

Exempt Unit Trust Consultation – CP 68
Markets Policy Division
Central Bank of Ireland
Block D, Iveagh Court
Harcourt Road
Dublin 2

10th October 2013

Sent by email to : fundspolicy@centralbank.ie

Re: Consultation Paper CP 68 – Consultation on types of alternative investment funds under AIFMD and unit trust schemes under the Unit Trusts Act 1990

Dear Sir/Madam,

The Association of Pension Trustees of Ireland (APT) has decided to make the following submission in response to CP 68. As our members administer the majority of Exempt Unit Trust (EUT) arrangements in Ireland, we asked them for submissions and have summarised their observations, numerically corresponding to CP68, as follows:

Introduction

The focus of the AIFMD is supposed to be on entities that account for “a significant proportion of trading activity on financial markets” “constituting an important source of counterparty risk for other market participants” (ESMA MEMO-10-572) and are not otherwise regulated. Inherent in the overall rationale for the AIFMD are the concepts of

- a. scale,
- b. active trading, and
- c. significant market impact.

It follows that small scale, passive entities of limited market significance are not the target of the AIFMD. This is also clear from the terms of the AIFMD itself.

1. By way of comment to the Introduction to CP 68, it is worth noting, as correctly set out by the Central Bank, that EUTs are mainly used by pension providers. This observation is important as the pension activities of pension providers are outside the scope of the AIFMD. Traditionally, the EUT is a method of ownership by one member pension arrangements where the investment discretion is retained by the individuals. The EUT is mainly used for practical and administrative reasons.

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2. The interpretation of the Unit Trust Act 1990 and its application to EUTs has been considered previously by the Central Bank (formerly the Financial Regulator). This interpretation has been adopted by the pensions industry, the insurance industry and State Bodies. The Revenue Commissioners state “*These exempt unit trusts are unauthorised. They would not be authorised by the Financial Regulator under the Unit Trust Act, 1990, as they are not open to the public generally. Investment in exempt unit trusts is confined to pension schemes and charities.*” Furthermore tax legislation specifically excludes unit trusts as defined in section 731(5)(a) of the Taxes Consolidation Act 1997 (as amended) from being an investment undertaking under section 738 and 739B of the Act. Clearly this represented the intent of the Government.

A reinterpretation of this legislation on the basis that EUTs are now arrangements set up for the purpose, or having the effect, of providing facilities for the participation by the public, as beneficiaries under a trust because “*individual pension schemes have emerged over recent decades*” has retrospective effect and undermines the reasonable expectations of investors and product providers. The EUT pensions industry is €3 billion in size and represents circa 4% of the pensions market, clearly a tiny minority of the general public. It is very difficult to assert that of a small number of partners say in a professional firm using an EUT to structure an investment to provide retirement benefits is an arrangement that provides facilities for the participation by the public. It is our view that such a change should be subject to legislative scrutiny.

In summary many pooled investments through EUTs, are inaccessible and unavailable to the public, which is why in our opinion they are outside the scope of the Unit Trust Act 1990.

3. Many EUTs are established under the terms of an umbrella Trust Deed, this approach is adopted for ease of administration. The Series Trusts are typically worded as separate undertakings with entirely different and unrelated objectives, managers and administrators.

Implementation of Alternative Investment Fund Managers Directive

10. The Central Bank discusses the conditions under which AIFs that do not require authorisation under domestic investment fund legislation, such as EUTs, should be permitted to market to retail investors.

This raises the fundamental question as to whether EUTs are “marketed” in the first place. The answer to that question, as further set out below, is that EUTs in their most common occurrence aren’t “marketed” at all.

While they are not regulated under the terms of Directive 2003/41/EC (IORPs Directive), EUTs are entities which support pension systems. In their most common occurrence, the EUT does not have an existence, which is separate to that of its pension investors.

11. Likewise, our members do not readily accept the premise of the question raised as to the assistance to be provided by CBI to “*entities which fall within the AIFMD but not as conventional investment funds*”.

