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Private Fund Directors: Don't Just Sit There – Do Something!



by **Peter Astleford**, **George Mazin** and **Peter McKeown-Walley***

If you don't want to pay up, do your best, even if it is your incompetent best. That is one message from Mr. Justice Andrew Jones, QC in the recent Cayman Islands Grand Court decision in *Weavering Macro Fixed Income Fund Limited v. Stefan Peterson and Hans Ekstrom*[1] ("Weavering") where the two defendants, both "independent" directors of the Weavering Macro Fixed Income Fund (the "Fund"), were each ordered to pay damages in the amount of US$111 million for wilful neglect or default in carrying out their duties.

The case arose out of the liquidation of the Fund following the discovery that Magnus Peterson, the promoter and principal investment manager, had been fabricating interest rate swaps as investments to inflate the net asset value of the Fund and hide the fact that the Fund was making losses. The messages from this case, however, are generally applicable to all private fund directors and, indeed, have relevance to all directors.

Weavering, *just one in a line of cautionary tales to both investors and industry alike, highlights how easy it may be for a director to become a puppet and for investors to suffer as a consequence.*

In *Weavering*, it appeared as though the defendants were chosen for their familial ties to Magnus Peterson rather than their professional judgment. While the defendants looked good on paper, Stefan Peterson was in fact the younger brother of Magnus Peterson and held a busy full time job with a large insurance company in Oslo. Hans Ekstrom was the Peterson brothers' 79 year-old step-father who had retired from his position as head of a large financial group's trustee department 13 years earlier. Although appointing relatives is not necessarily a bad sign, it certainly should raise the question of whether a board is truly independent and a proper check and balance.

Weavering, just one in a line of cautionary tales to both investors and industry alike, highlights how easy it may be for a director to become a puppet and for investors to suffer as a

consequence. In his judgment, Mr. Justice Jones focused upon the apathy and neglect of the defendants in carrying out their duties as directors. It was the fact that the defendants "*did nothing and carried on doing nothing for almost six years*" which led to the judgment against them and, as Mr. Justice Jones noted, the purpose of indemnity clauses such as that contained in the Articles of Association of the Fund is to protect directors who make an attempt to perform their duties but fail, not those who make no serious attempt to perform their duties at all. Accordingly, in giving his judgment, Mr. Justice Jones was compelled to re-visit the basic standards that are expected of any directors: to exercise their supervisory powers in a "*professional, businesslike manner [...] without subordinating those powers to the will of others*".

The following are some of the key "dos and don'ts" for directors to be learned from *Weavering*:

✓ **DO consider carefully which service providers are selected for appointment.**

It is important that directors consider carefully the contracts for the appointment of each service provider and independently assess the suitability of the appointments for the fund in light of industry standards. Mr. Justice Jones noted that not only did the defendants fail to consider the terms of engagement for certain service providers, they did not ensure the service providers appointed were in fact the correct parties.

✗ **DO NOT forget to check whether the party appointed is actually the party engaged.**

Minutes of the organisational board meeting of the Fund reflected resolutions to appoint PricewaterhouseCoopers as auditors to the Fund and Fortis Fund Services as administrator. Yet the parties actually appointed were Ernst & Young and PNC, respectively.

✓ **DO ensure you understand the nature of the services to be provided by service providers to a fund.**

Delegated functions require supervision and, particularly in investment funds, this supervision often represents the most significant way in which directors exercise their oversight. In *Weavering*, the board of directors delegated functions such as the accounting of the Fund's net asset value, management of the investment portfolio and custody of the assets They failed, however, to realise that the terms of PNC's engagement did not include monitoring the investment manager's compliance with investment restrictions.

✗ **DO NOT ignore gaps in the services to be provided by service providers.**

As neither PNC, nor any other party, was engaged to monitor investment restriction compliance, it was the defendants' duty as directors to monitor breaches of investment restrictions. However, aside from "noting" investment restriction compliance in board minutes, the defendants were found not to have adequately monitored investment restrictions. Had they done so, it is likely that they would have realised that the Fund was purported to be engaged in interest rate swaps well above the permissible leverage limits.

✓ **DO get all relevant reports from service providers.**

While many may assume that providing reports would be a basic part of a service provider's role, *Weavering* shows it is a director's responsibility to ensure they are provided and, once provided, they are read. In *Weavering*, PNC was only documented as having provided a quarterly administration report nearly two years after the launch of the Fund. Moreover, the first documented report offered the directors a chance to request information they would like to receive from the administrator, but it does not appear the defendants responded.

✗ **DO NOT assume that the reports provided contain all the necessary information.**

The quarterly reports produced did not contain monthly or quarterly management accounts. There was no evidence these accounts were ever requested despite monthly calculation of the Fund's net asset value and processing of its subscriptions and redemptions. This meant that the only documents the directors ever received to supervise the financial position of the fund were the half-yearly and year-end financial statements.

✓ **DO read the reports received.**

Although the Fund's directors began receiving the administrator's report, albeit almost two years after the Fund's launch, they rarely reviewed the reports as a means of supervising the Fund. Mr. Ekstrom testified to the fact that he had only looked at the first few pages of quarterly reports produced by PNC and even noted that he had never finished one because he had "no experience of these papers".

✗ **DO NOT underestimate the importance of reviewing reports from an independent director's perspective.**

Mr. Peterson reported that, after he had become a full-time executive of a company in the Weavering group, he felt he did not need to read the reports because they would only be independent verification of what he already knew. Yet, he further testified that had he actually read the reports he would have seen that the profitable interest rate swaps recorded on the accounts (although they were actually fictitious) were being closed out for no consideration. Mr. Justice Jones highlighted that it appeared Mr. Peterson did not separate his roles and attempt to review the reports from a director's standpoint to satisfy himself—as an independent director—about the financial condition of the Fund.

✓ **DO ensure regularity of board meetings and accuracy of records.**

The *Weavering* case shows that missing the bare essentials, such as staging board meetings, can spell disaster for directors. There were several instances where meetings were purportedly held, but did not in fact take place. Also, on several occasions, board minutes recorded parties as having attended when, in fact, they did not.

✗ **DO NOT conduct board meetings without the structure and formality that they require.**

Meetings that did take place were often held at Mr. Ekstrom's home and Mr. Justice Jones noted that he did not believe any real business was carried out at the meetings. Additionally, following Mr. Ekstrom's testimony, Mr. Justice Jones noted he was "*left with the impression of an elderly gentleman sitting at home chatting to his two stepsons in a congratulatory way about Mr. Magnus Peterson's apparently successful investment fund business*".

✓ **DO invite representatives of external service providers to board meetings.**

In *Weavering*, it is highlighted that Magnus Peterson and the two defendants were the only parties ever noted as having attended a board meeting. In his judgment, Mr. Justice Jones observed that service providers should be requested to attend board meetings, provide reports and answer questions on a regular basis.

✗ **DO NOT rely solely on the reports presented as an assurance that the company is being run properly.**

Mr. Justice Jones noted that having an oral report from the administrator to explain its written report or a discussion with a representative of the auditor to discuss the financial statements would have been normal and prudent business practice on the part of the directors.

