



Client  
Newsletter -  
Winter 2008

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## ▣ FINANCIAL SERVICES AND BANKING

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## ▣ UCITS IV – IS THE MANAGEMENT PASSPORT GOING PLACES?

### Background to the Management Company Passport

The Management Company Passport (“MCP”) was first introduced in Directive 2001/107/EC (the “Man Co Directive”). However, the MCP has failed to work to date. This failure is largely due to a lack of clarity in the wording of certain sections of the Man Co Directive. In particular, it appears to prevent remote management

(i.e. management from an EU member state other than the one in which the UCITS is domiciled) of UCITS constituted as contractual funds such as common contractual funds or unit trusts (“contractual funds”).

Furthermore, the extent to which the passport applies to Man Cos of UCITS investment companies has not been free from doubt. In January 2005<sup>1</sup>, the Committee of European Securities Regulators (“CESR”) issued Level 2 guidelines<sup>2</sup> which provided clarification on the MCP procedures contained in the Man Co Directive. These guidelines indicated that the Man Co Directive does not provide for a Man Co to manage a UCITS from another EU member state (“Member State”). Accordingly, despite the provision for an MCP in the Man Co Directive it has not yet worked in practice.

Later in 2005, the EU Commission (the “Commission”) issued a consultation paper on enhancing the framework for UCITS<sup>3</sup>. This was followed in 2006 with a more detailed consultation paper which

<sup>1</sup> CESR’s Guidelines for Supervisors regarding the Transitional Provisions of the Amending UCITS Directives (2001/107/EC and 2001/108/EC), January 2005

<sup>2</sup> Level 2 guidelines under what is known as the “Lamfalussy Process” for EU financial legislation. The Lamfalussy Process provides for four level of legislation and guidelines. Level 1 is the core principles provided for in the main Directive or Regulation. Level 2 is implementing measures (Directive or Regulations) adopted based on advice from CESR. Level 3 is consistent application of EU law through supervisory convergence. Level 4 is enforcement of timely and correct transportation of EU laws into the laws of Member States.

<sup>3</sup> Green Paper on enhancing the European Framework for investment funds – Com (23005) 314

announced a set of target modifications to the UCITS Directive<sup>4</sup>. The areas which the Commission recommended be considered for modification were, (i) a new simplified fund passport procedure (ii) mergers of UCITS funds on a crossborder basis (iii) UCITS master/feeder structures, (iv) key investor information (to replace the simplified prospectus) (v) measures to enhance cooperation between competent authorities and (vi) the MCP.

Following a lengthy consultation period, the Commission issued its proposals for amending the UCITS Directive on 16 July 2008. The proposals provide for the modification referred to at (i) – (v) above, but do not contain provision for a new, effective MCP. These proposals are commonly referred to as UCITS IV.

The MCP was not included in the current UCITS IV proposals because, during the consultation process, concerns were raised by a number of Member States and industry participants as to how clear allocation of responsibilities for supervision between the competent authority of the Man Co and the competent authority of the UCITS could be ensured. If this could not be ensured, it could be detrimental to investor protection and the international reputation of the UCITS brand.

In an effort to address this supervisory concern, the Commission had proposed a “partial passport” pursuant to which certain core administrative functions namely, (i) verification of valuation and pricing and (ii) maintenance of unit-holder/shareholder registers, would have to be carried out in the UCITS’ home Member State. However, the Commission recognised that its partial passport procedure had not provided a fully satisfactory solution to this issue. Consequently, it did not include provision for an updated MCP in its UCITS IV proposal. Instead, it requested CESR to provide advice which would help the Commission “to develop provisions permitting the introduction of a management company passport under conditions which are consistent with a high level of investor protection”.

Following the referral to CESR by the Commission, CESR issued a call for evidence on 17 July, 2008 (responses were received from a variety of sources including asset managers, fund administrators, law firms and industry bodies). A consultation paper containing draft advice was issued in September, 2008<sup>5</sup> and an open hearing was held on 13 October, 2008. On 31 October 2008, CESR issued its advice to the Commission on the introduction of an effective MCP (“CESR Advice”).

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<sup>4</sup> White Paper on enhancing the Single Market Framework for investment funds – Com (2006) 686

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<sup>5</sup> Consultation Paper on UCITS Man Co Passport – September, 2008 CESR/08-748

## Key elements of CESR Advice

### *Definition of domicile*

#### *Man Co*

- ▣ The Man Co's home Member State should be the Member State in which the Man Co's registered office or head office is situated.
- ▣ Authorisation of the business of Man Cos should be granted by the Man Co's competent authority. The CESR Advice sets out those conditions which must be satisfied in order for such authorisation to be granted. One of the pre-conditions for authorisation is that the Man Co must manage at least one UCITS in its home member state.
- ▣ The authorisation of the Man Co should allow the Man Co to provide services throughout the EU, either through the establishment of a branch or under the free provision of services.

#### *UCITS*

- ▣ The UCITS' home Member State for contractual funds should be the Member State in which the UCITS has received authorisation and in which the depositary of the UCITS is established.

- ▣ UCITS should be regulated in accordance with the law applicable in its home Member State and UCITS should be authorised only if the UCITS' competent authority has approved the choice of the Man Co, the fund rules and the choice of depositary.

### *Depositary (also known as the custodian or trustee)*

- ▣ UCITS should be authorised only if the UCITS' competent authority has approved the choice of depositary, which depositary should either have its registered office in or be established in the UCITS' home Member State.
- ▣ In order to regulate the flow of information deemed necessary to allow the depositary to perform its oversight and safe-keeping functions, the depositary and the Man Co should sign a written agreement.

### *Local point of contact in case of contractual funds*

- ▣ If the Man Co of a contractual fund is not established in the UCITS' home Member State, it should appoint the depositary or other financial institution to act as a local point of contact to perform certain functions, to include providing facilities for the receipt

and transmission of orders and acting as a local information agent.

*Applicable law and allocation of responsibilities in the case of free provision of services*

In the case of the free provision of services from another Member State, the key provisions of the CESR Advice are as follows:

- ▣ Any Man Co authorised and supervised by the competent authority of another Member State providing the activity of cross border collective portfolio management through the freedom to provide services should not be subject to any additional requirements in the UCITS' home Member State except in cases referred to in the UCITS Directive.
- ▣ The Member State where the UCITS is domiciled shall regulate the constitution and functioning of the UCITS including, the rules on investment policies and restrictions, valuation of assets, relationships with investors and marketing/distribution of the units/shares.
- ▣ The Man Co should comply with the organisational measures (including risk management process and conflict of interest procedures) provided by its home

Member State. However, the UCITS' competent authority should be satisfied that the Man Co's risk management process and conflict of interests policies are adequate for the UCITS which it proposes to manage. CESR further advises that the Commission should provide Level 2 guidelines on Man Co organisational measures, including risk management processes and conflict of interest procedures to ensure that these areas are harmonised in order to provide confidence between Member States and reduce the level of potential comments from the competent authority of the UCITS' home Member State.

In the case of a branch, in addition to the above, the competent authority of the Member State in which the branch is located should assume responsibility for ensuring that the services provided by the branch within its territory comply with the rules of conduct applicable in such host Member State.

CESR further provides that for the purpose of ensuring adequate supervision of the UCITS, the depositary and the Man Co, the competent authorities should have the power to conclude bi-lateral and/or multi-lateral co-operation agreements with each other. It further recommends that the Commission should provide Level 2

guidelines on the minimum standards for such co-operation agreements.

*Authorisation procedure for UCITS funds whose Man Co is established in another Member State*

- ▣ The competent authority of the UCITS' home Member State may authorise a UCITS only if it has approved the fund rules, the choice of the Man Co and the choice of the depositary. The CESR Advice sets out the circumstances in which the competent authority of the UCITS' home Member State should approve the choice of the Man Co (i.e. if the Man Co is duly authorised by its home Member State, its risk management process, conflict of interest procedures and proposed delegation arrangements are adequate and the choice does not impact the exercise of its supervisory functions).
- ▣ The CESR Advice lists the specific documents which must be provided to the UCITS' competent authority by a Man Co which applies for authorisation to set up and/or manage UCITS established in another Member State and the circumstances in which additional information may be required. These documents include (i) a report on risk

management, accounting and other internal procedures (ii) a description of the relationship between the Man Co and the UCITS' depositary (iii) information on any delegation arrangements (iv) information on dealing with conflicts of interest (v) details of the local point of contact and (vi) details of how the Man Co will ensure compliance with the requirements of the competent authority of the UCITS.

- ▣ The Man Co's home Member State should provide an Attestation to the competent authority of the UCITS certifying that the Man Co fulfils the conditions imposed by the UCITS Directive and that organisational arrangements, systems and controls in place in the Man Co's home Member State are adequate for the type of UCITS which it intends to manage.
- ▣ In the event that a Man Co has seriously and/or systematically infringed the provisions adopted pursuant to the UCITS Directive, the UCITS' competent authority should have the power to refuse or withdraw the approval of the choice of Man Co.

CESR further recommends that the Commission should establish implementing rules designed to detail the

procedure for (i) the authorisation of the UCITS, (ii) the approval of the choice of a Man Co authorised in another Member State by the UCITS' competent authority and (iii) to deal with cases in which disagreements occur between competent authorities, including determining whether mediation may be necessary.

*On-going supervision of the management of the Fund*

- ▣ The competent authority of the Man Co should receive the reports on the management activity performed through branches or through freedom to provide services as required by the legislation of the Member State.
- ▣ The UCITS' competent authority should receive the reports which the UCITS must provide under the law applicable to it. The competent authority of the Man Co must also have access to these reports.
- ▣ The Commission should provide Level 2 guidelines on setting up databases which will enable competent authorities to share information which could reduce the reporting burden on the UCITS and the Man Co.
- ▣ The competent authority of the UCITS should be able to request the co-operation of the Man Co's competent authority for on site verifications or investigations of

the Man Co to the extent that it is necessary with respect to the supervision of the UCITS.

- ▣ The Man Co's competent authority should be able to request the co-operation of the competent authority of the UCITS and its depositary for on site verifications or investigations of the depositary to the extent it is necessary with respect to the supervision of UCITS.
- ▣ In the event that the UCITS and the Man Co have different auditors, their respective auditors should enter into an information-sharing agreement in order to ensure the fulfilment of the duties of both auditors. The Commission should provide Level 2 guidelines on the minimum content which should be included in such agreements.

*Dealing with breaches of rules governing the management of the Fund*

- ▣ The UCITS' competent authority should be able to directly impose administrative sanctions and measures on any Man Co providing services either through the freedom to provide services or a branch for violation of the rules which fall within its remit provided such sanctions are effective, proportionate and dissuasive.
- ▣ If such sanctions are to be imposed upon Man Cos located in

other Member States, the UCITS' competent authority should inform the Man Co's competent authority. The Man Co's competent authority may make representation to the UCITS' competent authority in relation to the type of measure and level of the sanctions.

- ▣ The Man Co's competent authority should have the power to serve the legal documents which are necessary to enforce the sanctions or measures taken by the UCITS' competent authority against the Man Co.
- ▣ As a last resort, if the conditions under which the choice of Man Co was approved are no longer fulfilled and the interests of unit-holders/shareholders are prejudiced the UCITS' competent authority may withdraw the approval of the choice of Man Co.
- ▣ Claims against a UCITS and the Man Co in relation to the management of a UCITS should be lodged by investors in a court in the UCITS' home Member State in accordance with the law applicable to the UCITS.
- ▣ Member States should promote the setting up or development of efficient out-of-court complaints and redress procedures for the settlement of investor disputes concerning the management of UCITS.

### **Analysis of the CESR Advice**

In general, Member States and industry participants agree with the principle of taking further steps towards EU single market integration and achieving increased efficiencies, provided the integrity of the UCITS brand can be maintained. However, there still appears to be questions over how this can be best achieved.

The CESR Advice itself was not supported by five Member States (Ireland, Luxembourg, Poland, the Slovak Republic and Slovenia) as they remained concerned that the proposed supervisory framework would be difficult to operate effectively in practice. Indeed, a number of other Member States approved the general principles of the CESR Advice but expressed reservation about certain aspects of it including the complexity of the proposed MCP framework. CESR itself has recommended that Level 2 guidelines are necessary in order to allow the smooth introduction of the MCP framework.

The domicile of a UCITS is an important question not just from a legal perspective (which is considered in the CESR Advice as outlined above), but also from a tax perspective. A clarifying amendment to the definition of domicile in the UCITS Directive would not necessarily be sufficient to satisfy tax authorities in various jurisdictions that their criteria for domicile are satisfied.

As is evident from the above, the CESR Advice has not been unanimously supported and will require substantial level 2 guidelines to enable it to work. We therefore await the Commission's response to the CESR Advice to see if it deems it viable or if more work will be required to achieve a workable MCP.

**This article first appeared in the November 2008 edition of the Finance Magazine**

## Ireland and China: Financial Regulators Strengthen Connections

The Irish Olympic boxing team was not the only successful Irish group to travel to the People's Republic of China (the "PRC") recently; the Taoiseach, Brian Cowen T.D., led a trade mission to the PRC at the end of October.

During the visit he presided over the signing of a Memorandum of Understanding ("MoU") between the Irish Financial Services Regulatory Authority (the "Financial Regulator"), the China Securities Regulation Commission (the "CSRC") and the China Banking Regulatory Commission (the "CBRC").

The CSRC is the state agency of the Securities Policy Committee of the State Council of the PRC and is responsible for the supervision and regulation of national

securities and futures markets in the PRC, while the CBRC is the state agency of the State Council responsible for the regulation of the Chinese banking sector.

The signing of the MoU was the culmination of an initiative taken in the middle of 2007, following recognition of the fact that the lack of a MoU with the PRC left Ireland's funds industry at a disadvantage with some of its competitors. These countries had arrangements in place for a number of years for other financial services but which their fund industries were now able to benefit from.

The MoU is intended to form the basis of future co-operation between the two regulators, it should be noted that it does not create any binding international obligations on either of the parties. The MoU does not modify or supersede any laws or regulatory requirements in force in, or applying to, Ireland or the PRC and does not create any rights enforceable by third parties, nor does it affect any arrangements under other memoranda of understanding which either supervisory authority may have agreed with other regulators in third party countries.

The purpose of the MoU is to protect investors and promote the development of the securities markets by providing a framework for co-operation, increased mutual understanding and the exchange of information, to the extent permitted by the laws and regulations in force in Ireland

and the PRC, and the availability of respective resources of the regulators. It will facilitate financial institutions from either the PRC or Ireland doing business together in either country.

One important aspect which should be noted from the MoU is that, to the extent permitted by its domestic laws and regulations, the Financial Regulator, the CSRC and the CBRC will use reasonable efforts to provide the other regulatory authorities with any relevant information that is discovered which gives rise to a breach, or anticipated breach, of the laws and regulations in relation to the securities and futures markets of the other country.

