

Funds Quarterly Legal and Regulatory Update

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FUNDS QUARTERLY LEGAL AND REGULATORY UPDATE

Criminal Justice (Money Laundering and Terrorist Financing) Act 2010

The Third Anti-Money Laundering Directive was transposed into Irish law on 5 May 2010 by the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (the “CJA Act 2010”).

The Department of Justice and Law Reform has confirmed that the commencement date for the CJA Act 2010 will be 15 July 2010, except for Chapter 9 of Part 4 (Authorisation of Trust and Company Service Providers). This leaves a very short time frame for all designated persons to comply with the new requirements.

The CJA Act 2010 introduces the following important changes for designated persons:

- ▣ the definition of money laundering has widened to include the proceeds of any criminal conduct, however minor;
- ▣ the terminology of “Know Your Customer” has been replaced by “Customer Due Diligence” (“CDD”);
- ▣ the level of CDD required will be determined using a risk based approach. This can range from “simplified” where there is a low risk of money laundering or terrorist financing to “enhanced” where there is high risk of money laundering or terrorist financing;
- ▣ there are enhanced obligations to identify the “beneficial owner” whereby the designated person must ensure that they take reasonable measures to understand the ownership and control structure of the client;
- ▣ there is a new requirement to identify non domestic politically exposed persons (“PEPs”) i.e. those persons in a prominent public position and their families or close associates;
- ▣ those persons who meet the definition of “trust and company services provider” will need to be authorised;
- ▣ a guard at superintendant level or higher and/or a District Court judge has the power to direct a designated person not to carry out a specified service for a specific timeframe where a customer is subject to investigation;

- ▣ the number of offences that can arise under the CJA Act 2010 are significantly greater than under the old legislation;
- ▣ the Minister for Justice and Law Reform, in conjunction with the Minister for Finance, can approve the Guidance Notes to be used by designated persons. A Court can have regard to these Notes when determining if a designated person took all the appropriate measures.

Core Guidance Notes and sector specific Guidance Notes for the funds sector are currently under public consultation and are available on the Financial Regulator's website.

The closing date for comments on the draft Core Guidance Notes is the 2 July, 2010, while the closing date for comments on the sector specific Guidance Notes for the funds sector is Wednesday 14 July, 2010.

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

UCITS, Non-UCITS & Hedge Funds

(a) EC's Draft Directive on Alternative Investment Fund Managers

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

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

It is proposed that the Directive will:

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

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

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

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

MEPs of the European Parliament's ECON have voted in favour of the Parliamentary version of the EU's AIFM and European finance ministers have agreed to give the Presidency the mandate to negotiate on behalf of the Council with Parliament.

The three-way ("trilogue") discussions between representatives of the European Parliament's ECON (Economic and Monetary Affairs) Committee, the Presidency of the Council of the European Union and the European Commission have now begun.

On the negotiating table are the two differing versions of the draft Directive, approved in May by ECON and the Economic and Financial Affairs ("ECOFIN") Council, part of the Council of the European Union. The ECON team is understood to include the chairwoman of ECON, Sharon Bowles, the rapporteur, Jean-Paul Gauzès, and the six shadow rapporteurs taken from the main political blocs in the European Parliament. The Council is now represented by the Belgian government, the President of the Council of the EU, which took over the rotating presidency from the Spanish government on 1 July. The Commission officials present at the discussions are there to assist the parties agreeing on a compromise text. But they will naturally favour any wording which backs up their original version of the draft Directive, published in April, 2009.

Where there is already broad agreement between the texts, such as on registration and authorisation of EU managers, those areas will be incorporated immediately into the new compromise text, drafted by the EC. This will leave the negotiating teams free to discuss solutions to areas where there is disagreement – including the thorny issue of third countries. The other controversial areas include: valuation; depositaries; scope; leverage; remuneration; delegation; capital requirements; and short selling.

In order to reconcile the different approaches taken, the groups may agree to adopt either the ECON or Council position on a particular issue. Alternatively, they may agree to adopt a compromise position that combines elements of both texts.

