DILLON EUSTACE
SOLICITORS

QUARTERLY NEWSLETTER
JANUARY 2007

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I. INVESTMENT FUNDS

IMPORTANT CHANGES TO AUTHORISATION PROCESS FOR IRISH DOMICILED QUALIFYING INVESTOR FUNDS ("QIFS")

Following discussions over the last number of months between industry representatives and the Irish Financial Services Regulatory Authority (the "Financial Regulator"), new authorisation processes and enhanced product parameters for QIFs were announced on December 19, 2006.

QIFs are non-UCITS products which can be structured as investment companies, unit trusts or common contractual funds (single or umbrella with segregated liability), have a minimum subscription requirement per investor of Euro 250,000 (or equivalent) and which can be sold only to qualfying investor individuals with a minimum net worth of Euro 1.25 million (excluding principal private residence/contents) or institutions who own or invest on a discretionary basis at least Euro 25 million (or are themselves owned by qualifying investors).

QIFs are the vehicles which are most frequently used in the alternative investment space - hedge funds, fund of hedge funds, venture capital/private equity, real estate funds, etc - and are a mainstay of the non-UCITS Irish domiciled product offering.

The new authorisation regime will provide that, subject to meeting preagreed parameters, a QIF will now 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 will no longer be a prior review process.

A complete application will be one where all the relevant parties to the QIF (promoter, directors and relevant service providers) are all approved (i.e. have the appropriate authorisations/approvals from the Financial Regulator) and the QIF itself reflects the agreed parameters. The agreed parameters have been discussed with the Financial Regulator at meetings with industry over the last number of weeks and the intention is that those parameters will appear in a simplified and codified manner in a revised application form for QIFs. Those parameters are essentially the current parameters adjusted to take account of all QIF enhancements over the last

which are no longer seen as appropriate for the QIF regime.

It is proposed that the revised application form and a new notice dealing with the new QIF regime will be circulated in early January 2007 and that applications under the new regime will be accepted by the Financial Regulator from February 2007.

It is also envisaged that spot checks will be conducted on applications post authorisation and in the event of any non-compliance with the relevant requirements, applicants may experience difficulties with future authorisations on a pre-approved basis.

We consider these changes to be of huge significance to the Irish fund industry and represent a recognition of the time to market requirements of international promoters.

ANNUAL MANAGEMENT FEES

In June 2006 the Financial Regulator issued a consultation paper entitled "Annual Management Fees within Authorised Collective Investment Schemes". Collective investment schemes ("CIS") are permitted to charge annual management fees provided that the applicable constitutional document prescribes the method of calculation of such remuneration. Generally, these fees are calculated as a percentage of the net asset value of the CIS. The Financial Regulator had been asked to permit annual management fees where these fees were calculated based on the initial issue price of units rather than on the net asset value of the CIS.

On the basis of the information provided to the Financial Regulator during the consultation period, the Financial Regulator has now confirmed that it will permit retail CIS to charge an annual management fee based on the initial issue price of the units of the CIS, subject to the following requirements:

- the CIS is a structured product which, through investment in financial derivative instruments, provides for a specific return (for example, a guaranteed return or an element of capital protection) based on the performance of a particular index or underlying basket of assets provides a pre-defined return to investors;

- the fee to be charged is a percentage of the initial issue price per share, i.e. it will be adjusted to take account of dealing activity in the CIS; and

- the prospectus of the CIS will disclose the fee paying arrangement and provide a clear warning that the fee is fixed and not subject to the performance of the CIS.

CROSS INVESTMENT BY SUB-FUNDS WITHIN AN UMBRELLA STRUCTURE

The Irish Funds Industry Association (the "IFIA"), which is the representative body for the funds industry in Ireland, has reported to its members, that following the enactment of the Investment Funds, Companies and Miscellaneous Provisions Act, 2005 (the "Act"), the Financial Regulator's Notices and Guidance Notes were amended to reflect the legislative amendments introduced by the Act.

One of the key amendments included in the Act and the subsequent revised Financial Regulator Notices was to permit the cross investment by sub-funds of an umbrella structure. To address the additional disclosures required in the financial statements of such umbrella funds the IFIA undertook to prepare guidance in this regard. This information has now been forwarded to the Financial Regulator for its consideration and the IFIA shall revert to its members in due course once it receives a reply from the Financial Regulator.

PROFESSIONAL INVESTOR FUNDS - MINIMUM SUBSCRIPTION REQUIREMENTS

CIS which are authorised as professional investor funds must have a minimum subscription requirement of Euro 125,000 or its equivalent in other currencies. The Financial Regulator has now confirmed that they will allow professional investors funds to provide a derogation from the minimum subscription requirement to investors who are trustees of pension plans, provided that these investors commit to invest the minimum subscription amount within a period of 12 months.