✓ **DO produce real minutes of board meetings.**

No two meetings are exactly alike. For this reason, the minutes of one meeting should not be exactly the same as the last. *Weavering* re-emphasises that minutes should be accurate records of the matters actually considered, the discussions held and the decisions made at board meetings. Robust and detailed minutes help establish that directors have properly discharged their duty of care.

✗ **DO NOT allow minutes to become boiler plate.**

Mr. Justice Jones highlighted that the exact same template of board minutes was used for virtually every board meeting that took place, and some that never took place at all. These templates included no dialogue to show how decisions were made or resolutions passed. For example, as mentioned above, the minutes consistently stated that the defendants "noted" the investment restrictions were being complied with. Additionally, even some of the most fundamental elements of the minutes, such as the date of the meeting and attendees present, were often incorrect.

✓ **DO expect appropriate remuneration.**

As a general rule, independent non-executive directors should receive remuneration that corresponds to the responsibilities commensurate with the role and the time it will take to fulfil them.

✗ **DO NOT assume that a director's expected level of responsibility is tied to the level of his remuneration.**

A lower fee or gratuitous engagement does not mean the director in question is held to a lower standard or expected to do less in fulfilling the director's supervisory role. The defendants' counsel attempted to put forward a defence that Mr. Peterson and Mr. Ekstrom agreed to act as directors without a fee and, based on an observation made in one of the *Barings Plc* cases,[2] argued that the level of a director's remuneration may be considered in determining the scope of the director's responsibility. Mr. Justice Jones, however, distinguished this position. In his opinion, the fact that the defendants were not paid supported the plaintiff's argument that the defendants had never intended to carry out their duties in the first place.

✓ **DO ensure you clearly understand the financial position of the company you direct.**

Mr. Justice Jones noted the defendants were "*expected to acquire a proper understanding of the financial results of the investments and trading activity, without which they would not be able to perform a supervisory role*".

✗ **DO NOT fail to recognise and investigate unusual events.**

In late 2008, Lehman Brothers collapsed, one of the most significant financial crises in recent history ensued, and the Fund paid out US$138.4 million in redemptions. Mr. Justice Jones indicated that the defendants were seemingly not concerned by these events and never made any serious attempt to understand the Fund's overall financial position. Additionally, they never considered the detail in the Q3 and Q4 administration reports with regard to the counterparties to which the Fund was exposed. It took a fax from the administrator to the directors noting that a substantial proportion of the net asset value was exposed to Weavering Capital Finance, a company they had believed dormant since 2003, before red flags were raised.

✓ **DO read carefully the documents you are asked to sign.**

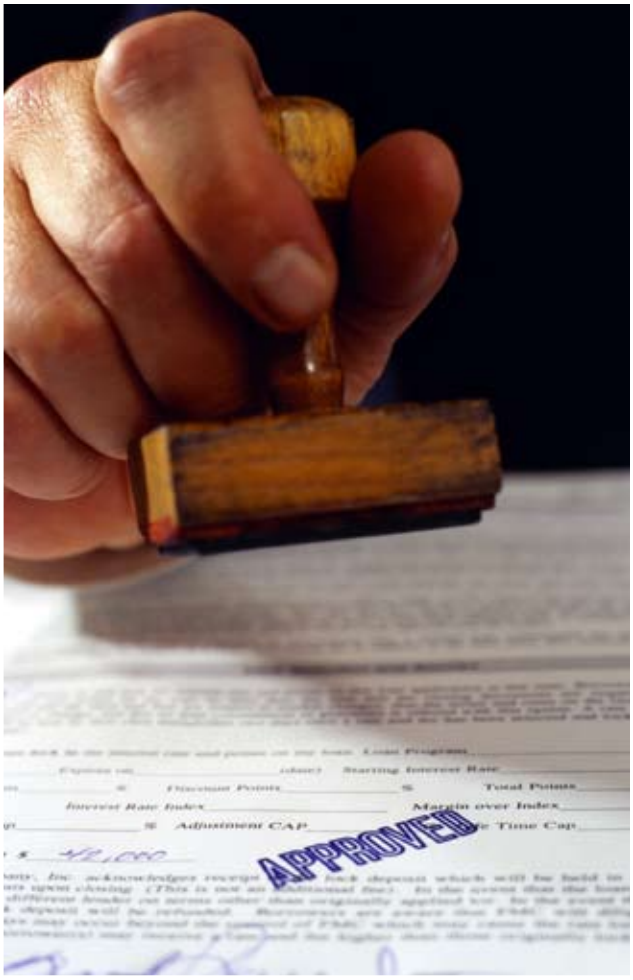
Almost as a mantra throughout the judgment, Mr. Justice Jones repeatedly stated that the defendants failed to "*apply their minds*" to their respective roles as directors. Instead, the defendants were consistently performing what Mr. Justice Jones called an "*administrative service*", by signing the documents they were asked to sign by Magnus Peterson without independently reviewing them to ensure they were appropriate.

✗ **DO NOT become a rubber stamp.**

These "rubber stamped" documents included anything and everything: from inaccurate board meeting minutes to a new Investment Advisory Agreement and new Management Agreement that could have fundamentally changed the management structure of the Fund, but both of which Mr. Justice Jones deemed to be "a sham".

Weavering stands as a reminder that sometimes it is a failure to meet the basic fundamentals that can cause the greatest harm. Those investment groups and directors who rely exclusively or largely on written resolutions or who have no or minimal minutes reflecting discussion and deliberation should consider especially carefully the effect of this judgment.

Board supervision relies on directors to seek out and then read, analyse and utilise the information they are given. As the global financial industry moves toward greater regulation, new laws such as the Alternative Investment Fund Managers Directive in Europe (the "AIFMD") are focussing minds on the need for a clear distinction between the roles of the governing bodies of funds and delegate service providers. As negotiations over the text of the AIFMD have unfolded, the liability applicable to different parties has become clearer. Also, the importance of each party to a fund knowing what it is, and is not, responsible for has become apparent. However, while more detail is being set out around the duties of a fund's governing body versus the duties of a delegate service provider, one thing has remained clear: directors have the responsibility to oversee the business of the company they direct and ensure that its business is carried out appropriately and in the best interests of the company's shareholders as a whole. If it is not, it is the directors who must explain why.



As corporate governance standards and legal requirements for directorships continue to evolve, it is prudent to remember that the law may protect those who try but fail. However, those who do not try will pay dearly.

The list set out above serves as a reminder to directors to ensure that the foundations of oversight are strong. As corporate governance standards and legal requirements for directorships continue to evolve, it is prudent to remember that the law may protect those who try but fail. However, those who do not try will pay dearly.

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* *The authors would like to thank Lindsay Trapp for her assistance in drafting the article.*

[1] Cause No. FSD 113 of 2010 (AJJ).

[2] *Re Barings Plc, Secretary of State v. Baker* [1998] BCC583, at p. 586.

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German Federal Court of Justice Decision Supports Loan Transfers by German Banks to Funds


by **Hans Stamm** and **Sebastian Göricke**

Introduction

The financial crisis in 2008 has led to regulatory changes in the financial sector worldwide. The regulatory environment for banks organised in the European Economic Area ("EEA") in particular has been subject to many material changes since 2008, and further regulatory changes are in the process of implementation by the competent national and supranational authorities. For example, the intended implementation of Basel III into European law through the so-called Capital Requirements Directive IV[1] is expected to require European banks to obtain additional regulatory equity and/or to reduce the risk-weighted size of their balance sheets. The likely result of such measures is that banks will reduce lending to companies, slowing economic growth in the EEA. The ability to dispose of loans is key to enabling banks to deleverage their balance sheets, thereby creating new lending business.

