# Funds Quarterly Legal and Regulatory Update

**Period covered:**
**1 January, 2010 to 31 March, 2010**

DILLON EUSTACE

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Contents

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| | |
|---|---|
| Third Anti-Money Laundering Directive – 2005/60/EC | Page 3 |
| UCITS, Non-UCITS & Hedge Funds | Page 3 |
| Finance Bill 2010 – Financial Services | Page 13 |
| Redomiciling an Investment Fund to Ireland | Page 14 |
| UCITS IV | Page 15 |
| Regulations on Accounts and Consolidated Accounts | Page 17 |
| The Companies (Miscellaneous Provisions) Act, 2009 | Page 18 |
| Data Protection – New Standard Contractual Clauses | Page 18 |
| Financial Services Ombudsman | Page 19 |
| The Financial Regulator | Page 19 |

DILLON EUSTACE

- FUNDS QUARTERLY LEGAL AND REGULATORY UPDATE

## Third Anti-Money Laundering Directive – 2005/60/EC

The draft legislation for the Criminal Justice (Money Laundering & Terrorist Financing) Bill 2009 ("the Bill"), which will give effect to Directive 2005/60/EC on the "Prevention of the use of the Financial System for the Purpose of Money Laundering and Terrorist Financing" (the "Third Anti-Money Laundering Directive") in Ireland, was presented to the Dail on the 19 November 2009. The Bill was presented to the Seanad for the Report Stage on the 23 March 2010 having concluded deliberations at both the Seanad Committee Stage on the 11 March 2010 and the Second Stage on the 2 March 2010.

While is it difficult to determine how long the Bill will take to progress through the Seanad it is hoped that the Bill will be passed into law in April 2010. However, until the legislation is passed, the Criminal Justice Act, 1994 (as amended) and the Criminal Justice (Terrorist Offences) Act, 2005 continue to apply.

On the 18 March 2010, the Financial Regulator invited public comment on the latest (March 2010) draft of the Industry Drafting Group's Core Guidance Notes on the prevention of the use of the financial system for money laundering or terrorist financing. Public comment on the draft guidance notes should be sent to both brendan.nagle@financialregulator.ie and brian.kelly@financialregulator.ie

The draft guidance notes are subject to further changes as the Bill nears the end of the legislative process.

If you would like further information on anti-money laundering requirements Dillon Eustace regularly advises on all aspects thereof and provides training sessions on this topic. Training can be held either at Dillon Eustace's office at 33 Sir John Rogerson's Quay, Dublin 2 or in house training can be provided at a venue of your choosing.

## UCITS, Non-UCITS & Hedge Funds

### (a) European Commission's Draft Directive on Alternative Investment Fund Managers

As previously set out the draft directive (the “Directive”) on Alternative Investment Fund Managers ("AIFM") covers Non-UCITS funds including hedge funds, private equity and commodity and aims to create a harmonised regulatory and supervisory framework for AIFM within Europe.

The Directive will require all applicable AIFM to be authorised and subject to harmonised regulatory standards on an ongoing basis. It will also increase the reporting and transparency of AIFM and the funds they manage for investors and public authorities. The aim is to improve Member States macro prudential oversight of the funds sector and take harmonised action where appropriate with regard to the proper functioning of financial markets.

It is proposed that the Directive will:

- Adopt an 'all encompassing' approach to ensure that no significant AIFM is outside of regulation and oversight, while providing exemptions for much smaller managers. It will only apply to AIFM managing a portfolio of €100 million plus. A higher threshold of €500 million applies to AIFM not using leverage (and having a five years lock-in period for their investors) as they are not regarded by the EC as posing systemic risks. According to analysis by the EC, a threshold of €100 million implies that about 30% of hedge fund managers, managing almost 90% of assets of EU domiciled hedge funds, would be covered by the proposed Directive;
- Aim to regulate major sources of risks in the alternative investment value chain by ensuring that AIFM are authorised and subject to ongoing regulation and that key service providers, including depositaries and administrators, are subject to robust regulatory standards, as is currently the situation in Ireland;
- Increase the transparency of AIFM and the funds they manage for supervisors, investors and other key stakeholders;
- Ensure that all regulated entities are subject to governance standards and have robust systems in place for the management of risks, liquidity and conflicts of interest;
- Permit AIFM to market funds to professional investors throughout the EU subject to compliance with regulatory standards; and
- Grant access to the European market to third country funds after a transitional period of three years. The EC have said this is to allow the EU to check whether the necessary guarantees are in place in the countries where the funds are domiciled (with respect to among others equivalence of regulatory and supervisory standards and exchange of information on tax matters).

