STATE STREET

IRELAND AND LUXEMBOURG

Seizing growth opportunities in cross-border funds

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For asset managers seeking growth through cross-border funds, Ireland and Luxembourg offer unmatched regulatory stability, operational efficiency and market access.

Early advocates of the Undertakings for Collective Investment in Transferable Securities (UCITS) directive had bold ambitions. Introduced in 1985, the directive aimed to create a unified cross-border funds market, enabling the collective investment schemes to operate seamlessly across Europe with a single authorisation from any member state.

In the almost 40 years since, the UCITS brand has become recognised as a hallmark of investor protection and regulatory oversight, making them attractive to investors worldwide.

Two countries have played a pivotal role in the growth of UCITS. Luxembourg was the first member state to adopt the directive into its domestic law in 1988, closely followed by Ireland later that year. Both countries have since become major global hubs for UCITS funds.

Today, Luxembourg and Ireland are the European domiciles of choice for cross-border fund distribution. In 2023, cross-border funds domiciled in Luxembourg and Ireland totalled EUR 5.5 trillion and EUR 4.8 trillion, respectively. Between them, the two countries oversee more than 95 percent of the market in Europe[1] with investors in every region of the globe.

Building hubs for cross-border expertise

Distributing investment products in markets across Europe and around the world is challenging. Cross-border funds are available to investors speaking a multitude of languages, investing in a range of currencies, working with numerous tax authorities, and transacting through multiple channels.

Successfully navigating these complexities requires a broad set of skills and extensive experience. Consequently, asset managers aiming to distribute cross-border funds must leverage deep expertise and robust support systems.

The early adoption of UCITS by Luxembourg and Ireland enabled them to build the necessary ecosystems more rapidly and extensively than other markets. Once established, both jurisdictions flourished as leading global fund hubs.

[1] https://www.efama.org/sites/default/files/files/fact-book-2024_lowres_0.pdf

Over time, these ecosystems have become self-sustaining. A wide range of professional services — from accountants and legal firms to administrators and technology providers — have concentrated in Luxembourg and Ireland to support the cross-border funds sector. For countries starting from scratch, replicating the depth of expertise and professional infrastructure in these jurisdictions is a formidable challenge.

Both countries have benefitted from the collaborative effort of multiple stakeholders. The Association of the Luxembourg Fund Industry (ALFI) was founded in 1988 to represent organisations from across the fund value chain.

The Irish Funds Industry Association (now known as Irish Funds), formed in 1991, plays a similar role.

Supportive policymaking environments have also helped, with successive governments recognising the contribution cross-border fund sectors make to their GDP. That has seen them work hard to support further growth through prompt and pragmatic — though still robust — regulatory regimes.

More in common than sets them apart

The two jurisdictions are much more similar than they are different. The fact that both Luxembourg and Ireland have been able to flourish simultaneously underlines the point; if one country had a clear edge they would have dominated over time. But that has not happened.

That said, the competition between the jurisdictions is valuable. Both are conscious of the need to evolve and innovate to continue attracting new funds. Both are determined to work with the leading service providers to ensure asset managers have access to best practices. And, in both countries, regulators and policymakers keep a close eye on decisions made by their counterparts.

Over time, this has increased the brand value of both Luxembourg and Ireland on the global stage. Both countries now have a reputation as high-quality cross-border fund jurisdictions that would be difficult to match.

How, then, to choose one jurisdiction over the other? Certainly, language and culture are often part of the equation. US- and UK-based asset managers, for example, have often gravitated toward Ireland. That is due in part to the strong cultural links between Ireland and the US and UK, as well as a shared common language.

In contrast, Luxembourg's geographical proximity to many European countries, including Germany, France and Italy, has made it a natural choice for asset managers. The use of German, French and English further enhances its appeal.

Regardless of the jurisdiction a manager chooses, they can rely on robust local infrastructure. A US asset manager working with a specific law firm or consultancy will likely find that their adviser has a presence in both Ireland and Luxembourg.

Despite their similarities, each jurisdiction offers distinct advantages in certain areas.

