Banc Ceannais na hÉireann
Central Bank of Ireland
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Feedback Statement on CP68:
Consultation on types of alternative investment funds under AIFMD and unit trust schemes under the Unit Trusts Act 1990 (including EUTs, REITS etc.)

Contents

Introduction

1. On 19 July 2013 the Central Bank of Ireland (the "Central Bank") published Consultation Paper CP68 *Consultation on types of alternative investment funds under AIFMD and unit trust schemes under the Unit Trusts Act 1990 (including EUTs, REITs etc.)* ("CP68"). The closing date for comments was 11 October 2013 and 9 responses were received. Following the completion of the consultation process, the Central Bank has carried out additional research prior to developing its position on the matters covered by CP68.

2. CP68 describes typical features of Exempt Unit Trusts (EUTs) established in Ireland and provides brief information on possible numbers of these in existence.

3. CP68 refers to the implementation in Ireland of Directive 2011/61/EU on Alternative Investment Fund Managers ("AIFMD") and to the definition of alternative investment fund ("AIF") under Article 4. It draws attention to the guidelines issued by the European Securities and Markets Authority ("ESMA") on key concepts of AIFMD[1]"(the ESMA Guidelines") and asks if an EUT is an AIF under AIFMD and also a unit trust scheme within the scope of the Unit Trusts Act 1990.

4. CP68 refers to the implications should EUTs be found to be AIFs under AIFMD. It then refers to the requirements applicable to unit trust schemes which are subject to the Unit Trusts Act 1990.

5. CP68 also invites comments on other types of undertaking such as Real Estate Investment Trusts (REITs) and Special Purpose Vehicles (SPV) as categories of undertakings which have been mentioned as possible AIF.

6. AIFMD came into effect on 22 July 2013. It is implemented in Ireland by the European Union (Alternative Investment Fund Managers) Regulations 2013 ("the AIFM Regulations"). Regulation 60 provides that:

   An Irish AIFM performing activities under these Regulations before 22 July 2013 shall, on and from that date, take all necessary measures to comply with these Regulations and shall submit an application to the Bank for authorisation under these Regulations within 1 year after that date.

7. AIFM who fall below the thresholds set out in Regulation 4(2) of the AIFM Regulations and do not require authorisation must register with the Central Bank, in accordance with Regulation 4(3), by 22 July 2014. Nothing in this feedback statement should be read with, seen as a clarification of or a supplement to the AIFM Regulations. This feedback statement is published to promote understanding of the policy formation process within the Central Bank and is not relevant to assessing compliance with regulatory requirements. The Central Bank recognises that particular issues may arise with the interpretation of the guidance included in this feedback statement as the outcome of our consultation. We will monitor queries received and, if necessary, provide additional guidance in the AIFMD Q&A.

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[1] Ref. ESMA/2013/611- 13 August 2013 http://www.esma.europa.eu/system/files/2013-611_guidelines_on_key_concepts_of_the_aifmd_-_en.pdf

Feedback on questions posed in CP68

Question 1: Do you believe that our brief summary on the organisation of EUTs as set out is correct?

8. Most respondents did not answer this question explicitly. One respondent agreed with the summary and one respondent drew attention to types of underlying investors within EUTs, noting in particular that individuals may invest in a life assurance pension policy which, in turn, invests as unit-holder in the EUT. Others responded to the reference in CP68, to the fact that EUTs are typically used by pension providers, by pointing out that the pension activities of pension providers are outside the scope of AIFMD.

9. One respondent noted that, in their case, EUTs are established for single investors and that this category of single trust EUT is not mentioned in the CP. This single investor EUT is described as self-directed and established to hold certain of the client's pension assets.

Central Bank: The Central Bank notes that no respondent disagreed with the description of EUTs set out in CP 68. The Central Bank acknowledges that different types of unit-holders may invest in EUTs and also that single investor EUTs may be established. This matter is addressed in more detail under "Outcome of our review" on page 10.

Question 2: Do you agree with our analysis that an EUT is an AIF?

10. The majority of respondents accepted that some EUTs could be AIFs. One respondent, who did not agree, noted that as AIFMD exempts occupational pension schemes, EUT structures with investors who would be individually exempt should also be exempt where they invest collectively. This respondent also noted that in their experience, EUTs do not raise capital before they are established.