One of the direct results of the signing of the MoU is that Chinese Qualified Domestic Institutional Investors ("QDII") shall now be able to invest into Irish domiciled investment funds, regulated by the Financial Regulator, on behalf of their clients, and Irish institutions will be able to access the Chinese Qualified Foreign Institutional Investor ("QFII") status and invest directly in the PRC subject to meeting those requirements. This is potentially a huge benefit for the Irish funds industry and crucially for the promoter selecting a county in which to domicile their funds.

### **Qualified Domestic Institutional Investors**

The QDII scheme permits Chinese domiciled investors to invest in foreign

securities markets via certain fund management institutions, insurance companies, securities companies and other asset management institutions which have been approved by the CSRC as QDII's. The QDII scheme, introduced in June 2006, allows Chinese domiciled institutions and residents to invest with Chinese commercial banks, as QDII's, for these entities to then invest in overseas financial products.

At the time of the original launch of the scheme, any investment by such a QDII was restricted to fixed-income and money market products. The scope of the QDII scheme was widened in May 2007 and QDII's may now invest in equity products. The stocks or investment funds in which a QDII invests must be listed on a stock exchange or regulated by a financial regulator that has signed a MoU with the CSRC.

The entering into by the Financial Regulator and the CSRC of the MoU makes it possible for QDII collective investment schemes to now invest into Irish regulated funds, opening up Irish regulated funds to one of the world's largest pools of private capital

This should result in Ireland, which has already earned a reputation amongst asset managers globally as the most attractive jurisdiction in which to establish a regulated fund, becoming even more attractive, due to the fact that a fund established in Ireland will now be able to

raise capital from PRC domiciled investors

### **Qualified Foreign Institutional Investors ("QFII's")**

The QFII system permits certain types of qualified foreign investors to invest in local currency and use specific accounts to invest in local Chinese securities markets. The return on the investment, including dividends and capital gains from the investment can then be legally exchanged into foreign currency and repatriated.

The China A share market was historically closed to foreign investors but in November 2002 was opened, via the QFII scheme, to permit qualified foreign investors to invest in the China A share market under certain foreign exchange flow and disclosure requirements. The major institutions that are permitted to apply to be a QFII include fund management companies, insurance companies, securities firms and commercial banks with qualifications prescribed by the CSRC and the other relevant PRC regulators. Upon the approval of the CSRC a QFII is granted an investment quota by the State Administration of Foreign Exchange ("SAFE") and, after selecting a PRC custodian bank and one or more local brokers, may place orders to buy and sell stock in the China A share market. Several China A Share Funds have been authorised by the Financial Regulator

since the first investments were made by QFIIs in July 2003.

As well as China A shares, the investment scope of a QFII extends to treasury bonds, convertible bonds, corporate bonds, warrants and other financial products approved by the CSRC.

The entering into by the Financial Regulator and the CSRC of the MoU should make it easier for Irish regulated fund management companies, insurance companies, securities firms and commercial banks to become QFII's, providing they have the qualifications prescribed by the CSRC and the other relevant PRC regulators.

The signing of the MOU by the Financial Regulator, the CSRC and the CBRC should result in increased levels of protection for investors in both Ireland and the PRC by providing a framework for co-operation, increased mutual understanding, the exchange of information, and the availability of the respective resources of each of the regulatory authorities. The MoU will facilitate investment by Chinese QDII's into Irish regulated investment funds, and access by Irish institutions to QFII status, permitting them to invest directly in the PRC. The signing of the MoU will strengthen Ireland's attractiveness and standing as a domicile of choice for investment funds.

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## Prohibition on Short Selling of Irish Quoted Banks

The Financial Regulator has introduced provisions to prohibit short selling of stocks on Irish publicly quoted banks. These measures are consistent with those introduced in the United Kingdom where Irish stocks are also listed. These provisions are necessary to ensure the orderly conduct of the market at this time. These measures will be kept under continuous review and the Financial Regulator may issue guidelines on application of these rules as required.

With effect from midnight on Thursday 18th September 2008, the Market Abuse Rules (March 2006) are amended by the insertion of the following Section 10:

### 10. Short Selling

10.1 A person, other than a market maker, may not enter into any transaction, transactions or arrangements which have the effect of generating a net economic benefit which would arise from a fall in the price of the shares of either the Governor and Company of the Bank of Ireland,

Allied Irish Banks Plc, Irish Life and Permanent Plc or Anglo Irish Bank Corporation Plc.

10.2. On 23 September 2008, and each business day thereafter, by 3.30pm each person who has on that day an economic interest involving 0.25% or more of the issued share capital to which Rule 10.1 would have applied if entered into after the issuance of this Rule, shall make disclosure on an RIS system setting out the name of the person who has the position, the company in which the position is held and the amount of that position.

### Guidance in relation to 'Short Selling'

10.3. The prohibition in Rule 10.1 applies to any new short positions, including increases in existing short positions. Where a person has an existing short position on 18 September, 2008, the rule does not prevent that short position being continued, nor does it prevent trading to reduce or close out the short position. Where a net short position arises, but does not arise because the person entered into transactions after 18 September to create that short position, Rule 10.1 does not apply, but Rule 10.2 may apply depending solely on whether 0.25% of the shares

of the company are involved or not.

10.4. For the purposes of Rules 10.1 and 10.2, regard should be had to the following points in interpreting the application of the exemption for market makers:-

- (a) a person is a market maker only to the extent that they are or have been operating as a market maker ordinarily as part of their business;
- (b) Market maker includes but is not confined to persons recognised as a market maker by a Market Operator (as defined in the Markets in Financial Instruments Directive) when operating as such;
- (c) A person who operates as a market maker may also undertake other activities and those are not covered by the market maker exemption.
- (d) operating as a market maker means trading in good faith as principal to fulfill orders or instructions received from clients;

- (e) operating as a market maker may include trading in good faith to hedge positions arising from client orders or instructions;
- (f) No discretionary management activity or proprietary trading for the purpose of achieving trading gains falls, other than in compliance with (b) above, within the scope of market making activity.

10.5. These rules apply to spread betting and Contracts for Differences as they do to all other ways in which an economic interest, whether direct or indirect, can be created.

10.6. These Rules apply throughout each day. It is not complied with if short positions are taken on an intra-day basis and closed out before the end of the day.

10.7. These rules apply to any person who benefits from creating a short position, including the contracting party and an intermediary who assists in putting the transactions or arrangements in place, while understanding its purpose or consequence.

- 10.8 While shorting the ISEQ index is covered by the rule, as drafted, the Financial Regulator does not propose to take action in relation to shorting of the ISEQ Index at this time. We will keep this matter under review. If shorting of the index becomes, in effect, a proxy for shorting financial stock, such that market abuse concerns are raised, we will review this guidance.
- 10.9 A disclosure obligation arising under these Rules applies to the holder of the net short position. A disclosure under Rule 10.2 is required even if the size of the net short position has not changed since the previous disclosure.
- 10.10 A disclosure under Rule 10.2 may be made either:-
- (a) directly to an RIS; or
- (b) indirectly to an RIS through the CAO

Where a person makes a disclosure in accordance with (a) above, the person is required simultaneously to notify the CAO.

- 10.11 Market making positions are exempt from Rule 10.2 disclosures.

The amended Market Abuse Rules were published by the Financial Regulator on 25 September 2008 and are available at [www.financialregulator.ie](http://www.financialregulator.ie).

## Financial Regulator Clarification on VaR Funds

### Introduction

On 29 October, 2008, the Financial Regulator published a short paper<sup>6</sup> and revised Guidance Note 3/03 providing for a clarification of the limits to be applied by a UCITS when calculating global exposure using the absolute Value at Risk methodology (absolute VAR).

### VaR Limit Clarification

The Paper describes the change as a technical clarification which allows flexibility in the quantitative parameters used to measure risk while ensuring that existing limits are not compromised.

### Guidance Note 3/03 - Purpose

A Commission Recommendation on the use of derivatives by UCITS (the "Commission Recommendation")<sup>7</sup> was issued in 2004 requiring competent authorities in Member States to implement risk management guidelines in line with standards indicated in the Commission

<sup>6</sup> Collective investment schemes – VaR limit clarification, October, 2008.

<sup>7</sup> Commission Recommendation 2004/383/EC of 27 April, 2004.

Recommendation in order to ensure investor protection. In light of this, Guidance Note 3/03 was issued by the Financial Regulator outlining the parameters for the use of derivatives by UCITS and providing guidance on the measurement and control of derivative associated risk by UCITS.

Guidance Note 3/03 contains detailed requirements regarding:

- ▣ the format and content of the Risk Management Process;
- ▣ the options for measuring and controlling risk exposure;
- ▣ requirements and limits on position exposure; counterparty exposure; and counterparty restrictions.

### **Measurement of Global Exposure and Leverage – Sophisticated UCITS**

A sophisticated UCITS fund is required to use an advanced risk measurement methodology to measure global exposure. The Financial Regulator recommends the use of the Value-at-Risk (VaR) method and requires that the VaR model employed by the UCITS meets certain quantitative and qualitative criteria.

#### **VaR**

VaR may be calculated using an acceptable proprietary or commercially available model. Absolute VaR or Relative VaR may be applied. Absolute VaR is the

VaR of the fund capped as a percentage of net asset value. The changes to the Guidance Note relate to the parameters for the use of absolute VaR and are considered in detail below. Relative VaR is the VaR of the fund divided by the VaR of a benchmark or a comparable, derivatives-free portfolio. Under Relative VaR, VaR is limited to twice the VaR on the benchmark or comparable, derivatives-free portfolio.

#### *Changes to Parameters for Absolute VaR*

Guidance Note 3/03 now applies a general limit (that may be raised only in exceptional cases) for absolute VaR of 20% of net asset value. This limit was previously set at 5% of net asset value. The quantitative standards applied by the VaR model must include a 99% confidence level and a holding period of 20 days.

The VaR model used must also adhere to the following requirements:

- ▣ minimum historical observation period of one year (less if justified, for example on the grounds of recent significant changes in price volatility);
- ▣ stress tests carried out at least quarterly (to assess the likely impact of potential movements in interest rates, currencies and credit quality);
- ▣ back testing of the VaR model (a formal statistical process to

compare actual portfolio returns to the VaR predicted).

Where the VaR model applies a confidence level or holding period other than as set out above, a scaling process must be applied and detailed workings of such process must be provided in the risk management process. The Guidance Note provides details of scaling calculations to be applied for an alternative confidence level or holding period. Where such alternative quantitative standards are applied, the VaR limit of 20% must be adjusted downwards accordingly.

### **Existing UCITS**

A manager of an existing UCITS that measures global exposure using absolute VaR and wishes to avail of these revised measures will need to make appropriate changes to its risk management process and, depending on the level of disclosure, the offering documents of the UCITS. Such changes will need to be made in accordance with the requirements of the Financial Regulator.

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## **Amended Prospectus Rules**

In August, the Financial Regulator published amended Prospectus Rules under Section 51 of the Investment

Funds, Companies and Miscellaneous Provisions Act, 2005.

The amendments made to the old Prospectus Rules were designed to introduce greater clarity and further refinements to the review process. Following consultation with interested parties and the Irish Stock Exchange, the old Prospectus Rules, published in March 2006, were amended to address issues raised by the respondents to the consultation and also to reflect changes arising from the Financial Regulator's experience as competent authority since March 2006.

The amendments made clarify the responsibilities of issuers, offerors or persons seeking admission to trading, the targets to which the Financial Regulator is committed and disclosures to be made in prospectus documents.

Further amendments to the Prospectus Rules are likely in the future and stakeholders are invited to provide feedback/suggestions to the Financial Regulator on the effectiveness and efficiency of the amendments.

The new Prospectus Rules came into force on 15 September, 2008 and can be found on the Financial Regulator's website at [www.financialregulator.ie](http://www.financialregulator.ie).

## Money Market Funds – Change to Valuation Rules

### Introduction

The Irish Financial Services Regulatory Authority (“Financial Regulator”) permits money market funds (UCITS/non-UCITS) to follow amortised cost valuation methodology and refer to money market funds in their title.

### New Guidance Note - 1/08 (Valuation of Assets of Money Market Funds)

The conditions imposed by the Financial Regulator in Guidance Note - 1/08 in respect of the use of the words “money market fund” in a fund’s title and the use of an amortised cost valuation methodology are set out below.

#### *General Principle/Use of Term “Money Market Fund”*

Funds which propose to use the words “money market fund” or “UCITS money market fund” in their title and which propose to follow an amortised cost valuation methodology must obtain a triple-A rating from an internationally recognised rating agency<sup>8</sup>. Such funds must be established as constant net asset value funds or as accumulating net asset value funds with a principal objective to preserve principal and maintain liquidity.

<sup>8</sup> For example, AAAM by Standards & Poors or Aaa/MR1+ by Moodys

Other types of money market funds may not use the words “money market fund” in their title and must value assets on a mark to market basis in accordance with Guidance Note 1/00.

#### *Use of Amortised Cost Valuation Methodology*


A money market fund is permitted to provide for the use of amortised cost as a method of valuation of assets subject to the following conditions:


- ▣ **Eligible assets:** Without prejudice to the requirements of the UCITS Regulations<sup>9</sup>, the assets of a money market fund are restricted to cash or high-quality money market instruments.
  
- ▣ **Maturity:** The assets of a money market fund are restricted to securities which comply with one of the following criteria:
  - (a) have a maturity at issuance of up to and including 397 days;
  - (b) have a residual maturity of up to and including 397 days;

<sup>9</sup> European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2003, as amended.

- (c) undergo regular yield adjustments in line with money market conditions at least every 397 days; and/or
- (d) the risk profile, including credit and interest rate risks, corresponds to that of financial instruments which have a maturity of up to and including 397 days or are subject to a yield adjustment at least every 397 days.

In the case of (c) and (d), the money market instruments must also meet with the final maturity requirements of the relevant rating agency.

 **Weighted average maturity:** The weighted averaged maturity (WAM) of the portfolio must not exceed 60 days.

 **Mark to market:** The money market fund must carry out a weekly review of discrepancies between the market value and the amortised cost value of the money market instruments. Escalation procedures must be in place to ensure that:

- (a) material discrepancies between the market value and the amortised cost value of a money market

instrument are brought to the attention of personnel charged with the investment management of the money market fund;

- (b) discrepancies in excess of 0.1% between the market value and the amortised cost value of the portfolio are brought to the attention of the management company or the investment manager;

- (c) discrepancies in excess of 0.2% between the market value and the amortised cost value of the portfolio are brought to the attention of senior management/directors of the management company, the board of directors or general partner, as appropriate of the trustee;

- (d) if discrepancies in excess of 0.3% between the market value and the amortised cost value of the portfolio occur, a daily review must take place. The management company, board of directors or general partner must notify the Financial Regulator with an indication of the action, if any, which will be taken to reduce such dilution;

- (e) weekly reviews and any engagement of escalation procedures are clearly documented.
- (f) The trust deed, deed of constitution, articles of association or partnership agreement must provide for these procedures or, alternatively, provide that review of the amortised cost valuation vis-à-vis market valuation will be carried out in accordance with the guidelines.

permitted to follow an amortised cost valuation methodology. The most significant change imposed is that money market funds wishing to use the amortised cost valuation methodology must have a triple-A rating from an internationally recognised rating agency and a supplementary market risk rating.

