



Banc Ceannais na hÉireann  
Central Bank of Ireland

Eurosystem

2013

**Consultation on types of alternative investment funds under AIFMD and unit trust schemes under the Unit Trusts Act 1990 (including EUTs, REITs etc.)**

**Consultation Paper CP 68**

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## Introduction

1. Exempt Unit Trusts (“EUTs”) is a term used to refer to unit trust schemes which are typically used by pension providers as investment vehicles. The reference to “exempt” is a reference to exemption from certain tax obligations, available under Irish tax law on the basis that the investors in such trusts are either pensions or charities.
2. Unit trust schemes fall within the scope of the Unit Trusts Act, 1990 (“UT Act”) and are authorised by the Central Bank in accordance with that Act. EUTs have been deemed to fall outside the scope of the UT Act and this has been linked to the fact that investment was restricted to tax exempt investors and they did not necessarily provide facilities for the participation by the public as required by the UT Act.
3. A typical EUT relies on a trustee under a deed of trust. It is also usual for an EUT to be established in the form of an umbrella (or master) trust with individual series (or sub-funds) established for individual investor(s). The series are created by way of supplementary deed which will usually include provisions to ring fence the assets and liabilities of the sub-fund from others in existence.
4. Available information indicates that there are circa 40 EUTs in existence. But this figure relates to master trusts and these are likely to have a significant number of sub-funds. Within these trusts are thousands of unit-holders including those which invest indirectly via an intermediary including an insurance company.

***Question for consideration: Do you believe that our brief summary on the organisation of EUTs as set out above is correct?***

## Implementation of Alternative Investment Fund Managers Directive

5. The Alternative Investment Fund Managers Directive (AIFMD) must be implemented in the national law of Member States by 22 July 2013. AIFMD requires that every alternative investment fund (AIF) must have an alternative investment fund manager (AIFM). Once authorised, an AIFM may freely market AIF which it manages, whether the AIF are authorised or not, to professional investors<sup>1</sup> in its home Member State and throughout the European Union. In AIFMD, an AIF is any collective investment undertaking which is not a UCITS and is defined quite broadly.

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<sup>1</sup> Professional investors are investors who are professional clients under MiFID.

6. Article 4 of AIFMD defines AIF. These are *collective investment undertakings*, including investment compartments thereof, which *raise capital from a number of investors*, with a view to investing it in accordance with a *defined investment policy* for the benefit of those investors (and which are not UCITS).
7. Given the breadth of this definition the European Securities and Markets Authority (ESMA) has published guidelines to assist in the determination of AIF, entitled “Guidelines on key concepts of the AIFMD”<sup>2</sup>. These guidelines set down characteristics in relation to each of: “*treatment of investment compartments of an undertaking*”; “*collective investment undertaking*”; “*raising capital*”; “*number of investors*”; and “*defined investment policy*”. Important guidelines in the context of EUTs are those which provide that where one compartment of an undertaking is determined to meet the criteria for an AIF, the undertaking as a whole should be regarded as an AIF; and, once an undertaking is not prevented by its national law or fund rules from raising capital from more than one investor it should be regarded as a collective undertaking, notwithstanding that there may be only one investor.
8. AIFM which fall below a threshold set out in the AIFMD do not require authorisation but must register with the Central Bank and report annually thereafter. Registered AIFM may not avail of the passporting provisions of AIFMD.<sup>3</sup>
9. Collective investment undertakings established in Ireland and authorised in accordance with domestic investment fund legislation are AIFs under the AIFMD. The regulatory regime which the Central Bank imposes on Irish authorised AIF is set out in the AIF Rulebook.
10. The Irish implementing AIFM Regulations<sup>4</sup> allow authorised AIFM, wherever authorised, to also market AIF to Irish retail investors, subject to conditions imposed by the Central Bank. This means that the Central Bank must not alone consider, as it is currently required to do, the extent to which authorised AIF, including those established in other jurisdictions, may market in Ireland but also the conditions under which AIF that do not require authorisation under domestic investment fund legislation should be permitted to market to retail investors. Currently there are a number of structures which will or are likely to fall within the definition of AIF and which market to investors other than professional investors.