The sale, to non-bank third parties, of (performing and non-performing) loans is an important option for banks, and this can be accomplished through several established structures, such as securitizations, portfolio sales and assignments to specialized debt funds. Historically, a high proportion of new lending business was sold to the securitization markets (including CLOs), but these markets have been relatively inactive since the financial crisis. However, other non-banks (particularly funds) remain active buyers of bank-originated loans.

The assignment of loan receivables (and the sale of the loans themselves) to non-banks in Germany had been subject to uncertainties, both of a regulatory nature and under civil law. Recently, however, the German Federal Court of Justice (*Bundesgerichtshof*) published a decision that clarified the German civil law aspects regarding such assignments.

This article summarizes the regulatory background of the sale of loans (including the assignment of loan receivables) to non-banks, as well as the new decision by the German Federal Court of Justice.

Regulatory Background – Credit Lending

Neither the German Federal Court of Justice nor the German Federal Administrative Court (*Bundesverwaltungsgericht*) have yet decided whether the assignment of a loan receivable would result in the assignee being deemed to carry on a German credit lending business, which would require the assignee to hold a credit lending license pursuant to the German Banking Act (*Kreditwesengesetz*).[2] In practice, however, market participants rely on a Circular issued by the German banking regulator (*BaFin*) to determine whether a license is required.

The likely result of such measures is that banks will reduce lending to companies, slowing economic growth in the EEA. The ability to dispose of loans is key to enabling banks to deleverage their balance sheets, thereby creating new lending business.

According to the Circular "Advice on the Credit Lending Business" dated 8 January 2009 ("BaFin Circular"), an entity only requires a license for a credit lending business if it grants a loan to a borrower. An important criterion for the determination as to whether a loan is granted is the existence of a (new) decision by the lender to grant the loan and/or the advance of the loan amount to the borrower. According to the administrative practice of the BaFin, this criterion is not met in case of the sale of a loan. Hence, the BaFin Circular states that the sale of a loan (or loan receivable) by the originator to a third party (including *inter alia* by way of disclosed or undisclosed assignments, sub-participations and demergers) in general does not trigger a license requirement for the purchaser, as the purchaser does not grant a loan to the borrower, but is rather acquiring the loan receivable from the originator. An additional argument set forth in the BaFin Circular is that the purchaser and the borrower do not enter into a loan agreement, but rather a loan agreement was initially entered into between the originator and the borrower and this loan agreement is still in place. The agreement between the originator and the purchaser is a purchase agreement and not a loan agreement and therefore does not trigger the license requirement for the purchaser.

An entity only requires a license for a credit lending business if it grants a loan to a borrower.

According to the BaFin Circular, however, certain measures, if taken by the purchaser after the purchase of the loan receivable, are considered by the BaFin to constitute a new credit decision and therefore trigger a licensing requirement for the conduct of a credit lending business. The BaFin Circular sets forth certain scenarios that trigger or do not trigger such license requirement, the most important of which are the following.

Amendment of Interest Rate

The mere amendment of the loan terms to establish a new interest rate after the expiration of a fixed interest period, so long as all other loan terms remain unchanged, does not require that the purchaser hold a credit lending license. According to the BaFin Circular, the adjustment of the interest rate was already provided for in the original loan agreement since the duration of the loan was not contemplated to match the duration of the fixed interest rate.

Prolongation

The prolongation (i.e., the extension of the original maturity) of a loan, by a purchaser of a loan receivable, generally requires that the purchaser hold a credit lending license, since a prolongation is considered by the BaFin as the granting of a new loan. In case of a prolongation of a loan, under German civil law the purchaser must determine whether it wishes to extend the maturity date beyond the original term of the loan and the terms under which it is willing to do so. Such decision by the purchaser involves the same elements as an original credit decision and is therefore comparable to the granting of a new loan. Pursuant to the BaFin Circular, no license is required if the original loan agreement already granted the borrower an option to extend the loan's term.

Deferral (*Stundung*)

According to BaFin practice, a deferral of the repayment date of a loan generally does not need to be considered as the granting of a new loan, and hence no credit lending license is required. In contrast to a prolongation, in the case of a deferral the purchaser and the borrower agree only to postpone the repayment date of the loan, and from a German civil law perspective, the unpaid loan amount remains payable at any time. If the terms of the loan are not otherwise amended in such a scenario, the decision to defer the payment date does not qualify as a new credit decision because the claim remains the same.

In its decision, the German Federal Court of Justice stated that loan receivables may be validly sold and assigned to entities that do not hold a relevant banking license.

Decision by the German Federal Court of Justice

The German Federal Court of Justice ruled on 19 April 2011[3] that the assignment of a loan receivable to an entity that was not licensed as a credit institution was not void, even if it constituted a violation of the German Banking Act. In the case, the German bank in question had granted two loans to a German partnership. A few years later, the bank transferred the loans (which were not in distress) to a new subsidiary by way of a demerger. Afterwards, the subsidiary assigned the loan receivables to another German corporate entity. Neither the subsidiary nor the German corporate entity held a relevant credit lending license in Germany.

In its decision, the German Federal Court of Justice stated that loan receivables may be validly sold and assigned to entities that do not hold a relevant banking license. According to the court, it did not need to address the issue of whether the assignee required a credit lending license in case of an assignment of a loan receivable, because even if the assignee would be required to hold a credit lending license and did not do so, the assignment would nevertheless be valid under German civil law. The court indicated that the licensing requirement was established in order to protect the public, rather than to protect individual borrowers; the assignment would be valid because the borrower does not have the right, under German civil law, to maintain the original counterparty. Furthermore, the court indicated that an assignment does not require the approval of the borrower as long as the terms of the loan remain the same.

According to the court, it did not need to address the issue of whether an assignment would be void if the assignee were a non-German entity. The plaintiffs had argued that in contrast to a German entity, a non-German entity is not subject to the supervision by the BaFin in case of a violation of the German Banking Act, and therefore such an assignment should be void. However, in the case of a non-German entity that is organised within the European Union, such adverse treatment could qualify as a violation of the non-discrimination rules under European law. A further argument that the court stated as a reason for the validity of the assignment is that only one of the two parties to the assignment would have violated the German Banking Act in the issue at hand, and the rules pursuant to which the assignment could be void in general require a violation of the relevant law by both parties. Hence an assignment of a loan to a non-German entity should be valid under German civil law.

The court also stated that neither the German banking secrecy rules (*Bankgeheimnis*) nor the German data protection laws (*Bundesdatenschutzgesetz*) would require that such an assignment be invalidated. Notwithstanding this positive decision by the German Federal Court of Justice, buyers of German loans (or loan receivables) need to take into account any restrictions imposed by such rules and laws, since the breach thereof could lead to damage claims and/or penalty payments.

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1 A draft of the directive and regulation that set the minimum capital requirement standards for banks organized in the European Union was published on 20 July 2011.

2 Section 32 paragraph 1 and Section 1 paragraph 1 sentence 2 No. 2 of the German Banking Act.

3 *See* BGH – XI ZR 256/10.