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Ireland leading in exchange-traded funds

Ireland has a significant advantage when it comes to ETFs holding US equities. The country has a double taxation treaty with the US, which means Irish-domiciled ETFs holding US equities pay only 15 percent withholding tax on dividends from these securities, compared to a 30 percent tax in Luxembourg.

This tax advantage has proven to be a trigger for ETF issuers domiciling physical ETF ranges in Ireland over the past 15 years.

As of September 2024, Ireland accounted for almost 72.66 percent of the European ETF market[2].

Case study

Capturing tax advantages and innovation in Ireland

A Central European active mutual fund manager, with a history of domiciling active mutual funds in Luxembourg, sought to enter the European ETF market with a range of actively managed ETFs, spanning both equity and fixed income, with exposure to US equities.

The key decision for the manager was whether to domicile the new ETFs in Luxembourg, given its existing knowledge and presence in that market, or whether to create a new umbrella and legal entity in Ireland.

Ireland's double taxation treaty reduced the withholding tax on US stock dividends by half, while its low corporate tax rate and cost-effective operations added to its appeal. The Central Bank of Ireland's active engagement with ETFs further assured the manager on regulatory risks. Coupled with a well-developed and expanding ecosystem of service providers specialising in ETFs, along with the country's strengths in technology and product innovation, these factors led the manager to select Ireland for its new ETF range.

Several other factors have driven the growth in Ireland. Not least, Ireland boasts a market-leading ecosystem for supporting global ETF issuers. Competition is fierce between service providers, custodians, industry bodies, legal firms, management companies and independent directors. Ireland also benefits from a very engaged regulator in the Central Bank of Ireland (CBI); as early as 2017, the bank published a paper based on a comprehensive review of ETFs and the structure for such products in Ireland.

Such advantages have helped Ireland increase its leadership position in recent years. European ETF managers, such as Amundi and BNP Paribas, have moved assets from Luxembourg to Ireland while many new global active ETF managers are choosing Ireland.

Still, there are opportunities for Luxembourg to grow its presence in the European ETF market, particularly through a listed and unlisted share class model. Luxembourg's Commission de Surveillance du Secteur Financier (CSSF) has approved submissions from asset managers who want to add an ETF share class to an existing mutual fund.

That allows mutual fund managers to enter the European market using their existing infrastructure as opposed to creating a new legal entity without having to change the name of the whole sub-fund. Listed and unlisted share classes have also been approved by the CBI, but the process is more cumbersome (though the fund industry has asked the CBI to review its position here).

The next wave of ETF growth is being driven by actively managed ETFs, and Luxembourg's solution of simply renaming the share class as an ETF may spur growth for active mutual fund managers in the country. This is particularly likely to be the case for fixed-income funds where there is no tax benefit in Ireland.

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[2] https://lipperalpha.refinitiv.com/2024/11/monday-morning-memo-the-dominance-of-ireland-as-etf-domicile-in-europe/

Luxembourg leading in private markets

Elsewhere, the increased appetite of investors for exposure to private markets has driven some divergence between Luxembourg and Ireland — in this case, with Luxembourg getting out in front.

Luxembourg was quickest to support new regulated funds offering private markets exposure, through vehicles such as the Reserved Alternative Investment Fund (RAIF), special limited partnership (SCSp) fund structure and Undertakings for Collective Investment Part II (UCI part II) funds. It was therefore in a stronger position to benefit from the private markets boom that has characterised much of the past decade.

By contrast, the current regulatory, tax and legislative frameworks limit Ireland's ability to attract private equity and sustainable infrastructure managers.

Case study

Tapping into Luxembourg's global distribution network

A large UK-based asset manager — one of the largest active managers in Europe — recently reviewed the optimal domicile to support its distribution strategy in the post-Brexit environment.

The manager is keenly focused on its distribution strategy and a reputation for bringing new investment ideas to market. It needed a post-Brexit solution for distribution to investors in the EU, Asia and Americas for both its traditional and alternative funds.

The key decision for the manager was whether to add to its existing Ireland-domiciled fund ranges or to look at Luxembourg as a new domicile. The manager knew Ireland well but was conscious of the expertise available in Luxembourg, as well as its extensive distribution connections for European and Asian investors.