The Directive is subject to a co-decision process which includes the ECON Committee of the European Parliament and the Council of Ministers Working Group. The ECON Committee of the European Parliament appointed a Rapporteur (MEP Jean-Paul Gauzes) who is responsible for guiding the Directive through Parliament.

In October, 2009 the IFIA reported that the EFAMA (The European Fund and Asset Management Association) AIFM Working Group on which the industry participates reached broad agreement on the issues they had been considering:

- Agreement on a level playing field, but as of yet without clarity on impacts for closed ended, listed funds passported under the prospectus directive or securitization vehicles (discretionary managed fund versus company issues);
- Definition of management services aligned to UCITS Annex II;
- Capital requirements aligned with UCITS with a similar cap;
- Valuation to be a function as per UCITS model;
- Depositary rules to follow current UCITS requirements and for there not to be full liability;
- Delegation requirements to be more flexible as current UCITS requirements, allow for delegation of portfolio / investment management to 3rd country non AIFM entities;
- To make the leverage requirements much more flexible; and
- Third country funds, to allow private placement and reverse solicitation according to national rules to continue, but not have provision for an EU passport.

In early November, 2009 the Swedish Presidency issued a compromise proposal of the Directive which has incorporated many welcome changes from the Commission's initial proposals including more alignment with other directives (mostly UCITS) and addresses many of the issues highlighted regarding valuation, delegation, leverage, scope, controlling influence, capital requirements, depositaries, delegation and Marketing requirements.

In late November, 2009 the Swedish Presidency released an updated, compromise proposal Directive text which reflected more up to date discussions of the EU Council AIFM Working Group at their meetings on the 16 and 17 November, 2009.

Spain took over the rotating presidency of the EU from Sweden at the beginning of this year and the Spanish Presidency has issued its first compromise text for the AIFM Directive. It is an "issues note" which lists the remaining issues of contention i.e. depositions, valuations, remuneration and third country issues.

The Spanish presidency has reinstated Article 35 which had been removed by the Swedish Presidency. It stipulates that non-EU managers and funds may only be able to access the EU market if there is a cooperation agreement in place between the jurisdiction where they are based and the EU jurisdiction they wish to market in. Potentially this could mean that the EU market could be effectively closed to non-EU funds and managers.

The deadline for MEPs to submit their amendments to the ECON (Economic and Monetary Affairs) Committee was 21 January, 2010 and ECON has held discussions of these amendments (of which there were 1669). There was meant to be a vote on these compromise amendments on 12 April, 2010 but it is likely that this will be delayed until late April.

EU Finance Ministers were due to discuss the Directive at the ECOFIN meeting on 16 March, 2010. However the Directive was moved from the agenda prior to this meeting.

The next formal meeting of ECOFIN is not until 18 May, 2010 and it is likely that the Spanish Presidency will seek an agreement then. There is an informal meeting of ECOFIN on 15 -18 April and the Spanish Presidency may seek to produce another compromise text of the Directive reflecting recent bilateral discussions for review at that informal meeting, but a formal decision would only be made at the meeting in May.

The IFIA stated that they and industry will continue to work closely with the Department of Finance to provide input to the Presidency and the attaché as interactions and considerations move to the ECON Committee of the European Parliament.
It is expected that the Directive will come into force in 2011. As an exception, the provisions regarding the treatment of third countries will only become applicable following a three year transition period.

For detailed information on AIFM, please refer to your usual contact in Dillon Eustace.

### (b) Disclosure in Complex UCITS Funds

The Financial Regulator is proposing changes to Guidance Note 3/07 “Structured Products and Complex Trading Strategies – Prospectus Disclosure Requirements” in 2010, whereby the following disclosures should be provided upfront in a prospectus:

- The underlying exposure. This should give an indication of the underlying asset class or trading strategies. It should also state whether the exposure is leveraged and will result in a long/short exposure. An example would be “*the fund has a direct* *and/or indirect leveraged exposure to {asset class x} and/or to the following trading strategies".*

- The expected risk-return profile (high level) which is normally expressed in terms of volatility or a volatility range.