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Recent Developments in the Luxembourg Financial Sector

by **Antonios Nezeritis**, **Jean-Louis Frognet** and **David Heinen**

Latest Developments in Luxembourg AML Regulations

On 19 July 2011, the Luxembourg financial supervisory authority, the *Commission de Surveillance du Secteur Financier* (the "CSSF") issued CSSF Circular 11/519 on the risk analysis regarding the fight against money laundering and terrorist financing ("Circular 11/519"). Circular 11/519 is addressed to all credit institutions and its purpose is to specify the CSSF's requirements relating to the risk analysis that these credit institutions are required to perform in accordance with the terms of the Luxembourg law dated 12 November 2004 on the fight against money laundering and terrorist financing as amended (the "Law of 2004"). Article 3(3) of the Law of 2004 provides that professionals that are within the scope of the Law "*are required to perform an analysis of the risks inherent in their business activities. They must set down in writing the findings of this analysis*."

According to Circular 11/519, the management of the credit institution is required to: (1) identify the risks of money laundering and terrorist financing ("ML/TF") to which the credit institution may be exposed; and (2) establish a methodology to categorise these risks and then define and implement measures to mitigate the identified risks.

Identification of ML/TF Risks

Circular 11/519 does not provide a list of potential ML/FT risks. Each institution must identify, categorise, and determine the importance of the particular ML/FT risks to which it considers itself to be exposed.

The following elements should be taken into consideration as they may reveal important information for an institution's analysis and assessment of its ML/FT risks. Such factors generally concern the nature of customers and the nature of the products offered and services provided, and include, but are not limited to:

Nature of Customers

- the geographical origin and/or the activity sector/profession of the customer;
- the means of entering into the business relationship with the customer (e.g., business providers, non face-to-face entry into business relationship); and
- the degree of complexity of the structure implemented for the benefit of the customer (e.g., use of front companies, trusts).

Nature of Products Offered and Services Provided

- the volume of cash transactions;
- the relations with correspondent banks (in particular when they are located in countries that do not apply ML/FT measures considered to be equivalent to those of Luxembourg);

- any transfers from or to countries that are subject to international financial sanctions;
- whether there is an offer of products/services facilitating anonymity (e.g., numbered accounts); and
- whether there is an offer of products/services that are not part of the regular activity of the institution

Measures to Mitigate ML/TF Risks

Following the identification of the risks to which it may be exposed, the credit institution must implement measures to mitigate those risks and must clearly and precisely describe such measures at different levels of its activities, in particular in relation to (the following is a non-exhaustive list) the institution's:

- acceptance procedure for entering into business relationships;
- regularisation of incomplete files;
- account blocking system;
- procedure to terminate a business relationship;
- procedure for the regular systematic review of business relationships;
- system for detecting complex, unusual and suspicious transactions;
- procedure for training and informing employees about such potential risks; and
- cooperation with the CSSF.

Self-Assessment Survey Questionnaire

An additional purpose of Circular 11/519 is to compile information regarding the self-assessment performed by each credit institution in accordance with the Law of 2004 and Circular 11/519. The credit institutions are required to answer a questionnaire annexed to Circular 11/519—the answers are intended to afford the CSSF a clear and precise view of the adequacy of the measures implemented to mitigate the risks identified by the concerned credit institution.

New Licensing Requirement for Non-EU/EEA Professionals Providing Financial Services in Luxembourg

The Luxembourg law of 28 April 2011 (the "Law of 2011") introduced a new licensing requirement for non-European Union ("non-EU") and non-European Economic Area ("non-EEA") financial professionals who do not have a permanent establishment in Luxembourg, to enable them to provide financial services to Luxembourg-domiciled clients. The Law of 2011 amended the Luxembourg law of 5 April 1993 on the financial sector, as amended (the "Law of 1993"), and entered into force on 9 May 2011. The CSSF issued Circular 11/515 on 14 June 2011 to further clarify the application of the provisions of the Law of 2011.

What Activities are Covered?

Pursuant to the Law of 2011, the new licensing requirement applies to "credit institutions and other persons from third countries, carrying on activities of the financial sector, which are not established in Luxembourg but which occasionally and temporarily come to Luxembourg, in particular to collect deposits and other repayable funds from the public and provide any other service under the Law of 1993."

The Law of 1993 regulates a wide range of financial providers and services, including credit institutions/banks and other professionals of the financial sector ("PFS") that provide, among others, MiFID investment services and ancillary activities.

When is the New License Required?

Circular 11/515 clarifies that the term "come to Luxembourg" indicates that, in order to be subject to the licensing requirement, one or more agents of the non-EU/EEA financial professionals must be physically present in Luxembourg when collecting deposits and/or providing financial services covered by the Law of 1993. Financial professionals who have Luxembourg-domiciled clients, however, do not *ipso facto* conduct their activities in the territory of Luxembourg. Pure cross-border activities carried out exclusively through communications (such as telephone, fax, e-mail) initiated from outside of Luxembourg will in principle not be subject to the new licensing requirement.

The CSSF considers that activities preceding (*en amont*) or following (*en aval*) the provision of financial services will not be subject to the licensing requirement. Accordingly, activities undertaken while in Luxembourg, such as the simple promotion of, or offering of general information regarding, financial services to the public (e.g., solicitation of clients, courtesy visits to clients and/or organization of road shows) will not trigger any licensing requirements, so long as the potential clients then contact the financial

professional, and enter into any contract with the financial professional, in its home country or any other country.

What Steps are Involved in Applying for the License?

The license is delivered by the Luxembourg Ministry of Finance, upon a recommendation by the CSSF.

The granting of the license is subject to the condition that the CSSF considers the regulatory and supervisory framework of the home country of the financial professional to be equivalent to the Law of 1993 in certain areas, notably:

- the requirement to hold a license delivered by a public authority;
- the professional honorability of the managers;
- the internal organization (organizational requirements; existence of human and technical resources; setting-up systems, resources and internal procedures); and
- the existence of conduct of business rules as well as requirements concerning own funds and participation in a deposit guarantee system.

Before filing a license application with the Ministry of Finance, the financial professional must submit to the CSSF a detailed description of the activities exercised by the financial professional in its home country, as well as those envisaged or exercised in Luxembourg. The CSSF will assess, on a case-by-case basis, whether the contemplated activities come within the scope of the license requirement and if the above-described condition is met. If the CSSF is not satisfied with the information provided, it may also ask for a legal opinion from an independent legal adviser clarifying the equivalence of the supervisory rules of the home country of the financial professional with those of Luxembourg.

The CSSF considers that credit institutions whose home country is represented in the Basel Committee on Banking Supervision (including, amongst others, Argentina, Australia, Brazil, Canada, China, Hong Kong SAR, India, Indonesia, Japan, Korea, Mexico, Russia, Saudi Arabia, Singapore, South Africa, Switzerland, Turkey and the United States) meet the equivalency and supervisory conditions. The CSSF has not issued any guidance with respect to PFSs.

Circular 11/515 specifies that the financial professionals must also comply with Luxembourg rules of territorial application, such as, for example, the Law of 2004 described earlier in this article, as well as consumer protection rules.

If passed into law, the bill will bring numerous changes to the current SIF regime.

