

## Dublin Solicitors' Bar Association Seminar

### Misselling and Misleading – Acting for the Promoters of Financial Products

In these difficult economic times, the duties and liabilities of the promoters of financial products are coming under much tighter scrutiny. In the decade prior to the global economic recession, steadily increasing values in shares and property meant that promoters of such schemes rarely had to examine their potential liabilities, and conversely investors paid little attention to the available avenues of recourse in the event that they lost money.

Potential liabilities are now of keen interest for both promoters and investors, as in many cases the value of the capital invested in the product has been significantly reduced, or even wiped out. Most cases centre around three fundamental issues:

1. Misselling of financial products to investors;
2. Failure to explain the terms of the product to investors; and/or
3. Misleading statements made to investors.

Today we will also deal with the regulatory requirements associated with the selling of financial products.

#### SMDF v Bloxham

A recent and ongoing example is the case taken by Solicitors Mutual Defence Fund (“**SMDF**”) against Bloxham Stockbrokers. The case is based on the investment by the SMDF of €8.4 million in a Dresdner bank bond in 2005. Morgan Stanley, who were recently joined to the proceedings as a third party on the application of Bloxham, arranged and dealt in the notes and issued them via an Irish special purpose vehicle. The global financial crisis resulted in the rating of the bond being down-graded, which constituted an “early redemption event” in the bond.

In June 2009, Morgan Stanley redeemed the bonds on the first date they could do so without incurring any losses on their part. The loss to the SMDF was 97% of the value of the funds initially invested.

The SMDF initiated legal proceedings in December of last year, contending that Bloxham failed to explain the true nature of the bonds and recommended the investment without properly understanding its nature and associated risks. In turn Bloxham have alleged that the losses were caused by, or at least contributed to, by Morgan Stanley. They also claim that Morgan Stanley did not give sufficient warning to them in relation to the possibility of early termination of the bonds.

Currently these proceedings have been adjourned by the Commercial Court until 8 June 2010. As of the date of writing, the last significant occurrence in the case was the joining of Morgan Stanley as a third party on the application of Bloxham.

#### Kilmartin v Bank of Ireland

This case, which received quite a considerable degree of media attention, provides another recent example of the misselling of financial products by financial institutions. The plaintiffs

had been sold an endowment mortgage in 1991 by their bank manager in Bank of Ireland, on the basis that it would provide a "nice little nest egg" of approximately €14,000 after fifteen years, as well as paying off the £50,000 (€63,000) mortgage.

An endowment mortgage is a mortgage loan arranged on an interest-only basis where the capital is intended to be repaid by an endowment policy. The underlying premise with endowment policies being used to repay a mortgage is that the rate of growth of the investment will exceed the rate of interest charged on the loan. In this instance, the endowment policy had resulted in a shortfall of €4,864, which the plaintiffs had to meet from their pension when the policy matured in 2006.

The Kilmartins claimed that they suffered loss of over €22,000 as a result of the bank's negligent advice that this type of mortgage would provide the plaintiffs with superior security and return, when compared with a traditional annuity mortgage. Also, they alleged that the bank had failed to warn them of the risk attaching to endowment mortgages.

The bank's counsel stated that his client's position was very simple – the endowment mortgage had cost the plaintiffs approximately €5,000 less than an annuity mortgage, and therefore they had not been ill-advised. Also, the bank manager claimed he had warned one of the plaintiffs verbally of the potential risks before they entered the mortgage.

In a potentially far-reaching decision for the banks, the Circuit Court President, Mr Justice Deery, found in favour of the plaintiffs and awarded them €16,000 in damages on the basis of the bank's negligent misrepresentation.

The Court was satisfied that the documentation supplied to the Kilmartins had not contained language highlighting the investment risks involved, or the potential risk to one's home. On the contrary, the documents suggested there was no risk.

In response to the bank manager's claim that he had warned one of the plaintiffs about the downsides of an endowment mortgage over the phone, the judge dismissed this argument as it would have been natural to have repeated the warning in a follow-up letter of 2 May 1991 and the manager had not done so.

