

# Regulatory *Update*\*

April 2007

## Introduction

Welcome to the first edition of PwC Regulatory Update, our new newsletter aimed at keeping you up-to-date with national and international regulatory developments affecting financial services' businesses in Ireland.

Our intention is that each issue of this newsletter will provide you with an overview of recent regulatory changes, as well as highlighting future developments coming down the tracks.

Should you wish to discuss any of the topics covered in this newsletter, or indeed other regulatory matters, please contact any member of our Regulatory & Compliance Services Team.

I hope that you find this newsletter to be interesting, informative and helpful to you and your organisation.

Jim McDonnell, Partner-in-Charge  
Regulatory & Compliance Services



## MiFID - it's going to change the business landscape.

Implementation of the Markets in Financial Instruments Directive (MiFID) has been underway for sometime now. The Directive will come into force on the 1st November 2007. It is one of the cornerstones of the European Union's (EU) strategy to establish pan European capital markets and it replaces and expands upon the Investment Services Directive.

The impact of MiFID is far reaching as it not only encompasses products and asset classes that have not been subject to

regulation before but it also introduces changes to the existing regulatory environment across the EU.

### Figure 1: Investment Products covered

- Transferable securities
- Money market instruments
- Units in collective investments
- Options, futures, swaps and any other derivative contracts related to securities, interest rates or yields
- Options, futures, swaps and any other derivative contracts related to commodities that may be settled in cash

- Options, futures, swaps and any other derivative contracts related to commodities that may be settled physically and are traded on a regulated market or MTF
- Options, futures, swaps and any other derivative contracts related to climatic variables, freight rates, emission allowances or inflation rates that may be settled in cash
- Financial Contracts For Difference
- Derivative instruments for the transfer of Credit risk

MiFID Regulations have now been transposed into Irish Law through the implementation of a Statutory Instrument (S.I. No. 60 of 2007). MiFID itself is a harmonised set of Conduct of Business requirements which covers all investment products (see Figure 1) and services (see Figure 2) and establishes rules around governance, trading, risk, compliance, operations, systems, customer documentation and outsourcing (see Figure 3).

#### Figure 2: Core Investment Services covered

- Reception and transmission of orders
- Execution of orders on behalf of clients
- Dealing on own account
- Portfolio management
- Investment advice
- Underwriting and/or placing of financial instruments
- Operation of Multilateral Trading Facilities

#### Figure 3: Some key requirements of MiFID

- All customers must be reclassified
- New customer agreements required
- Determine 'Best Execution' for all investment products
- Some firms required to provide public quotes for order-matching
- Firms to establish a Compliance function and effective compliance procedures
- Firms to establish Risk and Internal Audit functions based on complexity of business
- Document and assess the quality of 'Execution Venues'
- Obtain customer agreement to Execution policy
- Establish effective Conflicts of Interest procedures
- Carry out revised transaction reporting to regulators
- Inclusion of derivatives within EU legislation for the first time
- Inclusion of investment advice within EU legislation for the first time
- More stringent outsourcing requirements inside and outside the EU
- Rules established for 'Multilateral Trading Facilities'

The Financial Regulator has urged firms to look beyond the implementation of MiFID as just a compliance exercise and to think strategically about the new possibilities it can present. Importantly it has urged all firms which may be impacted by MiFID to examine the provisions of the Regulations and assess the impact for their firm as soon as possible.

#### Where is your Firm?

Firms need to ensure that their MiFID programmes have a proportionate and sensible approach to ensure compliance. The first step your firm must take when starting its MiFID programme is to understand the impact of the Regulations on your business. One of the key challenges with MiFID is deciding whether your business or business activities are in or out of scope. Start with the Regulations to understand the major impact areas. Take actions to understand the impact on the business and the likely cost of compliance. Review the strategic impacts which the Regulations may have on the business.

Once you understand the impact, the next step must be to conduct an impact analysis / gap analysis. This will involve rigorous assessment of the impact at a strategic and operational level. Project governance will need to be addressed and plans put in place to include resource and cost implications. Front, middle and back offices must all play a full role in the firm's MiFID project and will need to engage with all relevant changes for products and operations.

Following this phase you will need to agree an integrated implementation plan which is owned by senior management.

The MiFID requirements are wide-ranging and will require input from most areas of the organisation. Typically, effective steering groups within investment firms include Heads of Compliance, IT and Trading and Operations as a minimum, with representation at Board level. As MiFID projects develop, firms will need to develop a broader awareness-raising process to ensure that all business heads understand the effect that this Directive will have on their day-to-day processes and that the changes are communicated effectively to all relevant staff. The ultimate objective will be to turn MiFID from a detached project into an embedded part of the 'business as usual' process. Think now about what stage your organisation is at in terms of its implementation plan: the implementation date of the 1st of November is looming and firms need to be mindful of the implications of non-compliance from both a regulatory and business perspective.

## Improving Ireland's Attractiveness for Property Funds

The Financial Regulator has introduced a number of policy changes relating to property funds. These changes, which have been developed with industry and stakeholder representation, are designed to further enhance Ireland's competitiveness as a domicile for property funds, while at the same time ensuring an appropriate degree of prudential supervision and investor protection remains in place.