- The investment opportunity. This will normally follow along the lines of "*the investment strategy supporting this is as follows...".* There was some discussion as to whether and where this should be disclosed. It should be disclosed where it is not obvious to a reader what the investment rationale is. Asset managers will generally express this in terms of some sort of "alpha" and how they think they can extract it from the exposures and strategies previously disclosed above.

### (c) Proposed new European system of Financial Supervision

In late September 2009, the European Commission adopted an important package of draft legislation to significantly strengthen the supervision of the financial sector in Europe.

The aim of these enhanced cooperative arrangements is to sustainably reinforce financial stability throughout the EU; to ensure that the same basic technical rules are applied and enforced consistently; to identify risks in the system at an early stage; and to be able to act together far more effectively in emergency situations and in resolving disagreements among supervisors.

The legislation will create a new European Systemic Risk Board ("ESRB") to detect risks to the financial system as a whole with a critical function to issue early risk warnings to be rapidly acted on. It will also set up a European System of Financial Supervisors ("ESFS"), composed of national supervisors and three new European Supervisory Authorities for the banking, securities and insurance and occupational pensions sectors.

The current financial crisis has highlighted weaknesses in the EU's supervisory framework, which remains fragmented along national lines despite the creation of a European single market more than a decade ago and the importance of pan-European institutions.
These legislative proposals address those weaknesses both at the macro- and micro-prudential supervision levels by creating:

- an **ESRB** will have the power to issue recommendations and warnings to Member States (including the national supervisors) and to the European Supervisory Authorities, which will have to comply or else explain why they have not done so. The heads of the

ECB, national central banks, the European Supervisory Authorities, and national supervisors, will participate in the ESRB. The creation of the ESRB is in line with several initiatives at multilateral level or outside the EU, including the creation of a Financial Stability Board by the G20.

- an **ESFS** for the supervision of individual financial institutions ("micro-prudential supervision"), consisting of a network of national financial supervisors working in tandem with new European Supervisory Authorities, created by the transformation of existing Committees for the banking securities and insurance and occupational pensions sectors. There will be a European Banking Authority (“EBA”), a European Insurance and Occupational Pensions Authority (“EIOPA”), and a European Securities and Markets Authority (“ESMA”).

Regarding micro-prudential supervision, currently there are three financial services committees for micro-financial supervision (supervision of individual financial institutions) at EU level, with advisory powers only: the Committee of European Banking Supervisors (“CEBS”), Committee of European Insurance and Occupational Pensions Committee (“CEIOPS”) and the Committee of European Securities Regulators (“CESR”).
The new Authorities will take over all of the functions of those committees, and in addition have certain extra competences, including the following:

- developing proposals for technical standards, respecting better regulation principles;
- resolving cases of disagreement between national supervisors, where legislation requires them to co-operate or to agree;
- contributing to ensuring consistent application of technical Community rules (including through peer reviews);
- the European Securities and Markets Authority will exercise direct supervisory powers for Credit Rating Agencies; and
- a coordination role in emergency situations.

EU finance ministers are set to back the European Commission's intentions to draft laws in the autumn to introduce two new supervisory bodies in 2010.

"The aim should be to have the new European Financial Supervision system, comprising both macro-prudential and micro-prudential components, fully in place in the course of 2010," the draft said.

**(d) Undertakings for Collective Investment in Transferable Securities (UCITS) – collateral passed by UCITS to OTC derivative counterparties**

Regulation 18 of the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2003 ("the Regulations") provides that the assets of a unit trust and the assets of a common contractual fund shall be entrusted to a trustee for safe-keeping. Regulation 37 makes the same provision in relation to the assets of an investment company.

Regulation 45(g) of the Regulations permits UCITS to invest in financial derivative instruments, including OTC derivatives. This note addresses the passing of collateral by a UCITS to an OTC derivative counterparty.

The Committee of European Securities Regulators ("CESR") issued advice on Level 2 measures related to the UCITS management company passport to the European Commission in October 2009. This advice addressed, *inter alia*, matters related to OTC derivatives, including the passing of collateral by a UCITS to an OTC counterparty or broker in respect of financial derivative instruments.

