

Segregated
Liability for Irish
Investment
Funds

DILLON  EUSTACE

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SEGREGATED LIABILITY FOR IRISH INVESTMENT FUNDS

Introduction

The Investment Funds, Companies and Miscellaneous Provisions Act, 2005 (hereafter referred to as the “2005 Act”) was signed into law on 30th June, 2005. The 2005 Act provided for a number of significant developments in the Irish funds industry, including:

1. The provision of cross investment between sub-funds of the same umbrella, where the umbrella is structured as an investment company.
2. The introduction of a Non-UCITS CCF fund structure.
3. The introduction of segregated liability at sub-fund level for investment companies which are structured as umbrella funds.

Segregated Liability

Prior to the commencement of the 2005 Act, the position of an Irish umbrella investment company under Irish law was that although separate books, accounts and records were kept for each sub-fund and while assets and liabilities remained attributable to each sub-fund, the company as a whole remained legally responsible to third parties for the liabilities of each sub-fund.

This position can be contrasted with the position of an Irish umbrella unit trust, where the legislative regime already enabled the assets and liabilities of each sub-fund of an umbrella unit trust to be segregated from the assets and liabilities of the other sub-funds of that umbrella.

France and Luxembourg, two of the largest fund markets in the EU, have already introduced amendments to their legislation to provide for segregated liability between sub-funds of an umbrella investment company. The introduction of such amendments in Ireland shall be welcomed as it will allow for greater investor protection and choice, and will make Ireland a more attractive location for the establishment of investment funds, thereby increasing Ireland’s competitiveness in this area.

However, it is important to note that the concept of “protected cell” or “segregated liability” legislation is relatively new. Therefore, it remains possible that such segregation could be disallowed in jurisdictions outside the domicile of the investment fund or jurisdictions where such legislation is not recognised.

Procedural Regime for Segregated Liability under the 2005 Act

Section 25 of the 2005 Act amends Part XIII of the 1990 Act by inserting five sections (sections 256A to 256E) after section 256 of the 1990 Act to provide for segregated liability for investment funds. It provides a mechanism for an umbrella fund to avail of the benefits of segregated liability but also provides for certain safeguards to protect creditors.

If a new umbrella investment company is established in Ireland after 30th June, 2005, the 2005 Act provides that it will be automatically deemed to be a segregated liability fund.

If an umbrella fund is deemed to have commenced trading, it must follow the procedure set out in Section 25 of the 2005 Act in order to avail of segregated liability. All relevant creditors (as defined in Section 256B(2) of the 2005 Act) must be notified in writing of the intention of the umbrella fund to avail of segregated liability. The notice must be accompanied by the statement of assets and liabilities of each sub-fund which is not more than four months old. Both the notice and the statement of assets and liabilities must also be delivered to the Registrar of the Companies. A notice must be published in at least one national newspaper in accordance with the terms of the prospectus for the umbrella fund stating that the umbrella fund intends to consider a special resolution and that an application may be made to the courts opposing the special resolution. A relevant creditor may apply to the High Court opposing the special resolution, but must do so within 28 days of receiving the notice and must send a notice to the umbrella fund and the Financial Regulator who are entitled to make representations to the High Court before an order is made.

An application to the High Court may only be made by a relevant creditor who accounts for not less than 1% in number of the creditors of any sub-fund, or whose debts account for not less than 1% in value of the debts owed by any sub-fund. An order may be granted only if the High Court considers it just and equitable to do so. In considering whether it is just and equitable to make an order, the court may take into account the following matters:-

- a) terms of the agreement between the relevant creditor and the umbrella fund;
- b) conduct of the umbrella fund to the relevant creditor;
- c) reasonableness of the relevant creditor opposing the resolution; and

d) any other relevant matter.

Either party may appeal any decision by the High Court to the Supreme Court, notice of which must be filed within five days after the date on which the order is made. Notice to the Financial Regulator and any other party (i.e. relevant creditor or umbrella fund) must be made within two days of the order.

If no application to the High Court is made opposing the special resolution, it will take effect on the date which such resolution is passed or 31 days after the creditors were notified, whichever is later. If an application to the court is made opposing the special resolution, it will not take effect until the day after all applications made are withdrawn or the day the resolution is passed, whichever is later. If all applications are not withdrawn, the special resolution will not take effect until the period specified in the order or the appeal has lapsed.

Practical Implications of Segregated Liability

Under Irish law, the assets of one sub-fund of a segregated liability fund, will not be available to satisfy the liabilities of or attributable to another sub-fund within the umbrella.

An umbrella fund availing of segregated liability must comply with certain requirements under the 2005 Act, namely:

- ▣ A statement to that effect that it is “An umbrella fund with segregated liability between sub-funds” is required on the letterheads used by the umbrella fund; and
- ▣ A disclosure of that fact that the umbrella fund is a segregated liability fund must also be contained in any other dealings/agreements with third parties.

In addition, certain terms shall be implied into third party agreements regarding the consequences of segregated liability (e.g. the party or parties contracting with the umbrella fund shall not seek, by whatever means, to have recourse to any assets of any sub-fund in the discharge of all or part of a liability which was not incurred by that sub-fund and if they do succeed in having recourse, by whatever means they shall be liable to the umbrella fund on behalf of the affected sub-fund(s) to pay a sum equal to the value of the benefit obtained by it).

The 2005 Act provides that a sub-fund is not a legal person separate from that umbrella fund but the umbrella fund may sue and be sued and sub-funds may be subject to orders of the court as though they were a separate legal person by virtue of being a sub-fund of the

umbrella fund. The assets of any sub-fund may be used to discharge some or all liabilities of any other sub-fund in cases of fraud or misrepresentation. In addition, a sub-fund may be wound up as if it were a separate company provided that the appointment of the liquidator and the powers, rights, duties and responsibilities are confined to the sub-fund which is being wound up.

Conclusion

The 2005 Act represents another example of the willingness of the Irish government to adapt to prevailing market conditions and demands of the international investment community in an efficient and constructive way. The previous regime which did not permit sub-funds of investment companies structured as umbrella funds within Ireland to avail of segregated liability was unsatisfactory. The 2005 Act has rectified this issue as it allows for the complete segregation of liability of sub-funds of a corporate umbrella fund and expressly applies its segregation of liability provisions to receivers, examiners, liquidators, provisional liquidators and any other person (while ensuring appropriate protections for creditors).

The 2005 Act provides a clear and concise framework which will allow for greater investor protection and choice and will enhance Ireland's international reputation as a competitive hub for the establishment of investment funds. Its implementation should be welcomed.

If you have any queries or would like further information relating to any of the above matters, please refer to your usual contact in Dillon Eustace or any of the contacts listed below.

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