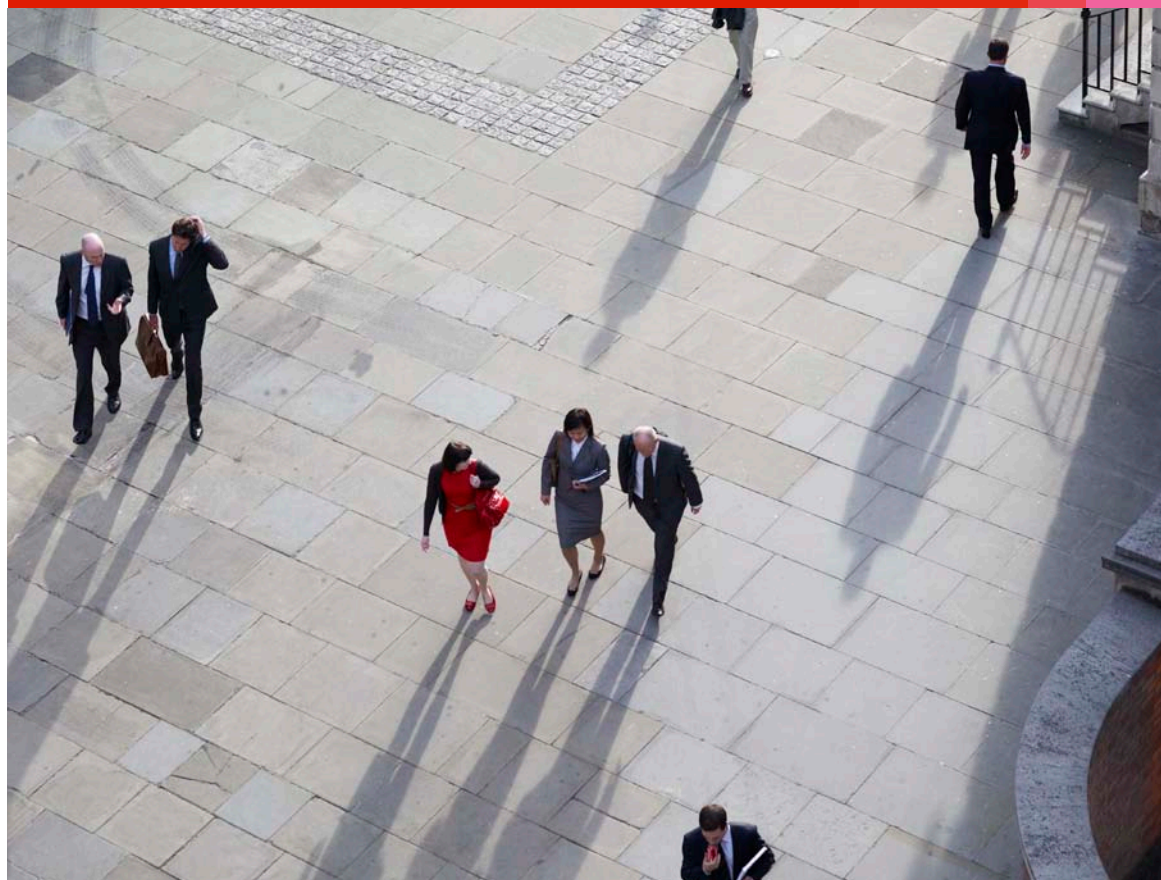


Regulatory Times

PwC Ireland
Asset Management
Regulatory News

Welcome to the second edition of our quarterly PwC newsletter. It covers both local and international regulatory topics affecting the Irish funds industry.



What is hot this quarter?