The advice noted that market practice may require collateral or margin to be passed by the UCITS to an OTC counterparty or broker in respect of OTC financial derivative instruments. As such these arrangements do not offend Regulations 18 and 37 of the Regulations.

The CESR advice also noted that:

- collateral passed must be taken into account in calculating risk exposure to the OTC counterparty as referred to in Article 52(1) of the UCITS Directive;
- collateral passed may be taken into account on a net basis only where there is a legally enforceable netting arrangement in place.

CESR work in relation to risk measurement, including the calculation of counterparty risk for UCITS, is ongoing with the intention to provide detailed Level 3 guidelines in these areas. The UCITS Notices and related Guidance Notes issued by the Financial Regulator will be amended in due course to reflect the provisions of Directive 2009/65/EC, the implementing measures required under that Directive and any guidelines issued by CESR.

**(e) Collective investment schemes – establishment of multiple share classes within a single scheme**

**Background**

Irish collective investment schemes (“CIS”) are permitted to establish separate classes of shares within a CIS (or sub-fund of an umbrella CIS) provided that the structures involved do not result in any prejudice to investors in one class vis-á-vis investors in another. The two fundamental principles, which underpin the Financial Regulator’s approach to the use of one or more classes within a single CIS, are:

• Each CIS must consist of a single common pool of assets; and
• The capital gains/losses and income arising from that pool of assets must be distributed and/or must accrue equally to each shareholder relative to their participation in the CIS.

Share classes can be differentiated on the basis of currency, distribution policies or charging structures.

As an exception to the above principles the Financial Regulator also permits currency hedging at share class level whereby the costs/benefits of the hedge transaction is allocated to the share class, rather than to the pool of assets as a whole. Guidance Note 3/99 – “Share classes – hedging against exchange rate movements” sets out the requirements of the Financial Regulator in relation to the creation of hedged share classes.
Following a number of industry submissions, the Financial Regulator has revised its approach in relation to other scenarios when CIS intend to create multiple share classes. The purpose of this note is to communicate arrangements which have been permitted to date and to outline what will be acceptable going forward.

**Interest Rate Hedging**

The Financial Regulator will permit interest rate hedging at share class level where the benefits and costs of such hedging may be accrued and attributed solely to investors in a hedged share class. Such arrangements must be effected in accordance with the principles established in Guidance Note 3/99.

**Financial Derivative Instruments at share class level**

The use of financial derivative instruments at share class level may only be permitted where:

 The CIS constitutional document makes specific provision for the creation of share classes and contains clear provisions for the charging of any resultant gains/losses on the transaction to the relevant share class;

 The prospectus must contain a clear description of the strategies being pursued at share class level and the effect this will have on investors in each share class;

 The use of financial derivative instruments at share class level creates positive benefits for investors and does not prejudice the interests of holders in other share classes.

The Financial Regulator will permit financial derivative instruments at share class level where their purpose is to effect currency and interest rate hedging (subject to the principles set out in Guidance Note 3/99) and different distribution policies or fee structures at share class level.

The Financial Regulator will also consider proposals where financial derivative instruments may be used at share class level to provide:

 a different level of participation in the performance of the underlying portfolio; or

 different levels of capital protection.

In such cases, the financial derivative instrument for each share class must be based on the same underlying portfolio or index. Moreover, the transactions cannot result in a leveraged return per share class, i.e. the participation rate can be up to but not exceeding 100% of the relevant shares classes performance of the underlying portfolio.

Where financial derivative instruments per share class, other than for the purposes of currency/interest rate hedging are proposed, the issue of segregated liability must be addressed. In this regard, the Financial Regulator will require:

- A legal opinion that the over-the-counter counterparty's recourse to the CIS is limited to the relevant share classes participation in the CIS's assets; and

- Confirmation from the board of the CIS/management company that they have reviewed and are satisfied that the proposal will, as a result of the agreement between the CIS and the over-the-counter counterparty, not result in any prejudice for investors in one class over another. The board must also confirm that there will be no cross liability between share classes.

In the case of professional and qualifying investor funds, the Financial Regulator will consider proposals for financial derivative instruments at share class level with different features, for example to provide an additional add-on exposure to that generated from the underlying portfolio, or to generate a leveraged return at share class level, or where the underlying to the derivatives are different versions of the same underlying, e.g. two classes with different swap instruments based on sub-indices derived from the same initial index.