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<sup>2</sup> Ref: ESMA/2013/600 – 24 May 2013

<sup>3</sup> Article 3(2) of AIFMD

<sup>4</sup> SI No 257 of 2013.

These include, for example, closed ended investment companies<sup>5</sup> and EUTs, which are not currently subject to domestic investment fund legislation because they are specifically excluded (closed ended investment companies), or have been considered outside of the scope of that legislation (EUTs).

11. The remainder of this Paper deals with the question of EUTs. While not considered in detail here, we are also inviting comments in relation to other undertakings such as Real Estate Investment Trusts and Special Purpose Vehicles, categories of undertakings which have been mentioned as possible AIF. We wish to consider further the regulatory perimeter created by the AIFMD. Clearly it is not open to the Central Bank to alter or clarify the definition of AIF in EU law. Without prejudicing our freedom of action to enforce the AIFMD in future, what can we do to assist entities which fall or are likely to fall within the AIFMD, but not as conventional investment funds? We intend, over the coming months, to look at different types of AIF and therefore invite comments in relation to this issue sooner rather than later and before the consultation response deadline.

#### **EUT related questions**

12. The Central Bank notified its intention to consider the status of EUTs in its consultation on implementation of AIFMD (*ref: CP60: October 2012*), and signalled its view that EUTs were likely to be considered as AIF:

*“The AIFMD defines AIFs as collective investment undertakings which are not UCITS. Exempt Unit Trusts are not currently subjected to the domestic regulatory regime although as AIFs they will be subject to certain requirements under the AIFMD. Where the AIFM of the Exempt Unit Trust falls below the thresholds referenced in footnote 5 the AIFM will be subject to registration requirements. If the AIFM is above the threshold, the full AIFMD regime will apply. The Central Bank will in the near future look at the option of extending the domestic regulatory regime to Exempt Unit Trusts...”*

13. There are two questions to address at the outset: Is an EUT an AIF under AIFMD? Is it also a unit trust scheme within the scope of the Unit Trusts Act 1990?

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<sup>5</sup> Investment companies which are not established under the Companies Act, 1990 Part XIII, do not have a variable capital structure and are subject to general company law.

### **Is an EUT an AIF?**

14. As indicated in CP60 the Central Bank took the view that EUT are likely to be considered AIF under AIFMD. Since then, following discussions with relevant stakeholders, it seems that a significant number of EUT series (or sub-funds) may each have a single investor. However on the basis that most EUT master funds are likely to have at least one series with more than one investor, the master trust is, under the approach outlined in the ESMA guidelines, likely to be an AIF.
15. There have been comments to support the opposing position – that EUTs, or at least many of them, are not AIF. These have focussed on arguing:
  - that the predominant use of an EUT is as a holding vehicle for an investment by a single pension investor;
  - that EUTs may not meet with the ESMA guidelines in relation to “raising capital” as there is unlikely to be a commercial communication in relation to the EUT. Capital will have been raised before it is established which indicates that it is more in the way of an SPV rather than an investment fund which raises capital.
  - that there is typically no active management of the EUT and in many cases it is self-directed by the particular investor.
16. The ESMA guidelines mentioned in paragraph 7 are designed to ensure a harmonised application across the European Union of the concepts that comprise the definition of AIF in the AIFMD. ESMA notes that an undertaking must satisfy each of the criteria set out in Article 4 of AIFMD (i.e. a collective undertaking, which raises capital and has a defined investment policy) but that the absence of a characteristic included under each of the ESMA guidelines does not mean an undertaking is not an AIF.
17. The argument that capital is raised before the EUT is legally established does not seem convincing as many investment funds are likely to seek capital, even informally, before a particular structure is established or authorised. Similarly the argument that the investment policy is a passive one and may be self-directed may not be significant – can an investment fund that is an AIF not have a passive policy? In the case of a master trust, where one or more series or sub funds have been established, it seems more appropriate to view the structure as a whole as an AIF, otherwise each sub-fund of an investment fund should be seen as an AIF.