As a result, the Kilmartins were awarded €16,002, broken down as follows:

- €6,039 for the shortfall on maturity of the mortgage;
- €1,963 for additional premiums and interest; and
- €8,000 for loss of projected surplus.

More worrying for the banks than the amount of this particular award is the number of similar claims which are alleged to be working their way through the Courts. While many may be statute-barred, those who only became aware of financial losses within the last six years will have an arguable case on the basis of this precedent. Bank of Ireland's counsel has stated they intend to appeal the decision to the High Court.

## **Liability of Investment Managers:**

Investment managers operating in Ireland owe specific duties to clients when providing investment management services. These duties differ from those of other service providers operating in the financial services industry, such as custodians and administration companies. The main headings, under which an investment manager owes legal duties to clients and the potential heads of liability to those clients for losses arising, are as follows:

### **Negligence**

A disgruntled investor may claim that an investment manager has acted negligently in providing services to the investor. As with all negligence-based actions, for such a claim to succeed, the investor will have to establish duty, breach, causation and loss.

An investor can usually establish the existence of a duty of care, due to the nature of the investment manager-client relationship (under the usual headings of proximity, reasonable foreseeability, and whether it is just and reasonable to impose liability). Where a duty of care exists, an investment manager must observe the applicable standard of care. Failure to do so constitutes negligence.

Investment managers will seldom guarantee the client a particular outcome, because the value of investments may rise and fall due to factors beyond their control. Nevertheless, the investment manager has a duty to use reasonable care and competence when carrying out its activities. When this standard is not adhered to, the client has a potential basis for a claim in negligence.

Put simply, the applicable standard of care is whether the investment manager provided the service with the *proficiency of an ordinary skilled person in that sector*. An investment manager would also be liable if it conducted a service which it was not competent to provide. Common practice in the sector is relevant to making a determination of negligence, so long as the practice is not deemed inherently defective. When the investment manager is regulated, the applicable regulatory standards are also relevant to determining negligence, as we will discuss in greater detail below.

Special rules apply to cases of "professional negligence". For example, claims for pure economic loss are more likely to succeed in cases of professional negligence. Furthermore, the courts hold professionals to a higher standard than non-professionals when determining whether a breach of duty of care has occurred. The Irish courts have yet to exhaustively define what constitutes a "profession" for professional negligence purposes. It is not clear that investment management is a profession for negligence purposes in Ireland. The English courts have indicated that an independent financial adviser is a profession.

While the above principles are well established in both Irish and English case law, it is important to note the Irish courts can be quite harsh in applying these principles to professional service providers. The Irish Supreme Court has, for instance, ruled in the Wildgust v Bank of Ireland case that a life insurer was liable to the plaintiff policyholder for informing a third party bank, which had a security assignment over the policy, that the premiums on the policy were paid up-to-date when in fact a payment had been missed.

Even though the bank never advised the plaintiff of this conversation, so that he did not rely on it, the insurer was found liable to the plaintiff for the loss resulting from the lapse of the policy. In the court's view, the insurer should have been aware that the plaintiff was liable to be damaged as a consequence of their incorrect statement that the premiums were up to date, whether it was the assignee bank or the policy holder who received the incorrect information.

### **Breach of fiduciary duty**

A claim for breach of fiduciary duty is a specific claim which is only likely to arise where an investment manager acts recklessly or puts itself in a position of conflict of interest. Properly run firms are unlikely to face a claim for breach of fiduciary duty. However, if such a claim is made, it is a very serious matter, and likely to have regulatory implications for the investment manager, if proven.

The overarching duty which a fiduciary owes to his client is an obligation of loyalty. This can be broken down into four distinct duties:

1. A fiduciary should not put himself in a position where his own interests and those of his client conflict.
2. A fiduciary should not profit from his role at the expense of his client.

3. A fiduciary should not allow the duties he owes to one client conflict with duties owed to another.
4. A fiduciary owes a duty of confidentiality concerning information acquired in a fiduciary capacity.