### Key policy changes

#### Custody/registration of assets:

Assets of property funds can now be registered in the name of the scheme or in the name of its wholly-owned special purpose vehicle (SPV), subject to the following conditions:

- 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;
- if this is not possible, a caution is registered on the title;

Alternative provisions are made where neither of the above is possible.

#### Use of subsidiaries /SPV's:

The Financial Regulator now provides that Professional Investor Fund (PIF) and Qualifying Investor Fund (QIF) schemes may establish multi-layered SPV structures subject to certain conditions.

The definition of 'property' has been changed so that it no longer includes leaseholds with unexpired leases of less than 70 years. Additionally, the Regulator has clarified that the definition of property-related assets now includes securities, other collective investment undertakings and property derivatives, with other types of assets being considered in the case of PIF and QIF schemes.

Other policy changes 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. Additionally, the Financial Regulator need not be informed of the appointment or resignation of each independent valuer. Furthermore, properties will be valued at 'market value' instead of 'open market value' as currently stated. The Financial Regulator has clarified that a full physical valuation must be carried out annually, but that the interim valuation may be carried out on a 'desktop' basis.

### Pending industry submissions

Other industry submissions that the Financial Regulator has agreed to consider relate to outstanding issues such as the level of leverage that can be employed by retail and professional investor funds, the assessment of investment restrictions on a gross asset basis and permitted investment in development land.

In conclusion, industry representatives in Ireland continue to work with the Financial Regulator on a number of outstanding issues. Further developments are expected to include a revised regulator's Notice and Guidance Note. All of this aims to make Ireland a real choice for locating property funds.

## Finance Act 2007: Changes to tax treatment of investors in funds

The Finance Bill was signed into law by the President on the 2nd April 2007. It contains some fundamental changes to the treatment of Irish investors in funds.

Since 2001, Irish investors have enjoyed the same tax treatment as non-Irish investors in Irish regulated funds - the so-called 'gross roll-up' treatment. In other words, no tax has been suffered within the fund and, when a distribution from the fund is made or the shares / units in a fund are redeemed, tax is withheld by the fund either at the rate of 20% or 23%. The investor would have no further tax to pay. The fund should not have to deduct this tax in the case of payments to non-resident investors.

However, over the same time, Irish investors have also availed of the 'offshore funds' regime to have the same rates of tax (20% or 23%) applied to income and gains arising on investments made in certain offshore locations - namely, in other EU / EEA countries or in OECD countries with a Double Tax Agreement in place with Ireland. These rates compared very favourably with the normal marginal rate of tax (e.g. 42% or 43%) that would otherwise have applied to income from investments made in these locations. Investors were using this particular regime in particular to facilitate foreign property investments (even where the actual property was in a non-EU / non-OECD jurisdiction).

This year's Finance Act attempts to curtail the use of the offshore funds regime for this purpose. Henceforth, Irish investors making new investments in an unregulated offshore fund will suffer tax on income at their marginal rate of 41%, while gains will be taxed at the capital gains tax rate of 20%.

In relation to investments already made at the 20th February, the tax rates applicable will depend on whether the investment vehicle is regarded as a 'Personal Portfolio Investment Undertaking' or 'PPIU'. If it is, then income will be taxed at the marginal rate of 41% and gains at the CGT rate of 20%. If it is not, then the previous favourable treatment will continue - i.e. tax rates of either 20% or 23%.

So, what is a PPIU? Broadly, it is either an investment vehicle or an offshore fund in relation to which the investor (or anyone connected with the investor) has influence in the choosing of the assets that the vehicle or fund will invest in (especially if that investment is property). In general, investments marketed to the general public should not be regarded as PPIU's. If an Irish regulated fund is regarded as a PPIU, then all income and gains will be taxed at 43% (or, in some circumstances, at 61%!). If the regulated fund is not a PPIU, then the existing gross roll up exit tax rates will continue to apply (20% / 23%).

Undoubtedly, this new regime confuses the situation in relation to investments in regulated funds, at least in comparison to the previous very simple regime. In addition to this, do not forget the introduction of deemed disposal rules for gross roll up funds which will kick in in January 2009. However, mainstream retail funds should be untouched by these changes and will still allow access to attractive rates of tax for Irish investors.

## New Fit and Proper requirements

The new framework for testing the fitness and probity of directors and senior managers of financial services firms took effect from the 1st of January this year. The new framework consists of two documents, one setting out guidance for completion of the test, including guidance on the considerations that underlie the concepts of fitness and probity and an Individual Questionnaire (IQ) to be completed by proposed new directors and managers and signed by appointing firms. Existing directors or managers will not have to complete the new IQ since they have already been subject to the sector-specific tests but will be subject to the test for any new positions.

## Minimum Competency Requirements

The Financial Regulator published Minimum Competence Requirements in July last year and implemented the requirements on 1st of January this year. These requirements were designed to establish minimum standards across all financial services providers from which consumers seek advice on, or seek to purchase, retail financial products. Compliance with the requirements requires either the holding of a relevant professional qualification (transitional requirements allow working towards the attainment of the relevant qualification by the 1st of January 2011) or satisfying the experience criteria for the 'grandfathering' exemption.

If you have any comments on the content of this publication, or have any other issues you would like to raise, please contact your usual tax contact within PricewaterhouseCoopers, or one of the following:

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