The aim will be for all the issues to be resolved, and majority backing effectively secured, before the compromise text is finally voted on. A full plenary session of the Parliament was scheduled to vote on the compromise text on 5 July but this has been rescheduled to September. Once the text has been approved by Parliament, it will pass to the next meeting of ECOFIN, which would be expected to adopt it.

In the unlikely event of a simple majority of MEPs voting against the eventual text, there would follow a second reading, a process limited to three months, during which a further compromise version of the Directive would need to be drafted and agreed upon. However, all parties to the trilogues have stated a preference for a First Reading passage.

Once Parliament and Council have voted in favour of the Directive, it will pass to the next stage, which is its implementation into national law. This process is expected to last until 2012, when the Directive would come into force.

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

(b) Disclosure in Complex UCITS Funds

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

- ▣ The underlying exposure. This should give an indication of the underlying asset class or trading strategies. It should also state whether the exposure is leveraged and will result in a long/short exposure. An example would be *“the fund has a direct and/or indirect leveraged exposure to {asset class x} and/or to the following trading strategies”*.
- ▣ The expected risk-return profile (high level) which is normally expressed in terms of volatility or a volatility range.
- ▣ The investment opportunity. This will normally follow along the lines of *“the investment strategy supporting this is as follows...”*. There was some discussion as to whether and where this should be disclosed. It should be disclosed where it is not obvious to a reader what the investment rationale is. Asset managers will generally express this in terms of some sort of “alpha” and how they think they can extract it from the exposures and strategies previously disclosed above.

(c) Proposed New European System of Financial Supervision

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

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

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

The current financial crisis has highlighted weaknesses in the EU's supervisory framework, which remains fragmented along national lines despite the creation of a European single market more than a decade ago and the importance of pan-European institutions.

These legislative proposals address those weaknesses both at the macro- and micro-prudential supervision levels by creating:

- ▣ an **ESRB** will have the power to issue recommendations and warnings to Member States (including the national supervisors) and to the European Supervisory Authorities, which will have to comply or else explain why they have not done so. The heads of the ECB, national central banks, the European Supervisory Authorities, and national supervisors, will participate in the ESRB. The creation of the ESRB is in line with several initiatives at multilateral level or outside the EU, including the creation of a Financial Stability Board by the G20.

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

Regarding micro-prudential supervision, currently there are three financial services committees for micro-financial supervision (supervision of individual financial institutions) at EU level, with advisory powers only: the Committee of European Banking Supervisors ("CEBS"), Committee of European Insurance and Occupational Pensions Committee ("CEIOPS") and the Committee of European Securities Regulators ("CESR").

The new Authorities will take over all of the functions of those committees, and in addition have certain extra competences, including the following:

- ▣ developing proposals for technical standards, respecting better regulation principles;
- ▣ resolving cases of disagreement between national supervisors, where legislation requires them to co-operate or to agree;

- ▣ contributing to ensuring consistent application of technical Community rules (including through peer reviews);
- ▣ the European Securities and Markets Authority will exercise direct supervisory powers for Credit Rating Agencies; and
- ▣ a coordination role in emergency situations.

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

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

(d) UCITS – Collateral Passed to OTC Derivative Counterparties

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

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

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

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

The CESR advice also noted that:

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

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

(e) CESR's Definition of European Money Market

CESR has published its guidelines on a common definition of European money market funds. The guidelines aim to improve investor protection by setting out criteria to be applied by any fund that wishes to market itself as a money market fund. The criteria reflect the fact that investors in money market funds expect the capital value of their investment to be maintained while retaining the ability to withdraw their capital on a daily basis. A common definition will also help provide a more detailed understanding of the distinction between funds which operate in a very restricted fashion and those which follow a more 'enhanced' approach.

CESR's guidelines set out two categories of money market fund: Short-Term Money Market Funds and Money Market Funds. This approach recognises the distinction between short-term money market funds, which operate a very short weighted average maturity and weighted average life; and money market funds which operate with a longer weighted average maturity and weighted average life. For both categories of fund, CESR expects that there should be specific disclosure to explain clearly the implications of investing in the type of money market fund involved. For Money Market Funds, for example, this means taking account of the longer weighted average maturity and weighted average life of such funds. For both types of money market fund, this should reflect any investment in new asset classes, financial instruments or investment strategies with unusual risk and reward profiles.