***Question: Do you agree with our analysis that an EUT is an AIF?***

### **Is an EUT a unit trust for the purposes of the Unit Trusts Act 1990?**

18. It could be argued that a proposed unit trust scheme which would limit investment to pension fund investors does not involve “participation by the public”, on the basis that the target investor class is quite limited and is not a category to which a person can easily obtain admission. However as individual pension schemes have emerged over recent decades, this argument has become weaker and now seems to lack merit.
19. We have now revisited the status of EUTs in the light of AIFMD implementation and also taking into account the continued increase in pension fund investment by individuals. In the light of both, we believe it is now appropriate to revise our approach to the authorisation of EUTs. It now seems clear that EUTs cannot be considered excluded from the class of unit trust schemes within the scope of the UT Act just because they are limited to pension fund investors.

*Question: Do you agree that an EUT is subject to the UT Act?*

### **Implications**

20. An EUT which is an AIF under AIFMD must have an AIFM who must ensure compliance with AIFMD requirements. An AIFM must at least provide the investment and risk management of the EUT. This is the case whether or not the UT Act applies. If the value of all AIF under management by the AIFM exceeds the AIFMD thresholds<sup>6</sup>, the AIFM must be authorised. The AIFM authorisation regime is similar to that applicable to UCITS management companies and MiFID firms, with detailed obligations in relation to liquidity and risk management, valuation and delegation. Moreover, an authorised AIFM must appoint a depositary to each of its AIFs, who must safe-keep the assets and oversee the management of the AIF.
21. If the value of all AIFs under management is below the AIFMD thresholds, the AIFM can opt not to be authorised but must register with the Central Bank, providing details of the individual AIF at time of registration and report annually thereafter. No other obligations will apply and no depositary will be required.

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<sup>6</sup> €100m, or €500m if the AIFs under managed are closed ended and not leveraged.

22. An EUT which must be authorised under the UT Act must be established as a retail investor AIF (RIAIF) or a qualifying investor AIF (QIAIF). On the basis of available information it is unlikely that investors in EUTs will meet with the QIAIF investor criteria and minimum subscription requirement. As a RIAIF, the EUT must meet with the investment diversification and borrowing requirements outlined in the AIF Rulebook. Of particular significance in the context of EUTs are rules which prohibit more than 30% of net asset value in any one property (in the case of real estate funds) and a limit on borrowing of 25% of the AIF's net asset value.
23. Moreover, in accordance with the Central Bank's AIF Rulebook, an EUT authorised as a RIAIF would not be permitted to have a registered AIFM and the AIFM must qualify as an authorised AIFM.

***Question: Is there any reason why the Central Bank would not apply the same regulatory regime to EUTs which are AIFs as to any other AIF?***

24. The stakeholders mentioned in paragraph 14 have pointed out that the application of AIFMD to EUTs is likely to result in substantial increased costs for pension fund investors. This may arise because of the authorisation requirements applicable to AIFM and the obligation to appoint independent depositaries.
25. While complying with the AIFMD, to the extent possible, the Central Bank is considering a transitional deadline of July 2015. On balance it appears more orderly to have a single date by which compliance with the AIF Rulebook will be required.

***Question: What transitional arrangements do you consider should be applied?***

### **Consultation responses**

The Central Bank invites all stakeholders to provide responses on the questions raised in this Consultation Paper. Responses which set out viable alternatives which recognise and address the regulatory risk to which the proposals in this document respond will receive particularly careful attention.

Please make your submissions in writing, and if possible electronically, as a Word document or a pdf document by email on or before 11 October 2013.

Submissions should be marked "**EUT Consultation, CP 68**" and sent to: [fundspolicy@centralbank.ie](mailto:fundspolicy@centralbank.ie). We will send an email acknowledgement to all responses



sent to this email address. If you do not get an acknowledgement of an emailed response please contact us on 2246000 to correct the situation.

In the event that you are unable to send your response electronically, please forward it, by post, no later than 11 October 2013 to:

**Exempt Unit Trusts Consultation – CP 68**

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19 July 2013**

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