Breach of fiduciary duty can give rise to an investor claim for damages, rescission, an account for profits by the investment manager, or an injunction. The range of remedies, particularly equitable remedies, makes breach of fiduciary duty a very serious head of claim by an investor.

The terms of the investment management agreement or other terms of appointment can, if properly drafted, limit the scope of an investment manager's fiduciary duty. However, it is very difficult to contract out of a fiduciary duty entirely.

### **Breach of contract**

Investment manager/investor relationships are usually founded on contract. An investment management agreement or terms of appointment will state an investment manager's contractual duties to the investor. Thus, in the event of an investor's expectations not being met, he may allege breach of contract by the investment manager.

As we all know, contractual terms can be categorised as those expressly stated in the contract and those implied into it, either by the parties, the common law or statute. As the parties have control over the express terms, great care should go into expressly stating the duties and obligations to be undertaken by each side. Most importantly, while an investment manager should contract to exercise skill and care, he should not guarantee the attainment of any defined performance results.

The Sale of Goods and Supply of Services Act 1980 provides that a person supplying services must do so with "due skill, care and diligence". The courts are also likely to imply terms into contracts, such as any requirements imposed on investment managers by the Financial Regulator.

From an investment manager's point of view, the most crucial term of an investment management agreement will be the exclusion clause. The exclusion clause will exclude or limit the extent to which the investment manager may be held liable for any breach of contract, as well as seeking to cover liability for negligent acts. Such clauses should be drafted in clear and unambiguous language, because if clarity is lacking, such terms will be construed against the party seeking to rely on them.

Due to the similarities between an investment manager's contractual duty to its client and the duty of care owed in tort, an investment manager is likely to face a claim in negligence as well as or instead of a claim for breach of contract in many cases. This may be particularly significant as third parties, who would be excluded from claiming for breach of contract due to privity of contract rules, will face no such limitation in negligence.

### **Misrepresentation**

Investment managers of certain investment products, such as investment funds, issue promotional material to investors which relates to the product. Typically, this material includes an offering memorandum/prospectus or marketing literature. These documents and any verbal statements made by the investment manager to the client in respect of the investment may constitute legal representations, if they are statements of material fact. An investment manager may be liable for such statements, if they constitute "misrepresentations".

A misrepresentation is a statement of fact of material importance to the transaction in question, made by a party to the contract or his agent, actually relied upon by the other

party to the contract, by positive words or conduct. In Ireland, a plaintiff must show “that there was a representation of a fact, that the representation was untrue and that the plaintiffs were induced to enter into the contract by reason of the representation”.

In the event that an investment manager makes misrepresentations to an investor, the investor may have remedies at common law or under statute.

- **Common law**

At common law, misrepresentation falls into three classes—innocent, negligent and fraudulent. In the case of an innocent misrepresentation, a misled party can avail of the equitable remedy of rescission, where the statement induced him to enter a contract.

If the misrepresentation could be classified as negligent, i.e. the person making the representation ought to have known it was untrue; a party may be entitled to damages as well as rescission. Damages may be claimed under the tort of negligent misrepresentation against a person owing another a duty of care.

Where the misrepresentation is of a fraudulent nature, a party may also seek damages under the tort of deceit. To establish this tort, it must be shown that a false representation had been made knowingly, or without belief in its truth, or recklessly without caring whether it is true or false. A plaintiff must also establish that the statement was intended to induce the plaintiff to act on upon it, that he did in fact act on it and suffered damages as a result.

- **Statute**

The Sale of Goods and Supply of Services Act 1980 places the right to claim damages for misrepresentation on a statutory footing. Any person who makes a non-fraudulent misrepresentation shall be liable to damages in respect of any contract which results, where such would have been liable to damages had the misrepresentation been made fraudulently, unless he can prove that he had reasonable grounds to believe, and did believe up to the time the contract was made, that the facts represented were true.

The courts have the power to award damages in lieu of rescission in respect of cases of innocent or negligent misrepresentation, where it is considered equitable to do so. This is in contrast to the common law position mentioned above where damages cannot generally be awarded for innocent misrepresentation.