PROFESSIONAL AND QUALIFYING INVESTOR FUNDS - INVESTMENT BY KNOWLEDGEABLE EMPLOYEES

Non-UCITS Notices 12 and 24 permit exemptions from the relevant minimum subscription requirement in the case of certain investors, including specified directors and employees. The Financial Regulator has confirmed that investments in professional or qualifying investor funds by these investors are not affected in the event that they subsequently resign from their qualifying directorship or employment.

INVESTMENT IN RUSSIA

To date, investment by retail CIS in Russian traded securities was limited to equity securities and such investment could not constitute the sole objective of the retail CIS.

The Financial Regulator has now confirmed that they will no longer impose any restriction in relation to investment by retail CIS in securities (both debt and equity) traded on the Russian securities markets; the RTS Stock Exchange and the Moscow Interbank Currency Exchange.

As a result of the lifting of this restriction it shall now be possible to establish retail CIS, including an undertaking for collective investment in transferable securities ("UCITS"), the sole objective of which is investment in Russian traded securities. The prospectus for such a scheme shall have to clearly disclose the relevant risk factors.

The prescribed minimum standards with respect to custody of Russian equity securities shall remain unchanged.

UCITS

SIMPLIFYING UCITS NOTIFICATION PROCEDURES

In June 2006, following two series of public consultations, the Committee of European Securities Regulators ("CESR") introduced guidelines relating to the notification of UCITS schemes in EU Member States, for the purpose of marketing those schemes in Member States other than the Member State in which they are domiciled, CESR/06-120b (the "CESR Guidelines").

The requirement for a UCITS scheme to be notified separately in each host Member State was regarded as a key barrier to efficient cross border fund distribution. Following two decades of divergent national practices in the enforcement of provisions of UCITS law, the notification procedure had developed to be, in effect, a registration procedure, which was time consuming and expensive. Some of the differences arise from provisions incorporated in national law. There are also areas of national law, such as administrative law, which influence the notification procedure but which are not subject to European Union harmonisation. These differences in national law hinder speedy alignment on a single approach to the notification procedure.

CESR considered that the current system should be replaced by a simple notification procedure (i.e notification rather than registration).

The CESR Guidelines seek to bring greater simplicity, transparency and certainty to the notification process. They aim to avoid uncertainty and prolongation of notification procedures and strive for speedier processing. They do so by clarifying the way in which host authorities should communicate grounded and demonstrable concerns regarding the UCITS' compliance with any applicable host law

The CESR Guidelines also enshrine common approaches to the documentation that must be submitted in the context of the notification procedure and to clarify the handling of sub-funds of umbrella funds.

The main objectives of the CESR Guidelines are as follows:

- Simplify the notification process and thus facilitate cross-border fund distribution;
- Provide proportionate investor protection;
- Reducing costs for investors and fund management companies;
- Eliminating barriers to the single market on UCITS in Europe;
- Furthering a level playing field between different investment products.

The CESR Guidelines do not constitute European Union legislation and CESR members (such as the Financial Regulator) will introduce these guidelines in their day-to-day regulatory practices on a voluntary basis. There is a general commitment by all regulatory authorities to accelerate the processing of notifications wherever possible. It is stressed that any CESR Guidelines to simplify the notification procedure must be consistent with the provisions of the current UCITS Directive, including the competences given to host Member State authorities.

As a result of the CESR Guidelines the Financial Regulator has issued an amended UCITS Notice 15, giving effect to the CESR Guidelines.

The revised UCITS Notice 15 is available from the Financial Regulator's website (www.financialregulator.ie) and the CESR Guidelines are available from CESR's website (www.cesr.eu-org).

EUROPEAN COMMISSION WHITE PAPER ON ENHANCING THE SINGLE MARKET FRAMEWORK FOR INVESTMENT FUNDS

On 15 November, 2005 the European Commission (the "Commission") published its White Paper on Enhancing the Single Market Framework for Investment Funds (the "White Paper"). In the White Paper the Commission proposes to modernise and compliment the existing single market framework for investment funds in a number of specific areas - notably by eliminating procedures and costs that do not materially enhance investor protection.

The White Paper foresees actions to:

- Strengthen single market freedoms, thereby enabling the fund industry to serve European and global investors more efficiently;
- Ensure that investors are in a position to make informed investment decisions and rely on qualified intermediaries for objective expert assistance;
- Assess whether a single market framework should be created to allow the cross-border sale of some types of non-UCITS type funds to retail investors and how this could most effectively be done; and
- Begin work on a European 'private placement' regime to facilitate the sale of non-harmonised funds and financial instruments to institutional and sophisticated investors in other Member States.