The guidelines will enter into force in line with the transposition deadline for the revised UCITS Directive (1 July, 2011). However, money market funds that existed before that date will be granted an additional six months to comply with the guidelines as a whole.

(f) CESR Guidelines for UCITS

CESR has published proposed guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS. These guidelines will accompany the level 2 implementing measures for the revised UCITS Directive 2009/65/EC that is expected to be adopted by the European Commission this summer.

The key purpose of these guidelines is to provide stakeholders with detailed methodologies in order to foster a level playing field among Member States in the area of risk measurement and the calculation of global exposure and counterparty risk for UCITS.

CESR stresses that the calculation of the global exposure represents only one element of the UCITS' overall risk management process. It remains the responsibility of the UCITS to select an appropriate methodology to calculate it; in that context, CESR proposes detailed methodologies to be followed by UCITS when they use the commitment or the Value at Risk (VaR) approach.

For the commitment approach, CESR sets out proposed guidelines on:

- ▣ The conversion of financial derivatives into the equivalent position in the underlying assets of those derivatives;
- ▣ the methodologies for netting and hedging arrangements and principles to be respected when calculating global exposure; and
- ▣ the calculation of global exposure when using Efficient Portfolio Management Techniques.

Under the commitment approach CESR has also identified, for interest rate-related financial derivative instruments that only expose the UCITS to general interest rate risk, two possible methodologies based on the sensitivity. CESR is consulting stakeholders on which option should be retained. In the context of the commitment approach, CESR also sets out its initial thoughts on specific guidelines for structured UCITS (i.e. formula funds) which would involve an alternative approach to the standard commitment methodology for such UCITS, as well as the criteria they would have to satisfy in order to apply such an approach.

For the VaR approach, CESR proposes guidelines on:

- ▣ the principles to be applied for the choice between Relative and Absolute VaR;
- ▣ the criteria to be used in the selection of the reference portfolio for use in the Relative VaR calculation;
- ▣ the methodology for the computation of the global exposure when using Relative and Absolute VaR with a set of quantitative and qualitative requirements to be respected; and
- ▣ additional safeguards which UCITS should put in place when calculating the global exposure with the VaR approach.

In these guidelines, CESR also defines a set of high-level principles relating to assets used as collateral to reduce counterparty risk and cover rules for transactions in financial derivative instruments.

(g) CESR Consultation Paper on Short Selling

In June, 2010 CESR published a consultation paper on short selling setting out possible policies for the regulation of short selling which can be grouped into the following areas: increasing transparency; reducing the risks related to “naked” short sales; and emergency powers for Competent Authorities to impose temporary short selling restrictions.

The consultation period is open until 10 July, 2010 and responses can be addressed directly to markt-consultations@ec.europa.eu or through the Irish Funds Industry Association.

Finance Bill 2010 – Financial Services

The Minister for Finance made reference in his Budget in December 2009 to the importance of the financial services industry and his intention to introduce changes to enhance the competitive position of the Irish Financial Services industry. As a result a number of specific and general measures have been introduced in the Finance Bill, 2010 (the “**Bill**”) to support the theme of encouraging the continued and further use of Ireland for a broad range of financial services.

Key Highlights

Specific Financial Services Industry Incentives

- ▣ A series of changes to encourage the continued use of Ireland as a domicile for collective investment funds and a location for the provision of management services to UCITS funds domiciled in any EU jurisdiction (see “Investment Management Package” of measures below).
- ▣ The extension of Ireland’s favourable financial services tax regime to cover Islamic financing.
- ▣ Favourable changes to the taxation treatment of operating leases.