### **European Communities (Markets in Financial Instruments) Regulations 2007 (the “MiFID Regulations”)**

In Ireland, investment managers who:

- provide investment advice;
- conduct discretionary portfolio management; or
- execute client orders;

in relation to “financial instruments”, are required to be authorised by the Financial Regulator, pursuant to the MiFID Regulations. Financial instruments include shares in companies, bonds, units in collective investment undertakings and a wide variety of derivatives.

The Financial Regulator may impose conditions to the investment manager’s MiFID authorisation, or impose conditions relating to the ongoing operation of the firm.

The MiFID Regulations divides the client base of MiFID firms into three categories - retail, professional and eligible counterparty, with different degrees of protection for each category, i.e. retail clients are afforded the greatest degree of protection.

An investment manager who breaches a condition imposed by the Financial Regulator relating to its authorisation, or who contravenes the MiFID conduct of business rules, will be subject to the Financial Regulator's Administrative Sanctions Procedure.

The Procedure gives the Financial Regulator the power to hold an inquiry into the alleged conduct of the investment manager, and determine whether a "prescribed contravention" (which includes a breach of the MiFID Regulations) has occurred. Upon a finding of a prescribed contravention, the Financial Regulator can impose a wide variety of sanctions on the investment manager and its directors and managers, including:

- Caution or reprimand;
- Direction to refund or withhold all or part of an amount of money charged or paid, or to be charged or paid, for the provision of a financial service;
- Monetary penalty (not exceeding €5,000,000 in the case of a corporate and unincorporated body, not exceeding €500,000 in the case of an individual, e.g. directors and managers);
- Direction disqualifying a person from being concerned in the management of a regulated financial service provider;
- Direction to cease the contravention if it is found that the contravention is continuing; and
- Direction to pay all or part of the costs of the investigation and inquiry.

Alternatively, at any time up to the conclusion of an inquiry, the Financial Regulator may enter into a binding settlement agreement with the investment manager.

### **Financial Services Ombudsman**

The Financial Services Ombudsman's office is a wholly independent statutory body which can hear complaints made by consumers relating to "regulated financial service providers". Regulated financial service providers include investment managers regulated by the Financial Regulator. The Ombudsman can also hear complaints made by limited companies which have an annual turnover not exceeding €3,000,000, i.e. certain institutional investors.

Before undertaking an investigation into a complaint, the Ombudsman requires that the complainant has attempted to resolve the issue with the financial service provider concerned. The Ombudsman must also afford the parties the opportunity to resolve the complaint by way of mediation.

Where mediation proves unsuccessful, the Ombudsman will investigate the complaint. He will pose questions to the parties and request copies of relevant documentation. The Ombudsman considers the matter and reaches a "decision". This decision can be appealed to the High Court by either side.

Where the Ombudsman finds against a financial service provider he can direct it to do one or more of the following.

1. Rectify or change the conduct complained of or its consequences;
2. Provide reasons or explanation for that conduct;

3. Change that practice; and/or
4. Pay compensation up to a maximum of €250,000.

On the basis of the published case histories, it is clear that the Ombudsman is prepared to scrutinise the representations made by an investment manager to a client in relation to the nature of an investment product or service.

### **Vicarious Liability**

An investor seeking redress may pursue the investment manager and its directors, managers, employees or agents. While a court may hold that the blame lies with a particular individual, more often than not an individual's employer will be held vicariously liable for their actions, particularly where the individual concerned was following accepted practice within that organisation. Analogously, in the case of an investment manager established as a partnership, the partners are jointly and severally liable for the wrongs of an individual partner.

The case is somewhat different in respect of a director. While a court may not hold the company vicariously liable for the acts of directors, directors will generally hold a full indemnity from the company to cover any actions taken against the director concerning his involvement in the company. Directors of investment management companies are usually covered by the company's directors and officers' insurance policy.

## Key Investor issues:

Having considered the potential liabilities and heads of claim facing an investment manager, it is useful to examine the key issues for investors. This is a helpful exercise for the investors themselves, but it is absolutely vital for the promoter or financial adviser who needs to ensure that the investors in the product are made fully aware of all the key issues from the outset. Also, the promoter or adviser must carefully document the terms and conditions on which the financial product is being offered, and ensure that they are read, understood and signed by any investor.

