(s) with limited liability and are notable for their structuring flexibility and significant contractual freedom.

Three distinct types of partnership can be formed in Luxembourg: the common limited partnership (*société en commandite simple* (SCS)), the special limited partnership (*société en commandite spéciale* (SCSp)) and the corporate partnership limited by shares (*société en commandite par actions* (SCA)).

The SCS and the SCSp are modelled on the Anglo-Saxon limited partnership regimes and are mostly used for closed-ended, alternative investment strategies. By contrast the SCA is a hybrid entity that exhibits a number of corporate and partnership characteristics. The principal difference between the limited partnerships is that both the SCA and SCS have separate legal personality, while the SCSp does not have legal personality distinct from that of its partners and the fact that, while SCS and SCSp are considered tax transparent, the SCA is a tax opaque vehicle.

Limited partnerships are typically set up as standalone structures. However, a limited partnership may be comprised of compartments and take the form of an umbrella fund if it opts in to one of Luxembourg's so-called 'product' labels such as the RAIF, SIF or even SICAR.

Public Limited Company

The public limited company (*société anonyme* (SA)) is subject to ordinary company law and to the rules of any product label it chooses to adopt. It may be structured as an umbrella fund with multiple compartments and is often suitable where an AIF is marketed to semi-professional or retail investors. An SA may be formed by a single founding shareholder whose liability is limited to the amount of its investment, and it possesses separate legal personality distinct from that of its shareholders.

SARL

The private limited liability company (*société à responsabilité limitéé (SARL))* is a corporate vehicle subject to ordinary company law and to the rules of any product label it chooses to adopt. The SARL may be suitable where there is a need for a tax blocker or a corporate fund, and where there are a limited number of investors and no listing of the fund on a stock exchange is foreseen, as SARLs are restricted by law to having no more than 100 investors.

FCP

The common contractual fund (*fonds commun de placement* (FCP)) is a contractual arrangement created by contractual deed. Under Luxembourg law, the FCP is an unincorporated body that does not have separate legal personality and is tax transparent. The FCP acts through its management company acting in its own name on behalf of the unitholders. It is an undivided co-ownership of assets that is not subject to any specific corporate law requirements but is, instead, governed in accordance with its constitutive document, the management regulations, and the legislation applying to any product label which it adopts, such as the regime applicable under Part II of the Luxembourg law of 17 December 2010 for retail and quasi-retail funds or the RAIF or the SIF regimes for alternative investment funds aimed at a qualifying investor base.

SICAV/SICAF

A corporate vehicle such as an SA, SCA, SCS, SARL, a cooperative company organised as a public limited company (SCOP) or an SCSp, can take the form of a SICAV or SICAF. The SICAV is most frequently used in the context of collective investment funds (both for open-ended funds and for closed-ended funds). A SICAV is an investment company with variable capital (*société d'investissement à capital variable* (SICAV)), a company whose capital is equal (at all times) to its net assets (i.e. the SICAV's capital increases and decreases automatically as a result of subscriptions or redemptions and variations in its net asset value) and possesses its own legal personality. An investment company with fixed capital (*société d'investissement à capital fixe* (SICAF)) is a company whose capital is fixed and that possesses its own legal personality. Variations in capital are possible but require that the formalities for varying the capital comply with Luxembourg company law.

B) Regulatory or 'product' regimes

In Luxembourg, once the legal form of the fund has been chosen, fund initiators have the possibility to add a product label to bring complementary benefits or to define the structure further.

Reserved Alternative Investment Fund (RAIF)

The RAIF was introduced in 2013 to enhance Luxembourg's fund offering. The prime advantage of the RAIF is that, while it is fully AIFMD compliant, it is not required to obtain CSSF authorisation, and hence time-to-market for a new RAIF (or a new RAIF compartment) is very efficient (and short compared to its (directly) regulated cousins). Investors gain comfort from the requirement that each RAIF must appoint a fully authorised AIFM, ensuring an indirect level of supervision at the level of the AIFM and a licensed depositary, ensuring the safekeeping of the assets of the fund. The RAIF is suitable for a multitude of investment strategies, including real estate, infrastructure, private equity, private debt and a range of other strategies. A RAIF may follow the risk-spreading regime as is applicable to SIFs, or alternatively qualify for the risk capital regime where, on the same basis as applies to SICARs – see below), it is not subject to risk-spreading obligations but can invest only in assets qualifying as risk capital.

A RAIF may be established as either a SICAV or a SICAF, both of which encompass a wide range of corporate forms (see above). Furthermore, a RAIF (other than a RAIF qualifying for the risk capital regime) may be established as an FCP, which as noted above is a contractual arrangement with which the Japanese investor market has great familiarity.

Specialised Investment Fund (SIF)

The SIF was introduced in 2007 and is a well-recognised and popular product label used for a variety of alternative investment strategies including private equity, venture capital, private debt and fund-of-funds, among others. Although a SIF is supervised by the CSSF, managers have a great deal of freedom in the permissible assets and investment restrictions. This notwithstanding, the SIF must comply with basic risk-spreading requirements: exposure to investments of the same type from the same issuer may not exceed 30% of the assets or commitments of a SIF. A SIF may be set up as a stand-alone fund or as an umbrella structure with compartments whose assets and liabilities are segregated by law. As a result, it combines investor confidence with a high degree of organisational freedom for managers.

As is the case for RAIFs, a SIF may be established as a SICAV, a SICAF or an FCP.

SICAR

The investment company in risk capital (*société d'investissement en capital à risqué* (SICAR)) is a dedicated vehicle for early-stage private equity and venture capital funds. A SICAR can only invest in assets qualifying as risk capital as defined under Luxembourg law and must be authorised by the CSSF. The SICAR is not subject to risk diversification rules, and benefits from favourable tax treatment on income and gains from risk capital investments.

In addition to the options covered above, a wide variety of Luxembourg and Irish funds can, in addition, be subject to the ELTIF (European Long Term Investment Fund), EuVECA (European Venture Capital Fund) and EuSEF (European Social Entrepreneurship Fund) rules.

Maples Group

The Maples Group is a leading service provider offering clients a comprehensive range of legal services on the laws of the Cayman Islands, Ireland, Luxembourg, Jersey and the British Virgin Islands, as well as independent fiduciary, fund administration, regulatory and compliance, and entity formation and management services. Having a multi-jurisdictional European footprint, the Maples Group provides clients with an unrivalled gateway to Europe. In addition to dedicated Funds & Investment Management teams on the ground in Ireland and Luxembourg, we also have partner-led European Funds & Investment Management teams in our London and Cayman Islands offices and a dedicated Irish Funds & Investment Management team in our Hong Kong office allowing us to service our clients from the time zone that suits their needs.

For those interested in Irish and / or Luxembourg fund structures please contact your usual Maples Group contact or one of the contacts listed in this update.

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January 2025