- Irish regulatory updates
- Consultation period begins for AIFM level II measures
- European Commission launches formal process to create UCITS V
- CESR, now ESMA, issues finalised guidance on Key Investor Information Document
- MiFID II review proposes UCITS III restrictions
- Asia Region Funds Passport to create competition for UCITS
- Update on the impact of Dodd Frank to non US fund managers
- Proposed new directives on short selling & OTC derivatives
- Germany introduces KIID equivalent

Irish regulatory updates

Re-domiciliation of Collective Investment Schemes to Ireland

The Companies (Miscellaneous Provisions) Act 2009 provides an efficient legislative mechanism for investment funds to re-domicile into Ireland. Since the introduction of this legislation a number of funds have re-domiciled and more are in the process of re-domiciling. While the legislation provided an efficient legal mechanism for funds to re-domicile to Ireland, industry has also been engaging with the Central Bank regarding the regulatory process and procedure for re-domiciling funds into Ireland e.g. the documentation that must be submitted to the Central Bank, confirmations required, etc. The Central Bank has now provided additional guidance in this regard, this can be found on the Central Bank's website: www.financialregulator.ie

Reduction in Minimum Subscription for Professional Investor Funds

In October the Central Bank revised NU 24 reducing the minimum subscription amount for Qualifying Investor Funds

(QIF) from €250,000 to €100,000. This meant that while the minimum subscription amount for a QIF was €100,000, the minimum subscription amount for a Professional Investor Fund (PIF) was €125,000. The Central Bank has now confirmed that the minimum subscription amount for a Professional Investor Fund (PIF) will be reduced from €125,000 to €100,000.

The QIF is "AIFMD ready"

Irrespective of the domicile of the AIF or the AIFM, the third country rules require that the AIFM complies with most, if not all, of the requirements of the AIFMD. While, unlike UCITS, the regulation is manager based as opposed to product based, an analysis of the provisions of the AIFMD shows that most of the regulatory requirements arise at the level of the AIF. Irish Qualifying Investor Funds (QIFs) comply with these requirements and are "AIFMD ready" and, accordingly, for both EU and non-EU AIFMs, establishing an Irish QIF will get the AIFM most of the way to AIFMD compliance.

Consultation period begins for AIFM level II measures

In December 2010, the Committee of European Securities Regulators (CESR), now ESMA (European Securities Markets Authority), published a call for evidence on the Alternative Investment Fund Managers Directive (AIFMD) level two measures, seeking industry feedback on the proposed legislation.

The European Securities and Markets Authority, which replaced CESR in January 2011, is expected to deliver its advice on the supporting measures by September 2011.

The measures include controversial rules on remuneration policies and depositories, as well as new requirements for the creation of an international passport for alternative funds.

The 'level-two' measures are divided into four parts: general provisions, authorisation and operating conditions, depository transparency requirements and leverage, and supervision.

The industry feedback will eventually help the Commission draw up implementing measures, technical standards and guidelines to make the AIFMD workable.

Brussels says the September 2011 deadline is necessary in order to implement the directive into national law by 2013.



European Commission launches formal process to create UCITS V

On 14 December 2010, the European Commission started a six-week consultation exercise focusing on the review of the depository function and manager remuneration in the UCITS Directive. The Commission wishes to create a level playing field in investor protection across Europe by introducing only certain targeted changes in both areas, aligning the Directive more closely with the recently adopted framework directive for Alternative Investment Fund Managers. The consultation period has been reduced to six weeks in order to enable the Commission to table its legislative proposal early in 2011. A draft UCITS V directive is expected to be published in July 2011, the same month the long-awaited UCITS IV directive will have to be implemented into member states' national laws.

In the first phase of the consultation process, the Commission is seeking the views of the UCITS funds industry on a number of additions to the legislation.

There have been several alterations to the UCITS regime over the years. UCITS III was the product and management company directive, UCITS IV was the market directive and UCITS V will focus

on investor protection.

The aim of UCITS V is to harmonise the levels of protection in different member states by imposing more detailed rules on the role and liability of depositories.

Its benchmark is the AIFM directive, adopted in November 2010, it contains depository rules inspired by the credit crisis.

Brussels also suggests the harmonisation of remuneration rules with AIFM and

other pieces of European legislation.