11. Those who accepted that some EUTs may be AIFs made a number of points in relation to those EUTs which they considered would not fall within the definition of AIF as follows:

- Each EUT should be examined on a case-by-case basis to ascertain if it is an AIF.
- Many EUTs are established as single investor trusts. Where these trusts are sub-trusts under a master trust structure, they could in reality be separated into stand-alone trusts in order to ensure that the collective element of an AIF was not met.
- An EUT may be established at the instigation of an investor and therefore could be deemed not to "raise capital".
- EUTs which receive the proceeds of existing pension funds should not be viewed as raising capital.
- Investment policy may be fully at the discretion of the investor.
- Whether an EUT is constructed in the legal form of an umbrella trust or not is of no significance. What is significant is what it actually does.
- The idea that most EUT master funds are likely to have at least one series with more than one investor is incorrect.
- Co-ownership arrangements between like-minded investors should be capable of being formed without being an AIF.
- A co-ownership structure may be more efficient than establishing individual structures where investors invest in the same property.

12. A respondent, who focussed on structured issues and not EUTs, mentioned that in the case of a structured note programme, "*a single issuer may potentially issue hundreds of series of notes, each such series constituting a limited recourse contractually ring-fenced issue."* This respondent thought it would not make sense for the entire structure to be regarded as an AIF for the sole reason that one series was deemed to fall within the definition, particularly with regard to the ring-fenced limited recourse nature of each issue. A determination should therefore be made at the level of each series without regard to other contractually ring-fenced obligations within the entity.

13. One respondent, who considered that an EUT is an AIF, considered that the single investor argument may be dubious if the one investor represents the accumulated investments of a number of individuals.

Central Bank: The Central Bank agrees that providers of EUTs must consider the particular arrangements of their structures in order to ascertain whether they are AIF. The Central Bank also agrees that single trust structures – trusts established for or by individual investors – do not fall within the definition of AIF under AIFMD if constitutionally limited to one investor. However, in accordance with the ESMA Guidelines, with regard to "number of investors", a single investor who invests capital from more than one legal or natural person with a view to investing it for the benefit of those persons should be regarded as an undertaking which raises capital from a number of investors.

The statement by the Central Bank in CP 68, that most EUT master funds are likely to have at least one series (or sub-trust) with more than one investor, was based on information provided to us by EUT providers. The related argument, that one collective undertaking within an EUT master structure, does not make the entire structure a collective investment undertaking, is not consistent with the ESMA Guidelines with which the Central Bank is committed to complying. These include a guideline on "*treatment of investment compartments of an undertaking*" which, in summary, provides that where an investment compartment is an AIF this is sufficient to determine that the undertaking as a whole is an AIF. It must also be noted in this context that many authorised investment funds, both UCITS and AIFs, are established as umbrella funds under arrangements where there is no recourse between the sub-funds and assets are legally ring-fenced at sub-fund level.

The notion that EUTs are created after capital is raised or provided by investors does not in the view of the Central Bank allow for EUTs to fall outside the definition of AIF. In practice this argument could be made by any number of investment funds and reliance on this element could be a measure for circumvention. The Central Bank therefore does not accept that a timing test alone is sufficient to ground a test as to whether external capital has been raised within the meaning of the AIFMD. With regard to the argument that EUTs fall within the pension fund exemption in the AIFMD the European Commission, in their AIFMD Q&A, mention that "*an AIF does not become a pension fund merely because pension funds are invested in it*", (ref: ID 1148).

Regulated AIF are generally required to set out investment policies in a prospectus. However the absence of this type of disclosure cannot be taken to mean that the EUT does not have a defined investment policy and ESMA guidelines set out a number of factors to be considered. It seems to us therefore that an EUT provider who suggests that a particular EUT should be regarded as outside of the scope of AIFMD on the grounds that it is self-directed by the investors, should be required to demonstrate that the initiative to establish the undertaking was entirely that of the investors and not by either the EUT provider or another intermediary and that its investments are also made by the investors.

In light of this analysis the Central Bank considers that providers of EUTs which are not established strictly for individual investors should consider that their EUTs fall within the definition of AIF in AIFMD and within the AIFM Regulations. Moreover, in order to be considered as a single investor undertaking, the undertaking should, in accordance with the ESMA Guidelines, be *prevented by its national law, the rules or instruments of incorporation or any other provision or arrangement of binding legal effect, from raising capital from more than one investor*.

Question 3: Is an EUT a unit trust for the purposes of the Unit Trusts Act 1990?

14. With the exception of one respondent, all respondents argued that EUTs are not unit trust schemes under the Unit Trusts Act 1990.

15. One respondent considered that the argument for subjecting EUTs to authorisation under the Unit Trusts Act, 1990 was not clearly set out in CP 68 and that this lack of clarity was in itself an indication of a weakness in the proposal to revise the prevailing approach. In a similar vein, another respondent considered that it was not appropriate to revisit and arbitrarily move away from the existing approach on the basis that the volume of investments by pensions seems a cause for concern.