In terms of solicitors advising on these issues the position has been clarified by the Solicitors Acts, 1954-1994 (Investment Business and Investor Compensation) Regulations 1998. If the solicitor wishes to provide investment business services, investment advice or insurance advice to clients which is separate from legal advice they must become authorised by the Financial Regulator and meet the relevant requirements of the Investment Intermediaries Act 1995. Solicitors can give investment advice to clients which is incidental to the provision of legal services provided we do not hold ourselves out as being an investment business firm. You will have noticed that in applying for practicing certificates we are required to give certain warranties and undertakings to the Law Society every year. Solicitors who do act as investment business firms or insurance intermediaries are required to show the Law Society evidence of their authorisation by the Financial Regulator. Such solicitors will always also be required to have in place a valid bond or bank guarantee which would indemnify against losses that may be suffered by a client in respect of breach of contract negligence or other civil wrong on the behalf of the solicitor or his or her staff. The indemnity needs to be equivalent to that which would be available under the compensation fund and the minimum level of cover in accordance with the Society's professional indemnity requirements. The "top ten" investor issues are:

**1. Capital guarantees** - one of the most important considerations for investors will be the extent to which the capital they initially invest will be guaranteed, if at all. This is a key issue in many of the complaints received by the Financial Services Ombudsman. The published complaint reports show that individual investors often think their capital is guaranteed, although it may well be stated in the documentation that this is not the case.

In such circumstances, the Ombudsman can and often does award compensation to the consumer where the financial institution or adviser failed to specifically draw the investor's attention to the fact their capital was not guaranteed, or if the investor was confused or misled in this regard. Therefore all documentation should clearly state whether an investor's capital is guaranteed, and investment managers should ensure the investor understands the position before signing.

**2. Limited liability** - the next question an investor may have is whether their liability is limited to the amount of capital invested. In most cases, this will depend on the type of special purpose vehicle ("SPV") used to facilitate the investment. For example, if the investors were to buy shares in a limited company or become limited partners in a limited partnership, then their liability will clearly be limited to the amount invested. However, if the SPV is an ordinary partnership or an unlimited company, then the investors could be personally liable for the debts of the SPV beyond the amount of capital paid in by them. In the latter circumstances, it would be vital for the promoters to draw the attention of the investors to these liability possibilities from the beginning.

**3. Risk profile** - a potential investor's appetite for risk will often dictate the type of investment they choose. Conservative investors may be looking for a low-yield, low-risk investment in which their capital is guaranteed. They will be prepared to take a lower rate of return in exchange for security and certainty of their capital. More aggressive investors will be looking for a high anticipated rate of return, and as a corollary will be more willing to gamble with their initial capital investment. A common situation would be for private investors to split their portfolio into a combination of secure low-yield

investments, with a smaller percentage of the capital to be placed in high-risk, high-return investments. In any case, the financial adviser should have the investor fill out a detailed questionnaire to establish and record their risk appetite before proceeding with the investment.

- 4. Rate of return and commissions paid** – ultimately, the rate of return is the reason that any investor puts their capital on the line rather than leaving it to earn interest in a deposit account. Although investment managers will want to paint the potential upside of the product in as flattering a light as possible to attract investors, they must always be careful not to guarantee any particular rate of return to investors. They must also clearly point out to investors that the value of their investment may fluctuate over the life of the product. Finally, all investment managers should clearly set out any ordinary commissions and charges that will apply during the life of the product, as well as any extraordinary charges which will be incurred where the investor seeks to exit the product before the appointed date.
- 5. Track record of the promoters** – although past performance is not a guarantee of future returns, investors will want to know that their money is in safe (and successful) hands.
- 6. Market sector** – investors should be provided with information in relation to the market into which they are investing. For example, they should know whether they are purchasing equities, bonds or commodities, as well as being appraised of the current conditions prevailing within the particular industry (i.e. mineral resources, energy, construction, etc).
- 7. Length of time** – the period for which an investor is committed to an investment and cannot renege without incurring severe penalties will be a crucial consideration in many cases.
- 8. Exit mechanism** – a related issue to the length of time of the investment is the method by which the investor can exit the product or scheme and realise and potential gains or losses.
- 9. Taxation** – every investor will want to know how they can invest or exit the investment in the most tax-efficient manner possible, and the rate of taxation which will apply to any potential gains once the investment is realised.
- 10. Ethical/environmental concerns** – some investors will also want assurances that the companies or industries in which they are investing are ethically run, or that their operations are carried out in a “green” fashion.