In a reference to the controversial Newcits funds, the Commission says remuneration principles have become necessary due to the "growing use of more complex and sophisticated strategies and access to more exotic investments, coupled with an increase in the usage of performance fee structures".

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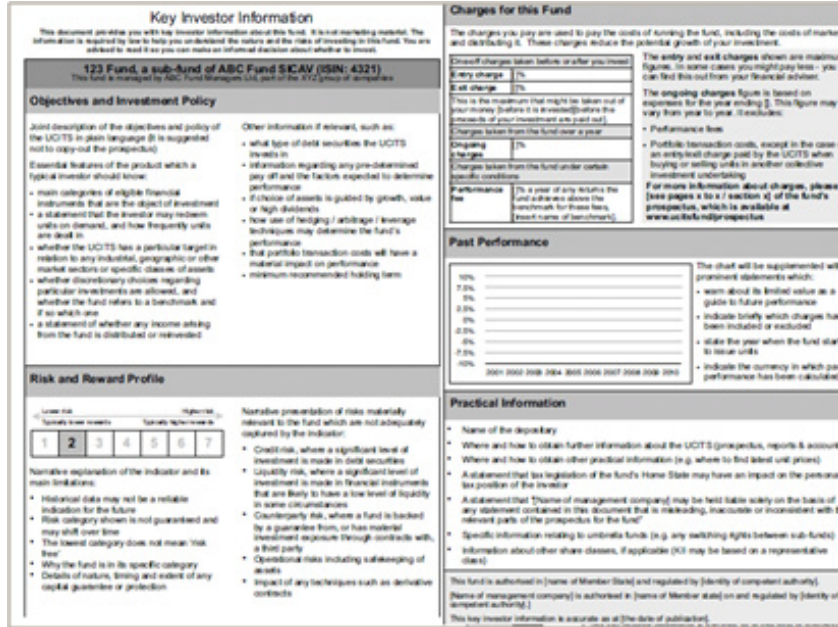
CESR, now ESMA, issues finalised guidance on Key Investor Information Document

CESR has published a number of guidelines to assist the industry in preparing for the transition to the Key Investor Information (KII) Document. These guidelines are;

- Guidelines – Selection and presentation of performance scenarios in the Key Investor Information document (KII) for structured UCITS.
- Guidelines – Transition from the Simplified Prospectus to the Key Investor Information document.
- CESR's guide to clear language and layout for the Key Investor Information document.
- CESR's template for the Key Investor Information document.

Additionally, CESR has published a number of Feedback Statements in relation to the above guidelines, which provide an explanation for the approach taken. The Feedback Statement are;

- Feedback Statement – CESR's level 3 guidelines on the selection and presentation of performance scenarios in the Key Investor Information document (KII) for structured UCITS.
- Feedback Statement – Guidelines for the transition from the Simplified Prospectus to the Key Investor Information document.
- Feedback Statement – A guide to clear language and layout for the Key Investor Information document.
- Feedback Statement – CESR's template for the Key Investor Information document.



MiFID II review proposes UCITS III restrictions

Europe is proposing a change to the way UCITS funds are classified under the Markets in Financial Instruments Directive (MiFID). The aim is to stop complex funds from being sold freely to retail investors.

A recent consultation paper on MiFID proposes tackling the issue of the increasing number of sophisticated strategies found within UCITS-wrapped vehicles.

Currently, under the MiFID regime, non-complex products, such as UCITS funds, can be sold freely to retail investors, meaning an assessment of an investor's knowledge and experience is not needed prior to sale.

The proposed changes to MiFID would mean that products, such as Newcits, could

only be distributed with a health warning or be restricted to just sophisticated investors.

Participants in the consultation process are asked to say whether UCITS should be excluded from the list of non-complex financial instruments. Hence, preventing them from being sold freely to retail investors. Participants are also asked whether other there should be partial exclusion of certain UCITS from this category. In this case, participants are asked to provide the criteria that could be adopted to identify complex UCITS.