Other arrangements similar to these examples will be considered on a case-by-case basis. The use of such financial derivative instruments at share class level is subject to the condition that the management of the CIS must be in a position to demonstrate segregated liability between share classes in the manner described above.

**New Issues**

The Financial Regulator will permit professional and qualifying investor funds to establish a separate class within a CIS where any gains/losses on investment in “New Issues” can be allocated for the benefit of investors not deemed to be Restricted Persons in accordance with Rule 5130 of the US Financial Industry Regulatory Authority (“FINRA”). The constitutional documents and prospectus must clearly provide for these arrangements.

### (f) CESR EU Depository Mapping

Since late 2008, CESR has been working on a number of issues related to UCITS depositaries. Initially, the focus was on assessing the impact of the Madoff fraud on the fund industry but the focus was then widened to include consideration of the duties and responsibilities of UCITS depositaries.

In this context, a mapping exercise was carried out among CESR Members to establish how the various rules on depositary obligations have been implemented in Member States. A high level summary of that mapping exercise was included as an annex to CESR’s response to the Commission’s consultation on the UCITS depositary function (Ref. CESR/09-781 published on 28 September 2009).

Since the mapping work began in 2009, there have been a number of requests from external stakeholders to have access to the detailed, country-level information that had been collected.

The full mapping exercise was published on 15 January, 2010 and is available from your usual contact in Dillon Eustace.

### (g) IFIA FRS Briefing Paper

In January, 2010 the Industry Technical Committee updated a briefing paper on the application of a number of key Financial Reporting Standards to investment funds, namely; FRS 21: Events after the balance sheet; FRS 23: The Effects of Changes in Foreign

Exchange Rates; FRS 25: Financial Instruments: Disclosure and Presentation; FRS 26: Financial Instruments: Measurement; FRS 28: Corresponding amounts.

Please call your usual contact in Dillon Eustace for a copy of the amended briefing paper.

### (h) Specific Investment Funds Financial Reporting Standards

In February, 2010, the Irish Funds Industry, responding to the Accounting Standards Board's (ASB) policy proposal regarding the future of UK/Irish GAAP, proposed the development of a set of discrete financial reporting standards for Investment Funds/Investment Companies.

Highlighting the shortcomings of current and converging financial reporting standards for Investment Funds/Investment Companies, the Irish Funds Industry proposed adapting the IFRS framework for Investment Funds/Investment Companies to develop a global framework and provide more meaningful and appropriate information for the users of Investment Funds/Investment Companies financial statements.

### (i) FAQs on the Prospectus Directive

On 12 March, 2010 the Financial Regulator published a list of questions most frequently of it regarding the Prospectus Directive 2003/71/EC.

Details of the FAQs are published on www.financialregulator.ie.

## Finance Bill 2010 – Financial Services

The Minister for Finance made reference in his Budget in December 2009 to the importance of the financial services industry and his intention to introduce changes to enhance the competitive position of the Irish Financial Services industry. As a result a number of specific and general measures have been introduced in the recent Finance Bill (the "**Bill**") to support the theme of encouraging the continued and further use of Ireland for a broad range of financial services.

### Key Highlights

*Specific Financial Services Industry Incentives*

- A series of changes to encourage the continued use of Ireland as a domicile for collective investment funds and a location for the provision of management services to UCITS funds domiciled in any EU jurisdiction (see "Investment Management Package" of measures below).

- The extension of Ireland's favourable financial services tax regime to cover Islamic financing.

- Favourable changes to the taxation treatment of operating leases.

*General Incentives also benefiting the Financial Services Industry*

- Traders/dealers in shares, banks, and insurance/reinsurance companies etc (who normally are taxable at the 12.5% tax rate) will be exempt from tax on certain foreign dividends.

- For corporates, the extension of the circumstances of when the 12.5% tax rate applies to foreign dividends (as opposed to the 25% tax rate).

- The introduction of a self-assessment system to make it easier for non-Irish tax residents to receive Irish dividends free of Irish withholding tax.

- Improvements in the double tax credit relief available to companies with foreign branches.

- Extension of the tax measures introduced in 2008 to assist companies in Ireland to attract non-Irish domiciled individuals to work in Ireland.