In July 2005, the Commission Green Paper identified the following shortcomings in the existing legislative framework:

- Bottlenecks and failures of the product passport: procedures for cross-border marketing take too long, are too costly and subject to too much supervisory interference;
- Sub-standard investor disclosures: the simplified prospectus does not help investors or their advisors to make sound investment decisions;
- Proliferation of small inefficient funds: the UCITS Directive (Directive 85/611/EEC as amended by Directives 2001/107/EC and 2001/108/EC) provides no mechanisms to facilitate the amalgamation of funds or pooled management of assets. The European fund market is populated by small and relatively expensive funds, driving up costs;
- Obstacles to functional and geographic specialisation. The UCITS Directive requires concentration of all value chain activities in one Member State: only the fund can be 'pass-ported'. These legislative restrictions prevent the fund industry from taking full advantage of all location and specialisation benefits on offer in the single market.

The White Paper proposes the following amendments to the UCITS Directive:

1. Removing Administrative Barriers to Cross-Border Marketing

There are few identifiable benefits from the present notification system. It is a pure cost for market participants. It severely hampers the roll-out of new products across the single market. Extensive efforts to remove the most important sources of administrative friction have been undertaken, culminating in CESR guidelines in June 2006 (as set out above). However, these worthy improvements cannot overcome the administrative and procedural obstacles that have their origin in outmoded provisions of the Directive.

The Commission will table proposals to amend Articles 44 to 47 of the UCITS Directive. The existing administrative procedures that must be satisfied before a fund can be marketed in another Member State - notably detailed ex-ante verification of fund documentation by the host authority and the current 2 month maximum waiting period - will be scaled back. Documentation and other exchanges shall take place on a regulator-to-regulator basis. Supervisory cooperation mechanisms will be introduced to ensure speedy resolution of identified problems. Host supervisors should focus compliance with local marketing and advertising rules on the intermediaries directly responsible for those activities in the host jurisdiction rather than the partner country fund manager.

2. Facilitating Cross-Border Fund Mergers

The UCITS market is populated by funds of sub-optimal size. Consequently, important economies of scale remain unexploited and the end investor bears unnecessarily high costs.

The Commission will propose additions to the UCITS Directive to create the appropriate legal and regulatory conditions for the merger of funds. These provisions will ensure that fund mergers take full account of the needs of investors in the merging funds. There will in particular be a need to ensure effective advance disclosure on the merger and to provide the possibility for the unit-holder to redeem free of charge.

3. Asset Pooling

Asset pooling allows simultaneous management of assets gathered by different funds – while maintaining a local fund presence in different target markets. The skills and costs of successful management teams can be

spread over a wider pool of assets. These techniques are not only relevant for investment funds but also as a possible model for pension funds. There are significant barriers to cross-border asset pooling.

The Commission will propose amendments to the diversification rules and other provisions of the Directive in order to allow an expansive approach to 'entity pooling'. In preparing legislation, the Commission will also further explore the soundness of virtual pooling techniques and the need for any amendment to the Directive to provide legal certainty and underpin effective management and supervision of such structures.

4. Management Company Passport

Currently, management groups need to establish a fully functional management company in each country where they domicile a fund: these must satisfy costly local substance requirements. This pushes up costs and prevents scale and specialisation gains.

The Commission will propose amendments to the Directive to allow an authorised management company to manage corporate and contractual funds in other Member States. The scope of passport-able services will need to be carefully tested and validated during the preparatory phase.

5. Strengthening Supervisory Cooperation

The above changes to the single market framework for investment funds will pave the way for cross-border operations, platforms or structures which may be legally and technically more complex. Different enforcement authorities may be responsible for different actors in the reconstructed value chain. Effective supervision of cross-border structures and functions will need to be underpinned by full and timely cooperation between the relevant national authorities. The Commission is confident that effective supervisory cooperation can be found for UCITS as they have been found for other sensitive areas of securities law enforcement (e.g. market abuse).

The Commission will table proposals to strengthen the provisions of the UCITS Directive relating to competent authorities and supervisory cooperation. Amendments will be modelled on the relevant provisions of more recent securities legislation (e.g. MiFID and the Prospectus Directive).

REGISTRATION OF A UCITS FOR SALE IN HONG KONG

In order to enhance the understanding of fund managers and practitioners on the requirements for the registration / authorisation of a UCITS for sale in Hong Kong the Hong Kong Securities and Futures Commission (the "SFC"), and to facilitate the authorisation process, the SFC has prepared a guide (the "Guide") in relation to the level of information which must be provided to the SFC on the risk management and control process of a UCITS which uses or will use the expanded investment powers, especially those using FDI's for investment purposes.

The Guide sets out the items and areas relating to the risk management and control process which the SFC expects to be provided in order to give the SFC a general and basic understanding of the risk management processes of the relevant fund. The SFC recognises that the extent and types of FDI's employed by each UCITS may vary and will most likely be different. Hence, the information relating to the risk management and control process should reflect how it is relevant to that specific fund and the information indicated in the Guide that should be provided to the SFC may vary for each application and not all items may be applicable or relevant to each fund.