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- ▣ **Stress testing:** A money market fund is expected to carry out monthly portfolio analysis incorporating stress testing to examine portfolio returns under various market scenarios to determine if the portfolio constituents are appropriate to meet pre-determined levels of credit risk, interest rate risk, market risk and investor redemptions. The results of the periodic analysis must be available for inspection by the Financial Regulator.

## Summary

Pursuant to the new Guidance Note 1/08, only those money market funds which apply strict criteria to the construction and management of their portfolios are

## REAL ESTATE

### In this issue:-








-  **Waste Management**
-  **Repair Covenants in Commercial Leases**

## Waste Management

### Introduction

The primary legislative instruments that govern recycling and disposal of waste in Ireland are the Waste Management Acts 1996 – 2008 (the “Waste Management Acts”), the Environmental Protection Act, 1992 (the “1992 Act”) (collectively the “Acts”) and the regulations made under the 1992 Act. Waste management legislation in Europe has strongly influenced current Irish legislation. The Acts have been implemented, among other things, to facilitate the transposition into national law of existing and future European waste legislation. The legislation regulates the activities in the waste sector which facilitates the orderly growth and technical development of the private waste industry and provides the required legal basis for waste management planning.

### **Main Objectives of the Waste Management Act 1996 (the “1996 Act”):**

-  Ensure a more effective organisation of public authority functions in relation to waste management, involving new or redefined roles for the minister, the Environmental Protection Agency (the “EPA”) and the local authority.
-  Measures designed to enhance performance in relation to the prevention and recovery of waste.
-  A detailed and up to date regulatory framework for the application of higher environmental standards, particularly as a response to EU and national waste disposal management requirements.
-  Prohibition on the transfer of waste to a person other than an authorised person.
-  Prohibition on the recovery or disposal of waste at an unlicensed facility.
-  Requires any person who carries on activities of an agricultural, commercial or industrial nature to take all such reasonable steps as are necessary to prevent or minimise the production of waste.
-  Substantial penalties for offences to include fines and/or

imprisonment plus potential liability for clean up costs.

Under the act and associated regulations all major local authorities are responsible for devising and reviewing the waste management plans in relation to non-hazardous waste authorisation and control of commercial waste collection activities. The EPA is empowered to licence and monitor the performance of waste management activities and is required to make a national plan in relation to hazardous waste.

#### **Regulations under the 1996 Act**

The regulations made under the Waste Management Act, 1996 includes;

- ▣ Waste Management (Licensing) Regulations, 1997 (S.I. No.133 of 1997) which provides a system of licencing by the EPA in relation to waste disposal facilities.
- ▣ Waste Management (Planning) Regulations, 1997 (No.137 of 1997) which specifies the matters to be addressed in waste management plans and the bodies to which proposed plans must be submitted.
- ▣ The Waste Management (Register) Regulations, 1997 (No.183 of 1997) prescribe entries to be made in registers maintained by the EPA and each

local authority to facilitate public access to information.

- ▣ The Waste Management (Packaging) Regulations, 1997 (No.242 of 1997) promotes and supports the recovery of packaging waste. The regulations impose obligations on all suppliers of packaged goods, packaging and packaging material to take necessary steps to recover packaging waste. Exemptions are available to suppliers who participate in an approved scheme for waste recovery.
- ▣ The Waste Management (Farm Plastics) Regulations, 1997 (No.315 of 1997) promotes and supports the collection and recovery of farm plastics used for sheeting, bale wrap and bale bags for silage importers and manufacturers of farm plastics are obliged to arrange for their collection and recovery. Exemptions are available to suppliers who participate in an approved scheme for waste recovery.

#### **The Waste Management (Amendment) Act, 2001 (the “2001 Act”)**

The primary purpose of the 2001 Act is to provide a legal mechanism by which the waste management process can be

brought to an early conclusion. Section 4 of the 2001 Act provides that the formulation of a waste management plan become an executive (management) function.

### **Environmental Protection Agency (the “EPA”)**

The EPA acts as a watchdog for the waste management industry. It is responsible for ensuring that local authorities carry out their environmental protection functions. If the EPA is of the opinion that a local authority is failing to carry out their functions satisfactorily it can request a report from the local authority, provide advice and make recommendations if it considers it necessary on the basis of that report. If the local authority fails to act on the recommendations the EPA can directly resolve the situation and as a last resort can deal with the situation as it sees fit and recover the costs from the local authority in question.

### **Authorisations**

Providers of waste disposal and recovery activities in Ireland are required to hold an authorisation in accordance with the Waste Management Acts. A waste recovery or disposal activity at a facility is either one of the following:

- ▣ An exempted activity (no authorisation required); or

- ▣ an activity requiring a waste (or IPPC (integrated pollution prevention and control)) licence; or
- ▣ an activity requiring a waste facility permit; or
- ▣ an activity requiring a waste certificate of registration/registration certificate.

The principal legislation governing the form of authorisation are:

- ▣ The Waste Management (Licencing) Regulations, 2004 (S.I. No. 395 of 2004);
- ▣ The Waste Management (Facility Permit & Registration) Regulations, 2007 (S.I. No. 821 of 2007) as amended by the Waste Management (Facility Permit Registration) (Amendment) Regulations, 2008 (S.I. No. 86 of 2008)

Depending on the authorisation required, these activities are controlled either by the EPA or by local authorities. All non-exempted local authority waste facilities are regulated by the EPA. The EPA is the authority which grants and enforces waste licenses for specified waste activities listed in the third and fourth schedule of the Waste Management Acts, 1996-2008. Licensing ensures that a high standard of environmental protection applies to the location, design, construction, operation and after care of waste disposal facilities.

## Updated Legislation

The Waste Management (Registration of Brokers and Dealers) Regulations, 2008 (S.I. No.113 of 2008) provides for the introduction of a registration system of waste brokers and dealers. These regulations follow on from the Waste Management (Shipment of Waste) Regulations, 2007 (S.I. No. 419 of 2007). The waste broker arranges to handle, transport, dispose of or recover controlled waste on behalf of other waste brokers including waste dealers who acquire waste and sell it on. The broker shares responsibility with the waste holders for the proper management of waste before and after its transfer and they are legally responsible for proper handling and disposal. Any individual or business that arranges the collecting, recycling, recovery or disposal of waste on behalf of another party must register as a waste broker with the National TransFrontier Shipments Office (the "TFS").

The Waste Management (Facility Permit and Registration) Regulations, 2007, as amended by the Waste Management (Facility Permit Registration) (Amendment) Regulations, 2008, and the Waste Management (Collection Permit) Regulations, 2007 as amended by the Waste Management (Collection Permit) (Amendment) Regulations, 2008 came into operation on the 1 June, 2008. The regulations govern the waste management permits, certificates of registration and waste collection permits.

## Repair Covenants in Commercial Leases

### Introduction

In recent years the commercial lease has assumed greater significance, with more emphasis than ever being placed on the commercial concerns affecting both landlords and tenants. One of the most critical concerns for both parties is their repair obligations in respect of the property. This update is a brief consideration of the salient issues.

### Repair Obligations

Broadly speaking, a tenant will be leasing either an entire building or part of a building in a multi-let situation. In respect of the former, the lease should be drafted so as to include a full repairing covenant on behalf of the tenant. In respect of the latter, the tenant's repairing obligations should be limited to the interior of the premises being leased, while the landlord remains responsible for the structure of the whole building and for all areas not being leased. In this situation the lease should provide for the landlord to be fully reimbursed by all tenants for the cost incurred in maintaining the building. This may be facilitated through a service charge provision included in the lease or by covenant on the part of the tenant to pay the landlord an apportioned amount of the cost of any works done.

Both of the above scenarios require particular attention to be paid to the definition of the 'demised premises'. In the case of a lease of part of a building the definition of the 'retained parts' should be considered in tandem with the 'demised premises' to ensure that there are no omissions in what either party is required to repair. A failure to accurately define the relevant areas and obligations of the parties could result in the landlord being unable to recoup monies spent on repairs and maintenance. It is normal for the landlord to be responsible for:

- ▣ roof and foundations;
- ▣ load-bearing walls and columns;
- ▣ external walls (excluding the glass in exterior windows);
- ▣ floors;
- ▣ ceilings; and
- ▣ all other structural parts (excluding the finishes applied to internal walls, ceilings and floors).

#### **Definition of 'Repair'**

The extent of the works which must be carried out in order to conform with the obligations to repair is unclear. Some authorities suggest that, regardless of the terms used, there is no requirement to give back to the landlord a different

premises from that which the tenant received when it entered into the lease. In other words, repairs are necessary only to restore the premises to its condition when the tenant took occupation. However, other authorities suggest that repair requires something to be restored by renewal or replacement. In this regard, it is maintained that including a term such as 'keeping the building in repair' can involve a duty to put a property into repair even if the property was in a poor state at the time of granting the lease.

Ultimately, where a dispute arises it will fall to the courts to decide on the intentions of the parties in any given case. Consequently, it is recommended that the lease should clearly reflect the extent of the obligations envisaged by the parties to the lease.

#### ***Impact of other Covenants in a Lease***

While the repair covenant in a commercial lease will be the first port of call when dealing with repair obligations, there are several other covenants which may have an impact on the lease. The following is a brief examination of some such covenants.

#### ***Redecoration covenants***

Most commercial leases will include a specific obligation on a tenant to redecorate the demised premises at the end of given periods, namely prior to the

rent review date. This ensures that the premises are in good order at that time. It is arguable that the tenant's general repair obligations encompass a redecoration requirement, however, the inclusion of a redecoration covenant can only be of added assistance to the landlord.

### ***Yield-up clauses***

All commercial leases include a provision which sets out the situation in relation to the yielding up of the property. Generally speaking, this will set out that the tenant can yield up the property only once it has complied with all the tenant's covenants contained in the lease. Consequently, a tenant, on yielding up the property, must have fully complied with the repair covenant in the lease.

### **Insurance provisions**

The obvious exception to a tenant's obligation to repair is where damage is caused as a result of an insured risk. A tenant should always establish that the 'insured risks' as defined in the lease are covered by the policy in place to ensure no ambiguities arise at a later date.

### **Statutory requirements**

Most commercial leases will include a generic covenant requiring tenants to comply with any statutory obligations which may arise with regards to the property. Compliance with the covenant may, from time to time, impose repair

obligations on a tenant. For example, the Energy Performance of Buildings Directive (2002/19/EC) will require all new non-residential buildings to produce an energy efficiency certificate in respect of the building as of July 1 2008, and all existing non-residential buildings will require same as of July 1 2009 (for further details please see "Implementation of Energy Performance of Buildings Directive in Ireland"). This will undoubtedly impose increased repair obligations on both landlord and tenants in the future.



### **Comment**

Evidently, it is imperative that great care be taken when drafting repair covenants in commercial leases. It is clear that the repair covenants should be viewed not in isolation, but rather in conjunction with other covenants which may have an impact on its interpretation and effect. Ultimately, landlords must seek to protect their investment as best they can with the minimal amount of expenditure incurred to themselves.

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## LITIGATION AND DISPUTE RESOLUTION

In this issue:-

-  **Bodily Injury and the Montreal Convention**
-  **Personal Injuries Assessment Board Acts and Limitation Periods**

### Bodily Injury and the Montreal Convention

#### Introduction

What constitutes bodily injury for the purposes of recovering compensation under the Montreal Convention is an area of law that has challenged judges and lawyers down through the years and is a topic on which there is a substantial amount of information. This article sets out some of the salient points which govern this area of law with particular emphasis on the law in Ireland.

#### An Exclusive Cause of Action

A starting point for this article is to understand the principle that the Montreal Convention (“the Convention”) provides an exclusive cause of action. This principle was very clearly established by the House of Lords in the landmark English case of *Sidhu and others .v. British Airways plc*, 1997. Lord Hope in

that case held that “*The Convention does not purport to deal with all matters relating to contracts of international carriage by air. But in those areas with which it deals - and the liability of the carrier is one of them - the code is intended to be uniform and to be exclusive also of any resort to the rules of the domestic law...*”

Essentially, what this means is that where no remedy is provided for a claimant under the Convention, no remedy exists. This case of *Sidhu* was cited in the Irish Supreme Court decision of *AHP Manufacturing B.V. t/a Wyeth Medica .v. DHL Worldwide Network N.V, DHL Worldwide Express GmbH and DHL International (Ireland) Limited*, 30 July 2001. This principal was also mentioned obiter dictum in the judgment of Blayney J in the Irish Supreme Court case of *S. Smyth and Company Limited .v. Aer Turas Teoranta*, 3 February 1997.

The Convention was given force of law in Ireland by virtue of the Air Navigation and Transport (International Conventions) Act 2004.

#### Article 17 of the Convention

Article 17 of the Convention provides that “*The carrier is liable for damage sustained in case of death or bodily injury (emphasis added) of a passenger upon condition only that the accident which caused the death or injury took place on board the aircraft or in the course of any of the operations of embarking or disembarking.*”

Provided the other criteria necessary to establish that there has been an “*accident*” within the Convention, it is clear that only physical injury sustained is recoverable under the Convention. Where the issue becomes more complex is in determining whether or not a passenger who has suffered a recognisable mental condition is entitled to be compensated.

### **Psychological Injury**

It has been established that purely psychological injury is not in itself sufficient for a claimant to recover under the Convention. In the English case of *Morris .v. KLM [2002] UKHL 7*, the Court of Appeal dismissed the Plaintiff’s claim on this basis. In that case, the Plaintiff, who was a fifteen year old girl, was sexually assaulted by a male passenger sitting next to her. She claimed that she suffered clinical depression as a result. She did not assert that there had been any physical injuries arising or connected with her depression. While finding there had been an “*accident*” within the meaning of the Warsaw Convention (the precursor to the Convention), the Court of Appeal dismissed her appeal on the basis that the Plaintiff had sustained a mental injury only which fell outside of Article 17.

The Irish Courts have also taken this view in the Circuit Court case of *Geraldine Howe .v. Cityflyer Express Limited, 12 October 1998*. In that case, the Plaintiff claimed to have suffered nervous shock

and post traumatic stress disorder as a result of one of the engines of the aircraft on which she was a passenger catching fire. Judge Haugh looked at the wording of the Warsaw Convention and said that had the translators “*wished to allow for an award of damages for nervous shock, the term “personal injury” would have been used.*” While Judge Haugh acknowledged that the Plaintiff suffered a personal injury, he held that she could not recover damages under Article 17 of the Warsaw Convention because her injury was psychological in nature.