**For further detailed information please call your usual Dillon Eustace contact or log onto www.dilloneustace.ie.**

## Redomiciling an Investment Fund to Ireland

In late December, 2009 the Irish government introduced new legislation (Companies (Miscellaneous Provisions) Act, 2009 to allow for a more efficient system for redomiciling non-Irish domiciled corporate funds into Ireland. It is expected that this regime will be in place this summer.

The new system will enable corporate funds established and registered in certain jurisdictions to apply to the Companies Registration Office in Ireland ("CRO") to continue as a company under the laws of Ireland and to apply to the Financial Regulator to be authorised as a fund in Ireland. This re-domiciliation regime will enable re-domiciled funds to be authorised in Ireland as either a non-UCITS or UCITS fund provided that they meet the relevant criteria for the chosen fund structure.

It is expected that redomiciliation will be used by promoters wishing to utilise the UCITS product or the Irish QIF product (the vehicle most used for hedge funds, FoHF and less liquid/highly leveraged products) with the new redomiciliation opportunity making the process more straight forward and, most importantly, avoiding the necessity of having to liquidate a portfolio or engage in asset for share swap arrangements.

Should you require any additional information on the redomiciliation process, please see the Dillon Eustace publication entitled “Re-Domiciling an Investment Fund to Ireland” published on www.dilloneustace.ie or refer to your usual contact in Dillon Eustace.

## UCITS IV

The European Council voted on 22 June, 2009 for the adoption of the UCITS IV Directive (the “Directive”), as already adopted by the European Parliament in plenary session on 13 January, 2009. The Directive has now been finally adopted in accordance with the co-decision procedure, thus marking the end of the first step for the implementation of a European text.

The UCITS IV proposal containing amendments to the UCITS Directive 85/611/EC was first proposed by the EC on 16 July, 2008. This proposal did not take into account the management company passport which, after having been debated at CESR level, was reintroduced in December 2008.

According to the Lamfalussy process, there remains three levels before the transposition of the Directive shall be considered as fully completed among Member States. Similar to MiFID, the Directive provides that the details of certain provisions should be covered by Level 2 implementing measures to be adopted by the EC with a view to harmonising the implementation of the text. On 13 February, 2009 the EC submitted to CESR a provisional request for technical advices on the new UCITS Directive implementing measures, most of which are due in July, 2010.

The final two steps of the Lamfalussy process will take place during and after the period of transposition of the Directive. Under level 3, CESR will be in charge of issuing interpretation recommendations to national authorities and under level 4, the EC will control and advise Member States as to a proper interpretation and application of the Directive. Member States will have until 1 July, 2011 to implement the text into national legislation.

The consultation paper that CESR published on 8 July, 2009 provides technical advice on the level 2 measures related to the UCITS management company passport. CESR's draft advice covers the organisational requirements that companies managing UCITS need to fulfil, and conflicts of interest those companies must avoid. The advice also includes details on the companies' rules of conduct, depositaries and risk management, as well as on supervisory cooperation.

The Directive was published in the Official Journal of the European Union on 17 November, 2009 and entered into force on the twentieth day following this publication. Here is a link to the text for your convenience:
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:FULL:EN:PDF ).

The following is a summary of the key implications of the Directive:

- Management Company Passport

The Directive enables European funds created under the UCITS regime to be managed by a management company authorised and supervised in a Member State other than the home Member State of the Fund.

- Fund Mergers

The Directive establishes a unified regime for both cross-border and domestic mergers of Funds. Pursuant to the Directive, all Funds are entitled to merge regardless of their structure (corporate, unit trust, or contractual type of funds).

- Master Feeder Structure

The Directive sets out the first European regulation concerning the setting-up of master feeder funds. A feeder fund is defined in the Directive as a UCITS or a sub-fund thereof which has been approved to invest at least 85% of its assets in units of another fund. It can also set aside 15% of its assets to invest in derivative instruments or liquid assets etc. As far as the master fund is concerned, it cannot itself be a feeder fund, nor hold units of a feeder fund.

- Key Investor Information

The key investor information shall replace the simplified prospectus which failed to provide investors with all basic information to enable them to make an informed investment choice. It is intended to be as short pre-contractual document written in a brief manner and in a non-technical language which shall provide easily understandable, fair, clear and not misleading information on the fund to contemplated or actual investors.