Proposed Changes to Luxembourg Law on Specialised Investment Funds

On 12 August 2011, the Luxembourg Government submitted to Parliament a bill to amend the Luxembourg law of 13 February 2007 applicable to specialised investment funds ("SIFs")(the "SIF Law"). The Government's intent, among other things, is to reflect the "experience" of the CSSF and adapt the SIF Law with respect to the AIFM Directive, which must be implemented into national law by 22 July 2013.

If passed into law, the bill will bring numerous changes to the current SIF regime. The bill provides for changes to the regulatory approval process and includes new provisions with respect to portfolio management, the delegation of certain functions to third parties, risk management and conflicts of interest. Finally, the bill, if passed into law, will introduce into the SIF Law additional flexibilities already adopted for UCITS and non-UCITS retail funds by the Law of 17 December 2010 on undertakings for collective investment. For further information on these proposed changes, please refer to www.dechert.com/Proposed_Changes_to_Luxembourg_Law_on_Specialised_Investment_Funds_09-07-2011/.

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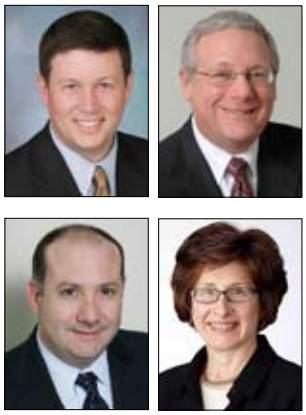
U.S. SEC Adopts New Rules to Reward Whistleblowers



by **Thomas C. Bogle**, **Alan D. Berkowitz**, **Stephen H. Bier** and **Kathleen N. Massey**

On May 25, 2011, the U.S. Securities and Exchange Commission ("Commission") issued new whistleblower rules pursuant to Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The rules provide a significant financial incentive to individual whistleblowers who voluntarily provide original information to the Commission that leads to a successful judicial or administrative action by the Commission resulting in monetary sanctions exceeding $1,000,000. In that event, the whistleblower will be entitled to between ten and thirty percent of monetary sanctions collected, with the precise amount determined at the Commission's discretion.

Qualifying Whistleblowers

Under the rules, only individuals (not companies or other entities) may qualify as whistleblowers eligible for an award. Certain individuals, however, are not eligible for an award, including:

- individuals who have a preexisting legal or contractual duty to report their information to the Commission or certain other government entities;
- attorneys, including in-house counsel, and others who attempt to use information protected by the attorney-client privilege or obtained from client engagements to make whistleblower claims for themselves (unless disclosure of the information is permitted under federal or state attorney conduct rules);
- persons who obtain the information in a manner that is determined by a U.S. court to violate federal or state criminal law; and
- certain U.S. government and non-U.S. government officials.

In addition, compliance and internal audit personnel are generally ineligible for whistleblower awards. Directors, trustees and certain senior executives of a company also are not eligible to be whistleblowers with respect to information provided to them by another person, or information provided to them in connection with the company's process for handling potential non-compliance with the federal securities laws, subject to certain exceptions. However, these executives may be eligible for a whistleblower reward with respect to information they learn directly. For example, if a company's treasurer personally discovers that another company officer is engaging in fraudulent conduct, the treasurer may obtain an award for a whistleblower submission to the Commission. However, if the treasurer was informed of the fraudulent conduct by a subordinate, consistent with the company's compliance program, then the treasurer would not be eligible for an award.

Directors, trustees, certain senior executives, and compliance and audit personnel may become eligible for an award when:

- the whistleblower reasonably believes that disclosure of the information to the Commission is necessary to prevent substantial injury to the financial interest or property of the company or investors;
- the whistleblower reasonably believes that the company is engaging in conduct that will impede an investigation of the misconduct (e.g., destroying documents); or
- the company's audit committee, chief legal officer, chief compliance officer and/or the whistleblower's supervisor have known the information for at least 120 days.

The rules provide a significant financial incentive to individual whistleblowers who voluntarily provide original information to the Commission that leads to a successful judicial or administrative action resulting in monetary sanctions exceeding $1,000,000.

Voluntary Submission

In order to be eligible for an award, a whistleblower must provide information to the Commission voluntarily. Under the Commission's rules, the information must be provided to the Commission before an individual receives a request from the Commission or other regulatory authority that relates to the same subject matter. A request for information that renders the provision of information involuntary includes:

- any request, inquiry or demand for information from the potential whistleblower by the Commission;
- requests made in connection with an examination or inspection, or an investigative request, by a self-regulatory organization; and
- investigative requests by Congress, any other federal or state authority, the Department of Justice, a registered entity or a registered futures association.

Original Information

In order to qualify for an award, a whistleblower must provide "original information" about a possible violation of the federal securities laws that has occurred, is ongoing or is about to occur. Generally speaking, "original information" must be based upon the whistleblower's independent knowledge or independent analysis, not already known to the Commission and not derived exclusively from certain public sources.

The rules include provisions designed to incentivize—but not require—employees to report compliance matters internally. Under the rules, a whistleblower will still be eligible for an award if he or she first reports information through an internal reporting process (or to Congress or certain other authorities), and then subsequently submits the same information to the Commission within 120 days. In this case, the whistleblower would be eligible for an award even if an internal report causes the whistleblower's employer to self-report the matter to the Commission before the whistleblower submits information to the Commission.

A whistleblower will still be eligible for an award if he or she first reports information through an internal reporting process (or to Congress or certain other authorities), and then subsequently submits the same information to the Commission within 120 days.

Successful Judicial or Administrative Action

A whistleblower will be deemed to have provided information leading to a successful judicial or administrative action if the information reported to the Commission is sufficiently specific, credible and timely to cause the Commission staff to commence or recommence an examination or investigation, or inquire concerning different conduct as part of an ongoing effort, and the Commission brings a successful action and recovers more than $1,000,000 based in whole or in part on conduct that was the subject of the information. To determine whether the relationship between the information provided and the allegations in a subsequent complaint or order is sufficiently close, the Commission staff will consider the

similarity of the people, entities, places, times, conduct and victims. The Commission staff also will consider whether the information provided included allegations, provisions of the securities laws, culpable persons or victims that were identified in the complaint or order. Information will also be deemed to have led to a successful action if the information concerned conduct already under investigation by the Commission and certain other government entities, and the submission materially added to the information the Commission already possessed and significantly contributed to the success of an action.

The rules make it unlawful for anyone to interfere with a whistleblower's efforts to communicate with the Commission, including threatening to enforce a confidentiality agreement.

Monetary Reward

The Commission is required to award 10% to 30% of the sanctions collected to an eligible whistleblower. For purposes of determining the amount of an award, the Commission will aggregate any recovery the Commission obtains in an enforcement action with recoveries obtained in certain related actions based on the same information that led to the Commission's successful action. According to the rules, the factors that will cause the Commission to approve a higher award to an eligible whistleblower include:

- the significance of the information provided;
- subsequent assistance provided by the whistleblower;
- law enforcement interest in the matter;
- whether the whistleblower reported the matter through internal compliance systems; and
- whether the reported misconduct involved regulated entities or fiduciaries.

Factors that decrease an award include:

- culpability of the whistleblower in wrongful conduct;
- unreasonable reporting delay; and
- interference by a whistleblower with a company's internal compliance and reporting systems.