The issues become more complicated when a passenger suffers a psychological injury and a physical injury. There are no leading Irish decisions on this topic. However, now set out are some of the situations which can arise in this area and which have been looked at by other jurisdictions:

(i) **Physical Injury leading to psychological injury**

There is case law which favours recovery for psychological injuries provided such injuries are caused by the physical injuries sustained. This was the view of the District Court in the United States case of *Jack .v. Trans World Airlines Inc, 854 F Supp 654 (ND Cal, 1994)*. It distinguished between a situation where a psychological injury was caused by the physical injury and one which was not but

merely related to the accident itself. No recovery was allowed in the latter situation. The generally accepted view would be that damages are recoverable if a claimant can prove that his psychological injuries were caused by his physical injuries.

(ii) **Psychological injury leading to physical injury**

The House of Lords in the English case of *King .v. Bristow Helicopters [2002] UKHL* examined this scenario. The Plaintiff in that case was a passenger on board a helicopter when, shortly after take off, the engines failed. The helicopter did not crash but safely landed. The Plaintiff sustained post traumatic stress disorder as a result of which he developed the onset of onset of peptic ulcer disease. The Plaintiff's appeal was allowed.

Lord Hope in that case said “*A peptic ulcer disorder involves the tissues of the body, and it is not difficult to see that it is a kind of bodily injury...while there is no general right to recover damages under Article 17 for mental injury sustained by a passenger, damages for the physical manifestations of a mental injury will be recoverable.*”

On this basis, the Plaintiff could recover but only in respect of the peptic ulcer as it was a physical injury caused by psychological trauma.

(iii) **Post traumatic stress disorder- a form of bodily injury?**

The issue of whether Post Traumatic Stress Disorder (“PTSD”) could be considered a physical injury to the brain and so give rise to recovery under the Convention has arisen in a number of leading cases in the United States and the United Kingdom.

In the United States case of *Weaver v Delta Airlines Inc (1999) 56F Supp 2d 1190*, the Plaintiff maintained she sustained chronic PTSD as a result of an emergency landing of the defendant airline with whom she was travelling as a passenger. The Plaintiff relied on scientific research to show that her PTSD evidenced an injury to her brain. On this basis, she was able to recover under the Warsaw Convention.

Similarly, in *In re Crash at Little Rock, Arkansas, on June 1, 1999 (2000) 27 Avi 18,428*, the Judge held that...“*evidence presented at the trial, both in the form of expert testimony and exhibits, established*

*that PTSD is a biological/physical as well as a psychological injury.*" However, the decision in that case was later rejected by the Court of Appeal. The Plaintiff's doctor had opined that the Plaintiff's brain had undergone a physical change on the basis of symptoms of disrupted sleep and concentration and flashbacks. The Court of Appeal found this was not enough to establish a physical change to the Plaintiff's brain and said certain tests which could have shown the functioning of her brain were not applied.

The majority view in the *King* case (supra) was that recovery was possible under the Warsaw Convention if evidence was produced of injury to the brain. Lord Mackay said *"I would apply the simple test, does the evidence demonstrate injury to the body, including in that expression the brain, the central nervous system and all the other components of the body?"*

### **Conclusion**

What the above case law demonstrates is that a clear precedent has been set that psychological injury alone is not sufficient for a claimant to recover damages against an airline under the Convention. Although not bound by the decision of the Circuit Court in the case of *Howe* (supra), it is likely that the Irish High Court, which is a court of unlimited jurisdiction, will find the arguments made by the House of Lords in the English case of *Morris* (supra) very persuasive. This is good news for the airlines which might otherwise be faced

with exaggerated, or even fraudulent claims, by opportunistic passengers.

## **The Personal Injuries Assessment Board Acts and Limitation Periods**

### **Introduction**

The introduction of the Personal Injuries Assessment Board ("PIAB") by the Personal Injuries Assessment Board Act 2003 ("the 2003 Act") changed dramatically the way personal injury claims are processed in Ireland. Challenges to the legislation have been few and mainly cosmetic. The PIAB Act 2007 introduced cost penalties in the event of a claimant refusing a PIAB award and being awarded the same or less by the courts. This Act increased the pressure on claimants to accept PIAB awards. There is one aspect though of the 2003 Act, limitation periods, where there is a lacuna in the law which has not been rectified by legislation.

### **Limitation Periods**

As Section 7 of the Civil Liability and Courts Act 2004 ("the 2004 Act") reduced the limitation period from three years to two years, this meant that the time frame within which PIAB had to deal with a claim was quite short. This could result in a situation where, if PIAB did not deal with a claimant's assessment in a timely fashion, then that claim could become statute

barred. It is for this reason that section 50 of the 2003 Act is of importance. Section 50 states:

*"In reckoning any period of time for the purposes of any limitation period in relation to a relevant claim specified by the Statute of Limitations 1957 or [the Statute of Limitations \(Amendment\) Act 1991](#), the period beginning on the making of an application under [section 11](#) in relation to the claim and ending 6 months from the date of issue of an authorisation under, as appropriate, [section 14](#), 17, 32 or 36, rules under [section 46](#) (3) or [section 49](#) shall be disregarded."*

Therefore, once a claim is made to PIAB the two year limitation period stops and does not recommence until six months after the authorisation has issued. An authorisation is the document allowing the claimant to bring court proceedings in respect of his or her claim.

The issue here is that Section 50 only refers to limitation periods specified in the Statute of Limitations Act 1957 ("the 1957 Act") and the Statute of Limitations (Amendment) Act 1991 ("the 1991 Act"). There are other types of personal injuries claims which have limitation regimes outside both of these Acts.

## Maritime Claims

The issuing of proceedings in personal injury cases arising out of any incident on a vessel is governed by Section 46(2) of the Civil Liability Act, 1961 ("the 1961 Act"). For most claimants' solicitors this was a little known limitation period. The limitation period is two years. Section 46(2) states:

*"Where, by the sole or concurrent fault of a vessel damage is caused to that or another vessel or to the cargo or any property on board either vessel, or loss of life or personal injury is suffered, by any person on board either vessel, then, subject to subsection (3) of this section, no action shall be maintainable to enforce a claim for damages or lien in respect of such damage, loss of life or injury unless proceedings are commenced within two years from the date when such damage, loss of life or injury was caused; and an action shall not be maintainable to enforce any claim for contribution in respect of an overpaid proportion of any damages for loss of life or personal injuries unless proceedings are commenced within one year from the date of payment."*

When the general limitation period was three years practitioners tended to be more easily wrong footed by this Section. The main point is that Section 50 of the

2003 Act does not specify the 1961 Act when reckoning time for limitation purposes and maritime incidents resulting in personal injuries claims fall outside the 2003 Act.

### **Aviation Claims**

Aviation claims, whether for cargo or injury, have always been governed by international conventions which in turn have been given force of law by the Air Navigation and Transport Acts, as amended, and by EU Regulations. The present regime is governed by the Montreal Convention 1999 (“the Convention”) and Council Regulation (EC) No. 2027/97 of the 9 October 1997 (which essentially repeats the Convention as amended by Regulation EC No. 889/2002).

Article 35 of the Convention states:

#### *“Limitation of actions*

1. *The right to damages shall be extinguished if an action is not brought within a period of two years, reckoned from the date of arrival at the destination, or from the date on which the aircraft ought to have arrived, or from the date on which the carriage stopped.*

2. *The method of calculating that period shall be determined by the law of the court seized of the case.”*

Interestingly Article 35 states that the “right to damages shall be extinguished” if the action is not brought within the two year period and this is more draconian than the normal limitation rules. Also when claiming for damages arising out of international carriage by air, a claimant’s only cause of action is under the Convention. The important issue here is that this limitation regime is separate from the 1957 and 1991 Acts as are specified in Section 50 of the 2003 Act.

### **Actions Against the Estate of Deceased Person**

This is another situation where the former limitation period of three years, prior to the implementation of Section 7 of the Civil Liability and Courts Act 2004, did not apply. It again caused pitfalls for claimant’s solicitors who always felt that, under the old rules, a three year limitation period applied in all claims for personal injuries.

The position relating to the suing of the estate of a deceased person is governed by Section 9 of the 1961 Act. This Section states:

- “9.—(1) *In this section “the relevant period”*

*means the period of limitation prescribed by the Statute of Limitations or any other limitation enactment.*

- (2) *No proceedings shall be maintainable in respect of any cause of action whatsoever which has survived against the estate of a deceased person unless either-*
- (a) *proceedings against him in respect of that cause of action were commenced within the relevant period and were pending at the date of his death, or*
- (b) *proceedings are commenced in respect of that cause of action within the relevant period or within the period of two years after his death, whichever period first expires.”*

The position here is more open to interpretation than for maritime and aviation claims. The reference to “*the relevant period*” in subsection (1) has to be two years as provided by Section 3(1)

of the 1991 Act as amended by Section 7 of the 2004 Act. Section 3(1) of the 1991 Act is clearly caught by Section 50 so is the position not abundantly clear? The answer has to be, not necessarily so.

Section 9(2)(b) of the 1961 Act refers to commencing proceedings “*within the relevant period or within the period of two years after his death, whichever period first expires*”. There are two limitation periods here. While the first one, “*the relevant period*”, is caught by Section 50 it is far from clear that the second period is. That period is specified by Section 9 of the 1961 Act only and not by any of the Acts mentioned in Section 50 of 2003 Act. This view may not have been the intention of the legislature because it does create a distinction between claimants with causes of action against a deceased person and those with a cause of action against a living person. However, the ordinary meaning of Section 50 of the 2003 Act would have to lead one to the view that Section 9 of the 1961 Act, at least insofar as it applies to the second limitation period, is excluded.

### **Conclusion**



It is quite clear that three specific areas where personal injuries arise have been excluded from the PIAB process by what is very obviously a failing by the draftsman. They are not areas where a large number of claims arise but claims do arise. PIAB have resolved the situation by agreeing not to assess any claims which

are submitted to them from these three areas (relying on Section 17 of the 2003 Act to do so) and issuing an authorisation immediately. It is the practical application by PIAB rather than the legislature which has come to the rescue.

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## CORPORATE LAW AND M&A

### In this issue:-

-  **Directors' Reliance on Professional Advice**
-  **The Investor Compensation Scheme**

## Directors' Reliance on Professional Advice

### Introduction

In the current economic climate with liquidations on the rise and corporate governance issues more regularly in the headlines, directors may be forgiven for being apprehensive about possible restriction proceedings further down the line should their company find itself in difficulty. In this article we consider some of the factors that the courts have taken into account in deciding whether or not directors should be restricted. We have focused, in particular, on the emphasis placed by the courts, in a number of cases both in Ireland and overseas, on the importance of directors seeking professional advice in particular circumstances.

### Tralee Beef and Lamb

In the recent Supreme Court case of In the Matter of Tralee Beef and Lamb Ltd

(In Liquidation) Kavanagh -v- Delaney & ors<sup>10</sup> ("Tralee Beef and Lamb") a non-executive director of a liquidated company appealed his restriction as a company director by the High Court pursuant to Section 150 of the Companies Act 1990 (as amended by Company Law Enforcement Act 2001 - Section 41). In his judgment, Hardiman J. strongly criticised the Section 150 regime whereby a liquidator, who has formed the opinion that a relevant director has acted honestly and responsibly in discharge of his functions, is required to bring restriction proceedings against that director unless the Director of Corporate Enforcement ("Director") relieves him of his obligation to do so. In this case, the Director neither granted the liquidator this relief nor gave any reason for not doing so. Hardiman J. was also critical of the reversal of the onus of proof whereby the respondent must prove not only that he has acted responsibly and honestly in relation to the Company but also prove the negative proposition that "there is no other reason why it would be just and equitable" to make a restriction order. Due to serious concerns about the justice of the procedures leading to the decision to restrict the director in question the Supreme Court overturned the restriction order.

The Director is currently studying the judgment to consider if, and to what extent, there is a need to modify the

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<sup>10</sup> [2008] IESC1

practices adopted by the Office of the Director of Corporate Enforcement (“ODCE”) in this respect, however, no timeframe for a response to the judgment has yet been issued. It does seem likely, however, that the ODCE will be more willing than it has been in the past, to relieve liquidators of their duty to bring proceedings where they are satisfied that the directors in question have acted ‘honestly and responsibly’.

### **La Moselle**

The issue of dishonesty for the purposes of S. 150 is relatively clear-cut and has been held to imply “something akin to improper dealing with money or other assets of the company”<sup>11</sup>

The question as to whether or not directors have acted “responsibly” for the purposes of S. 150 has been explored in a number of cases in recent years, however, the seminal judgment is that of Shanley J in *Re La Moselle Clothing Limited and Rosegem Limited*<sup>12</sup> (“La Moselle”) who identified the following criteria:

- ▣ The extent to which the director has or has not complied with any obligation imposed on him by the Companies Acts.
- ▣ The extent to which his conduct could be regarded as so incompetent as to amount to irresponsibility.

- ▣ The extent of the director’s responsibility for the insolvency of the company.
- ▣ The extent of the director’s responsibility for the net deficiency in the assets of the company disclosed at the date of the winding up or thereafter.
- ▣ The extent to which the director in his conduct of the affairs of the company has displayed a lack of commercial probity or want of proper standards.

The High Court per Finlay Geoghegan J in the *Tralee Beef and Lamb* case adopted the above criteria, but went on to assert that the duties owed by a director are not only those imposed by the provisions of the Companies Acts, but also, include the fiduciary duties and duties of skill and care under the Common Law.

### **Directors and Professional Advice**

Directors have an unenviable course to navigate. On the one hand they must make difficult decisions during a challenging period. On the other, they must have regard to an extensive range of duties and obligations which are not immediately discernible in the Companies Acts or the Common Law. Directors will very often seek advice from lawyers, accountants and other professionals and it is argued that in certain circumstances this course of action may be necessary to protect the directors from liability and we

<sup>11</sup> *Re USIT World* [2005] IEHC 285

<sup>12</sup> (1998) 2 ILRM 345

intend to examine this proposition in more detail here.

In the UK case of *In Re Uno plc and World of Leather plc*<sup>13</sup> ("World of Leather") the directors took professional advice in respect of key decisions when their business was in difficulty and this proved crucial to their defence of the UK equivalent of restriction proceedings which hinged on the outcome of those decisions.