- Simplified Notification Procedure

A fund wishing to market its units in a Member State different than its country of incorporation will notify its supervisory authority of such project, through a notification procedure which will then be transferred by its home regulator to the competent supervisory authorities of the contemplated host country (new "regulator-to-regulator" procedure).

- Enhanced Cooperation between Supervisory Authorities

The proposed amendments to the Directive will result in increased cross-border operations necessitating a full and timely cooperation between supervisory authorities. The Directive encourages the exchange of information, harmonises the powers of the supervisory authorities and allows for the possibility of immediate verifications and investigations, consultation and mutual help mechanisms.

For detailed information on UCITS IV, please refer to your usual contact in Dillon Eustace.

## Regulations on Accounts and Consolidated Accounts

In November, 2009, the European Communities (Directive 2006/46/EC) Regulations (S.I. 450 of 2009), implementing Directive 2006/46/EC on Company Reporting in Ireland, were signed into law. On the 25 February 2010, an amending regulation to S.I. 450 of 2009 namely S.I. 83 of 2010 ("the Regulations") was published bringing clarity to the effective date of the Regulations.

The key changes are as follows:

- Irish incorporated companies (excluding investment companies) whose securities are admitted to trading on a regulated market or on a multilateral trading facility will be required to prepare and include a **Corporate Governance Statement** in the annual (directors') report <u>for financial year's ending on/after 18 November 2009 (the Regulations)</u>;
- However, the requirement to include a description of the main features of the internal control and risk management systems of the company in relation to the financial reporting process <u>and</u> the auditor's opinion on same shall only apply <u>for financial year's beginning on/after 18 November 2009 (the Regulations).</u>
- Listed investment companies (i.e. listed fund companies), who are not already subject to annual reporting obligations in relation to a governance code by virtue of that listing, will have to produce a **Corporate Governance**

**Statement** for financial year's beginning on/after 18 November 2009 (the Regulations).

- Disclosure requirements for "off balance sheet arrangements" and "related party transactions" will apply to listed and unlisted companies in respect of financial years ending on/after 18 November 2009.
- Amendment to existing fair value rules whereby Regulation 3 extends the right of both public and private companies, which prepare annual accounts under the Companies Acts to use fair value accounting for a variety financial instruments in accordance with IAS 39 in both their individual and consolidated accounts.

It should be noted that a person who contravenes these Regulations is guilty of an offence and is liable on summary conviction to a fine of €5,000 or three months imprisonment or both and on indictment to a fine of €50,000 or imprisonment for a term not exceeding three years or both.

## The Companies (Miscellaneous Provisions) Act, 2009

On the 23 December, 2009, the Companies (Miscellaneous Provisions) Act, 2009 (the "Act") was signed into law introducing a number of important changes to Irish company law.

Sections 1, 2 and 3 (a) – (h) and Section 4 of the Act have commenced relating to:

- The use of US GAAP by certain companies on a temporary basis therefore reducing the burden on those companies listed on the US Securities and Exchanges Commission, which want to relocate their head office to Ireland;
- The creation of a new type of purchase called an "overseas market purchase" to facilitate international companies re-domiciling to Ireland, which are not listed on the Irish Stock Exchange and that wish to avail of the market purchase regime when undertaking share buy-back programmes;
- The continuity of membership by directors of committees of enquiry established by the Irish Auditing and Accounting Supervisory Authority (IAASA) ensuring membership doesn't change during an enquiry, which could endanger fair procedure and process; and
- The limit of potential costs to the Exchequer of certain types of investigations into the affairs of the company, as the High Court may now require the applicant (e.g. such a director) calling for an investigation to give unlimited security for payment of costs of the investigation. Previously the security was limited to an amount up to IR£250,000.

Section 3(i) to (j) and Section 5 relating to migrating funds have not yet been commenced as the Financial Regulator is currently liaising with Cayman, Bermuda, Gibraltar and the Channel Islands to agree reciprocal arrangements. This is likely to take another six months. When these sections are commenced, the Act will introduce a mechanism whereby certain collective investment undertakings can migrate their registered offices into and out of Ireland without firstly having to wind up in their current jurisdiction thus attracting investment funds business from third countries who are seeking to relocate to a well regulated jurisdiction.