The Guide has been prepared based on the European Commission's Recommendation 2004/383/EC on the use of FDI's by UCITS (the "EC Recommendation"). The Guide is intended for guidance only and should not be regarded as exhaustive.

The EC Recommendation on the use of FDI's by UCITS set out the general requirements of a risk management process. This process which should includes details on setting the limitations of the UCITS global exposure to derivatives and overall risk exposure; ensuring the adaptation of risk-measurement methodologies applicable to the differentiated risk-profiles of a non-sophisticated and a sophisticated UCITS; setting appropriately calibrated standards to assess leverage; applying appropriate standards and recognised risk-mitigation techniques to limit counterparty risk; using adequate methodologies when applying limitations to issuer risks and applying relevant cover rules.

The EC Recommendation also indicated that the global exposure is calculated taking into account: the current value of the underlying assets; the counterparty risk; future market movements and the time available to liquidate the positions. In addition, total exposure should be assessed on the basis of both the default risk of the UCITS and the leverage produced by the use of FDI's. The global exposure relating to FDI's may not exceed

200 % of the net asset value on a permanent basis. The overall risk exposure may not be increased by more than 10% by means of temporary borrowing so that the UCITS' overall risk exposure may not exceed 210% of the net asset under any circumstances.

General Information to be provided to the SFC:

- a description of the entities or business units responsible for FDI valuations, risk measurement and management.
- descriptions of the overall level of expertise of the key personnel (e.g. employment history), and/or departments involved and independence of these personnel/entities (e.g. reporting lines within the organisation).
- information of the specific types of FDI that will be utilised by the UCITS. An explanation of the types of risks that may impact the fund by utilising the specific types of FDI referred to above.
- a description of the valuation rules for the specified types of FDI, including the policy with regard to the valuation of illiquid or over the counter FDI, and in particular, the frequency of valuation and policy on independent verification.
- a brief overview of the systems being used to monitor, measure and manage the risk process.
- a summary of policies in relation to the monitoring and management of legal risk, particularly in the context of over the counter derivatives and any other relevant risks.

Information with regards to Risk Exposure and Leverage to be provided to the SFC:

- a description of the methodology used by the UCITS to calculate its global exposure and leverage with the appropriate rationale based on whether the fund is classified as a sophisticated or a non-sophisticated fund as per the EC Recommendation (e.g. if a sophisticated fund uses VaR it must indicate the calculation parameters, both quantitative and qualitative.)
- policies and procedures for stress testing and scenario analysis, where applicable

- procedures and policies of the UCITS to monitor and control the levels of global exposure and leverage are in compliance with requirements, including details of the management controls and systems for:
  - monitoring trade execution;
  - monitoring position netting;
  - monitoring of compliance with internal policies / procedures and quantitative limits; and
  - preventing limit breaches.

- a description of any additional risk management policies and procedures used e.g. benchmarks, back testing, tracking-error, stop-losses.

- a description of the methodology used by the fund to calculate its counterparty exposure.

- procedures and policies of the UCITS to monitor and control its counterparty exposure and risk, including:
  - counterparty approval criteria
  - policy on collateral
  - policy on netting
  - details of the management controls and systems for monitoring of compliance and quantitative limits e.g. concentration limits and preventing limit breaches.

Information on reporting procedures to be provided to the SFC:

- Description of internal reporting procedures including the escalation procedures and remedial policy in the event of limit breaches.

REAL ESTATE FUNDS

As discussed in our Quarter 3 Client Newsletter, the Financial Regulator has agreed to certain changes to the regulatory regime applicable to property funds.

The Financial Regulator has now indicated its intention to revise some of the conditions which they impose on property funds, which are contained in Non-UCITS Notice 18 ("NU18").

The Financial Regulator also intends to issue a new guidance note in due course.

The guidance note will provide that PIF and QIF schemes may establish multi-layered SPV structures subject to the following conditions:

- Each SPV must be wholly owned by the scheme or by its wholly owned subsidiary(ies);
- The shares in each SPV must be registered in the name of the trustee;
- The underlying assets must be registered in the name of the trustee or, in the name of the scheme or its SPV. The trustee must be appointed as trustee to each SPV and must be in a position to demonstrate to the Financial Regulator that it has sufficient controls in relation to each layer of the SPV structure;
- The prospectus must clearly disclose the intention to establish SPVs and the periodic reports must include information (i.e. name and where established) on those in existence on the reporting date;
- The majority of directors appointed to the board of the SPV will be directors of the scheme. The guidance note will set out conditions under which the Financial Regulator will grant a derogation to PIF and QIF schemes from this requirement. At a minimum, a least one director of the scheme must be on the board of the SPV; and
- The assets of each SPV must be valued by the scheme or its delegate.