General Incentives also benefiting the Financial Services Industry

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

- ▣ For corporates, the extension of the circumstances of when the 12.5% tax rate applies to foreign dividends (as opposed to the 25% tax rate).
- ▣ The introduction of a self-assessment system to make it easier for non-Irish tax residents to receive Irish dividends free of Irish withholding tax.
- ▣ Improvements in the double tax credit relief available to companies with foreign branches.
- ▣ Extension of the tax measures introduced in 2008 to assist companies in Ireland to attract non-Irish domiciled individuals to work in Ireland.

For further detailed information please call your usual Dillon Eustace contact.

UCITS IV

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

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

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

which are due in July, 2010. On 12 April, 2010, the European Securities Committee voted in favour of all the proposed level 2 measures.


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

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

The Directive was published in the Official Journal of the European Union on 17 November, 2009 and entered into force on the twentieth day following this publication. Here is a link to the text for your convenience:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:FULL:EN:PDF>).

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

 Management Company Passport

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

 Fund Mergers

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

▣ Master Feeder Structure

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

▣ Key Investor Information

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

▣ Simplified Notification Procedure

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

▣ Enhanced Cooperation between Supervisory Authorities

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

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

British Government Reveals Role of New Financial Regulator

In June, 2010 the Finance Minister George Osborne announced radical changes in the way banks and financial institutions will be regulated. Mr Osborne and the new coalition government feel that the structure of regulation was partly to blame for the severe impact the financial crisis had on the British banking sector and he wants to reform it so that it will not happen again.

Mr Osborne has announced that the current Financial Services Authority (“FSA”) will be wound up by 2012 and its functions will be taken over by the Bank of England (“BoE”).

A new committee called the Financial Policy Committee (“FPC”) will be established by the BoE, which will be responsible for overseeing macro- economic and financial issues that could threaten stability in the future.

In addition a new Prudential Regulation Authority will be set up as a subsidiary of the BOE, and carry out its orders. It will regulate retail and investment banks, building societies and insurance companies.

The third part of the reform is the creation of a new Consumer Protection and Markets Authority, which will regulate the conduct of all authorized financial firms providing services to consumers.

It is expected that Hector Sant who is the current chief executive of the FSA will become the first chief executive of the Prudential Authority and a deputy governor of the BoE.

Data Protection

Data Protection - New Standard Contractual Clauses

The European Commission has approved new standard contractual clauses on the transfer of data to data processors established in third countries. The difference between the new clauses and the previous clauses is that the new clauses include provision for the onward appointment of sub-processors being appointed by data processors in third countries. This is

a welcomed development in the area of data protection. The new clauses came into force on 15 May, 2010.

For further details please contact David Nolan in Dillon Eustace.

Data Protection Commissioner's Annual Report - 2009

On 8 April, 2010 the Data Protection Commissioner ("Commissioner") launched his report for 2009. The report focused on the responsibility of private and public sector organisations with respect to handling their customers' personal information.

During 2009 the Office of the Data Protection Commissioner opened for investigation 914 complaints. This slight decrease on the figure for 2008 (1031) can be accounted for in some respects by a drop in the last two years in complaints about unsolicited direct marketing text messages, phone calls, fax messages and emails. The report states that this is attributable in part to a series of prosecutions against a number of companies operating in the premium rate text messaging sector.

The Commissioner considers that the message from his Office should now be clear - entities that continue to commit offences in relation to electronic marketing face prosecution. The Commissioner also reports on efforts to minimise the number and impact of personal data security breaches and, when such breaches occur, to encourage organisations to voluntarily report the incidents to his Office. 119 data security breach incidents were reported to the Office in 2009, which is nearly 50% more than in 2008.

The Commissioner also highlighted his concerns about the current inability of his Office to investigate the sending of unsolicited text messages, emails or the making of unsolicited phone calls by candidates for election or political parties.

The Report also outlines views conveyed by the Commissioner on the DNA Bill, the Communications (Retention of Data) Bill, the Spent Convictions Bill and Google Streetview in Ireland.