## Data Protection - New Standard Contractual Clauses

The European Commission has approved new standard contractual clauses on the transfer of data to data processors established in third countries. The new clauses will come into force from 15 May, 2010.

For further details please contact David Nolan in Dillon Eustace.

The link to the new clauses is set out below for convenience.

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:039:0005:0018:EN:PDF

## Financial Services Ombudsman

On the 15 February 2010, it was announced that Bill Prasifka has been appointed as the new Financial Services Ombudsman and will take up office by the end of March 2010. Mr Prasifka succeeds Joe Meade who retired on 3 January 2010.

Mr Prasifka is currently Chairman of the Competition Authority, a role he has held since March 2006. Previously, Mr Prasifka has worked as the Irish Commissioner for Aviation Regulation.

## The Financial Regulator

- Chief Executive – On the 4 January 2010, Matthew Elderfield took up the position as the new Chief Executive of the Financial Regulator taking over from Mary O'Dea. The roles of Chief Executive and Consumer Director will be combined. Matthew Elderfield will become the Head of Financial Supervision in the new restructured Central Bank, once legislation passes through the Oireachtas confirming the restructuring.

Mary O'Dea will now take up the post of Assistant Director General, Financial Operations within the Central Bank.

On the 12 January 2010, it was announced that Jonathan McMahon has been appointed as Assistant Director General with responsibility for Financial Institutions Supervision within the Central Bank, which will include oversight of the supervision of banks and insurance companies.

The new Registrar of Credit Unions, when appointed, will report into Mr McMahon's division.

- Weaknesses in Sales Processes for Older Customers - The Financial Regulator, in February, published its findings following a four part examination conducted over 2009 of selected credit institutions, life insurance firms and investment and stockbroking firms in relation to the suitability of investment products sold to older customers.

  The issues identified during the examination included the following-

  - Firms should have a practical definition of an older customer with the Financial Regulator suggesting 60 as the appropriate benchmark;
  - Firms are required to gather and record sufficient information including income and asset and liability detail from the customer to enable it to provide a suitable recommendation to the customer;
  - Older customers should be offered the option of having a third party present at a sales meeting;
  - Firms should advise older customers of the need for an emergency fund to cover medical or other long term care expenses;
  - Firms must prepare specific statements of suitability tailored to the consumer as distinct to issuing generic versions.

  The compliance issues identified during the inspection are already subject to separate engagement by the Financial Regulator with the individual firms concerned, however all firms are required to consider the issues identified in the findings and ensure the appropriate amendments are made to procedures accordingly.

- General Charging Issues – On the 8 February, Matthew Elderfield, as the Head of Financial Supervision, announced that the Financial Regulator is conducting a review of its approach to how overcharging is dealt with under the Consumer Protection Code following recent cases where financial institutions continue to experience control failures that result in customers being overcharged. The Financial Regulator in conducting its review will focus on the timeliness of resolving overcharging in firms and the grounds for enforcement against such failures.

- Address to Leinster Society of Chartered Accountants – On the 11 March 2010 Mr Elderfield, as the Head of Financial Regulation, made his first public appearance since arriving in Ireland by addressing the Leinster Society of Chartered Accountants. Mr Elderfield discussed the need to overhaul our approach to financial regulation using a balanced and measured approach. He advised that he intended to implement a framework of assertive risk based regulation underpinned by a credible threat of enforcement whereby the riskiest firms manage themselves better and that firms and management are held more accountable for their actions.

- Administrators appointed to Quinn Insurance – On the 30 March 2010, the High Court appointed two joint provisional administrators to the Quinn Insurance Group. The application was made under the Insurance Act, 1983 by lawyers acting on behalf of the Financial Regulator. The court was advised that the Financial Regulator took this action following serious concerns about the way the group was managing its affairs. Following their appointment, the administrators will run the general insurance business as a going concern under different management in the interest of policyholders. The Financial Regulator now has an on-site presence in the company's offices.

**Dillon Eustace**

**This Funds Quarterly Legal and Regulatory Update is for information purposes only and does not constitute, or purport to represent, legal advice. It has been prepared in respect of the current quarter and, accordingly, may not reflect changes that have occurred subsequent to the start of such period. If you have any queries or would like further information regarding any of the above matters, please refer to your usual contact in Dillon Eustace.**

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