### **World of Leather**

The UK Department of Trade and Industry ("DTI") had brought disqualification proceedings against five former directors of Uno plc and its subsidiary World of Leather plc ("the Companies"). The Companies carried on business as furniture retailers, but they found themselves in difficulties in late 1999 and unable to obtain further credit. This meant that the Companies had to rely upon customers' cash deposits as working capital. They ran promotions offering 10 per cent discount to customers who paid 100 per cent deposits. This boosted customer cash held from £2.2million to £10.8million.

The directors felt that they could not place any of the customer deposits in a separate trust account and continue to trade. From November 1999 to March

2000, the directors sought in vain a buyer for the businesses.

The directors obtained advice from Rosenblatt solicitors, Dibb Lupton Alsop, PricewaterhouseCoopers and KPMG on whether or not the Companies could continue to trade whilst using the customer deposits as working capital. All the advisers offered similar advice to the effect that, although, in an ideal world, customer deposits should be ring-fenced, they were not required to cease trading so long as there was a reasonable expectation that the Companies could avoid insolvent liquidation. The legal advice received by the directors was also that if they decided to cease trading without fully examining the available options, they could be criticised for causing greater loss to creditors.

The DTI contended that a director would be guilty of conduct showing a serious want of probity if he were party to permitting the company to accept deposits in circumstances where there was no certainty that the company would be able to meet the customer's order and where the customer's payment was put at risk.

The DTI claimed that the directors were, in effect, using the unsuspecting cash-paying members of the public as a substitute bank without offering them any form of choice in the matter. By embarking on and pursuing the deposit/discount scheme, the directors

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<sup>13</sup> *In Re Uno plc and World of Leather plc, between Secretary of State for Trade and Industry v Gill & Ors* [2004] EWHC 922 (Ch)

were aggravating the position of the cash-paying customer.

Blackburne J was not persuaded that the charge of unfitness was proved. To qualify for disqualification, the conduct has ordinarily to be either dishonest or otherwise lacking in commercial probity or display incompetence to a marked degree. The judgement which the defendants had to make during this four month period was whether to cease trading there and then, with the inevitable consequence of an insolvency in which the group's unsecured creditors, including, in particular, those who had paid cash deposits but not yet received their goods, would receive nothing and in which, in addition, there would be a loss of several hundred employees' jobs, or whether to continue to trade in the reasonable expectation of effecting a corporate solution which would ensure that all creditors would be paid and all customers would receive the goods for which they provided a deposit. While mindful of the plight of the cash-paying customers, he could see no real grounds for criticising the directors. In fact, Blackburne J commended the directors' decision to obtain full legal and professional advice before continuing to trade. With this advice they were able to demonstrate that there was a reasonable prospect of finding a solution, and achieving a satisfactory outcome for all of the company's creditors. The applications were therefore dismissed.

### **Re Squash (Ireland) Ltd**

Similar circumstances were considered in this jurisdiction in *Re Squash (Ireland) Ltd*<sup>14</sup>. In this case the directors of a sporting and leisure company which was facing financial difficulties had devised a scheme whereby they would buy out the freehold interest in a property which they held under the Landlord and Tenant (Amendment) Act 1980 (the "Act") and sell this on to a third party thereby clearing their debts. However, the holder of the freehold interest was a government department who informed the directors that the Act did not apply to State property. The company continued to accept subscriptions from sporting members while they sought counsel's opinion on the matter of the freehold. When their legal advice confirmed that the company could not rely on the Act the decision was taken not to accept further subscriptions and to have the company wound up in an orderly manner.

Restriction orders were imposed on the directors by the High Court based on the liquidator's affidavit highlighting the acceptance of subscriptions while liquidation was imminent. On appeal to the Supreme Court, McGuinness J considered the *La Moselle* principles and noted that features such as keeping proper books of account, seeking professional advice and abiding by it all went towards a finding that the directors

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<sup>14</sup> [2001] IESC 200; [2001] 3 IR 35 (8 February 2001)

had acted responsibly. McGuinness J could not find that the directors of Squash (Ireland) Ltd had acted irresponsibly as, while it was unfortunate that they did not identify the problem with the lease at an earlier stage, it was an important factor in finding for the directors that “at the time they had professional and legal advice, which they took”<sup>15</sup>.

### **Re Usit World**<sup>16</sup>

In this case, a travel company which was in difficulties paid the sum of €250,000 to its solicitors in respect of fees due as well as future fees, the day before the liquidator was appointed. The liquidator contended that that the payment was one made at the expense and therefore to the detriment of creditors and at a time when the Board ought to have been acting in the interests of the creditors. The directors countered that it would have been impractical to brief another firm fully in the time available, and that this firm had many years of experience dealing with the USIT group. Moreover, the Board had resolved that this payment should be made as it would be in the interests of the group as a whole, since legal advice would be needed.

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<sup>15</sup> Ibid. p15: McGuinness J considered each of the LaMoselle principles in turn as they applied to the Squash (Ireland) Directors and considered the taking of professional advice to go to the second principle i.e. whether they were “so incompetent as to amount to irresponsibility”.

<sup>16</sup> In The Matter of: USIT WORLD PLC (in liquidation) and In the Matter of the Companies Acts 1963-2001, [2005] IEHC 285

The court took into account the directors’ contention that if legal advice was not taken at that time they “might equally be suggested as acting irresponsibly” and that if these solicitors were not in a position to continue to act for the group, it would have been detrimental to the group given the firm’s familiarity with the group’s position for some time and given the complex nature of issues likely to arise in situations of examinership and insolvency generally. Given these considerations and the small nature of the fee relative to the scale of the company’s enterprise and to the overall losses to creditors, the court did not consider the payment to be irresponsible.

This issue of directors’ reliance on professional advice has also been examined in a number of other Common Law jurisdictions and the following is a brief summary of the conclusions which the courts in those jurisdictions have drawn:

### **United States**

The US courts have held that if a director seeks out the advice of an attorney and relies on that advice in good faith he has done all that could be expected and cannot be held liable if that advice turns out to be erroneous<sup>17</sup>. For example, reliance on the professional advice of an attorney has been held to be a valid

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<sup>17</sup> FDIC v Caldwell No. CV 84-2929 FFF (CD Cal 1987)

defence to a violation of the US National Bank Act<sup>18</sup>.

### Canada

The Canada Business Corporations Act ("CBCA")<sup>19</sup> contains a provision whereby directors are considered to have discharged their duty to act honestly and in good faith and exercise due care, diligence and skill to the extent that they rely in good faith on a report of a person whose profession lends credibility to a statement made by the professional person. This provision was examined in the leading case of Peoples v. Wise<sup>20</sup>. Here a department store was taken over by a former competitor and a joint procurement policy was implemented, under which the two companies would divide responsibility for purchasing inventory. The companies became insolvent and some of the directors were accused of favouring the interests of Wise Stores over Peoples in breach of their duties as directors.

The directors stated that, in implementing the joint procurement policy, they had relied in good faith on the opinion of the vice-president of administration and finance, an officer with a commerce degree and fifteen years of experience in administration and finance. He was not an

accountant or subject to the regulatory overview of any professional organisation however, and did not carry independent insurance coverage for professional negligence. The Supreme Court narrowly construed the relevant section and held that he was not a "professional" as contemplated under the relevant section and reliance on his advice did not give rise to a defence to a breach of duty claim.

### Reliance

While such a requirement has not been enshrined formally in statute in this jurisdiction it is nevertheless settled law in Ireland that a director is not only permitted to obtain and rely upon advice from professional advisers but he is also obliged to seek such advice where the proper exercise of his office demands the obtaining of expert advice<sup>21</sup>. Such advice, however, should be reasonable and within the scope of the advisor's expertise and competence<sup>22</sup>.

It is clear from case law outlined above, both in Ireland and elsewhere, that not only is it prudent and advisable to seek professional advice (such as legal, accounting, investment etc.) but it is also a *requirement* to do so<sup>23</sup>. It is possible for directors to take some comfort from the

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<sup>18</sup> First National Bank of Fairbanks v Noyes 257 F. 593 (9<sup>th</sup> Cir 1919)

<sup>19</sup> Section 123 (5)

<sup>20</sup> [2004] 3 S.C.R. 461, 2004 SCC 68

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<sup>21</sup> Fry v Tapson (1884) 28 ChD 268

<sup>22</sup> Rowland v Witherden (1851) 3 Mac & G 568

<sup>23</sup> As discussed in a number of the above cases, failure by directors to take professional advice where necessary will often be considered irresponsible by the courts.

instances where reliance has been placed upon such professional advice as this has in many cases been persuasive in the Courts in restriction proceedings and a deciding factor in some<sup>24</sup>.

Having said this, directors cannot afford to be complacent about their duties to a company and its shareholders, particularly in the current downturn. Moreover, in the case of non-executive directors who are not, generally speaking, involved in the day to day running of the company of which they act as non-executive director, they must take steps to ensure that they receive all relevant information and reports available (including taking professional advice where necessary) to avoid any sanctions being imposed on them arising out of their appointment. As we have seen above duties are contained in the Common Law as well as the Companies Acts, and accordingly may not always be clear which makes the director's job of ensuring compliance with their various duties more challenging, (particularly as there is no distinction between the responsibility attaching to executive and non executive directors in Irish Company Law). In this regard, it should be noted that this same level of responsibility makes the role of non-executive directors more onerous. As they would not be involved in the 'hands-on' running of the company's affairs, they would be exposed to less information and

have less access, and therefore they are subject to a potentially greater risk.

### **The Future**

There is some good news, however, in the form of the Companies Consolidation Bill, which purports for the first time in Irish Company Law to codify directors' duties and incorporate the Common Law duties of skill and care in legislation. Such approach is likely to add a welcome degree of certainty to this area and will assist directors (particularly non-executive directors) in understanding the parameters of their roles and duties.

It is emphasised that there is no room for complacency on the part of directors in the ever-evolving corporate and financial arenas. Vigilance, observance of duties and responsibilities, and the judicious use of available resources (particularly the services of lawyers, accountants, valuers etc.) are the *sine qua non* of the director's role. The courts will continue to play a central role in shaping the development of the principles in this area, and directors should be aware that whilst reliance on professional advice is clearly in their interest, prudent regard to all the circumstances surrounding the day-to-day running of their companies should be had. Directors should continue to pay attention to all aspects of their position, and recognise that the role of the company director (whether executive or non-executive), with all its concomitant duties

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<sup>24</sup> Such as World of Leather as described above

and responsibilities, is never one which can be undertaken lightly.

## The Investor Compensation Scheme

### Introduction

The current crisis in the financial markets has brought the Irish Deposit Protection Scheme, as administered by the Financial Regulator, into the media spotlight. This, however, is only one of the two main compensation schemes that provide compensation to individuals when regulated firms go out of business. The other compensation scheme, the Investor Compensation Scheme (the “Scheme”), provides compensation for clients of failed investment firms. The Scheme’s workings are worthy of analysis.

### Background to the Scheme

Prior to the introduction of the Investor Compensation Directive (Directive 97/9/EC) (the “ICD”) in March, 1997, the implementation of investor compensation schemes in EU Member States was, to a large extent, left to the discretion of the national governments, the upshot being that varying levels of unprotected exposure to investment losses existed for investors across the EU.

The ICD sought to enhance investor protection by providing for a harmonised minimum level of investor protection

across the EU. The ICD was transposed into Irish law on 1 August, 1998, by the enactment of the Investor Compensation Act 1998 (the “ICA”), the principal feature of which is the provision for the incorporation of the Investor Compensation Company Limited (the “ICCL”).

The ICCL is now the specialist, independent body which is charged by the ICA with establishing and maintaining funds out of which compensation payments can be made to ‘eligible clients’ (as the term is defined in the ICA) of certain categories of failed investment firms.

### Operation of the Scheme

Authorised investment firms (see below) are required to contribute to the Scheme by making annual contribution payments to the funds maintained by the ICCL. There are currently, in fact, two funds – Fund A and Fund B – each designated to meet claims from investors of different categories of authorised investment firm. The question of which fund a firm contributes to depends on the nature or category of the authorised investment firm. The amount required to be contributed by each authorised investment firm depends on criteria such as the number of “eligible clients” (as defined in the ICA) that are managed by the firm or the amount of the firm’s total income from investment and insurance business in the previous financial year.

The Financial Regulator (“FR”) is appointed as the supervisory authority for the purpose of the ICA and is vested with a significant amount of control over the operation of the ICCL itself and over the compensation funds established by it. For example, FR prior approval must be obtained in respect of the establishment by the ICCL of any new compensation funds (section 19(2), ICA) and in respect of the borrowing or raising of money by the ICCL (section 13(1), ICA). The ICA also vests in the FR the power to impose severe penalties on investment firms who do not comply with their obligations under the ICA.

#### **Who must contribute to the Scheme?**

Section 21(2) of the ICA provides that “authorised investment firms” must make contributions to the investor compensation funds. The term “authorised investment firms” is defined in the ICA. The ICCL categories authorised investment firms as follows:

- ▣ investment firms and insurance intermediaries regulated by the FR;
- ▣ stockbrokers regulated by the FR;
- ▣ insurance brokers, agents and tied agents of insurance companies;
- ▣ banks and building societies that carry out investment services and are licensed by the FR;

- ▣ accountants certified by their professional bodies to conduct investment business; and
- ▣ credit unions that provide investment and/or insurance services.

#### **The ICCL’s Review of Funding**

There have been three separate cases to date (two in 1999 and one in 2001) involving failed investment firms which have given rise to claims (almost 3,000 in all) for compensation being made to the ICCL. This has impacted upon the level of funds held by the Scheme.

The ICCL, whose board including a number of industry representatives, including a representative from the Professional Insurance Brokers Association Limited and The Irish Banking Federation, reviews the structure of and the rates of contribution to the Scheme every three years. The results of the most recent review, carried out in 2006, were published in June 2007. See the ICCL document “Arrangements for the Funding of the Investor Compensation Scheme Operated by ICCL – June 2007”. This latest review reports that the ICCL believes that the best way of building up the levels of funds is through the authorised investment firms’ continuing their annual contributions payments. The review notes that the ICCL is in ongoing discussions with the Financial Regulator to develop a coordinated billing and

collections system for the ICCL contribution.

In order to ensure that authorised investment firms make their required payments to the Scheme, the ICA provides for a variety of sanctions against those who default in their contribution obligations.

### **Enforcement of Obligations to Contribute to the Scheme**

The ICA seeks to create a two-tier system in which the ICCL and the FR interact with each other to encourage and enforce compliance with investment firm contribution obligations.

In the event that an investment firm does not make the required contribution payment within 35 days of payment falling due, the ICCL will issue 2 reminder notices to the investment firm. The reminder notices will highlight to the investment firm that an interest penalty of 1.25 per cent. per month (or part of a month) applies in respect of late payment. Any sums due to the ICCL are recoverable in court as a simple contract debt (section 21(5), ICA).