Consultation on Development of a Data Security Breach Code of Practice

The Data Protection Review Group (the “Review group”) established by the Minister for Justice and Law Reform considered, amongst other things, how to ensure that the reporting obligations of organisations in relation to data security breaches are sufficiently robust to protect the rights of underlying data subjects. Following a period of public consultation, the Review Group issued a report recommending that:

"The reporting obligations of data controllers in relation to data breaches should be set out in a statutory Code of Practice as provided for under the Data Protection Acts. The Code, broadly based on the current guidelines from the DPC, should set out the circumstances in which disclosure of data breaches is mandatory. Failure to comply with the disclosure obligations of the Code could lead to prosecution by the DPC."

A draft Code of Practice (“the Code”) has been prepared in response to this recommendation and is available on the Commissioner’s website. In summary the Code states that where there is a loss of control of personal data by a data controller it must be reported to the Commissioner within **two working days** of the data controller becoming aware of the incident, except in a limited number of circumstances.

The exceptional circumstances include:

- ▣ where the data has been securely encrypted;
- ▣ the incident has been reported without delay to the affected data subject;
- ▣ the loss of personal data affects less than 100 data subjects and does not include sensitive personal data or personal financial data that could be used to carry out identity theft.

Data controllers, subject to the reporting requirements, must provide a detailed report of the incident setting out:

- ▣ the amount and nature of the personal data that has been compromised;
- ▣ what action is being taken to secure and / or recover the personal data that has been compromised;

- ▣ what actions are being taken to inform those affected by the incident or reasons for the decision not to do so;
- ▣ what actions (if any) are being taken to limit damage or distress to those affected by the incident;
- ▣ a chronology of the events leading up to the disclosure; and
- ▣ details of the measures being undertaken to prevent repetition of the incident.

MiFID 2

In April, 2010 CESR published three consultation papers which are seen by industry as a steps towards reviewing certain aspects of MiFID which may result in amendments thereto. The review includes proposed technical advice by CESR on investor protection and intermediaries (CESR/10-417), equity markets (CESR/10-394) and transaction reporting (CESR/10-292). CESR invited comments on all of the three consultation papers by 31 May, 2010.

The consultation papers addressed areas of the MiFID legal framework needing improvement, including quality, cost and consolidation of post-trade transparency data and delays in the publication of such data. CESR intends to publish feedback statements for the three consultations and is aiming at providing its final advice to the Commission by the end of July, 2010.

European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations, 2010

In late May, 2010 Directive 2006/43/EC (the “8th Company Law Directive”) was transposed into Irish Law by Statutory Instrument Number 220 of 2010 entitled the European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations, 2010 (the “Regulations”).

These Regulations give effect to the 8th Company Law Directive on statutory audits of annual accounts and consolidated accounts, amending Council Directive 78/660/EEC on the annual accounts of certain types of companies and Council Directive 83/349/EEC on consolidated

accounts and repeals Council Directive 84/253/EEC on the approval of persons responsible for carrying out the statutory audits of accounting documents.

Regulation 91 of the Regulations states that “public-interest entities” shall, within 6 months of the Regulations being made (i.e. by 20 November, 2010), establish an audit committee in respect of it.

Public-interest entities are defined as in the Regulations as:

- ▣ companies or other corporate bodies governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State;
- ▣ credit institutions; or
- ▣ insurance undertakings.

Exemptions to the Regulations are set out in Regulation 91 thereof. For example, a subsidiary undertaking can be exempt from the Regulations where the parent undertaking has established an Audit Committee in accordance with the Regulations. To avail of an exemption, it may be necessary to insert appropriate wording in the annual report.

Please contact the author or your usual contact in Dillon Eustace should you require further information on the Regulations.

The Financial Regulator

Introductory Statement by the Head of Financial Regulation to the Public Accounts Committee

On the 13 May 2010, the Head of Financial Regulation, Mr. Matthew Elderfield, addressed the Public Accounts Committee where he briefly outlined the changes the Financial Regulator has made to date and the proposed changes to be made in the supervision of financial institutions. He also commented on the main regulatory issues highlighted in the Comptroller and Auditor General’s Special Report 72 and finally he set out the changes proposed for credit institutions in the area of related party lending.