## Legal & Regulatory Compliance:

Apart from ensuring that investors are aware of the vital information about the nature of their investment, as discussed above, the promoters must at the same time consider numerous technical issues, such as the structure of the investment vehicle and the regulatory approvals and documentation that will be required.

### 1. Investment Vehicle:

The form of investment vehicle to be used as the SPV must suit the purpose and details of the scheme. The first question is what form the SPV should take. For example, should it be a private limited company, a public limited company, a partnership, or a limited partnership? Often this will be dictated by legal considerations such as limited liability, or restrictions on the maximum number of members permitted by law (such as the prohibition on an Irish private limited company having more than ninety nine members). Also, there will often be a question as to where the company will be incorporated, as this will obviously affect the relevant rights and obligations of the investors under local law.

Having decided on the appropriate vehicle, the next question will be the form of interest in the SPV that each investor will acquire, such as shares, loan notes or a partnership interest. In most cases, this will be decided or influenced by the nature of the investment vehicle. As mentioned above, investors will want to know if their interest can be freely transferred, or if they will be "locked in" for a minimum period.

### 2. Issuing a prospectus:

Whether or not a prospectus will need to be issued is a critical question for many proposed investments. Given the expense and time involved in publishing a prospectus, as well as the potential liabilities involved, where possible investment managers will try to avoid having to do so. There are two main questions to be answered in determining whether a prospectus has to be issued, which are:

i) *Do the Prospectus (Directive 2003/71/EC) Regulations 2005 (the "**Prospectus Regulations**") apply?*

The Prospectus Regulations will not apply to particular types of investments which are being offered to members of the public if certain criteria are met. All of the following criteria must be met in order for the Prospectus Regulations to apply to an investment.

The first criterion is whether the instruments in the proposed investment are either:

- a) Shares in companies or other securities equivalent to shares in companies;
- b) Bonds or other forms of securitised debt which are negotiable in the capital markets;  
or
- c) Any other securities normally dealt in giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement (in each case excluding instruments of payment).

If the instruments match any of the descriptions in (a) to (c) above, then the second question is whether they are freely transferable.

If the securities are transferable, then the next question is whether the investment is an offer of securities by a collective investment undertaking, other than the closed-ended type, e.g. undertakings for collective investment in transferable securities ("**UCITS**"), unit trusts, investment companies or investment limited partnerships. These collective investment undertakings are separately regulated under the EC (Undertakings for Collective

Investment in Transferable Securities) Regulations 2003 (the “**UCITS Regulations**”), and will be discussed further below.

If the answer to this question is no, then the final issue is whether the consideration for the offer of transferable securities is expressly limited to less than €2,500,000.

In short, if the investment involves the offer of transferable shares, bonds or other securities, which fall outside of the UCITS Regulations, and the total consideration for the offer exceeds €2.5 million, then the Prospectus Regulations will probably apply.

ii) *Is there is an obligation to publish a prospectus under the Prospectus Regulations?*

Even where the Prospectus Regulations apply, they do not oblige an investment manager to publish a prospectus in every instance. Where the securities being offered to the public will not be admitted to trading on a regulated market (as defined by the MiFID Regulations) and the investment falls within one or more of the following categories, the promoter will be relieved of the obligation to publish a prospectus. The categories are:

- The offer of securities is made solely to qualified investors;
- The offer of securities is addressed to fewer than 100 persons (other than qualified investors);
- The offer of securities is addressed to investors where the minimum consideration payable is at least €50,000 per investor, for each separate offer;
- The offer of securities has a denomination per unit of €50,000 or more; or
- The offer of securities expressly limits the total consideration for the offer to less than €100,000.