16. Respondents argued that investment vehicles limited to investment by Revenue approved pension funds and charities could not be regarded as providing for "public participation" and at least a case by case analysis was required. It was also suggested that an amendment to the Unit Trusts Act 1990 would be required to achieve a position whereby all EUTs would be subject to the Act by virtue of being an EUT.

17. One respondent, who strongly disagreed with "*the suggestion in CP68 that the growing number of individual pension schemes undermines the argument that EUTs do not involve participation by the public*", noted that individual pension schemes require Revenue approval which is only granted when, inter alia, an independent professional "Pensioner Trustee" from an approved list is appointed.

18. The consequences of an authorisation requirement were mentioned by one respondent who considered that

    - It would not be possible to appoint a depositary for certain EUT assets due to the nature of those assets;
    - Pension funds and management companies of such funds are defined as professional clients under MiFID and on this basis an EUT whose unit holders comprise solely of pension schemes may not be RIAIFs. Smaller pension funds may not be able to provide the minimum subscription requirement which applies to QIAIFs;
    - The regulatory regime applicable to authorised AIFs may contradict government policy towards one member pension schemes or "gainsay" existing pensions regulations.
    - Most corporate trustees of EUTs are also MiFID firms but AIFMD does not permit a MiFID firm to be an AIFM.

19. On the other hand, one respondent considered that it may have been reasonable in 1990 to assume that an EUT was not a unit trust scheme under the 1990 Act when EUTs were predominantly the preserve of large defined benefit occupational pension schemes. However, since the early to mid-2000s, EUTs have been established often as a means of offering geared pension property investment to individual pension investors. This respondent added that further wider access to EUTs also opened up at this time with the introduction in 2001 of "gross roll up" for life assurance company non pension savings and investment business, i.e. investment returns rolled up within the life company tax free with realised policy gains being subject to exit tax on encashment or maturing – the life company could invest in an EUT as a "gross" investor. While this respondent considers that it is very difficult to see how such "retail" EUTs could still be said to not be "arrangements made for the purpose or having the effect of providing facilities for the participation by the public…." it suggests that there may be an argument to allow an exemption from the 1990 Act, but only to registered charities and the trustees of large occupational pension schemes.

Central Bank: The Central Bank considered all of these arguments and the widely differing views there can be on the test of "availability to the public" contained in the definition of unit trust scheme in the Unit Trusts Act 1990.

However, since the issue of the Consultation Paper, the EU (Alternative Investment Fund Manager) Regulations, 2013, which implement AIFMD into Irish law, have come into force. Under these Regulations marketing of AIF to retail investors is subject to conditions or requirements imposed by the Central Bank and it is not relevant whether the AIF meets a test of "availability to the public" or not.

Guidance issued by the Central Bank provides that AIF which market to retail investors in Ireland must, if not authorised by the Central Bank, be authorised by a supervisory authority and subject to an equivalent level of investor protection to that provided under Irish laws, regulations and conditions governing Retail Investor AIF.

We accept however that regulated occupational pension fund schemes, other than small self-administered schemes (SSAS) can be permitted to be marketed without seeking an authorisation under the Unit Trusts Act 1990 on the basis that they are marketing to professional investors.

Question 4: 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?

20. Seven respondents answered this question and some common themes emerged. The largest number of comments related to costs. It was considered that the proposed approach would cause substantial hardship to individual investors and increase substantially the cost of providing pension contracts to individuals. EUTs have been operating in a lower cost environment previously and it is difficult to see the merit in forcing regulation on these vehicles and their investors when the only apparent result in an increase in costs. Another respondent mentioned that a cost benefit analysis should be obtained to ensure that any increased costs on investors are merited.

21. Reference was made to pension fund regulation and that "*throughout the EU occupational pension schemes are separately regulated and investment strategies are, in the main, also limited by regulation*". Another respondent considered that "*the area is already extensively regulated by the Pensions Board and Revenue" and "EUTs are predominately used by this industry*". This respondent noted that "*qualifying fund managers (for PRSAs) use EUTs as a single investor vehicle and is supervised by the Revenue*".

22. Practical reasons were also cited in response to this question where respondents considered that the investments held within EUTs could not comply with the investment rules applicable to authorised RIAIF. Moreover certain assets were illiquid and could not be disposed of – this could result in a situation where an AIFM must resign from the EUT to avoid being in breach of AIFMD which would have implications for investors.