Anti-Retaliation

Under the Dodd-Frank Act and the Commission's rules, employers are prohibited from discriminating against a whistleblower because of any lawful act taken by the whistleblower:

- in providing information to the Commission, or in any way assisting an investigation or judicial or administrative action; or
- in making disclosures required under the Sarbanes-Oxley Act or the Securities Exchange Act of 1934, or any other law or rule subject to the Commission's jurisdiction.

Financial services firms should re-examine their policies in light of the rules, and reinforce the expectation that employees report compliance matters internally, consistent with their policies and procedures.

A whistleblower is protected if he or she possesses a reasonable belief that the information provided to the Commission relates to a possible securities law violation that has occurred, is ongoing, or is about to occur. In addition, the rules make it unlawful for anyone to interfere with a whistleblower's efforts to communicate with the Commission, including threatening to enforce a confidentiality agreement.

The Dodd-Frank Act creates a private cause of action that allows an individual to sue for alleged retaliation in violation of the statute. Persons bringing successful retaliation claims under the Dodd-Frank Act are entitled to:

- reinstatement with the same seniority status that the individual would have had but for the discrimination;
- two times back pay, with interest; and
- compensation for litigation costs, expert witness fees and reasonable attorneys' fees.

Financial services firms must take caution not to impermissibly retaliate against employees who provide information to the Commission under the rules.

Special Considerations for Investment Advisers and Other Financial Services Firms

Unlike other Commission registrants, registered investment advisers and registered investment companies are required by federal law to have rigorous internal compliance programs. Most compliance programs require employees to report compliance matters internally to the chief compliance officer or a related office. Financial services firms should re-examine their policies in light of the rules, and reinforce the expectation that employees report compliance matters internally, consistent with their policies and procedures. At the same time, however, financial services firms must take caution not to impermissibly retaliate against employees who provide information to the Commission under the rules.

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FATCA: Update on Current Guidance for Non-U.S. Investment Funds

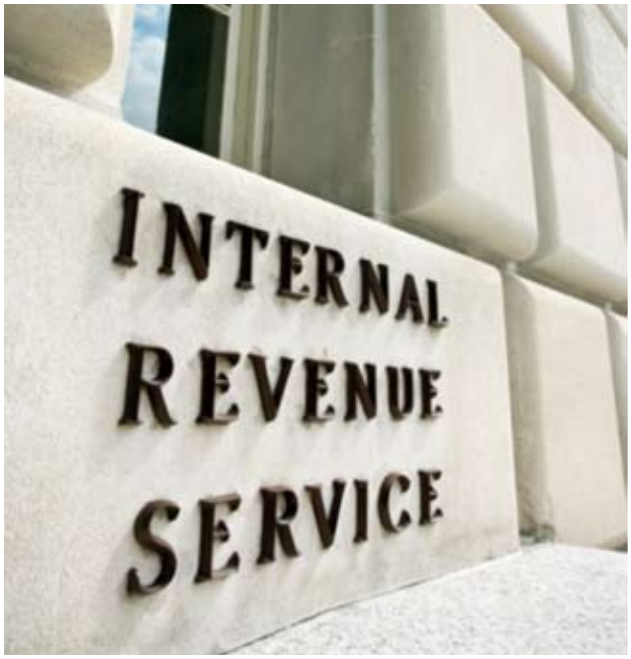
by **Adrienne M. Baker**

Background

Included as a revenue offset in the Hiring Incentives to Restore Employment Act enacted on March 18, 2010 (the "HIRE Act"), the Foreign Account Tax Compliance Act ("FATCA") adds new chapter 4 (sections 1471-1474) to the U.S. Internal Revenue Code of 1986, as amended (the "Code"). Chapter 4 of the Code imposes new information reporting and withholding requirements on "foreign financial institutions" ("FFIs," which term includes most non-U.S. investment funds, including UCITS funds, hedge funds and private equity funds)[1] with respect to certain U.S. investors or account holders ("U.S. accounts").[2] Compliance is enforced through a new 30% withholding tax on certain income and gross sales proceeds derived from U.S. sources (referred to as "withholdable payments")[3] by non-compliant FFIs.

Notice 2010-60

On August 27, 2010, the U.S. Department of the Treasury ("Treasury") and the U.S. Internal Revenue



Service (the "IRS") published Notice 2010-60, which provided very preliminary initial guidance and requested comments on a number of issues relating to the implementation of FATCA. In particular, Notice 2010-60 identified non-U.S. collective investment vehicles that prohibit the sale of their interests to certain U.S. persons as a potential category of FFI that, subject to certain additional requirements, could possibly be deemed to be FATCA-compliant, and requested comments on a number of related points. In response, many commentators, including a number of asset management industry groups, submitted proposals to Treasury detailing various conditions under which non-U.S. investment funds could be either exempt from or deemed compliant with any FATCA obligations.

Notice 2011-34

On April 8, 2011, Treasury and the IRS issued Notice 2011-34, their second installment of written guidance under FATCA. Notice 2011-34 responds to certain priority concerns identified by commentators and requests further comments on a number of issues, but is lacking in any meaningful relief for the vast majority of non-U.S. investment funds. A summary of those areas of Notice 2011-34 of particular interest to non-U.S. investment funds follows.[4]

Preexisting Individual Account Due Diligence

Notice 2011-34 modifies the procedures provided in Notice 2010-60 for identifying U.S. accounts among preexisting individual accounts,[5] and describes a new procedure for certifying completion of the due diligence requirements relating to preexisting individual accounts.

Although FFIs generally may rely on electronically searchable information[6] to determine whether preexisting individual accounts contain indicia of U.S. status that may require additional documentation from account holders, more stringent standards, requiring a diligent review of paper and electronic account files and other records, apply to "private banking accounts"[7] and certain "high value" accounts generally having a value or balance of $500,000 or more.

As part of the new certification procedure outlined in Notice 2011-34, the responsible officer of an FFI must certify that, between the publication date of Notice 2011-34 and the effective date of the FFI's FFI agreement, FFI personnel did not engage in any activity of assisting account holders as to strategies for avoiding identification of their accounts as U.S. accounts. Furthermore, the responsible officer must certify as to the existence of written policies and procedures prohibiting employees from providing such advice.

Passthru Payments

A FATCA-compliant FFI generally must agree to withhold tax (at a 30% rate) from any "passthru payment" made to a "recalcitrant account holder"[8] or non-compliant FFI. For this purpose, a "passthru payment" is defined as any withholdable payment or other payment attributable to a withholdable payment.

Notice 2011-34 generally treats any payment made by an FFI to an account holder as a passthru payment to the extent that the payment is a withholdable payment and, as to the remainder of the payment, in an amount equal to the passthru payment percentage of such payment. The passthru payment percentage generally is that percentage of an FFI's total assets that represent U.S. assets[9] as of each of the last four quarterly testing dates (generally coinciding with the FFI's fiscal quarters).

In a fund of funds context, an FFI may rely on the passthru payment percentage of any underlying FFI that is itself FATCA-compliant or deemed compliant, but only if the underlying FFI calculates and publishes its passthru payment percentage. A FATCA-compliant or deemed compliant FFI that fails to calculate and publish its passthru payment percentage in the manner set forth in Notice 2011-34 (generally within three months of its quarterly testing date on a website or other database searchable by the public) will be deemed to have a passthru payment percentage of 100%. An FFI that is neither FATCA-compliant nor deemed compliant will be presumed to have a passthru payment percentage of zero percent. The IRS intends to maintain a database that will permit FFIs and other withholding agents to determine whether an FFI is FATCA-compliant or deemed compliant.