The Irish Banking Crisis, Regulatory and Financial Stability Policy 2003 – 2008 and the New Strategic Approach to Banking Supervision

On the 9 June, 2010 the Governor of the Central Bank issued his report to the Minister for Finance on the Irish Banking Crisis, while on the 21 June, the Central Bank published their new strategy on banking supervision in Ireland, which outlines the new approach to the regulation for retail, wholesale and international banks in Ireland.

Both reports are available on the Financial Regulator's website.

Central Bank Announces New Senior Appointments

The Central Bank has made five new appointments at Assistant Director General ("ADG") level. The appointments are to new directorates in the restructured Central Bank. Peter Oakes has been appointed ADG for Enforcement, Gareth Murphy has been appointed ADG for Markets Supervision, Patrick Brady has been appointed ADG for Policy and Risk, Bernard Sheridan has been appointed ADG for Consumer Protection and Gerry Quinn has been appointed Chief Information Officer and will head up the Information Technology Division.

Consultation Paper 41– Corporate Governance Requirements for Credit Institutions and Insurance Undertakings ("CP 41")

On the 27 April, 2010 the Financial Regulator published CP 41, which proposes an enhanced corporate governance regime for credit institutions and insurance undertakings.

The Financial Regulator's proposals as set out in CP41 include:

- ▣ imposing requirements in terms of the minimum number of directors on the board;
- ▣ limiting the number of directorships which directors may hold so as to ensure they can comply with the expected demands of board membership of an institution;
- ▣ requiring that board membership is reviewed at a minimum every 3 years;
- ▣ requiring clear separation of the roles of Chairman and CEO and precluding an individual who has been CEO, director or senior manager during the previous five years from becoming Chairman of that institution;
- ▣ setting out clearly the role of the independent non-executive directors;

- ▣ requiring the board to set the risk appetite for the institution and to monitor adherence to this on an ongoing basis;
- ▣ setting out the minimum requirements for board committees; and
- ▣ requiring annual confirmation of compliance to the Financial Regulator.

CP 41 proposes that the requirements will apply to all credit institutions and to insurers licensed by the Financial Regulator, including Irish licensed and authorised subsidiaries of international financial services groups. The proposed new requirements will not apply to foreign incorporated subsidiaries of an Irish entity. However those institutions are encouraged to adopt equivalent good corporate governance practices in their foreign incorporated subsidiaries.

While there is an acknowledgement of proportionality when implementing these measures, there is, nevertheless, a very clear emphasis on the need for good corporate governance aligned with robust regulation to secure the long term interests of the banking and insurance sectors.

The closing date for submissions was the 30 June 2010.

Consultation Paper 45 – Amendments to the Minimum Competency Requirements (“CP45”)

On 30 June, 2010 the Financial Regulator published CP 45 regarding the Minimum Competency Requirements. They are seeking views by 13 August, 2010 on the following proposals:

- ▣ changing the 3 year CPD cycle to an annual 15 formal hour requirement;
- ▣ phasing out ‘grandfathering arrangements’ over a 4 year period whereby a recognised qualification must be achieved by 2015;
- ▣ amendment to making public the register of accredited individuals on request; and
- ▣ detailed requirements are proposed regarding records to be maintained to demonstrate compliance with the Requirements.

The Financial Regulator is aiming at introducing the new requirements in the second quarter of 2011.

Financial Regulator - Transition of Prospectus Scrutiny Function

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

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

The successful management of the project will ensure a smooth and seamless transition of this function from the ISE to the Financial Regulator by the end of 2011. A joint steering committee, comprised of senior management representatives from both the Financial Regulator and the ISE, has been established to oversee the process. A Stakeholder Consultative Group has also been established to ensure that relevant market participants are involved in this strategically important project.

Short Selling of Irish Financial Stocks

In the context of the forthcoming Bank of Ireland rights issue, the Financial Regulator has confirmed that its approach, consistent with the approach of the UK Financial Services Authority when it had a short selling ban, is that a person cannot net off a short position in the pre-existing share capital of the Governor and Company of the Bank of Ireland with a long position in nil-paid rights when calculating its compliance with the short selling ban on Irish bank shares. The Financial Regulator has also clarified that this does not apply with respect to fully-paid rights.

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