The fund industry has until the beginning of February 2011 to respond to the consultation paper.

Asia Region Funds Passport to create competition for UCITS

UCITS dominance of Asia's cross border funds industry could face a serious challenge as Australia is pushing for a new Asian funds passport which will enable firms in the region to sell their funds across the region more easily. The Asia region is enthusiastic about the development of an Asia Region Funds Passport and appears ready to embrace the challenges involved in its establishment.

A report researched by PwC, commissioned by Australia's Financial Services Council, incorporates the views of leading funds management industry bodies and participants across the Asian region. More than eighty per cent of industry body and market participants surveyed endorse the development of an Asia Region Funds Passport.



It is currently expensive and inefficient, and in some cases not possible, for fund managers to operate across the Asia region. An Asia Region Funds Passport would provide a uniform framework which would address so of these issues. There will be a challenge in setting up a system which has proved as flexible and efficient as the UCITS regime, especially

considering the different legislative and taxation requirements in various Asian countries.

Update on the impact of Dodd Frank to non US fund managers

One of the most significant aspects of the new law is that it eliminates the "private investment adviser" exemption from registration with the US SEC for advisers to private funds.

The Dodd-Frank Act creates new exemptions for private fund advisers, advisers to venture capital funds, and foreign private advisers. The SEC has now proposed rules to implement these new exemptions. The exemptions are not mandatory and an adviser that qualifies for an exemption can still choose to register. The Dodd-Frank Act also provides exemptions for advisers to family offices and small business investment companies regulated by the Small Business Administration.

The Dodd-Frank Act subjects Exempt reporting advisers to file Form ADV with the SEC. Only certain sections need to be completed, these are listed below. Exempt reporting advisers that are registering with any state securities authority must complete all of Form ADV.

- Identifying Information
- SEC Registration
- Other Business Activities
- Financial Industry Affiliations and Private Fund Reporting
- Control Persons
- Disclosure Information

As a result of the Dodd-Frank Act, the SEC determined that the "pay-to-play" rule adopted last July should be amended, and has proposed rules to broaden the scope of the rule to apply to exempt reporting advisers and foreign private advisers.

Venture Capital Adviser Exemption

As mentioned in our previous newsletter, venture capital advisers are exempt. The SEC has now clarified the definition of a "venture capital fund" as a private fund that:

- invests in equity securities of private companies in order to provide operating and business expansion capital (i.e., "qualifying portfolio companies," which are discussed below) and at least 80 percent of each company's securities owned by the fund were acquired directly from the qualifying portfolio company;
- directly, or through its investment advisers, offers or provides significant managerial assistance to, or controls, the qualifying portfolio company;

- does not borrow or otherwise incur leverage (other than limited short-term borrowing);
- does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances;
- represents itself as a venture capital fund to investors; and
- is not registered under the Investment Company Act and has not elected to be treated as a Business Development Company.

A “qualifying portfolio company” is any company that (i) is not publicly traded, (ii) does not incur leverage in connection with the investment by the fund, (iii) uses the capital provided by the fund exclusively for operating or business expansion purposes rather than to buy out other investors, and (iv) is not itself a fund.

The proposed rule includes a grandfathering provision for a venture capital fund if it satisfies certain criteria under the grandfathering provision.

Private Fund Adviser Exemption

An investment adviser that solely advises “private funds” and has less than \$150 million in assets under management in the United States is exempt. The Dodd-Frank Act defines the term “private fund” to mean an issuer that would be an investment company under the Investment Company Act, but for section 3(c)(1) or 3(c)(7) of the Investment Company Act.

The exemption is available to non-U.S. advisers who have their principal office and place of business outside of the United States, as long as all the adviser’s clients that are United States persons (in general, as defined in Regulation S of the Securities Act of 1933 (the “Securities Act”)) are qualifying private funds. A non-U.S. adviser would only need to count private fund assets it manages from a place of business in the United States toward the \$150 million threshold.



