

Banking and
Capital Markets
Update –
Spring 2010

DILLON  EUSTACE

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BANKING AND CAPITAL MARKETS

Life Settlements: Using Irish Investment Vehicles to Minimise US Taxes on Life Settlement Payments

We continue to see life settlements (in particular, relating to life policies insured on US citizens residing in the US) as an increasingly popular asset class. As a result of a US ruling issued by the Internal Revenue Service (Revenue Ruling 2009-14) on 1 May, 2009, there now exists potentially negative US tax consequences for non-US investors who acquire life policies and receive death benefits from a US insurance company on the death of a US citizen residing in the US. As a direct consequence, we have seen Ireland increasingly being examined and used as a jurisdiction to locate the offshore investment vehicle to acquire such life policies so as to avail of the benefits of the Ireland/US Double Taxation Convention to avoid the potential negative US tax issues arising from the above ruling.

Offshore investors have successfully used either Irish regulated funds or Irish special purpose vehicles in an attempt to minimize such US withholding taxes and the type of vehicle depends on a combination of different factors.

For further information, please see our publication “Life Settlements: Using Irish investment vehicles to minimise US taxes on life settlement payments” on our website or contact any member of our Banking & Capital Markets team.

Financial Regulator Issues Consultation Paper on New Corporate Governance Standards Proposed for Banks and Insurers

On 27 April, the Central Bank and Financial Regulator announced the commencement of a public consultation on new corporate governance standards for all credit institutions and insurers licensed or authorised by the Financial Regulator including Irish licensed and authorised subsidiaries of international financial services groups.

Consultation Paper CP 41 on “Corporate Governance Requirements for Credit Institutions and Insurance Undertakings” sets out minimum requirements as to how banks and insurance companies should organise the governance of their institutions including

membership of their boards of directors, the role of the Chairman and the operation of various board committees.

The consultation paper sets out the minimum standards and expectations that will apply to the boards of directors of banks and insurers. These include:

- ▣ a minimum of five directors on a board of directors;
- ▣ requirements regarding the role and number of the independent non-executive directors;
- ▣ limits on the number of directorships which directors may hold to ensure they can comply with the expected demands of board membership of a credit institution or insurance company;
- ▣ clear separation of the roles of Chairman and CEO;
- ▣ a prohibition on an individual who has been a CEO, director or senior manager during the previous five years from becoming Chairman of that institution;
- ▣ criteria for director independence and consideration of conflicts of interest;
- ▣ a requirement that board membership is reviewed at a minimum every three years;
- ▣ a requirement that boards set the risk appetite for the institution and monitor adherence to this on an ongoing basis;
- ▣ minimum requirements for board committees;
- ▣ the establishment of a remuneration committee comprising a majority of independent non executive directors; and
- ▣ a requirement for an annual confirmation of compliance to be submitted to the Central Bank.

The consultation paper is part of a wider strategy to update the domestic regulatory framework applying to banks and insurers. It has been announced that corporate governance frameworks for other industry sectors are also planned. The Financial Regulator has invited funds industry representatives to work on an appropriate corporate governance

code for the funds industry and corporate governance for credit unions will be dealt with as part of the forthcoming Strategic Review of the Credit Union Sector. In addition, the consultation paper specifically seeks views on the extension of these proposals to investment firms.

The Financial Regulator proposes to issue further requirements, including remuneration requirements and a revised fitness and probity framework, in due course. In addition, the Financial Regulator has said that it may also consider the need for additional requirements in respect of internal governance and risk management as international initiatives in these areas are published.

Failure to comply with the requirements may be subject to sanction under the Administrative Sanctions Framework. The Financial Regulator has stated that it is intended that the enhancement of corporate governance, together with more intrusive supervision and a credible threat of enforcement, will contribute to the improvement of the resilience of the Irish financial sector.

Interested parties are asked to comment on the proposals by 30 June, 2010 and it is expected that the new corporate governance standards will be published in Autumn, 2010.