It is unclear how the passthru payment mechanism will apply to FFIs that are treated as partnerships or otherwise tax transparent for U.S. federal tax purposes. Treasury and the IRS request comments regarding the application of passthru payment percentages to partnerships and other flow-through entities.

Certain Deemed-Compliant FFIs

Notice 2011-34 describes certain limited categories of FFIs that will be deemed to be FATCA-compliant. A deemed-compliant FFI generally will be required to (i) apply for deemed–compliant status with the IRS, (ii) obtain an IRS-issued FFI identification number

("FFI-EIN") identifying it as a deemed-compliant FFI, and (iii) certify every three years to the IRS that it satisfies the requirements for such treatment.

With respect to investment funds, the provision for deemed compliance is disappointingly narrow. Specifically, Notice 2011-34 states that, under future guidance, an investment fund will be deemed to be FATCA-compliant if (i) all holders of record of direct interests are FATCA-compliant or deemed-compliant FFIs or exempt foreign governments (or their agencies or instrumentalities), international organizations or foreign central banks, (ii) the fund prohibits subscription by persons other than those described in (i), and (iii) the fund certifies that any passthru payment percentages that it calculates and publishes will comply with the requirements of Notice 2011-34.

Furthermore, with respect to funds (such as exchange-traded funds or "ETFs"), the interests in which are regularly traded[10] on an established securities market (which interests are not considered financial "accounts" under FATCA), Notice 2011-34 states that, although such FFIs maintain no U.S. accounts, they are FFIs and therefore subject to certain obligations under FATCA to the extent that they receive passthru payments. Such funds would therefore be required to enter into FFI agreements, withhold on passthru payments made to non-compliant FFIs, and certify that any published passthru payment percentages comply with the requirements of Notice 2011-34. Rather than provide a blanket exception for such funds, Notice 2011-34 states merely that Treasury and the IRS are considering under what circumstances such funds could be deemed compliant.

Notice 2011-34 concludes its discussion of deemed-compliant investment funds by stating that Treasury and the IRS continue to consider comments received regarding whether there may be a category of funds that may be deemed compliant because (i) all direct interest holders are FATCA-compliant or deemed compliant FFIs, U.S. financial institutions, certain foreign governmental entities, international organizations or foreign central banks, or non-compliant FFIs acting as distributors, (ii) distribution agreements prohibit sales to reportable U.S. persons, non-compliant FFIs holding for their own account, and non-financial foreign entities other than certain excepted entities, and (iii) the fund satisfies other as-yet-unidentified requirements.

Regrettably, the Notice does not refer to potential exemptions, deemed compliance or other special treatment for widely held investment funds (however defined) or for funds that offer interests directly to investors (rather than through distributors or global platforms) and do not permit investment by reportable U.S. account holders.

Centralized Compliance Options

Notice 2011-34 discusses the intention of Treasury and the IRS to provide certain affiliated groups of FFIs with an option to appoint a designated FFI to assume an oversight role with respect to the FATCA compliance of some or all members of the group.

Treasury and the IRS similarly are considering whether a centralized compliance option should be provided for investment funds having a common asset manager or other agent. The Notice contemplates that such an option would permit the common asset manager or other agent to execute a single FFI agreement on behalf of each affiliated fund that contracts with the manager or other agent to perform the functions required under the FFI agreement with respect to the fund. This option would be limited to those situations in which the manager or other agent is able to monitor the fund's compliance with its FFI agreement based on its legal agreements and other arrangements with each fund. The manager or other agent would act as the point of contact for the IRS with respect to all issues concerning the affected funds, or could designate an agent to assume this responsibility. Funds participating in such an arrangement would continue to be liable for the performance of their obligations under the FFI agreement.

Notice 2011-53

Notice 2011-53, the third and most recent installment of written FATCA guidance, was issued by Treasury and the IRS on July 14, 2011.[11] Although the FATCA legislation provides for an effective date of January 1, 2013, Notice 2011-53 reflects the decision of Treasury and the IRS to apply a phased-in approach to the implementation of FATCA. This decision resulted from industry commentary demonstrating that FATCA's complexity will require significant modifications to the information systems of FFIs and withholding agents. The phased-in approach of Notice 2011-53 is designed to provide FFIs and withholding agents with adequate time to make such modifications.

Pursuant to Notice 2011-53, an FFI will have until June 30, 2013 to enter into an FFI agreement with the IRS. The due diligence obligations of FFIs will begin in 2013. Withholding on U.S. source income (but not U.S. source gross proceeds) paid to non-compliant FFIs and recalcitrant account holders will begin on

January 1, 2014. U.S. source gross proceeds will become subject to FATCA withholding on January 1, 2015. The obligations of compliant FFIs to compute and publish their passthru payment percentages will not begin before the first quarter of 2104, and withholding by FFIs on passthru payments (other than payments of U.S. source income and gross proceeds) will not begin before January 1, 2015.

Future Guidance and Next Steps

Treasury and the IRS anticipate issuing proposed regulations incorporating the guidance described in Notice 2010-60, Notice 2011-34 and Notice 2011-53 by the end of 2011. Final regulations, together with draft and final versions of the FFI agreement and the information reporting forms to be used by FFIs and withholding agents, are expected in the summer of 2012.

Various industry groups are continuing to press Treasury for guidance that would alleviate the FATCA burdens imposed on widely held investment vehicles and funds that prohibit investment by reportable U.S. account holders. There can be no assurance as to whether and in what form any such guidance may issue.

In the interim, non-U.S. funds should begin to decide whether to permit reportable U.S. account holders, and determine who will be responsible for performing the due diligence required to identify U.S. account holders. Offering documents will require updating to include related risk disclosure. Subscription procedures will need to be revisited. Distribution agreements and platform arrangements may also need revisiting to ensure that such arrangements will not impede FATCA compliance.

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1 The term "foreign financial institution," as defined for FATCA purposes, includes non-U.S. banks, broker-dealers, custodians, clearing agents and insurance companies, in addition to non-U.S. investment funds.

2 "U.S. accounts" for which reporting is required under FATCA (referred to herein as "reportable U.S. accounts") include accounts held by U.S. persons (as defined for U.S. federal income tax purposes, with certain exceptions as noted below) and also accounts of certain non-U.S. entities that have such U.S. persons as owners. The categories of U.S. persons that do not trigger FATCA reporting include publicly traded corporations (and certain corporate affiliates), most U.S. tax-exempt entities, the United States and its agencies and instrumentalities, banks, real estate investment trusts, regulated investment companies (i.e., U.S. mutual funds) and common trust funds.

3 "Withholdable payments" for FATCA purposes include dividends, interest (including portfolio interest and original issue discount), rents, annuities and royalties derived from U.S. sources, as well as gross proceeds from the disposition of securities that produce U.S. source dividends or interest.

4 Notice 2011-34 provides guidance in the following six areas: (i) due diligence procedures for FFIs identifying preexisting individual accounts; (ii) "passthru payment" calculations and withholding procedures; (iii) certain deemed-compliant FFIs; (iv) FFI reporting obligations with respect to U.S. accounts; (v) obligations of qualified intermediaries; (vi) treatment of expanded affiliated groups of FFIs; and (vii) the effective date of FFI agreements.