Foreign Private Adviser Exemption

As mentioned in our previous newsletter, a foreign investment adviser is exempt as long as it meets all the below criteria:

- No place of business in the US
- Fewer than 15 clients in the US
- Less than \$25m in AUM
- Cannot sell generally to the public

In its proposed rule, the SEC has provided the following definitions and safe harbours for several of the terms set forth in the new statutory exemption:

- A safe harbour rule for counting clients;
- A definition for “investor”, “in the United States”, “place of business” and “assets under management”; and
- A safe harbour for “holding out,” such that an adviser will not be deemed to be holding itself out as an investment adviser solely because the adviser participates in a non public offering in the United States of securities issued by a private fund under the Securities Act.

These proposed rules and rule amendments were issued by the SEC on November 19, 2010 and published in the Federal Register on December 10, 2010. The period for submitting comments to the SEC on the proposals will run until January 24, 2011.

Proposed new directives on short selling & OTC derivatives



The EU Commission has published a proposed directive on short selling and certain aspects of Credit Default Swaps (“CDS”) (the “Proposed Short Selling Directive”) and also a proposed directive regulating OTCs, central counterparties and trade repositories.

Both directives now pass to the European Parliament and the EU Council for negotiation and adoption, with it being proposed that the Proposed Short Selling Directive be implemented by July 2012 and the directive on OTCs by the end of 2012.

The aim of the Short Selling Directive is to harmonise requirements relating to short selling across the European Union. The proposal also gives national regulators clear powers in exceptional situations to temporarily restrict or ban short selling in any financial instruments, subject to the coordination of ESMA.

The proposal requires that all share orders be flagged short if they involve a short sale and that investors disclose net short positions to regulators when these reach 0.2% of share capital and to the market when they reach 0.5%.

Notably, the proposal does not permit naked short selling.

In draft OTC derivatives proposal, the Commission proposes that information on OTC derivative contracts should be reported to trade repositories and be accessible to supervisory authorities. More information will also be made available to all market participants.

The Commission also proposes that standard OTC derivative contracts be cleared through central counterparties (CCPs). This will reduce counterparty credit risk.

The proposal applies to all types of OTC derivatives. However, when non-financial firms (such as manufacturers) who use OTC derivatives to mitigate risk arising from their core business activities (“commercial hedging” used to protect against exchange rate variations for example), they are exempt from the CCP clearing requirements.

Key elements of the OTC Derivatives proposal are:

- Greater transparency
- Greater safety - reducing counterparty risks
- Greater safety – reducing operational risks

This proposal is fully in line with the EU’s G20 commitments and the approach adopted by the United States.

Germany introduces KIID equivalent

Following on from our article in the last edition of Regulatory Times which focused on Hong Kong's introduction of a KID equivalent, "the Product Key Facts Statement", another jurisdiction has introduced a local version of this document. Germany has introduced their version namely the PIB. Concerns have been raised by the industry around the introduction of this German specific document and whether the new UCITS IV KIID and the current Simplified Prospectus will be deemed sufficient for the purposes of meeting these local disclosure requirements. In particular and as Germany will not be seen to adopt the KIID grandfathering period, there are concerns around the potential impact that this disclosure document will have on foreign UCITS looking to passport into Germany.

In summary, there are two relevant German legislative initiatives to be considered, the introduction of a local marketing document, (PIB) and the transposition of UCITS IV. It is likely that the PIB will be required for German investors, however it is also possible that where a KIID is prepared, the KIID will be deemed to meet the disclosure requirements of the PIB. Given that these legislative initiatives have yet to be finalised and further clarity is needed on the specific rules, it now looks more likely that Germany will continue to accept the Simplified Prospectus for foreign UCITS for the purposes of PIB disclosures and which become effective 1 July 2011 and up until the date for KIID introduction by the UCITS' home state and no later.

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