Where the securities are to be admitted to trading on a regulated market, a different set of exemptions to the obligation to publish a prospectus apply.

Under the Prospectus Regulations, a “qualified investor” is defined as:

- Legal entities authorised or regulated to operate in financial markets (such as credit institutions, investment companies, insurance companies and pension funds);
- Other entities not so authorised or regulated, whose sole corporate purpose is to invest in securities;
- Governments, central banks and supranational organisations (such as the IMF);
- Legal entities which are not small to medium-sized enterprises (i.e. those entities which have at least two out of the following three: (i) more than 250 employees, (ii) a balance sheet exceeding €43 million or (iii) net turnover in excess of €50 million).
- Natural persons and small to medium-sized enterprises entered on the register maintained by the Financial Regulator for that purpose.

If the Prospectus Regulations apply and an investment does not fall within one of the exceptions listed above, then the investment manager will have to publish a prospectus in connection with the offer of the securities. Such a prospectus will have to be approved by the Financial Regulator before it can be published.

### 3. UCITS & Non-UCITS

Collective investment undertakings in Ireland are also regulated by the Financial Regulator. Two separate regimes apply, depending on the type of investment vehicle used.

#### **UCITS:**

The investment undertaking will fall within the ambit of the UCITS Regulations where the sole object of the investment vehicle is the collective investment of capital raised from the public in transferable securities (such as shares, bonds or other negotiable instruments) or other liquid financial assets which are listed on a regulated market. The undertaking must also operate on the principle of risk-spreading, and the units held by each investor in the UCITS must be capable of being repurchased or redeemed (directly or indirectly) out of those undertakings' assets upon request by the investors.

Once a UCIT complies with the above criteria, it may be constituted as an investment company under Part XIII of the Companies Act 1990, a unit trust under the Unit Trusts Act 1990 or a common contractual fund under the Investment Funds, Companies and Miscellaneous Provisions Act 2005.

As well as conforming to the terms of the UCITS Regulations, UCITS must comply with the UCITS Notices published by the Financial Regulator. UCITS are required to publish a simplified and full prospectus in relation to the investment, and both of these documents must be kept up to date. The prospectus must outline, inter alia, the objectives and specific investment policy of the UCITS.

#### **Non-UCITS:**

The Financial Regulator is also responsible for the authorisation and supervision of collective investment schemes other than UCITS, in accordance with the Central Bank and Financial Services Authority of Ireland Act 2003 (as amended). A collective investment undertaking will fall outside the UCITS Regulation where:

- It is of the closed-ended type, i.e. it will only issue a fixed number of shares once, which are purchased by the investors in the fund;
- It raises capital without promoting sale of its units to members of the public in the EU; or
- Its units may only be sold to members of the public outside the EU, under the terms of its constitutional documents.

A non-UCITS fund can take the form of a unit trust, a common contractual fund, an investment company (under the Acts specified above) or an investment limited partnership, under the Investment Limited Partnerships Act 1994.

The Financial Regulator has published a lengthy Non-UCITS Series of Notices with which non-UCITS must comply. Non-UCITS are chiefly aimed at professional or institutional investors, with more relaxed investment restrictions. A non-UCITS fund must also publish a prospectus, which must contain sufficient information for investors to make an informed judgment on the investment proposed to them.

### 4. Revenue Compliance

#### **Small Self-Administered Pension Schemes ("SSAPS"):**

SSAPS are aimed at business owners who wish to have control over their investment options. They allow the owners of a business to decide in what they wish to invest their pension funds (such as securities, property, currencies or government bonds).

Special Revenue approvals are required in the case of SSAPS, to ensure that a scheme is established *bona fide* for the sole purpose of providing relevant benefits to its members, and is not merely a mechanism for tax avoidance. The Revenue Commissioners are also concerned with the potential for conflicts of interest to arise, as the members of the SSAPS are also the owners of the relevant business and the trustees of the scheme.