There is nothing in the definition of AIFs, as delineated by ESMA, which points toward the Directive for alternative investment fund managers targeting other managers than those of investment funds. Because AIFs by nature are unconventional the ESMA guidelines serve to draw the distinction between AIFs and other, unregulated, investment vehicles. Co-ownerships, special purpose vehicles,

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Partnerships, joint ventures (etc.) are well known examples of such, much more loosely defined, entities. They all have some or more features in common with the AIF, but they are not AIFs because they do not predominantly share its characteristics.

Accordingly, the notion that some entities may fall within the Directive but are not investment funds must be rejected.

That being said, any one or all of these non-AIF vehicles could potentially be or become regulated, but we believe this would have to be under separate legislation.

Is an EUT an AIF?

13. The first point to note is that the EUT is a legal structure and is not a fund by its mere existence. Whether a company is subject to MiFID depends on the nature of its activities. Likewise the activities of the EUT will determine if the EUT is an AIF. There may be EUTs which are AIFs and EUTs which are not. The Directive itself declares that the legal structure of the AIF is of “no significance” (Art. 2.2.).

14. Whether a 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.

In that context, it is worth noting, as outlined above that the EUTs typically used by pension providers are separate undertakings, involving different and unrelated parties, entirely segregated in terms of their objectives, assets and liabilities. Having asked our members it is an incorrect assumption by the Central Bank, that “*most EUT master funds are likely to have at least one series with more than one investor*”. In our opinion the blanket approach being adopted by the Central Bank to this matter is inherently flawed. In fact that many EUTs have no collective investment element at all.

The notion that series or sub-trusts of an EUT will, whether the individual series consist of multiple investors or a single investor, make the overall trust collective in nature is incorrect. Sub trusts of an EUT commonly used in the pensions industry are not series of the one undertaking. Each sub trust is entirely segregated, has separate legal structures and bear no common features other than being under the same master trust for cost and administrative efficiency.

16. As highlighted above, all of the features of an AIF, as outlined by ESMA, are important in order to be able to properly distinguish the AIF from other legal structures. Our members are of the opinion that it is important that co-ownerships between like-minded investors, special purpose vehicles between business relations, investment partnerships between spouses and JVs between business relations can continue to be formed, on an informal basis. These are not AIFs and since legal form or structure is of no significance the organisation of such structures under the terms of an EUT does not alter that assessment.

If such structures are deemed AIFs it would mean that the purchase of property, between a number of like-minded pension investors would fall within the scope of AIFMD. Ultimately the clients retain the discretion as to how their investment is managed, who have access to the rental accounts and who limits the delegation of duties to practical issues such as property management. This is a feature of the majority of EUTs.

Our membership are of the opinion that if the Central Bank wish to bring EUTs under AIFMD new legislation will be required, as we believe the Directive does not provide the authority if the entities do not bear the features of an investment fund.

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17. We strongly disagree with this assumption, as already highlighted one cannot assume all EUTs have some form of pooled investment when this is clearly not the case. In many cases EUTs receive the proceeds of existing pension funds, but we believe that under any circumstances this could not be viewed as raising capital.

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

As set out above, we agree that an EUT is an AIF if it entirely, or in the main, it bears the features of an AIF. An EUT is a legal structure and may be used as a framework for other non-AIF purposes such as to house a co-ownership between investors. We do not agree that the EUT by its nature is an AIF. Furthermore, we do not agree that there are entities which fall within AIFMD but not as conventional investment funds. If an EUT is not an investment fund, which we believe is often the case, it falls outside the scope of the AIFMD.

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

18 & 19. The argument for subjecting EUTs to authorisation under the Unit Trust Act 1990 is not in our opinion clearly set out in this Consultation Paper (CP 68). The general references made to the “AIFMD implementation” and “*the continued increase in pension fund investment by individuals*” but lack of specific arguments makes it difficult to agree (or argue against) the Unit Trust Act authorisation. We believe that this lack of clarity is in itself an indication of the strength or lack of to bring EUTs under the UT Act.