If payment is not made within 10 days of the ICCL's second reminder notice, the ICCL will report the investment firm's non-compliance to the FR, which in turn is vested with powers to enforce compliance and sanction non-compliance. Section 27(3), ICA provides that the FR may direct

the authorised investment firm and its directors and managers to among other things (i) comply with the investment firm's obligations under the ICA and/or (ii) suspend the carrying on of the business of an authorised investment firm or to suspend entering into certain transactions (including the acquisition or disposal of assets) for a period not exceeding twelve months. Any FR direction given under section 27, ICA, can be appealed by the investment firm.

Failure to comply with any direction of the FR given in accordance with section 27, ICA may result in further penalties. Section 28, ICA provides the FR with a discretionary power to revoke the authorisation of investment firms under the relevant authorisation legislation. In the case of the non-compliance of credit institutions, this power is not discretionary and the FR must amend the authorisation of the credit institution so that it may no longer provide investment business services. In the case of the non-compliance of an investment firm that is an insurance intermediary or an investment business firm (as so defined in the Investment Intermediaries Act, 1995), the FR must inform the product producers who have appointed the insurance intermediary/investment business firm of the non-compliance, in which case the product producers must cancel the written appointments of the insurance intermediary/investment business firm.

The severity of the sanctions provided for in section 28 is somewhat mitigated by section 28(10) where in the case of certain categories of investment firms the Financial Regulator is required to give not less than twelve months' notice to the investment firm of its intention to revoke the investment firm's authorisation.

### **Enforcement in Practice**

To date, the FR has not found it necessary to exercise its powers of sanction under the ICA against non-compliant investment firms. In practice, it is the ICCL which is most active in enforcing compliance with contribution obligations.

As mentioned, sums due to the ICCL are recoverable in court as a simple contract debt. Since its incorporation, the ICCL has threatened to take legal action against a number of investment firms for failure to make the required contribution to the Scheme. Often, the threat of legal action has been sufficient to elicit payment from defaulting firms. However, certain cases have necessitated the issuing of debt recovery proceedings in the District Court by the ICCL.

### **Conclusion**

Considering the current crisis in the financial markets, coupled with the desire of the ICCL to build-up the level of funds in the Scheme over the coming years, it is expected that the ICCL is likely to adopt

an increasingly strict approach with regard to payment of investment firm contributions to the Scheme. Accordingly, increased legal action by the ICCL against defaulting investment firms in the coming months would not be surprising.

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## EU AND REGULATORY AFFAIRS

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### The Payment Services Directive 2007/64/EC


The payment services directive 2007/64/EC (“PSD”) was formally adopted and published in the Official Journal of the European Union and requires to be transposed into the national law before 1 November 2009.

The PSD establishes a harmonised legal framework for payments services in the EU/EEA.

The PSD essentially deals with three issues:

-  it establishes who may provide payments services;
-  it establishes transparency requirements to ensure that payment

service providers give requisite information to their customers as related to payments; and

-  it sets out the relative rights and obligations of payment service providers and payment service users.

More detailed guidance will be issued as we move towards the transposition date.

### Retention of Data Directive 2006/24/EC

Directive 2006/24/EC on the “retention of data generated or processed in connection with the provision of publicly available electronic communications services or of public communications networks and amending Directive 2002/58/EC” (the “Directive”) must be implemented in Ireland no later than 15 March, 2009.

In summary Internet Service Providers (“ISPs”) would have to keep records on personal data traffic for at least 6 months no more than 2 years. This does not refer to the content of communications, but to who people are contacting, when and where they are communicating and what type of communication it is.

This data would be made available to the Gardai and other public authorities for crime or public order investigations.

Ireland has challenged the legal validity of the Directive before the European Court of Justice and proceedings are ongoing.

Further guidance will be issued as we move towards the transposition date.

## Financial Regulator Warning on Advertisements for Financial Products & Services

### Introduction

The Financial Regulator issued a statement in July aimed at reminding regulated entities of their obligations when advertising financial products and services to ensure that all advertising seeks to inform consumers and is not misleading. Deficiencies in certain regulated entities' advertising processes and procedures came to the Financial Regulator's attention through the ongoing monitoring of advertisements and include:

### Inclusion of Key Information in Small Print

Key information or qualifications in respect of a product or service should not be included in the small print of an advertisement. Any restrictions or limitations on the availability of a product or service must be highlighted in the body of the advertisement and in a font size that is equivalent to the predominant font size that is used in the advertisement.

### Font Size

The size of the font in any advertisement should be appropriate to the channel used. For example, it is not always possible for a consumer to read the small print on bus or billboard advertisements, whereas consumers usually have more time to read and absorb the content of advertisements in magazines and newspapers etc.

### Introductory/Promotional Rates

A regulated entity advertising promotional or introductory rates is required to state the expiry date of that rate and provide an indication of the rate that will apply thereafter. The Financial Regulator stated that it had noticed that some regulated entities omit this information, particularly in relation to the current promotion of fixed-term and instant access deposit accounts.

### Definition of an Advertisement/Websites

The definition of an advertisement in the Consumer Protection Code includes the homepage of any website or the homepage of an individual product that is promoted on any website. It is therefore important to ensure that any pages of a website that would fall within the definition of an advertisement are also compliant with the advertising provisions.

## **Controls & Checks for Monitoring Advertising Requirements**

Regulated entities were also reminded of the need to ensure that they have adequate systems and controls in place to ensure compliance with the Code. These provisions apply equally to the advertising provisions. It is therefore important that controls and checks are put in place before any advertisement is published to ensure that it is compliant with relevant advertising requirements and that proposed advertisements are reviewed in this context. This review should also take into account the intended channel for the advertisement and seek to ensure that the advertisement is appropriate for the channel selected.

Regulated entities were requested to ensure that these issues are brought to the attention of all staff whose duties include preparing and signing-off advertisements for financial products and services. Commenting on this issue Consumer Director Mary O’Dea said, ‘We require advertisements to be fair and not misleading. We actively monitor advertisements and where issues arise we address these directly with the regulated entity.’ The Financial Regulator’s Annual Report states that 133 advertising issues were investigated in 2007 (up from 84 in 2006). 93 of these advertisements were amended and 10 were withdrawn.

In addition, the Financial Regulator has urged regulated entities to review the content of a letter that had been issued on 12 June 2007, which highlighted key advertising concerns in advance of the Consumer Protection Code coming into full effect (a copy of the 2007 letter is available to view at [www.financialregulator.ie](http://www.financialregulator.ie)).

## **Health Service Competition**

### **Introduction**

In deciding whether or not to impugn national public health bodies for abusive anti-competitive practices under Article 82 of the EC Treaty, national and supranational courts are required to balance the need for effective competition in the internal market against a requirement to respect Member State sovereignty in areas falling outside the full competence of the Community. Article 14(2) of the EC Treaty commits the Community to the establishment of an internal market which “shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured” in accordance with the requirements of the treaty, including its competition provisions.

Bearing in mind the respective competences of the Member States and Community under the EC Treaty, it is necessary to revisit the EU’s case law to examine the extent to which supranational

judicial enforcement of Article 82 is constrained in those markets where public health bodies participate. To do so requires, first, to explore whether or not public health bodies enjoying dominant positions in domestic markets fall outside the scope of Article 82; and, secondly, to consider whether or not Article 152(5) of the EC Treaty entitles Member States, through their public health bodies, to engage with impunity in abusive conduct injurious to competition in violation of the requirements of Articles 10, 3(g) and the competition provisions of the EC Treaty.

#### **Article 82 and Public Health Bodies**

Community case law indicates that Article 82 is an instrument of *ex post* competition management which is designed to control abusive exploitation by one or more undertakings of a position considered dominant in a relevant market of the European Union. Inherent in the effective application of the Community's competition rules is an appreciation that economic operators can undermine the goals of the internal market through anti-competitive behaviour as readily as state measures impugned by Articles 25, 28 or 49 of the EC Treaty.

Articles 81 and 82, as a general statement, complement the free movement of the EC Treaty, insofar as their proper enforcement against private and public entities ensures the viability of an internal market characterised by the abolition, as between the twenty seven

Member States, of all obstacles to intra-Community trade.

The requirements of Article 82 are clear, precise and unconditional. They are capable of engendering in private individuals legal rights upon which they may rely before the national courts. Reliance upon Article 82 by private citizens and competition enforcement agencies against dominant undertakings enables the punishment before the courts of anti-competitive behaviour by private or public bodies. Prima facie, any undertaking that enjoys a position of dominance in a relevant market and through its conduct towards competitors, customers or consumers abuses that position, behaves in violation of the requirements of Article 82.

The precise application of the Community's competition rules to dominant public health bodies is determined by a constantly evolving teleological judicial interpretation of Article 82 which has regard to all provisions of the EC Treaty. Among these provisions is Article 152(5) which provides that Community action in the field of public health must fully respect the responsibilities of the Member States for the organisation and delivery of health services and medical care. It is undisputed that public health bodies hold a position of special responsibility in national health markets. In many cases, they enjoy a position of dominance in domestic health markets through the

intervention of state legislators and governments. All dominant undertakings are subject to special responsibilities. Indeed, the Court of Justice has held in *Nederlandsche Banden-Industrie Michelin v Commission* [Case 322/81] that “a finding that an undertaking has a dominant position is not in itself a recrimination but simply means that, irrespective of the reasons for which it has such a dominant position, the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition on the common market”.

Central to the potential application of Article 82 to the market conduct of public health bodies is the judicial interpretation of the term “undertaking”. The EC Treaty, while making reference to the term in several places, does not define the concept. Historically, the supranational courts have sought to impose a broad definition of the notion of undertaking, thereby enabling the Community to maximize its competence over all markets falling within the parameters of the EC Treaty. Advocate General Roemer proffered a useful early definition of the term in *Italy v Council* [Case 32/65] stating that “apart from legal form or the purpose of gain, undertakings are natural or legal persons which take part actively and independently in business and are not, therefore, engaged in a purely private activity”. In cases involving private economic operators, the Court of Justice has not been reluctant to interpret the

term expansively, embracing within its ambit any collection of resources established to carry out economic activities, including companies, partnerships, sole traders or associations. In *Van Landewyck (Heintz) Sarl v Commission* [Case 209-215/78], the Court of Justice held that any entity engaged in commercial activity is capable of fulfilling the definition of an undertaking even in the absence of the pursuit of profit.

Judicial identification of those public bodies which are “undertakings” subject to the competition rules is more challenging. In *Hofner and Elser v Macrotron GmbH* [Case C-41/90], the Court of Justice considered any entity engaged in an economic activity to be an undertaking for the purposes of the competition rules irrespective of its legal status and the way in which it is financed. This definition is helpful. It is necessary, however, to look more closely at the judicial criteria used to identify which public bodies are within or outside the ambit of Article 82. In earlier times, the Court’s approach focused on the market activities of state bodies *qua* regulators and *qua* economic operators. The judgment in *Commission v Italy* [Case 118/85] recognises that “the State may act either by exercising public powers or by carrying on economic activities of an industrial or commercial nature by offering goods and services on the market”. To enable the enforcement of Article 82 against any public body, a finding that the body had engaged in activities of a commercial or economic character is

pivotal. In consequence, where public bodies exercise state authority for the purpose of market regulation, the case law reflects that those bodies will fall outside the scope of Article 82 so long as they do not participate or compete in the market. Thus, in *Diego Cali and Figli Srl v Servizi Ecologici Porto di Genova SpA* [Case 343/95], activities which form part of the essential functions of a Member State will never constitute economic activities within the meaning of Community competition law.

It follows that the classification under Article 82 of any public entity as an undertaking depends entirely on the economic nature of the activity performed by it. Community jurisprudence reveals that the courts will treat the activities of a public body which are economic in nature as falling under Article 82 while, concurrently, treating conduct by the same body which is non-economic/regulatory in nature as outside the remit of the competition provisions. Lawyers acting for or against public bodies where Article 82 is pleaded should ensure appropriate reliance on expert legal and economic evidence to establish to the satisfaction of the courts the precise extent of the economic/non economic activities carried on by those public bodies.

Advocate General Maduro in *FENIN v Commission* [Case C-205/03 P] opines that the Community courts' traditional approach for establishing whether or not

a public body is an undertaking within the scope of Article 82 turns on the concurrent application of two tests, respectively the comparative criterion and market participation tests.

The comparative criterion test focuses on whether or not the activity of a public body is capable of being performed by private operators, for the purposes of determining if that activity is economic in nature or not. Where an activity can only be carried out by a public body and that activity can not be performed by a private entity, that body can not be considered to be an undertaking within the meaning of Article 82. In *Hofner and Elser*, an activity was held to be an economic activity since "employment procurement has not always been, and is not necessarily, carried out by public entities" while in *Firma Ambulanz Glockner v Landkreis Sudwestpfalz* [Case C-475/99] public health organisations providing services in the market for emergency and ambulance services were held to be undertakings subject to the competition rules on the basis that "such activities have not always been, and are not necessarily, carried out by such organisations or by public authorities".

Sole reliance, however, on the comparative criterion test is problematic. Advocate General Maduro states that the "comparative criterion would, literally applied, enable any activity to be included within the scope of competition law. Almost all activities are capable of being

carried on by private operators”. As a result, it has been necessary for the courts to delimit the scope of the test by the concurrent application of the market participation test. Under the market participation test, it is not the mere fact that, in theory, private operators may carry on economic activities on a given market which is decisive. Rather, it is the fact that those activities are actually carried on in a Member State under market conditions that determines the application of Article 82. Such market conditions are distinguished by conduct which is undertaken with the objective of capitalisation as opposed to activities pursued solely pursuant to the principle of solidarity.

In *Commission v Italy* [Case C- 35/96], it was not contested that the public body participated in the market inasmuch as it actually “offered goods and services on the relevant market”. The Court of Justice held that public bodies are undertakings for the purposes of the competition rules where they “offer for payment, services ..(..).. relating in particular to the importation, exportation and transit of goods, as well as other complementary services such as services in monetary, commercial and fiscal areas”. In certain cases, a clear link between participation in the market and the carrying on of the economic activity is required. In *Hofner and Elser*, however, the Court has shown itself willing to imply the economic nature of the activity engaged in by the public body where the Member State allows

private undertakings to participate in the same relevant market.

It is fair to say that the comparative and market participation tests in a number of more recent cases have been honed. In *Ambulanz Glockner*, it was held that “any activity consisting in offering goods and services on a given market is an economic activity” for the purposes of Community competition law. In *FFSA and Others v Commission* [Case T-106/96], the mere fact that an entity “is a non-profit making body does not deprive the activity which it carries on of its economic nature since ..(..).. that activity may give rise to conduct which the competition rules are intended to penalise”. These latter judgments are in line with the Court’s approach in *Van Landewyck*. Even where no profit making activity is carried on by a public entity, there may be market participation capable of undermining the objectives of competition law.

