

Overview of
Recent
Developments
in the Financial
Services
Industry

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OVERVIEW OF RECENT DEVELOPMENTS IN THE FINANCIAL SERVICES INDUSTRY

Introduction

There have been a number of significant international and Irish legal and regulatory developments since July 2007 in the financial services arena. A number of these developments stem from the continued movement at EU level towards the integration of European financial markets as envisaged by the Financial Services Action Plan, whilst a number of these developments are domestic in nature albeit arising from international market developments (for example, the regulation of non-deposit taking lenders engaged in retail lending in Ireland arising from concerns over defaults in the sub-prime mortgage sector). As the pace of legal and regulatory developments continue unabated, it remains important to ensure that the interests of the financial services industry and government policy remain aligned in order to ensure the ongoing success of Ireland as an attractive location for funds, financial service providers and asset managers.

A summary of a number of the key developments are set out below.

Key Developments affecting the Irish Funds Industry

Ireland is now seeing many UCITS take advantage of the new structuring possibilities under UCITS III, particularly for long/short type products, total return swap arrangements and portfolios made up of derivatives on baskets of securities and on financial indices including hedge fund and commodities indices. This has led to an increasing complexity within UCITS products, a greater focus on valuation issues, on collateral issues and more generally as to what does and does not qualify as an eligible asset for UCITS.

(i) Eligible Assets Directive

Additional clarification on that latter point was provided in March 2007 by the European Commission's Directive 2007/16/EC (the "Eligible Assets Directive") which gives some room for flexibility in interpreting what may or may not fall within the UCITS concepts of "money market instruments" and "transferable securities" as well as clarifying the parameters for UCITS investing in other asset types including closed-ended funds and derivatives on

financial indices. At the same time, the Committee of European Securities Regulators (CESR) issued its guidelines concerning eligible assets for investment by UCITS and, subsequently in July 2007, CESR issued additional guidelines on the classification of hedge fund indices as financial indices. The Eligible Assets Directive has now been implemented into Irish law pursuant to the EC (Undertakings for Collective Investment in Transferable Securities) (Amendment) Regulations 2007 (the “Amendment Regulations”).

Closed-ended funds may qualify as transferable securities provided that they are subject to certain corporate government mechanisms, their asset management activities are carried out by an entity subject to national regulation for the purpose of investor protection and they fulfil the eligibility criteria applicable to transferable securities.

Financial indices, whether or not composed of eligible assets, can be regarded as eligible assets provided that they are sufficiently diversified, they represent an adequate benchmark for the market to which they refer and they are published in an appropriate manner. As regards hedge fund indices, such indices must be subject to additional requirements regarding publication of their selection and construction methodologies as set out in the level three guidelines issued by CESR in July, 2007.

The Eligible Assets Directive opens up new opportunities, one example being the possibility of permitting UCITS to invest more than 10% of net assets into loan type investments (such as loan assignments) and the broader use of the term “financial instruments” to describe assets which may be deemed to qualify as “transferable securities”.

(ii) *Consultation Paper 31 - Proposed amendments to the UCITS Notices and related Guidance Notes*

The Financial Regulator has issued Consultation Paper 31 which highlights the proposed amendments to the UCITS Notices and related Guidance Notes to reflect the new Amendment Regulations and CESR's guidelines. The amendments to the UCITS Regulations came into effect on 19 December 2007. However, the Amendment Regulations provide that UCITS authorised by the Financial Regulator before this date have until 23 July 2008 to comply whilst UCITS authorised from 19 December 2007 must comply with the new requirements from the date of authorisation. In addition, the Financial Regulator proposes to establish new conditions under which a money market fund is permitted to follow an amortised cost valuation methodology and to use the words “money market fund” in its title. Pursuant to the proposed new Guidance Note -/08, only those money market funds which apply strict criteria to the construction and management of their portfolios are permitted to follow an amortised cost valuation methodology. The most significant change proposed 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. The new Guidance Note -/08 is currently going through the Industry consultation process.

(iii) QIF Fast Track

The most important developments as regards Non-UCITS Funds has been the new fast track authorisation process introduced in February 2007. Initially slow to take off, this development has now been seen as a resounding success with large volumes of QIF funds being launched using the new process by end December 2007.

The new process provides that, subject to meeting pre-agreed parameters, a QIF will be capable of being authorised by the Financial Regulator on a filing only basis so that once a complete application for authorisation is received by the Financial Regulator before 3.00pm on Day X, a letter of authorisation for the QIF can be issued by the Financial Regulator on Day X + 1. There is no longer a prior review process.

Key Developments affecting Investment Firms, Intermediaries and Credit Institutions

The implementation of the Markets in Financial Instruments Directive 2004/39/EC ("MiFID"), a cornerstone of the Financial Services Action Plan, has been a significant event for all asset managers located in the EU/EEA and not just in Ireland. Brief details of MiFID and a number of other developments affecting the Irish financial services industry are set out below.

(i) Markets in Financial Instruments Directive 2004/39/EC ("MiFID Directive")

MiFID together with the Directive 2006/73/EC ("MiFID Directive") as implemented in Ireland by the EC (Markets in Financial Instruments) Regulations, 2007, SI 60 of 2007, as amended (the "MiFID Regulations"), took effect on 1 November, 2007. The MiFID Directive was a major part of the EU's Financial Services Action Plan designed to extend the coverage of the previous regime pursuant to Council Directive 93/22/EEC (i.e. the Investment Services Directive, the "ISD") and to introduce new and more extensive requirements to which firms were required to adapt, in particular in relation to their conduct of business and internal organization.

(ii) *Client Asset Requirements*

The Financial Regulator issued new Client Asset Requirements in November 2007 (the “CAR”), which apply to both investment firms subject to the provisions of the MiFID Regulations and to investment business firms authorised under the Investment Intermediaries Act, 1995, as amended, (the “IIA”). The CAR replace the Financial Regulator’s Client Money Rules (issued in February 2004) (the “CMR”) and covers firms that hold ‘client assets’. The concept of “control” of client assets has been deleted from CAR following the amendment of the IIA by section 11 of the Markets in Financial Instruments and Miscellaneous Provisions Act 2007.

(iii) *Irish and European anti-money laundering legislative developments*

Directive 2005/60/EC on the "Prevention of the use of the Financial System for the Purpose of Money Laundering and Terrorist Financing" (the “Third Directive”) replaces and repeals the existing anti-money laundering directive 91/308/EEC (as amended). A draft Criminal Justice (Money Laundering) Bill, 2008 has been published in respect of the implementation of the Third Directive. The Third Directive is aimed at preventing the use of the financial system for the purpose of money laundering and terrorist financing and widens the scope of previous anti-money laundering legislation. It is based on the revised 40 recommendations of the Financial Action Task Force (“FATF”). The principal purpose of the Third Directive is to update European legislation in line with international law and ensure the consistent application of FATF recommendations across the European Union Member States.

Certain Developments affecting “Non-Deposit taking Lenders”

The introduction of new provisions in Section 19 of the Markets in Financial Instruments and Miscellaneous Provisions Act 2007 (“the Act”) enacted on 1 November, 2007 provides for a new regulatory regime for non-deposit taking lenders to be called “retail credit firms” and “home reversion firms” by way of amendment to Part V of the Central Bank Act 1997. Once authorised, retail credit firms and home reversion firms will become regulated financial service providers for the purposes of both the Financial Regulators Consumer Protection Code and the Financial Services Ombudsman Scheme.

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