EUTs are not considered excluded from the Unit Trust Act because they are limited to pension fund investors. They are considered excluded because they are not generally available to the public – in the same manner that a co-ownership between a group of colleagues is not available to the public.

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

20. We believe that the appointment of a depositary for certain EUT assets is not possible due to the nature of the assets.

22. Pension funds and management companies of such funds are defined as professional clients under Annex II of MiFID and on this basis, an EUT whose unitholders comprise solely of pension schemes, may not be an RIAIF. As a closed ended QIAIF is subjected to a minimum investment of €100,000, smaller pension funds that are unable to meet this threshold would be forced to exit, which places them at a disadvantage. Again this contradicts government policy, which explicitly exempted one member pension schemes from the IORPS Directive, to enable a broader range of investment choice. Other areas where the investment restrictions imposed may gainsay existing pensions regulation include:

- The Occupational Pension Schemes (Investment) Regulations 2006 (S.I. 294/2006) sets out rules for investments permissible in occupational pension schemes, to include a framework on borrowing.
- The Revenue Commissioners have issued investment rules for occupational pension schemes. The statutory authority for the rules is contained in section 779A , Taxes Consolidation Act 1997.

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- The Pensions Board has recently issued “Investment Guidelines for trustees of defined contribution pension schemes”.
- Where the EUT is used as custodial vehicle for a PRSA (such as is the case for some PRSAs), Chapter X of the Pensions Act sets out rules for the governance of PRSA investments.

23. If certain collective EUTs are considered AIFs and also authorised Unit Trusts under the Unit Trust Act 1990, the following problem arises, depending on whether the trustee of the authorised unit trust is considered the AIFM or not. Most corporate trustees of EUTs are also MiFID firms. AIFMD does not permit a MiFID firm to be an AIFM, therefore the legal ownership of all of the underlying assets will be required to be transferred to another AIFM that is not a MiFID firm, with legal and other undetermined costs to the pension investors.

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 AIFs?

Having discussed this with our members, we believe that this approach will if implemented, cause substantial hardship to individual investors and increase substantially the cost of providing pension contracts to individuals. We would highlight the following reasons for these statements:

1. Many of the investments held within an EUT would fall foul on the strict investment guidelines of AIFs and would in many cases force the disposal of assets at substantial loss to investors.
2. In certain instances certain assets cannot by their nature be disposed of and therefore this caused a problem for the AIFM. They could be placed in a position that they are forced to resign from an EUT to avoid being in breach of AIFMD. This has obvious implications for the pension investors and possibly the tax exemption of their investments.
3. The transitional deadline proposed of July 2015, is in the opinion of our Members not workable. We believe due to the illiquid nature of certain assets held within EUTs it would be better to ring fence these assets and not allow the introduction of any new funds to these structures. The proposed deadline would inflict unnecessary losses to investors who never intended to invest in a vehicle that had such restrictions placed on it by regulations.

In summary we believe that the proposal by the Central Bank to apply AIFMD to EUTs and deem them subject to the Unit Trust Act is incorrect in the proposed format. It does not take into account a variety of factors set out in this submission, which makes the implementation of the proposals incorrect under the current legislation.

We are of the opinion that there is currently no authority in the AIFMD to regulate administrators of EUTs, which are not AIFs. This is irrespective of the fact that there may be a need to further regulate EUTs, but we believe this is a separate matter. The principles for proper management of the EUT (or any other investment vehicle) may be improved by adopting certain parts of the AIFMD, but certain restrictions are not workable with the existing investments held. Finally our members do agree that the management of EUTs should be subject to certain supervision, but the suggested current proposals we believe will inflict unnecessary losses on clients and result in further restricting investment choice for individual pension holders.

SUBMISSION ON BEHALF OF THE MEMBERS OF APTI

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