The EC Treaty itself provides limited guidance to those activities which may be considered economic or non economic for the purposes of Article 82. Articles 30, 45 and 46 of the EC Treaty set out the list of non economic grounds upon which Member States may rely to justify state obstacles to intra-Community trade in goods and services. Among the grounds identified is the protection of public health. The exercise by Member States of the right under Articles 30 or 46 to fetter interstate trade in goods and services on this ground, however, is subject to the

superior requirements of Community law. The right is subject to the Community's doctrine of proportionality and can never operate as a justification for arbitrary discrimination or the imposition of disguised restrictions on trade in breach of the superior requirements of Articles 28, 29 or 49. Similarly, while Article 152(5) requires the Community in the field of public health provision to respect the responsibility of Member States for the organisation and delivery of health services and medical care, it does not follow that public health bodies may engage with impunity in abusive behaviour which distorts competition in upstream and downstream markets in clear violation of the spirit and superior requirements of Article 82.

Advocate General Maduro in *FENIN* appears to recognise that entire segments of national health markets fall outside the scope of the Community's competition rules. Implicit in his reasoning is an understanding that those segments remain within the exclusive competence of the Member States governments where solidarity predominates in those markets. The Grand Chamber of the Court of Justice in *FENIN* confirms that the definition of undertaking in Article 82 covers any public entity engaged in an economic activity, regardless of its status and method of financing, underlining that it is the activity of offering goods or services on the market that is the characteristic feature of an economic activity. The court went on to hold,

however, that in considering the application of Article 82 to Spanish public health bodies, the purchasing activities of those bodies should not be divorced from the subsequent use to which the goods or services were put by the Member State. It found that the nature of the purchasing activity must be determined according to whether or not the subsequent use of the purchased goods/services amounts to an economic activity. Where goods or services are purchased by a public body and those goods or services are subsequently put to a solely non-economic public health use, Article 82 can not be applied to that body.

Given the procedural exclusion of key arguments raised by the appellant, the decision in *FENIN* must be regarded in the national courts of the Member States as having restricted application. It is emphasised that the Court of Justice limited its decision to situations where public health bodies purchase goods from suppliers and subsequently use those goods solely for a non economic purpose in accordance with the principle of solidarity. The Court of Justice did not consider what its finding might have been, if the subsequent use to which the goods were put was in whole or in part an economic use.

Most Member State health markets comprise both public and private medical treatment. Where public health bodies purchase goods/services from suppliers and subsequently uses, those purchases

in whole or in part for an economic purpose, the ruling in *FENIN* should not apply. Put otherwise, where public health bodies purchase goods/services on the market and permit those goods subsequently to be used for and economic/part economic purpose, Article 82 should apply if those public bodies engage in abusive conduct.

### **Articles 10, 3(g) and 82 and National Health Markets**

In Community law, public health bodies may be considered to be emanations of state by reference to the degree of control exercised over them by domestic governments or parliaments. In situations where a dominant public health body is considered not to fall within the direct scope of Article 82 by reference to the decision of the Court of Justice in *FENIN*, Article 10 of the EC Treaty requires Member States to abstain from any measure which could jeopardise the attainment of the objectives of the Community's competition rules.

Article 10 obliges Member States, including their emanations of state, to take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of the EC Treaty. Member States are required to give full effect to the obligations, duties and Community tasks provided for under the EC Treaty including those flowing from Articles 3(g) and the competition provisions. Article 10, when read in

conjunction with Article 3(g), specifically commits all Member States and their public health bodies to "a system ensuring that competition in the internal market is not distorted".

In Community law, pharmaceutical goods, medical equipment and the services of doctors and pharmacists have long been held to benefit from the free movement provisions of the internal market. In line with the judgments of the Court of Justice in *Wolf W. Meng* [Case C-2/91], *Leclerc* [Case 229/83] and *Ohra* [Case C-245/91], Member States are not entitled as a matter of Community law to engage in any activity (regulatory or economic) which would facilitate or reinforce the distortion of competition in the internal market for these goods or services.

### **Conclusions**

First, where a public health body purchases goods or services and the ultimate use to which that public body puts those goods or services is an entirely non economic use, the conduct of that public body will not fall to be assessed under Article 82.

Secondly, where the ultimate use to which goods or services purchased by a public health body are put is wholly or partially economic in nature, abusive conduct by that undertaking may be assessed by reference to the requirements of Article 82.

Finally, regardless of whether or not the conduct of public health bodies is directly subject to the requirements of Article 82, Member States must at all times dutifully ensure that competition in upstream or downstream markets is not distorted by their emanations of state in contravention of the requirements of Articles 3(g), 10 and the competition provisions of the EC Treaty.

## Registration of Pension Administrators and Trustee Training

Under Section 27 of the Social Welfare and Pensions Act, 2008 ("2008 Act"), which amends the Pensions Act, 1990, pension scheme administrators, with effect from 1 November 2008, will now be required to register with the Pensions Board before they carry out their functions and the Pensions Board will have responsibility to audit administration service standards and to withdraw registration or apply sanctions if required standards are not met.

All administrators currently providing core administration functions to schemes and trust Retirement Annuity Contracts ("RACs") and who wish to continue supplying those services will be required to register with the Pensions Board prior to the registered administrator provisions of the 2008 Act.

Under Section 28 of the 2008 Act, employers will be required to arrange trustee training for each trustee within six months of their appointment and at least every two years thereafter. Where a person is a trustee at the time the legislation commences there is no requirement on the trustee to undertake training within 6 months, however the ongoing two year training requirement will apply.



Where an employer breaches the obligation to provide regular training it may be prosecuted.

An employer will not be under an obligation to provide training to professional trustees and pensioner trustees, as it is expected that such trustees will undertake regular training to keep their skills current.

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## INSURANCE LAW







### In this issue:-

-  **Data Protection Code of Practice for the Insurance Sector**
-  **Publication of Solvency II Framework Directive**
-  **Consultation Paper – Life Assurance Information Regulation**
-  **Insurance Statistical Review for 2007 Published**

### Data Protection Code of Practice for the Insurance Sector

Following extensive discussion with the Irish Insurance Federation and individual insurance companies, the Office of the Data Protection Commissioner published, on the 20 August 2008, a data protection Code of Practice for the Insurance Sector in Ireland to provide a clear framework for insurance companies to process their customer data in accordance with the Data Protection Acts 1988 and 2003 and to alleviate public concern arising from media reports last year that personal information held by the Gardaí and by the Department of Social & Family Affairs was being routinely accessed by private investigators acting on behalf of insurance companies.

This Code provides for:

-  improvements in information and options available to customers on the use of their personal data;
-  the use by insurers of only licensed private investigators and that they contractually engage the private investigator on the basis that the private investigator will comply with applicable Data Protection legislation;
-  specific periods for which customer data may be held and used;
-  the circumstances in which personal data may be shared with other bodies;
-  procedures for keeping data secure; and
-  ensuring that only necessary information is sought by insurance companies.

For further information in relation to any of the above matters, please contact any member of our Financial Services Department who will be happy to assist with any queries.

### Publication of Solvency II Framework Directive

In July 2007 the European Commission published one of the most important documents for insurance regulation in decades with the publication of the long awaited Solvency II Framework Directive.

It is expected to be adopted by the European Parliament in 2009/2010 with an implementation deadline of no later than 31 October 2012. This Directive has created a huge amount of controversy amongst Member States. The proposal that caused most controversy was the proposal for group supervision. The Directive introduces an entirely new EU wide harmonized insurance regime. It updates and recasts some 13 insurance Directives and sets out the regulation of life insurance, non-life insurance, reinsurance, insurance groups and the winding up of insurance entities.

At the heart of Solvency II is a risk based solvency capital requirement. It aims to use the unique risk profile of each insurance company as a basis for its regulatory capital. All current and future risks in all areas of the insurer's business will need to be measured, monitored and managed effectively in an integrated corporate-wide risk management function.

Solvency II will apply to all insurers and reinsurers underwriting or in run off. The smallest (re)insurers (premium income less than €5 million annually) are exempt with an opt in clause. Branches and subsidiaries of non EU groups are included as are all legal forms of a (re)insurer, meaning that Lloyd's syndicates, mutuals, co-operatives and proprietary insurers are all affected in the same way.

## Consultation Paper – Life Assurance Information Regulations

In September 2008, the Financial Regulator published a consultation paper ("CP34") on the Life Assurance Provision of Information Regulations, 2001 (the "2001 Regulations"). CP34 is looking for industry's views on a proposed simplified disclosure regime for life assurance products, based on the 2001 Regulations.

The 2001 Regulations set out the information which must be provided to policyholders including details such as the projected benefits, charges and commissions, and other general product information.

The closing date for submissions is 10 October, 2008.

CP34 can be found on the Financial Regulator's website at [www.financialregulator.ie](http://www.financialregulator.ie)

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## TAX

### **In this issue:-**

#### **Taxation Update**

### Taxation Update

Following on from the changes highlighted in Budget 2009, Finance (No.2) Bill 2008 (as initiated) ("Finance Bill") was released on 20<sup>th</sup> November 2008 and sets out the Government's proposed legislative changes to the taxation regime in Ireland for 2009. The provisions of the Bill are subject to amendment and will not attain the force of law until the Bill is passed as an Act. The salient provisions of the Finance Bill are as follows;

#### **Personal Taxes**

##### **Income Tax on Irish Source Income**

There is a technical change to Irish income tax in respect of non-Irish residents who are in receipt of Irish source income. This change is however subject to a number of exemptions which have been extended in two respects by the Finance Bill.

Firstly, interest paid on wholesale debt instruments (this includes certain certificates of deposits and commercial paper) to non-Irish residents will not be subject to Irish income tax provided that the recipient is tax resident in an EU Member State or tax resident in a country

with which Ireland has signed a double taxation agreement.

Secondly, a non-resident will not be chargeable to Irish income tax in respect of discounts arising on securities issued by a company or investment undertaking in the ordinary course of a trade or business, provided again that the recipient is tax resident in an EU Member State or in a country with which Ireland has a double taxation agreement. This is a welcome development for Irish based entities who wish to issue bonds and other debt instruments, including securities to an international investment market.

The above amendments apply to relevant interest paid or discounts arising on or after 1 January 2009.

##### **Irish Tax Residence Rules**

The Finance Bill also contains a proposed amendment to the tax residency rules. Generally an individual is regarded as resident in Ireland for tax purposes, in any given year, if he/she is present in Ireland for 180 days or more in that year or present for 280 days or more in aggregate between that year and the immediately preceding year. Prior to the Finance Bill an individual, for the purpose of the 180 days or 280 days test, was regarded as being present in Ireland for a day if he/she was present in Ireland at midnight. The Finance Bill proposes to change this test and from 1 January 2009 an individual will

be regarded as present in Ireland for a day if the individual is present in Ireland at any time during that day. This tightening of the tax residency rules will make it easier for individuals to be categorised as Irish tax resident.

### **Deposit Interest Retention Tax**

The Deposit Interest Retention Tax (DIRT) rate has been increased to 23%.

### **New Income Tax Levies**

While income tax rates have remained unchanged (at 20% and 41% respectively), provision has been made for the introduction of income tax levies, as follows:

- ▣ Income up to €100,100 p.a. will be subject to a levy of 1%
- ▣ Income between €100,101 and €250,120 p.a. will be subject to a levy of 2%
- ▣ Income in excess of €250,120 p.a. will be subject to a levy of 3%

These levies will apply from 1 January 2009 and will be payable on gross income before any relief for any capital allowances, losses or pension contributions. In addition, it should be noted that the levy will apply to exempt income such as profits from stallion fees etc. The levy will not however apply to Irish deposit interest, credit union dividends, social welfare payments and certain other payments. Employers will

be responsible for the collection and payment of the levy in relation to payments they make to their employees and will be obliged to pay the levy to the Revenue Commissioners within 14 days of the end of each month.

### **Remittance Basis**

The Finance Bill proposes to widen the remittance basis of taxation. The aim of this proposed amendment is to increase the appeal of Ireland as a jurisdiction for foreign direct investment and is therefore targeted at attracting highly skilled and highly paid individuals to Ireland.

This relief will apply to individuals who:

- ▣ are not domiciled in Ireland;
- ▣ are resident in Ireland;
- ▣ were resident in a jurisdiction with which Ireland has a double tax treaty, but not within the European Economic Area ("EEA"), prior to becoming resident in Ireland;
- ▣ work in Ireland for at least a three year period; and
- ▣ are paid from abroad.

Prior to becoming Irish resident the individual must have been employed by a foreign incorporated company which is resident in a jurisdiction with which Ireland has a double tax treaty, but not within the EEA. There is no minimum time frame as to how long the individual must have been so employed.

Individual to whom the relief applies will account for tax under the PAYE system however under the provisions of this relief individuals who satisfy the above conditions will be entitled to recalculate their tax liability based on the greater of:

- ▣ the sum of any employment income earned, received or remitted in that tax year; or
- ▣ an amount equal to €100,000 plus 50% of any employment income in excess of €100,000.

The difference between the tax paid and the tax liability computed will be refunded to the individual taxpayer.

This section will take effect from 1 January 2009.

## **Corporation Tax**

### **Relief and Double Taxation Agreements**

Irish domestic tax law provides for preferential treatment in relation to certain payments to and from countries with which Ireland has a double taxation agreement in place. Domestic tax law also provides for an exemption, in certain circumstances, from capital gains tax for gains arising on the disposal of shares in a subsidiary company, where the subsidiary company is tax resident in an EU Member State (including Ireland) or a country with which Ireland has a double

taxation agreement (generally referred to as the Participation Exemption). Prior to the Finance Bill, the ability to avail of this preferential treatment was dependent upon there being a double taxation agreement in force between Ireland and the relevant country. The Finance Bill proposes that the benefits available under Irish domestic tax law will be available in certain cases where the double tax agreement is signed between Ireland and the relevant country (as opposed to being signed and having force of law). This is a welcome development given that there can be a delay between the actual signing of a tax treaty and completion of the legislative formalities to give effect to it. In this regard during 2008 Ireland signed double taxation agreements with Georgia, Malta, Macedonia, Turkey and Vietnam. This amendment is due to take effect when the Finance Bill is passed.

### **Funds**

The rate of tax applying to any income and gains on investment funds and life assurance policies will increase by 3% from 1 January 2009. For most gains the rate will increase from 23% to 26%, however for certain regular income distributions, the rate will increase from 20% to 23%. The new income tax levies as introduced by the Finance Bill will not apply to payments in respect of investment undertakings, payments in respect of offshore funds or payments in respect of Irish and foreign life policies. The Finance Bill also proposes increasing

the rate of tax on any gain arising to an individual on a chargeable event in relation to an investment undertaking which is a personal portfolio investment undertaking by 3% to 46%. Similarly this change is to take effect from 1 January 2009.