Generally, a scheme is regarded as "small" where it has less than 12 members. However, irrespective of the number of members, a scheme will always be regarded as "small" where 65% or more of the value of the investments of the scheme relate to the provision of benefits for directors of the sponsoring employer, and their spouses and dependants.

The trustees of SSAPS must always include a Revenue approved "Pensioner Trustee", who must be an individual widely involved in occupational pension schemes and their approval. In cases of corporate bodies, the majority of the directors with voting control of the company should be acceptable as pensioner trustees in their own right. The individuals or corporate body concerned must give a number of prescribed undertakings:

- Not to consent to any action contrary to Revenue regulations;
- Supply annual reports and periodic actuarial reports;
- Not to terminate any SSAPS otherwise than in accordance with its terms;
- Not to delegate powers to any other trustee or to any outside person so as to circumvent the above undertakings; and
- To notify Revenue immediately upon ceasing to be a trustee of the SSAPS.

All SSAPS investments must be made on an arm's-length basis. Aside from this general rule, the investment powers of trustees are circumscribed in a number of specific areas. For example, loans to members of the SSAPS are prohibited, as are acquisitions of property intended for disposal or letting to the employer.

The SSAPS is prohibited from "self-investing", i.e. acquiring fixed assets from the employer or acquiring shares in the employing company. Nor may SSAPS invest in works of art, jewellery, yachts, etc. Finally, investments in private companies must be limited to 5% of the SSAPS assets and 10% of the particular private company's share capital.

### **Approved Retirement Funds ("ARFs")**

ARFs allow individuals to re-invest their pension funds and withdraw regular income or lump sums as and when required. The individual can choose to invest in stocks or property, and can control their risk profile. ARFs must be managed on behalf of the investor by Qualifying Fund Managers ("**QFM**"), which are specified by S.748A of the Taxes Consolidation Act 1997 as one of the following:

- Banks;
- Building societies;
- Trustee savings banks;
- Post Office;
- Credit Union;
- Collective investment undertakings (as discussed above);
- Life assurance companies;
- Stockbrokers; or
- Certain authorised investment intermediaries.

[When transferring their pension funds to an ARF, the investor may take up to 25% of the fund value as a tax free lump sum. In most cases, at least €63,500 must be invested in an Approved Minimum Retirement Fund ("**AMRF**") or used to purchase an annuity, and the remainder may be invested in an ARF.]

Prior to the establishment of an ARF by an eligible individual (e.g. the holder of a Personal Retirement Savings Account (“**PRSA**”) or Retirement Annuity Contract (“**RAC**”), or members of Retirement Annuity Trust Schemes), the QFM must receive a certificate from the Life Office, Scheme Administrator or PRSA Provider. The beneficial owner of the ARF must also furnish a declaration containing:

- a. Name, address and tax reference number;
- b. Confirmation that the assets to be transferred consist only of assets to which they are beneficially entitled;
- c. Confirmation that the assets to be transferred are currently held in a RAC, PRSA or an exempt approved occupational pension scheme; and
- d. Confirmation that:
  - i. the Approved Minimum Retirement Fund requirements have been met (i.e. they have transferred a minimum of €63,500 to an AMRF or used that sum to purchase an annuity); or
  - ii. the beneficial owner is in receipt of a specified income (i.e. over €12,700 per annum for life); or
  - iii. they are aged over 75.

[Income and gains of ARF funds are exempt from tax, however any distributions from an ARF to the investor are subject to tax. The Revenue takes a broad view of what constitutes a “distribution”, and this includes the acquisition of real property from and loans to the beneficial owner or a connected person. The QFM is responsible for the discharge of all taxes due on distributions.]

## 5. Unregulated “Schemes”

Even in instances where none of the above regulatory consents or approvals need to be obtained, investment managers will still be bound to comply with the relevant provisions of the Companies Acts 1963 – 2009, the Partnership Act 1890 and the Limited Partnership Act 1907.

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