



Legal Update

Crypto Funds in Ireland

The soaring prices of certain crypto currencies and non-fungible tokens (NFTs) as well as the extreme volatility encountered in these markets have resulted in high levels of interest in the potential for crypto funds and inevitably, as Ireland is one of the leading fund domiciles, queries have arisen over the potential to launch an Irish domiciled and authorised fund product targeting this asset class.

The establishment of such funds poses a number of challenges in the EU context, in particular, and fortunately the Central Bank of Ireland (the “Central Bank”) has issued some guidance with regard to both UCITS and AIFs.

Central Bank Guidance

The Central Bank periodically issues guidance to the financial industry in the form of Q&As relating to queries likely to arise under existing legislation. These are published in order to assist in limiting uncertainty and are subject to the Central Bank’s right to revise its related approach at any time. Among the areas addressed are Q&As specifically focussed on UCITS and the AIFMD respectively. On 29th July 2021 the Central Bank published updates to its Q&As on both UCITS and the AIFMD (the “Guidance”) to address the potential for authorised funds falling under these categories to invest directly or indirectly in crypto assets. These are Q&As ID1100 and ID1145 respectively.

Terms of the Guidance

The Central Bank guidance clarifies that it primarily relates to crypto-assets that are based on an intangible or non-traditional underlying assets. This would include the crypto currencies with the largest market capitalisation such as Bitcoin and Ether. It notes that such assets can present significant risks, including liquidity risk; credit risk; market risk; operational risk (including fraud and cyber risks); money laundering / terrorist financing risk; and legal and reputation risks.

The assets of UCITS must meet the related eligible asset criteria and indirect exposure to assets must be capable of being appropriately risk managed. However, the Central Bank has clarified that as it has not seen information which would satisfy it that crypto-assets are capable of meeting either of these criteria and as such it is “highly unlikely” to approve a UCITS directly or indirectly investing in crypto-assets. Similarly, in light of the risk

management issues identified and the potential for retail investors to fail to appreciate these it is also “highly unlikely” to approve a RIAIF proposing any such direct or indirect exposure.

However, in the case of a QIAIF such a concern is less pronounced due to the of profile of investors. Accordingly, while related funds will not be able to avail of the 24-hour fast track approval process, AIFMs can make a submission to the Central Bank outlining how the risks associated with such exposures would be managed effectively in relation to the QIAIF without being subject to this negative presumption applicable to retail funds.

So what can be done in Ireland?

While direct or indirect investment in relevant crypto assets may be effectively restricted means for regulated Irish funds, investments in eligible assets that derive value from this industry, such as company shares operating in related or economically correlated business areas, are possible and accordingly may constitute a viable means for them to obtain exposure to this sector. There is also potential to invest into digital assets that fall outside the scope of the Central Bank’s advice on crypto assets as defined in the Guidance (for example into tokenised versions of traditional assets that constitute eligible assets and accordingly potentially even into stable coins).

It is also possible to make a submission outlining why a specific strategy should be permitted. Such a submission would need to address the specific concerns outlined in the Central Bank guidance although, while this may be a viable route for QIAIFs in particular it is however unlikely to be successful at present for retail products including



UCITS and RIAIFs. Finally unregulated funds may also pose an option, provided other practical difficulties such as the need for a depositary can be successfully addressed.

Future Developments

It should be noted that the Central Bank has confirmed that it will keep its approach in relation

to crypto-assets under review, in particular in light of related European regulatory discussions. Furthermore, market participants will continue to be free to make submissions to the Central Bank seeking to reassure it that the risks identified can be adequately addressed to the extent required to permit a related scheme to be authorised. Accordingly, those with an interest in the area should stay alert for future developments.

Contact and Further information

Asset Management at Clerkin Lynch

We advise on the structuring, establishment and ongoing operation of investment funds in Ireland, including UCITS and Alternative Investment Funds, for international distribution. We assist clients in liaising with and obtaining appropriate regulatory authorisations from the national regulatory authority, the Central Bank of Ireland. We also advise on issues affecting clients throughout the asset management and broader financial sector, including with regard to AML, MiFID, crypto-currencies, distance selling and internet-based products and investments. ESG is an area of particular focus for the practice and one the team has specific expertise in.

The Asset Management and Funds team liaises with other departments of the firm, including Banking and Financial Services, Corporate, Data Protection and Technology to assist clients with a comprehensive range of legal services when appropriate. The result is ensuring that client issues can be addressed in a seamless and efficient manner. We only provide Irish legal services but work through our network of international legal firms to provide comprehensive cross border legal services, and when required, to provide cost efficient solutions in related contexts.

Author Biography

Mark Browne has in excess of 20 years legal experience advising on issues pertaining to UCITS. A frequently published author and speaker regarding issues relating to the financial services industry, including UCITS in particular, he has been recommended as a leading investment funds lawyer by The Legal 500 and Chambers & Partners (Europe and Global). Previous editions of Chambers Global noted that "he garners significant praise for launching UCITS funds and ICAVs, as well as handling the relevant regulatory issues with clients describing him as "terrific: he is responsive, almost always available and knowledgeable." and reported that clients stated "the amount of attention he gave us was outstanding," praising his "knowledge of how to get the deal done, and his great end product." He is recognised as a "notable practitioner" by IFLR1000, the guide to the world's leading financial law firms. He was previously named as 'Investment Fund Formation Lawyer of the Year in Ireland' in the CIM Global Awards and Investment Management lawyer of the year in Ireland by the Lawyer International 's Legal 100 awards.



Mark Browne
Partner
Head of Asset Management and Funds
Email: markbrowne@clerkinlynch.com
Phone: +353 1 611 4400



Ben Lynch
Trainee Solicitor