In addition the Finance Bill introduces a technical amendment to ensure that an investor who accounts directly to the Revenue Commissioners on a self assessment basis for exit tax on a deemed disposal of units in an investment undertaking can offset the tax accounted for against any exit tax arising on a subsequent actual disposal of units. This technical amendment was required as a follow up to the amendments introduced by Finance Act 2008 which provided that in certain circumstances the investor (as opposed to the fund or its service provider) would be required to self assess for exit tax arising on a deemed disposal, however no provision was included at the time for a credit to be made available to the investor, where a subsequent actual disposal was made.

### **Corporation Tax Relief for Certain Start Up Companies**

As outlined in the budget the Finance Bill contains a new relief from corporation tax in respect of certain companies which commence to trade in 2009. The relief however will not apply to *excepted trades* (dealing in or developing land, petroleum and minerals) or companies whose trade

consists of the provision of certain professional services. Anti-avoidance provisions have been introduced to exclude new companies which take over existing trades from this relief.

Under the relief where the corporation tax payable by a company does not exceed €40,000, the corporation tax payable by the company for the accounting period will be reduced to "nil" in so far as it relates to a new trade. The relief will apply for a period of 3 years from the date of the commencement of the new trade. The relief will also apply to corporation tax payable on chargeable gains arising on the disposal of qualifying assets (essentially assets used for the purpose of the new trade) during the 3 year period.

An element of marginal relief is available where the corporation tax liability exceeds €40,000 but does not exceed €60,000. There is no relief where the €60,000 limit is exceeded. As currently drafted the relief will only apply where a trade is commenced in 2009 and it remains to be seen whether a similar type relief will be available for trades commenced in 2010 and further years. It is also important to note that limitations have been placed on the relief in relation to companies engaged in road transport in order to comply with EU State Aid rules.

The commencement of the above is subject to a commencement order from the Minister for Finance, which is due to

be made after consultation with the European Commission.

### **Preliminary Corporation Tax**

The Finance Bill provides for changes in relation to the payment of preliminary corporation tax by “large companies” (i.e. companies whose corporation tax liability for the preceding accounting period exceeded €200,000). Large companies will now be required to make two preliminary corporation tax payments as opposed to one. In respect of companies with a 31 December year end, the first instalment of preliminary corporation tax will be due on or before 21 June. This first instalment must be equal to either 50% of the corporation tax liability for the preceding accounting period or 45% of the final corporation tax liability for the accounting period in question. The second instalment of preliminary tax will be due on or before 21 November and this payment must bring the total preliminary corporation tax paid to 90% of the final corporation tax liability for the accounting period in question. The balance of the tax remains due when filing the return (e.g. 21 September of the following year for a company with a 31 December year end).

The Finance Bill also proposes bringing the payment date for income tax by tax resident companies in line with the payment dates for corporation tax. In addition, where accounting periods are shorter than 7 months, 90% of preliminary

corporation tax will be payable in one instalment as before.

The revised rules for payment of preliminary corporation tax are due to take effect for accounting periods commencing on or after 14 October 2008.

### **Extension to Pay And File Dates**

Where a company files a return and pays the related tax on line via the Revenue Online Services (ROS) the due dates for same are extended to the 23 of the month. This applies to returns and payments of RCT, VAT, PAYE and corporation tax. These extended deadlines are to take effect from 1 January 2009. The extended deadline will not apply to tax returns which are filed late.

### **Research and Development**

The Finance Bill has introduced a number of favourable amendments in relation to research and development (“R&D”) tax credit legislation which are designed to encourage companies to carry on R&D activities in Ireland. The current regime provides for a 20% tax credit in respect of incremental expenditure on qualifying R&D. A company may claim this credit against its corporation tax liability. The Finance Bill proposes to increase the available credit to 25%. A company’s R&D tax credit is calculated based on its incremental R&D spend over and above its qualifying R&D spend in its base year.

The Finance Bill proposes to set 2003 as the base year for all future accounting periods. It should be noted that the Finance Bill also proposes to reduce the time limits in which R&D credit claims must be made to 12 months from the end of the accounting period in which the qualifying expenditure was incurred. This amendment will apply to claims made on or after 1 January 2009.

The Finance Bill further provides that where a company has a corporation tax liability in the accounting period preceding the accounting period in which the qualifying R&D expenditure is incurred, any excess can be used to reduce the corporation tax of that period. Any remaining excess can be carried forward indefinitely against future corporation tax liabilities. Alternatively the Finance Bill provides that any excess credit arising at this point may be paid to the company by the Revenue Commissioners on an appropriate claim in this regard being made. The amount payable by the Revenue Commissioners to the company in respect of the excess tax credit shall not exceed the greater of:

- ▣ the corporation tax paid by the company for the preceding 10 accounting periods,

or

- ▣ the payroll liabilities (i.e. PAYE, PRSI and levies) for the period in which the expenditure giving rise to the excess credit was incurred.

The Finance Bill has relaxed the requirements in relation to claiming tax credits for expenditure on buildings or structures used for R&D. The requirement that the expenditure must be incurred on a building or structure used “*wholly and exclusively*” for the purpose of R&D activities has been removed and effectively replaced with a requirement that the building or structure has a minimum of 35% use which is attributable to the R&D activities carried on by the company for a defined 4 year period. The full tax credit will be available for offset against the corporation tax liability of the company for the accounting period in which the relevant expenditure is incurred (as opposed to being spread over 4 years as is currently the case).

#### **Tax Treatment & Certain Venture Fund Managers**

The Finance Bill also contains a provision which relates to the taxation of venture fund managers involved in investing in companies carrying out R&D. The driver for this change would appear to be a desire on the part of the Irish Government to encourage venture capital managers which invest in R&D companies and therefore help drive innovation to establish in Ireland. The relief provides that where a company or partnership makes an investment which remains in place for at least 6 years in the shares of a private company which is set up after 1 January 2009 and carries on a business of research, development or innovation

the relevant share of any profits from that investment will be subject to capital gains tax at the rate of 12.5% for companies and 15% for partnerships.

### **Capital Taxes**

#### **Capital Gains Tax and Capital Acquisitions Tax**

The rate of capital gains tax has been increased from 20% to 22%. The increased rate will apply to disposals made on or after 15 October 2008. In addition the payment deadlines for capital gains tax have been changed. The payment date for capital gains tax arising on disposals made in the period 1 January to 30 November will now be 15 December of that year. The payment deadline for capital gains tax arising on disposals in December will be 31 January the following year. This change in payment deadlines will apply for all disposals in 2009 and subsequent years.

In line with the above, the rate of capital acquisitions tax has increased from 20% to 22% in respect of gifts and inheritances taken on or after 20 November 2008. In addition, the definition of agricultural property has been extended to include gifts or inheritances of agricultural land, pasture and woodland situated in a Member State of the EU. Previously relief was restricted to agricultural property situated in Ireland.

### **Stamp Duty**

#### **Stamp Duty**

The Finance Bill confirms the changes to the rates of stamp duty announced in the Budget in relation to commercial property. The top rate of stamp duty is to be reduced from 9% to 6% in the case of non-residential property and will apply where the consideration exceeds €80,000. The reduced rate will apply to instruments executed on or after 15 October 2008.

Provision is also made for the exemption of the sale of stocks or marketable securities from the 1% stamp duty charge where the consideration does not exceed €1,000 and the transaction does not form part of a larger transaction or a series of transactions in respect of which the consideration exceeds €1,000. An appropriate statement in relation to the above is required to be included on the instrument of transfer.

In order to encourage persons to stamp documents executed before the enactment of the Finance Bill and in order to facilitate a smooth transition to E-Stamping the Finance Bill contains a limited stamp duty amnesty in respect of penalties. Where an instrument is unstamped or insufficiently stamped, Irish stamp duty legislation provides for a fixed penalty of €25 and penalties ranging from 10% up to 30% of the unpaid stamp duty depending upon when the instrument is stamped. The Finance Bill provides

that the penalties will not apply to instruments first executed before the passing of the Finance Act 2009 in respect of which the stamp duty which has not been paid on time provided that the instrument is delivered to the Revenue Commissioners for stamping (together with the duty and interest arising thereon) within 56 days of the passing of the Finance Act 2009.

### **Value Added Tax**

#### **Value Added Tax**

There have been no significant amendments in relation to VAT, other than the increase in the standard rate of VAT from 21% to 21.5% and the introduction of a margin scheme for travel agents.

The Finance Bill does provide for some technical amendments in relation to the new VAT on property regime which has been in effect from 1 July 2008.

In addition the codifying of existing practices adopted by the Revenue Commissioners in relation to the imposition of penalties and appropriate mitigation (where applicable) will also apply in relation to VAT.

### **Revenue Matters**

#### **Revenue Penalties**

The Finance Bill contains a wide range of measures in relation to the imposition of civil penalties in the context of audits by the Revenue Commissioners and has incorporated certain aspects of the Revenue Audit Code of Practice 2002 into legislation. The main changes are as follows;

- A Revenue Officer will now be entitled to issue an opinion to a taxpayer where he feels that a penalty is due. If an agreement is not reached between the parties the Revenue Commissioners may apply to court for a determination as to whether the individual is liable to the penalty. This provision is intended to apply to existing disputed audit cases and new cases as regards tax geared and fixed penalties. This change was necessitated as a result of fears that the authority of the Revenue Commissioners to impose penalties was contrary to Article 6 of the European Convention on Human Rights 2003 (right to a fair and public hearing). Concerns were raised as the Finance Bill (as initiated) provided that if the court decided to impose the same or a different penalty amount the overall settlement would be automatically published in the list of tax defaulters. This concern has now been addressed at the Committee Stages and an amendment has

been introduced which ensures that no publication will arise where (i) the penalty does not exceed 15% (ii) the aggregate of the tax liability and the penalty do not exceed €30,000 or (iii) there has been a qualifying disclosure.

- ▣ It is proposed that a new section 1077C will be inserted into the TCA 1997 to provide that where a person is found liable by a court to pay a penalty that such penalty will be recoverable and payable in the same manner as the tax is recovered and paid.
- ▣ The penalty matrix contained in the Revenue Audit Code of Practice 2002 dealing with settlements arising out of Revenue audits and investigations has been given a statutory footing. The new provision replaces the concept of negligence with that of carelessness. This would appear to be a lower burden of proof and it is likely that this will result in an increased number of cases where penalties are enforced.
- ▣ Fixed penalties for non compliance are to be increased significantly across all tax heads.
- ▣ Under the current Audit Code of Practice the reduced mitigation in respect of the tax geared

penalties is restricted by 50% in the case of a second qualifying disclosure. No mitigation is currently provided for in the case of subsequent disclosures. The Finance Bill provides that reduced mitigation will only apply where the second disclosure is made within 5 years of the date of the first disclosure. Disclosures made after this 5 year period will qualify for full mitigation.

### Revenue Powers



The Finance Bill proposes expanding the scope of the powers of the Revenue Commissioners. The main changes are:

- ▣ The category of documents that the Revenue Commissioners can not access has been restricted to documents that are entitled to legal professional privilege, documents of a confidential medical nature or professional advice of a confidential nature given to a client. The rationale for this measure is a result of estate agents claiming privilege in relation to Irish residents owning foreign property.
- ▣ A amendment to the definition of “financial institution” has been included to expand to expand its scope to include financial institutions authorised in another EU state, operating in Ireland

under a passport regime. This may result in additional reporting for such entities.

## LISTINGS

### In this issue:-

-  **Funds Listing Update**
-  **Debt Listing Update**

## Funds Listing Update

### August 2008

In August we saw the listing of **Coronation Africa Fund** a sub fund of **Coronation Global Opportunities Fund**. The sub fund will invest primarily in equity securities of companies which are either domiciled in Africa or are established in another continent but which derive a significant proportion of their earnings from African countries.

### September 2008

Iveagh Global Strategies plc listed the Iveagh Wealth Fund which will seek to achieve capital growth through a long term strategic asset allocation framework. The Sub-Fund will hold a broad range of globally diversified investments. **Multi-Asset Platform Fund SPC** listed **Global Hedge Segregated Portfolio**. The Segregated Portfolio will invest all of its assets in the Global Hedge Segregated Portfolio, a Segregated Portfolio of the Master Fund.

Lastly in this period we saw the listing of **Baring Multi-Manager Property Companies Fund**, a fund of **Baring Multi-Manager Funds Plc**. The Fund will seek to achieve its investment objective by investing up to 100% of its assets in UCITS funds domiciled in a Member State, Guernsey Class A Schemes, Jersey Recognised Funds, Isle of Man Authorised Schemes, United Kingdom or Guernsey based investment trust companies.

### October 2008

During this period we saw the listing of a new umbrella fund. **E.I. Sturdza Funds Plc** launched **Strategic China Panda Fund** which hopes to achieve long term capital growth in the value of its assets by investing in equity securities quoted or traded on stock exchanges in Hong Kong, China, Taiwan or Singapore. The Fund may emphasise investment in companies operating in these geographical areas which are involved in international trade, property and construction activity, engineering, electronics or the service sectors. We also saw the listing of the seventh sub fund of **Coronation Global Opportunities Fund**. **Coronation Africa Frontiers Fund** which like the **Coronation Africa Fund** will invest in equity securities of companies domiciled in Africa. **Lyxor/Northwood European Fund Limited** also listed in this period and **Lyxor/Global Advisors Fund Limited** listed in November. The investment objective of each Fund is to

seek medium term capital appreciation. To achieve this objective, each Fund will aim at tracking a wide range of trading and/or investment opportunities and may take advantages of trends, price movements and price volatilities, and consequently implement investment strategies such as, but not limited to, hedge fund strategies and/or managed futures strategies

Due to current market conditions, the Listing Department in Dillon Eustace has been dealing with an increased level of queries impacting our clients' funds listed on the Irish Stock Exchange. These queries generally relate to changes in Prime Broker relationships, extended redemption periods, compulsory redemptions, consideration of amendments to investment policies and changes to existing cash arrangements.

The Irish Stock Exchange is aware of the challenges that funds may currently have operating within the requirements of the Listing Rules and is working with the Listing Sponsors to accommodate the current needs of fund promoters.

## Debt Listing Update

### August 2008

Banque AIG filed a supplement to its EMTN programme on 11/8/08 while Corsair (Jersey) No. 1 Limited listed its Series 1 €10,000,000 First-to-Default Cash Settled Credit-Linked Notes due

2014 under its multi-issuer programme on 21/8/08.

### September 2008

Barbican Investments PLC and Barbican No. 1 Limited updated their Secured Obligation Programme on 25/9/08.

### October 2008

Corsair (Jersey) No. 7 Limited listed its Series 1 €50,000,000 Floating Rate Secured Portfolio-Linked Notes due 2015 under its multi-issuer programme on 2/10/08.

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**If you have any queries or would like further information relating to the above matters, please contact us at any of our offices listed above or through your usual contact in Dillon Eustace.**

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