5 The term "preexisting individual account" refers to an account held by an individual as of the effective date of an FFI's agreement with the IRS to comply with FATCA (such agreement referred to herein as an "FFI agreement").

6 Notice 2011-34 defines the term "electronically searchable data" to include information that is stored in the form of an electronic database against which standard queries in programming languages may be used; the term does not include files or other information stored in an image retrieval system (such as .pdf files or scanned documents).

7 Private banking accounts include accounts of private banking, wealth management or similar departments of an FFI, as well as accounts of departments that (i) focus on servicing high net worth individuals or their families, (ii) provide personalized banking, investment advisory, trust and fiduciary, estate planning, philanthropic or other services not generally provided to account holders, or (iii) gather personal, financial and professional information about individual clients beyond that which ordinarily is gathered from retail customers.

8 The term "recalcitrant account holder" refers to an account holder that fails to comply with reasonable requests for information required by an FFI to comply with its FATCA obligations.

9 In a somewhat circular fashion, Notice 2011-34 defines a "U.S. asset" to include "any asset to the extent that it is of a type that could give rise to a passthru payment."

10 Although further clarification is needed as to what constitutes "regular trading on an established securities market," mere listing of fund shares without actual trading would appear to fall short under the most liberal of interpretations.

11 Notice 2011-53 was later revised on July 25, 2011 to reflect some clarifying changes.

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Ireland's Chilean Difficulty*

by **Declan O'Sullivan**

Although Chile does not generally impinge on the Irish consciousness, in early September Chile was uppermost in the thoughts of the Irish funds industry. This is because the Chilean Pensions Regulator, the CCR, delisted UCITS funds domiciled in Ireland as approved investments for Chilean pension funds.

UCITS are investment funds that can be sold to institutions and retail investors throughout Europe under European single market rules and, increasingly, beyond Europe in countries like Hong Kong, Taiwan and Chile. They are attractive investment products because they are highly regulated with their assets protected by independent custody arrangements. Most of the investment in UCITS is made by pension funds and insurance companies across the globe and these are highly regulated.

While a number of international banks have pulled out of Dublin's International Financial Services Centre (IFSC), the funds business—which is serviced by fund administrators, custodians, lawyers and accountants both in the IFSC as well as in towns and cities across the country such as Cork, Waterford, Wexford, Limerick and Kilkenny—continues to go from strength to strength. The value of assets in funds domiciled in Ireland grew by more than 29% in 2010 and now stands at €987bn.

UCITS are a significant Irish export product (with Irish UCITS representing 13% of established UCITS) and Chile is an important market. It emerged from the Pinochet years as one of the most prosperous and well-run economies in South America—an attractive market for fund managers. By recognising and allowing investment by Chilean pension funds in UCITS, the CCR opened up a market for Irish-domiciled UCITS that was valued at over €6 billion in assets under management. However, Chile is also in a region that has suffered from sovereign default and its rules for investments by pension funds means that the credit risk of the country where the fund is domiciled must also be taken into account.

By recognising and allowing investment by Chilean pension funds in UCITS, the CCR opened up a market for Irish-domiciled UCITS that was valued at over €6 billion in assets under management.

During 2010 and culminating in the EU/IMF bailout, Ireland underwent a series of credit rating downgrades that triggered a breach of the Chilean rules for pension fund investment. The Irish funds industry, with the assistance of the Irish Government and the regional Irish Ambassador in Latin America, lobbied hard to prevent Irish funds from being delisted as approved investments. They highlighted the international nature of UCITS and their governance by a European legislative framework with independent custody arrangements. Explanations were also given on the protection of property rights under the Irish constitution and the fact that while funds might be domiciled in Ireland, the assets of these funds were

mostly domiciled outside Ireland—so that the risk of an Irish Government raiding Chilean pension fund assets was minimal or non-existent. Following this engagement, the CCR agreed not to automatically disapprove Irish funds, but instead put Irish funds on a "watch list" subject to ongoing review.

However, Moody's assigning Ireland a Junk Bond Status for Irish sovereign debt proved a tipping point for the Chilean authorities, who took the decision to delist Irish funds.

The Irish funds industry, with the assistance of the current President of IFSC Ireland and former Taoiseach (Prime Minister) John Bruton, will be spending a lot of time in Chile over the coming weeks and months, seeking changes to the Chilean rules and giving Chilean pension funds the positive message about the safety of Irish UCITS. They will look to be supported in their endeavours by the EU and global regulatory bodies who recognise that the safeguards within the UCITS structure mean that there can be no real risk of expropriation by government action.

This Chilean action is significant for the Irish funds industry and for the asset managers whose funds are affected. While there are concerns about how this will impact upon the competitiveness of Ireland as a fund domicile, most observers consider that Ireland's Chilean difficulty is a temporary blip.

In addition to retail investment funds such as UCITS, Ireland is a major centre for the administration of hedge funds and other alternative fund structures, many of which are also domiciled in Ireland. There is significant European legislation coming down the track on the regulation of alternative investment fund managers, which may lead many of these funds to relocate from offshore jurisdictions such as Cayman to the EU, and Ireland is poised to be a major beneficiary from this increased regulation.

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* This article is based upon an article that appeared in the September 11, 2011 issue of Ireland's *The Sunday Independent*.

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Upcoming and Recent Events

OCTOBER 12, 2011
Global Fund Managers Navigating the Intersection of Dodd-Frank and the AIFMD
New York

Legislative and regulatory initiatives on both sides of the Atlantic create the potential for overlapping regulatory jurisdiction. This program will highlight those areas and suggest strategies for minimizing unnecessary regulatory burdens.

OCTOBER 11, 2011
New and Proposed U.S. Reporting Requirements Impacting Investment Advisers
London

A number of the reporting requirements proposed and adopted by the Securities and Exchange Commission and other government agencies under the Dodd-Frank Act will soon be effective. These new reporting requirements include Form 13H, Form N-PX, and Form PF. Speakers will explore the scope and requirements of each of these new or proposed reporting obligations and discuss the extent to which the requirements are expected to impact SEC-registered advisers and unregistered advisers.

OCTOBER 4, 2011
Panorama des évolutions de la réglementation financière américaine et son impact sur l'asset management français (Overview of U.S. financial regulatory developments and their impact on the French asset management industry)
Paris

Topics to be covered include: U.S. investment adviser registration; reforms of derivatives regulation; proposed repeal of certain CFTC exemptions; the Volcker Rule and other developments from banking regulators; and the SEC's Whistleblower rules.

SEPTEMBER 22, 2011
Breakfast Update: The Latest from Washington Affecting Fund Managers
London

After two years as the senior private fund adviser for the SEC's Division of Investment Management, we welcome back David Vaughan to Dechert. In this session, Mr. Vaughan shared his perspective on the latest developments in U.S. regulatory issues, while some of our London-based U.S. and UK securities lawyers discussed the European perspective. Topics included: entities that must register or claim an exemption within typical fund management structures and the prospects for regulatory oversight of exempt reporting advisers.

For more information, or to receive materials from the seminars listed above, please contact Beth Goulston at +1 202 261 3457 or beth.goulston@dechert.com.

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