Custody / Registration of Assets

The assets of a property fund can be registered in the name of the scheme or in the name of its wholly owned SPV subject to the following conditions which will be set out in the guidance note:

- A restriction is placed on the registered title of the property to the effect that title cannot be disposed of without the prior consent of the trustee;
- Where this is not possible, a caution is registered on the title to put prospective purchasers on notice that the prior consent of the trustee is required for sale of the property;
- Where neither of the above is possible, the scheme will undertake, through a provision in the custodian contract, that it will not invest in

property assets unless the trustee is satisfied that that the property cannot be disposed of without its prior consent or that arrangements equivalent to those set out in (i) and (ii) are in place.

Promoter/Investment Manager Approval Process

The guidance note will indicate that applications from non-regulated promoters and investment managers may be considered, where appropriate expertise can be demonstrated and subject to a review of the firm's fitness and probity.

Independent Valuer

The Financial Regulator will no longer need to be informed of the appointment or resignation of each independent valuer. The basis for the appointment of the independent valuer(s) will be set out in the prospectus and details of the appointments will be provided in the periodic reports. Paragraph 3 of NU18 will be amended to reflect these new requirements.

Valuation

Paragraph 4 of NU18 will be amended to require that properties will be valued at "market value" instead of "open market value" as currently stated. Properties must be valued twice yearly. The guidance note will clarify that a full physical valuation must be carried out on a yearly basis and that the interim valuation may be carried out on a "desktop" basis. The guidance note will also provide information in relation to "desktop" valuations.

Non-UCITS Notice 24 (Qualifying Investor Schemes) will be amended, to apply the requirement in paragraph 5 of NU18, that properties must be valued prior to acquisition. The Guidance Note will provide for a derogation for PIF and QIF schemes, to the extent that properties may be purchased within 10% of the valuation price.

Unlisted Property Related Assets

Paragraph 6 NU18 will be deleted. Instead, the guidance note will clarify that limits set out in other Notices may be relevant, depending on asset type.

Redemption Procedures

Paragraph 13 of NU18 will be deleted and the guidance note will refer to the fact that open-ended or semi-open property funds will be considered if they can provide sufficient liquidity.

II. MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE ("MIFID")

The European Commission has now formally adopted MiFID's Level II implementing measures, consisting of a draft directive and a regulation.

The Department of Finance had been providing impacted firms with regular updates on the status of MiFID and has now published daft a draft statutory instrument, the European Communities (Markets in Financial Instruments) Regulations (the "Regulations"), for the implementation of MiFID into Irish law. The Regulations contain detailed definitions and also set out the areas where any exemptions will apply. The Regulations also set out provisions for the regulation and supervision of investment firms and disapply the Investment Intermediaries Act, 1995, as amended (the "IIA") to the activities of such investment firms.

The Regulations also set out certain requirements for the operation of "regulated markets". They include provisions for market transparency and integrity, mechanisms for reporting transactions and the maintenance of records. Mechanisms for the operation of cross-border activities are also set out in the draft Regulations. They also include provisions with regard to 'Acquiring Transactions'.

Companies currently within the scope of the Investment Services Directive (the "ISD") will be required to comply with the requirements of MiFID. Some companies will also be brought within scope of this type of regulation for the first time. The status of other companies remains unclear.

As MiFID approaches, issues such as how its requirements will interrelate with other major European legislation such as the Capital Requirements Directive and the existing UCITS framework and what the impact on investment firms will be are being addressed by the Department of Finance and the Financial Regulator.

An interesting issue yet to be answered relates to the inclusion or exclusion of companies providing certain administration or transfer agency services to collective investment schemes. It can be argued that traditionally

in Ireland, the administration of collective investment schemes has not been regarded as a service provided under the Investment Services Directive. Evidencing this is the fact that the IIA, which transposed much of the ISD into Irish law, makes special provision for investment business service (g): “the administration of collective investment schemes, including the performance of valuation services or fund accounting services or acting as transfer agents or registration agents for such funds”. This investment business service does not equate to any of the investment services listed in the Annex of the ISD.

Thus, traditionally an Irish fund administration company and transfer agent authorised only to perform investment business service (g) has not fallen within the scope of the ISD. An investment business firm in Ireland providing administration / transfer agency services to collective investment schemes would not, on the face of it, be required to comply with the requirements of MiFID. Under Article 3 of the Level I directive Member States can exempt firms from the requirements of MiFID in certain circumstances. However, administrators / transfer agents that are executing orders on behalf of clients cannot be exempted under this article. In Luxembourg it is currently deemed that a company acting as a transfer agent and registrar to collective investment schemes qualifies as an investment firm for the purposes of the ISD. Thus, this type of firm will be required to comply with the requirements of MiFID while being able to avail of the opportunity to passport to other Member States including Ireland.

The result of all this would appear to throw up the potential for two different categories of administrator / transfer agent to collective investment schemes within Ireland, one that may be required to be MiFID compliant and the other that may not. The relevant authorities are no doubt addressing this apparent discrepancy in the application of the definition of investment services between Member States.