Financial Regulator Announces Transition of Prospectus Scrutiny Function

On 21 April, in line with EU requirements, the Financial Regulator announced the commencement of a joint project with the Irish Stock Exchange (ISE) to unwind the delegation of prospectus scrutiny tasks which have been carried out by the ISE on behalf of the Financial Regulator under a delegation arrangement since 2005. Under EU law, the role of prospectus scrutiny must be returned to the Financial Regulator by 31 December, 2011.

Prospectus scrutiny involves the review of prospectus documents for equity, debt and closed-ended funds. It is an important function because of the need to ensure that prospectuses are compliant with relevant legislative provisions.

It is hoped that the successful management of the project will ensure a smooth and seamless transition of this function from the ISE to the Financial Regulator by the end of 2011. A joint steering committee, comprised of senior management representatives from both the Financial Regulator and the ISE, has been established to oversee the process to ensure that the review process remains efficient and market friendly. A Stakeholder

Consultative Group has also been established to ensure that relevant market participants are involved in this strategically important project.

Eurosystem Launches Preparatory Work on the Establishment of Loan-Level Information Requirements for ABSS in its Collateral Framework

The Governing Council of the European Central Bank (ECB) has decided that work should begin on the establishment of loan-by-loan information requirements for asset-backed securities (ABSs) in the Eurosystem collateral framework. Having analysed the positive feedback received in the public consultation on the matter, the Governing Council decided that the ECB and the 16 national central banks of the euro area would proceed with the preparatory work for the establishment of loan-level information requirements.

On 23 December, 2009, the ECB launched a public consultation on the establishment of loan-by-loan information requirements for ABSs. The consultation ended on 26 February, 2010 and over 50 responses were received from a broad range of market participants. Market participants showed significant support for the initiative and confirmed that the Eurosystem would not face any major obstacles in introducing loan-level data requirements in its collateral framework. In view of this positive conclusion of the public consultation, on 22 April the Governing Council of the ECB agreed that the Eurosystem could proceed with its preparatory work for the establishment of loan-level information requirements. This preparatory period is expected to last approximately six months. It will be dedicated to further developing the ABS loan-level data requirements, as well as the technical implementation aspects that were mentioned in the public consultation, in particular:

- ▣ the gradual phasing-in of loan-level data requirements;
- ▣ the risk control scheme applicable to ABSs for which loan-level data are temporarily not submitted;
- ▣ the design of the data-handling infrastructure;
- ▣ the final definition of the RMBS loan-level data template, taking into account the detailed technical comments received; and
- ▣ the possible future introduction of loan-level templates for other asset classes. This further technical preparatory work will be conducted by the Eurosystem in

collaboration with market participants. Technical working groups composed of relevant market participants and Eurosystem experts will be created to finalise the different loan-level templates and tackle technical issues related to the initiative.

It is envisaged that the Governing Council will assess the results of this preparatory work after Summer 2010 and subsequently decide when to announce the loan-level data requirements.

Subject to the approval of the Governing Council, market participants would have a 12-month adaptation period before having to submit loan-level data.

The preparatory work will begin immediately and it has been reported that it should be completed by September 2010. It is expected that this will address the loan-level information requirements, as well as the technical implementation aspects covered by the initial public consultation. Subject to the approval of the Governing Council, market participants would have 12 months before the obligation to submit loan-level ABS information comes into force.

ECB Introduces Graduated Valuation Haircuts for Lower-Rated Assets in its Collateral Framework and Confirms its Amendments to Eligible Collateral Criteria

The Governing Council of the European Central Bank (ECB) has decided to keep the minimum credit threshold for marketable and non-marketable assets in the Eurosystem collateral framework at investment-grade level (i.e. BBB-/Baa3) beyond the end of 2010 except in the case of asset-backed securities (ABSs).

In addition, the Governing Council has decided to apply, as of 1 January 2011, a schedule of graduated valuation haircuts to the assets rated in the BBB+ to BBB- range (or equivalent). The schedule applies to credit quality step 3 of the Eurosystem's harmonised rating scale (available on the ECB's website), in which the long-term rating of assets is BBB+/BBB/BBB- by Fitch or Standard & Poor's, Baa1/Baa2/Baa3 by Moody's or BBBH/BBB by DBRS.