While both Ireland and Luxembourg offered access to a developed and growing ecosystem, as well as local expertise, ultimately, Luxembourg's strong international reputation and global distribution network into the asset manager's target investors made it the domicile of choice for this manager's new funds.

Nonetheless, the launch of the European Long-Term Investment Fund (ELTIF) 2.0 regime provides further opportunities for innovation, increased access to, and demand for, investments in private markets to more retail investors.

While the final technical standards on ELTIF 2.0 are still pending, the CBI has already published a revised Alternative Investment Fund Rulebook which contains a dedicated ELTIF chapter. The goal is to meet the needs of both ELTIF investors and sponsors, making Ireland an attractive jurisdiction for their establishment.

Developments in innovation and technology

Luxembourg and Ireland are not complacent in their current status as cross-border investment pioneers. Both centres recognise they need to continue innovating and modernising. New technologies, in particular, offer opportunities for different types of fund structure and novel approaches to aspects of fund servicing. Providing an environment supportive to such advances will be important.

Luxembourg, for example, became one of the very first EU Member States to pass a series of laws recognising blockchain transactions, therefore allowing the use of distributed ledger technology and the creation of a legal framework around dematerialised securities. Several firms are looking at how to tokenise a share class in the ETF space, for example.

In Luxembourg there is also interest in developing products that provide investors with exposure to digital currencies such as Bitcoin and Ethereum.

When it comes to servicing, Luxembourg is making progress in areas where technology can boost efficiency. New work to standardise flows and manage anti-money laundering regulation and compliance is ongoing.

Ireland, meanwhile, is also making efforts on technology and innovation. Irish Funds has launched a series of work streams to consider the application of technologies such as AI and tokenisation.

Indeed, given the fact that many leading technology companies have a strong presence in Ireland, there is already an extensive ecosystem to support the development and application of new technology.

AI and automation will enhance operational efficiency across the entire value chain. Industry-wide efforts are focused on mapping the steps necessary to tokenise traditional shares of regulated funds, addressing the operational aspects, and identify the changes needed in Ireland.

The CBI has also announced an innovation sandbox, through which larger firms will be able to develop partnerships with FinTechs and digital specialists. Such initiatives provide an opportunity to explore what new technologies might offer and how to develop new ideas, while ensuring good standards of investor protection.

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Maintaining future market leadership

The success of the UCITS brand is drawing a growing global audience, with investors from Asia and South America joining their North American and European counterparts in these cross-border funds. This expansion strengthens the position of Luxembourg and Ireland, which are uniquely quipped to support a diverse investor base, offering capabilities that other markets may find challenging to replicate.

This is not to suggest that either jurisdiction is standing still. Both countries have a crucial advantage given that their infrastructure is already in place. But other jurisdictions recognise the valuable prizes on offer. For example, in the wake of Brexit the UK believes it can compete in some areas of this market.

It will be critical for Luxembourg and Ireland to continue to invest in product evolution, to prioritise supportive policy and regulation, and to embrace technological change.

Between them, the two territories have established their dominance in the cross-border funds market over the best part of four decades. But asset managers expect them to continue innovating and evolving over many years to come.

New talent will help in this regard — and access to pools of well-educated and highly-motivated young people is a key feature of both countries. In Ireland, for example, 61 percent of the population aged 25-34 years are third-level educated[3], and the sector informs a wide range of university programs. Luxembourg, meanwhile, ranks number-one in the European Union in terms of the proportion of young people who hold university or other higher-education qualifications[4].

Finally, the two countries need to continue making the case for building stronger, deeper, harmonised and globally relevant European capital markets. This will be vital in securing the long-term financial wellbeing of European investors, and ensuring Europe can deliver on its green and digital transition.

[3] https://www.cso.ie/en/releasesandpublications/ep/p-eda/educationalattainmentthematicreport2023/keyfindings/

[4] https://www.researchluxembourg.org/en/luxembourg-ranks-1st-in-eu-for-higher-education-levels/

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