It should be noted that in order to avail of passporting opportunities, an Irish company acting as a transfer agent to collective investment schemes currently authorised only to provide investment business service (g) of the IIA could apply to extend its authorisation with the Financial Regulator to include investment business service (a): "receiving and transmitting, on behalf of investors, of orders in relation to one or more investment instrument" and (b): "execution of orders in relation to one or more investment instrument, other than for own account".

That being said, an entity wishing to provide transfer agency services within Europe may look favourably on establishing operations in Ireland irrespective of the existing benefits of the jurisdiction, given the potential

for the requirements of MiFID to be disapplied. For investment business firms in Ireland generally, the issue of how to apply the requirements of the interrelating regulatory and statutory requirements i.e. between the new draft regulation, the existing handbook and code of conduct, the new combined code expected shortly and any new bills, remains to be seen.

III. EUROPEAN COMMUNITIES (CAPITAL ADEQUACY OF INVESTMENT FIRMS AND CREDIT INSTITUTIONS) REGULATIONS, 2006

The Department of Finance has published draft statutory instruments in relation to Directive 2006/48/EC and Directive 2006/49/EC on Capital Adequacy for Investment Firms and Credit Institutions.

The draft European Communities (Capital Adequacy of Investment Firms and Credit Institutions) Regulations, 2006 and draft European Communities (capital Adequacy of Investment Firms and Credit Institutions) (No. 2) Regulations, 2006, establish a new method of calculating the capital requirements for credit institutions and investment firms and are due to come into effect on 1 January, 2007.

The Financial Regulator has recently written to regulated investment firms and credit institutions requesting;

their views on their proposed implementation of the Capital Requirements Directives ("CRD");

that they confirm if they intend to switch to the new CRD regime by 1 January 2007 or 2008, in which case the Financial Regulator must be notified by 31 October 2006 and 31 December 2006 respectively; and

that they confirm which electronic format they will use to submit information regarding their regulatory capital calculations, to the Financial Regulator i.e. will they use the XBRL file format or the manual option. This 'electronic reporting' requirement will be effective from the end of March 2007 and it will apply to calculations under the CRD.

The provisions set out below will apply to investment firms and credit institutions from 1 January, 2007. The extent to which they will apply depends upon the entities current reporting methodology and / or the nature of its business and / or the investment instruments traded by it:

The revised rules on the definition of capital, in particular, the requirement to deduct certain items 50% from Tier 1 and 50% from Tier 2 own funds and the prudential filter provisions of Article 64 (4);

The revised rules on scope of application and consolidation; the key change here is in respect of the requirements for 'amended solo' treatment;

The revised capital requirements for 'free deliveries' in the trading book under Directive 2006/49 Annex II paragraph 2;

The updated and revised definition of the trading book;

All the changes to the rules on position risk as introduced in Directive 2006/49, including credit derivatives and collective investment undertakings;

The counterparty credit risk treatment of credit derivatives; and

The revised treatment of foreign exchange risk in collective investment undertakings as per paragraph 2.1 of Annex III to Directive 2006/49.

IV. JAPAN

NEW FINANCIAL INSTRUMENTS AND EXCHANGE LAW

The Japanese government has recently enacted a new legislative framework for financial instruments and exchanges. The new law, titled the Financial Instruments and Exchange Law (the "FIEL") establishes a cross sectional legislative framework for user protection covering a wide range of financial products. The material provisions of the FIEL will come into effect in summer 2007.

The FIEL amends a total of 89 laws and abolishes another 4, consolidating or replacing the existing provisions within the new framework. Amongst the laws consolidated into the new legislation will be the Financial Futures Trading Law, the Law Concerning Foreign Security Firms, the Law Concerning the Regulation of Investment Advisory Services Relating to Securities, the Securities and Exchange Law, the Commodities Fund Law, the Trust Business Law and the Law for Investment Trust and Investment Companies.

Importantly, the scope of the definition of 'securities' shall be expanded. All forms of interests in trusts will be deemed to be securities, and

interests in collective investment schemes will be comprehensively positioned as securities. In relation to collective investment schemes, under the new law, ownership interests in any scheme that

(1) collects capital or contribution in monetary or other similar form from two or more persons;
(2) conducts business / undertakes investments using the money; and
(3) distributes profits or properties to investors from the collective investment scheme

shall be deemed to be and shall be treated comprehensively as securities, regardless of the legal feature of the scheme. This has clarified and removed the uncertainty which existed under various provisions which the FIEL is replacing.

The scope of the new law will also cover a variety of investment instruments, such as investment in commodities using capital or contributions in monetary or other similar form (commodities funds) and investments in trust beneficiary rights on real estate (real estate funds), amongst others.