23. Others suggested that as it would not be appropriate to subject EUTs to the QIAIF/RIAIF regulatory regime it would be important to develop a set of distinct rules which would reflect the particular nature of EUTs as long term investments and allow for the differing investment and liquidity requirements of their investor base. A respondent agreed that the investor base is unlikely to meet with QIAIF requirements but it would not be possible for EUTs to comply with the RIAIF regime. This respondent mentioned that the proposed ELTIF regime might be appropriate (COM (2013) 462).

24. One respondent suggested that an EUT specific regulatory framework might be devised which would focus only on an authorisation requirement for the investment manager, a depositary and a fund administrator. Another respondent suggested a similar approach but one which might best be set out in applicable tax law.

Central Bank: If EUTs are established, as many contributors have pointed out, as single investor arrangements, then they are unlikely to fall within the scope of AIFMD. The question therefore relates solely to those EUTs which are collective in nature. On the basis of information provided there is as yet no reason persuasively made as to why investors in this type of unit trust scheme should not be subject to the same level and type of investor protection as that which applies to investors in other authorised unit trust schemes.

With regard to the role of the Revenue Commissioners in relation to EUTs, this is not described accurately in feedback received. The Revenue Commissioners require EUTs to provide an annual return but do not apply any form of regulation to the EUT.

Question 5: What transitional arrangements do you consider should be applied?

25. CP68 referred to the possibility that the Central Bank, while complying with AIFMD, would consider a transitional period to extend to July 2015 before EUTs would be required to comply with the AIF Rulebook. While those respondents who addressed this question supported a lengthy transitional period some did not consider that it would be possible for existing EUTs to meet this timeframe.

26. One respondent considered that the illiquid nature of assets held within EUTs would not allow for compliance with AIF Rulebook diversification requirements. This respondent suggested that existing EUTs might be ring fenced with no new investment permitted. Compliance with the AIF Rulebook may result in unnecessary losses to investors who had not invested in a regulated vehicle at the outset.

27. Another respondent agreed with a July 2015 date for compliance with AIFMD. However in the case of the Unit Trusts Act 1990, this respondent considered that existing EUTs should be grandfathered indefinitely and expressed the view that a significant number (and possibly the majority) of existing EUTs have investment policies which are incapable of being accommodated within the RIAIF regulatory regime. These should not be required to dispose of assets acquired in good faith under existing rules. Moreover, new EUTs should be permitted a period of at least five years to comply with portfolio composition and diversification rules as would apply to European Long Term Investment Funds in the European Commission's formal proposal for these funds.

28. Another respondent who supported the longest possible transitional arrangement also thought that staggered compliance dates would be important for the Central Bank.

Central Bank: The AIFM of EUTs within the scope of AIFMD must comply with the transitional arrangements set out in the AIFM Regulations. Accordingly AIFM which fall below the threshold set out in Regulation 4 must register with the Central Bank by 22 July 2014.

AIFM which are above the thresholds set out in Regulation 4 must, in accordance with Regulation 60, seek authorisation by 22 July 2014. However in recognition of the timing of the publication of this feedback statement, the Central Bank is willing to work, within the legal timescales provided for in law, for the completion of authorisations of potential AIFM identified in this consultation, who have made contact with us by the July 2014 deadline.

Also, if appropriate, the provision set out in Regulation 60(3) regarding closed end AIF may be applicable.

Outcome from our review:

In the light of our analysis of responses to questions 1-5, the Central Bank is issuing the following guidance to market participants which will be reflected in our AIFMD Q&A:

> Marketing of alternative investment funds (AIF) in Ireland is subject to the EU (AIFM) Regulations 2013 (the AIFM Regulations). Under these Regulations, which implement AIFMD in Ireland, marketing of AIF to retail investors is subject to conditions or requirements imposed by the Central Bank and it is not relevant whether the AIF provides for participation by the public or otherwise. Our analysis indicates that while there may be EUT which can have only a single investor, other EUT fall within the scope of the AIFM Regulations.
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> Guidance on the application process issued by the Central Bank provides that AIF which market to retail investors in Ireland, if not authorised by the Central Bank, must be authorised by a supervisory authority and subject to an equivalent level of investor protection to that provided under Irish laws, regulations and conditions governing Retail Investor AIF.
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> In that light:
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> i. From 1 May 2014, new unit trust schemes made available to beneficiaries in Ireland should seek authorisation from the Central Bank under the Unit Trusts Act 1990, where they are alternative investment funds under AIFMD, notwithstanding that they hold an exemption from tax obtained from the Revenue Commissioners, given on the basis that the investors in such trusts have a tax-exempt status as either pensions vehicles or charities.
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> ii. As an exemption from the generality of i) above, new unit trust schemes should not seek authorisation if the eligible investors are confined to charities and/or regulated occupational pension schemes where the occupational pension scheme has multiple beneficiaries and is not a Small Self-Administered Scheme ('SSAS'). A unit trust scheme which has a tax exemption from the Revenue Commissioners, while allowing PRSAs, ARFs/AMRFs, PRBs and/or RAC schemes to invest, does not meet the requirements for this exemption and should seek authorisation in accordance with i) above. A unit trust scheme which is exempt from the requirement to seek an authorisation because it meets the grounds for this exemption may, nevertheless, meet the conditions for being an AIF as defined in the AIFMD. In that eventuality, the manager (alternative investment fund manager under AIFMD) must register under the EU (AIFM) Regulations 2013 or, if the AIFM exceeds the relevant AIFMD thresholds, seek authorisation.
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> iii. As an exemption from the generality of i), a unit trust scheme which is constitutionally confined to one ultimate beneficiary should not seek authorisation. However, where there are multiple sub-trusts, the constitutional documents for the master trust and the sub-trusts must be organised so that each sub-trust can have only one beneficiary and there is no sharing of benefits between sub-trusts. A beneficiary which is a vehicle for investment by multiple ultimate beneficiaries does not count as a single beneficiary for the purpose of calculating whether this exemption applies. Also, where an EUT could have more than one investor, but turns out only to have one, the conditions for availing of this exemption are not met as there must be a constitutional prohibition on more than one beneficiary for this exemption to be met.
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> iv. Unit trust schemes which are already in existence and which, had they come into existence after 1 May 2014, would have required authorisation under i) above, must apply for authorisation by 1 October 2014, unless they have, in the interim, restructured to avail of one of the exemptions listed at ii) and iii) above.
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> v. As an exemption to iv), unit trust schemes which are closed-ended schemes and the AIFM of which can avail of the grandfathering arrangement set out in Regulation 60(3) of the EU (AIFM) Regulations 2013 are recommended not to seek authorisation. For the purposes of Regulation 60(3) 'closed-ended schemes' can be read to include EUTs which have an appropriate formal plan in place in relation to their termination.

Additional issue: CP 68, in paragraph 11, invited comments in relation to other types of undertakings such as Real Estate Investment Trusts and Special Purpose Vehicles as categories of undertakings which have been mentioned as possible AIF.

29. One response was received which comprehensively addressed issues for consideration in relation to structured issues, issued by a special purpose vehicle. A number of reasons are set out in order to consider such issues outside the scope of AIFMD and these included that the structured issues were capital market issuances for financial intermediation purposes. They were not collective investment undertakings, they did not have a defined investment policy and they were comparable to ordinary bond issues or normal debt financing.

30. This response also referred to the consequences for undertakings and their managers where the undertaking is deemed to be an AIF under EMIR (Regulation (EU) No 648/2012) or the proposed EU Regulation on Money Market Funds (COM(2013) 615/2) and requested affirmation from the Central Bank that structured issues fall outside the scope of AIFMD.

Central Bank: We do not propose to issue any general conclusion on SPVs pending further consideration of the issue by ESMA. However, since the publication of the Consultation Paper the Central Bank has included the following in the AIFMD Q&A:

Q. I am an SPV. Should I now seek authorisation as, or appoint, an AIFM?

A. As a transitional arrangement, entities which are either:

a) Registered Financial Vehicle Corporations within the meaning of Article 1(2) of the FVC Regulation (Regulation (EC) no 24/2009 of the European Central Bank), or
b) Financial vehicles engaged solely in activities where economic participation is by way of debt or other corresponding instruments which do not provide ownership rights in the financial vehicle as are provided by the sale of units or shares

are advised that they do not need to seek authorisation as, or appoint, an AIFM, unless the Central Bank of Ireland issues a Q&A replacing this one advising them to do so. The Central Bank of Ireland does not intend to do that at least for so long as ESMA continues its current work on this matter. If entities which believe they fall under (b) but not (a) wish to write to the Central Bank of Ireland in this regard, they may email AIFMDsecuritisation@centralbank.ie.

With regard to REITs, two of these have listed on the Irish Stock Exchange to-date – others may be proposed. Those that have been established have indicated that they are likely to be AIFs. We have not encountered a REIT structure in Ireland which we do not believe to be an AIF and therefore consider that the onus remains on any REIT to demonstrate otherwise. This position can be reviewed in the light of future ESMA work.

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