This graduated haircut schedule will replace the uniform haircut add-on of 5% that is currently applied to these assets. It has been confirmed that the haircut schedule will be based on the following parameters:

- ▣ the new haircuts will be duly graduated according to differences across maturities, liquidity categories and the credit quality of the assets concerned. The lowest

haircuts will apply to the most liquid assets with the shortest maturities and the highest haircuts will apply to the least liquid assets with the longest maturities;

- ▣ the new haircuts will be at least as high as the haircut currently applied (which is a flat 5% add-on for the assets concerned over the haircut that would apply to similar assets with a higher credit quality);
- ▣ no changes will be made to the current haircut schedule foreseen for central government debt instruments and possible debt instruments issued by central banks that are rated in the above-mentioned range; and
- ▣ the new haircuts will not imply an undue decrease in the collateral available to counterparties.

It is expected that the specific schedule of haircuts will be published by the ECB in July, 2010.

Furthermore, the Governing Council confirmed that the following instruments **will no longer be eligible** as collateral as from 1 January, 2011:

- ▣ marketable debt instruments denominated in currencies other than the Euro, i.e. the US Dollar, the Pound Sterling and the Japanese Yen, and issued in the Euro area;
- ▣ debt instruments issued by credit institutions which are traded on the accepted non-regulated markets (including the STEP market, the OTC Market for Bank of England Euro Bills and other prescribed OTC markets for various treasury bills and commercial paper); and
- ▣ subordinated debt instruments when they are protected by an acceptable guarantee.

Step Market Committee Introduces Fees for Issuers with Programmes which have or will apply for a Step Label

The STEP Market Committee has announced that issuers wishing to apply for, or to renew, a STEP label under the STEP Market Convention for their short term programmes will now be required to pay fixed fees to the STEP Secretariat which is intended to be used to cover administrative costs of the STEP Secretariat.

The fees will be EUR 5000 for new programmes and EUR 2000 per annum for existing programmes which have applied for a STEP label.

The STEP Committee has confirmed that the collection of the above contributions will start as of 1 June 2010 under the following conditions:

- ▣ New programmes will be exempt from contributing until 31 December 2010;
- ▣ Existing programmes will be requested to contribute to EUR 1000 for the remainder of 2010.

 CONTACT US

Our Offices

Dublin

33 Sir John Rogerson's Quay,
Dublin 2,
Ireland.
Tel: +353 1 667 0022
Fax.: +353 1 667 0042

Cork

8 Webworks Cork,
Eglinton Street,
Cork, Ireland.
Tel: +353 21 425 0630
Fax: +353 21 425 0632

Boston

26th Floor,
225 Franklin Street,
Boston, MA 02110,
United States of America.
Tel: +1 617 217 2866
Fax: +1 617 217 2566

New York

245 Park Avenue
39th Floor
New York, NY 10167
United States
Tel: +1 212 792 4166
Fax: +1 212 792 4167

Tokyo

12th Floor,
Yurakucho Itocia Building
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: +813 6860 4885
Fax: +813 6860 4501

e-mail: enquiries@dilloneustace.ie

website: www.dilloneustace.ie

Contact Points

For more details on how we can help you, to request copies of most recent newsletters, briefings or articles, or simply to be included on our mailing list going forward, please contact any of the team members below.

Conor Houlihan

e-mail: conor.houlihan@dilloneustace.ie
Tel : +353 1 667 0022
Fax: + 353 1 667 0042

Mark Thorne

e-mail: mark.thorne@dilloneustace.ie
Tel : +353 1 667 0022
Fax: + 353 1 667 0042

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DILLON  EUSTACE

DUBLIN CORK BOSTON NEW YORK TOKYO

33 Sir John Rogerson's Quay, Dublin 2, Ireland.
www.dilloneustace.ie

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