The scope of "derivative transactions" will also be expanded and transactions on a wide range of assets and indexes will be covered in the FIEL. Currency and interest rate swaps, weather derivative transactions, and credit derivative transactions will be also categorised as derivative transactions.

The FIEL shall require registration for "sales and solicitation" operations of securities and derivative transactions, as well as "investment advisory," "investment management" and "customer asset administration" services for cross-sectional regulation. For interests in collective investment schemes, "sales and solicitation" by the members of the scheme (so-called self-offering), will be also subject to regulation. In addition, it is clearly stated that the management of properties for investment purposes in collective investment schemes (so called self-management) will be subject to the regulation.

The new registration, disclosure and reporting requirements shall be substantially similar to those currently in effect.

V. CHINA

CHINA QUALIFIED FOREIGN INSTITUTIONAL INVESTORS

The China Securities Regulatory Commission ("CSRC"), the People's Bank of China ("PBOC") and the State Administration of Foreign Exchange ("SAFE") have recently issued new regulations on domestic securities investment by qualified foreign institutional investors ("QFII") (the "Revised Rules") that govern the regime allowing qualifying foreign institutions approved by the CSRC as QFIIs to invest in China A shares and other Renminbi ("RMB") - denominated securities in the People's Republic of China ("PRC") subject to the granting of quotas by SAFE.

QFII Qualifying Criteria

The qualifying criteria in terms of assets-under-management ("AUM") for QFII applicants that are fund management institutions has been reduced to USD5 billion in the most recent financial year. The requirement to have being operating as a fund management business for over five years remains.

The qualifying criteria for insurance companies has been reduced to USD5 billion in securities assets held in the most recent financial year.

Other types of institutional investors such as pension funds, charitable funds, donation funds, trust companies, government investment companies are subject to similar qualifying criteria of having been established for at least five years and having AUM or a securities portfolio of at least USD5 billion in the most recent financial year.

There is no change to the qualifying criteria for securities companies and commercial banks.

Opening of Securities Sub-Accounts

Under the Revised Rules, each QFII may now hold multiple securities sub-accounts with the PRC securities registration and settlement house ("PRC Clearing House") corresponding to multiple RMB special accounts. The securities sub-accounts may be opened as direct accounts or as nominee accounts. Where the QFII establishes a securities account for a fund, the account may be opened in the name of "the QFII + the name of the fund". Assets in such accounts belong to the relevant fund and are independent of the QFII and the custodian.

Under the original QFII rules a QFII was required to appoint a PRC custodian and open one RMB special account and only one securities account with the PRC Clearing House.

Proprietary investments of a QFII through its QFII quota had to be commingled in the same account with assets of the QFII's customers and investors investing through its QFII quota. Such an arrangement raised issues of custody risk as the proprietary assets of the QFII were not segregated from the assets of the underlying customers. The Revised Rules go some way to reducing the custody risks and address the issue of segregation of assets between a QFII and its customers and among the sub-accounts for different funds and customers. A QFII is required to file reports on the underlying investors for whom it maintains the nominee accounts and on the investment activities of such investors through such accounts.

The Revised Rules recognise the interests of underlying investors investing through QFIIs by providing that QFIIs may appoint the actual beneficial investors to exercise shareholder rights with respect to underlying investments, and that as nominee for beneficial investors, a QFII may use its votes in part and may cast its votes in different ways according to the interests of the underlying beneficial investors.

Remittance, Repatriation and Lock-Up

The Revised Rules do not set out specific requirements with respect to remittance and repatriation. They do however provide that remittance, repatriation and any lock-up period shall be adjusted by SAFE based on the economic and financial situation of the PRC, the foreign exchange balance of payments and according to arrangements set by the PBOC. The previous rules on lock-up periods and repatriation limits in the original QFII rules have been abolished. Therefore there are no longer any rules in place that impose those lock-up periods and repatriation limits.

Investment Restrictions

Under the original rules a QFII could not hold more than 10% of the total outstanding shares in one listed company and the total shares held by all QFIIs in one listed company could not exceed 20% of the total outstanding shares of that listed company.

The original rules also required QFIIs to disclose their interests in listed companies in accordance with relevant rules and to take into account domestic (i.e. A shares or B shares) and overseas shares (ie. H shares) of the of the same company as well as interests in convertible bonds and depository certificates.

Under the Revised Rules each underlying offshore investor investing through QFII may not hold more than 10% of the total outstanding shares in one listed company (excluding strategic investment by such offshore investor in accordance with the relevant regulations) and all offshore investors may not hold more than 20% of the total outstanding shares in one listed company. The new restrictions look at the interest of the underlying offshore investor instead of the QFII itself.

There is no substantial change in the permitted investments under the Revised Rules, except that it is now expressly provided that investments may be made in securities, investment funds and warrants. Permitted investments include domestic listed securities, listed bonds, securities investment funds, listed warrants and other RMB-denominated securities that the CSRC may approve. QFIIs may also participate in initial offerings of shares or convertible bonds and to subscribe for share placements.

VI. TAXATION

VAT ON PROPERTY

The Revenue Commissioners have published the final report of their VAT on Property Review Project on their website. The Revenue Commissioners had being carrying out a review of the current system of applying VAT on property transactions. The review recommends significant changes to the system. A copy of the report is available at www.revenue.ie/piblications/corppubs/vat_on_property_review_report.pdf

In the Summary of the 2007 Budget Measures and Policy Changes, the Minister for Finance indicated that it was planned to engage in a wide ranging consultation process with interested parties before deciding on any changes to the VAT treatment of property transactions. A document outlining the consultation process may be found on the Dept of Finance web site at www.finance.gov.ie under 'Consultation Processes'.

BUDGET 2007 - SOME HIGHLIGHTS

STAMP DUTY

The Minister for Finance announced that the Mortgage Head of Charge in Schedule 1 to the Stamp Duties Consolidation Act, 1999 is being abolished for mortgage deeds executed on or after 7 December, 2006. Mortgage deeds covered by the announcement include primary, collateral, additional and equitable mortgages together with transfers of mortgages.

The scope of the charge encompassed any instrument (regardless of where executed) that created security over Irish Property, "Irish Property" being widely defined. This Irish stamp duty charge that is now abolished amounted to 1% of the total value of the mortgage over Euro 254,000 capped at Euro 630 and Euro 12.50 on each counterpart or collateral instrument. The Revenue Commissioners have agreed, on an administrative basis until the enactment of the Finance Act, 2007, to give immediate effect to the Minister's announcement. Therefore, mortgage deeds executed on or after 7 December, 2006 do not need to be presented to the Revenue Commissioners for stamping.

The Minister has signalled that relief from stamp duty for member firms of the Irish and London Stock Exchanges may be amended in Finance Act, 2007 to account for the fact that practices in share dealing have advanced since the Member Firm relief was first introduced. It is hoped this will account for transactions like contracts for difference and short sales.

CORPORATION TAX

Small companies have the option of paying their preliminary tax at the lower of 90% of the final liability of the current accounting period or 100% of the final liability of the previous accounting period. A small company is a company with an annual corporation tax liability of less than Euro 150,000 (increased from Euro 50,000). New or start-up companies with a corporation tax liability of Euro 150,000 or less for their first accounting period will not be required to pay preliminary tax in respect of that first accounting period and will instead be required to pay their final corporation tax liability for that accounting period at the same time as they are required to submit their tax returns (9 months after the end of the accounting period). Both of these measures will come into effect for preliminary tax payment dates arising after 6 December, 2006. Consequently the Revenue Commissioners confirmed this would also apply for preliminary tax payment dates that fell due before Budget Day where preliminary tax had not yet been paid.

VAT

The VAT registration thresholds for small businesses are being increased from Euro 27,500 to Euro 35,000 in the case of services, and from Euro 55,000 to Euro 70,000 in the case of goods. These increases will take effect from 1 March, 2007. The annual VAT cash accounting threshold for small firms will increase from Euro 635,000 to Euro 1,000,000 with effect from 1 March, 2007.

The frequency of VAT payments, currently six per year, for smaller businesses is being reduced with effect from July 2007. A business with an annual liability of Euro 3,000 or less, the option of filing returns on a six-monthly basis will be available. A business with an annual liability between Euro 3,001 and Euro 14,400, the option of filing returns every four months will be available.

CAPITAL GAINS TAX

An exemption from capital gains tax applies in the case of individuals aged 55 and over who dispose of qualifying business or farming assets subject to certain conditions. Disposals made to a child or favourite niece / nephew are relieved in full. The threshold for will be increased from Euro 500,000 to Euro 750,000 from 1 January, 2007.

RESEARCH AND DEVELOPMENT CREDIT

The base year expenditure against which qualifying incremental expenditure on research and development ("R&D") is measured under the tax credit scheme is being fixed at 2003 for a further 3 years to 2009. This will provide an additional incentive for increased expenditure on R&D in 2007, 2008 and 2009. The 2003 base year had originally been fixed for the first three years of the scheme (2004 to 2006) and was due to roll forward to 2004 for the purpose of calculating the 20% tax credit for 2007.

From 1 January, 2007, expenditure by companies on sub-contracting R&D work to unconnected parties will qualify under the tax credit scheme up to a limit of 10% of qualifying R&D expenditure in any one year. This is in addition to the existing provision in the scheme in relation to subcontracting to universities.

It will be necessary to inform the European Commission about these changes from a State Aid perspective.

VII. OTHER NEWS

NEW OFFICES

We have now completed the move to our new custom built 50,000 sq ft premises on Sir John Rogerson's Quay on Dublin's South Quay's.

We have also opened a new southern office in Cork's city centre.

DILLON EUSTACE
SOLICITORS

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