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Dechert LLP

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Preface

Dear Reader,

We are pleased to introduce *ICLG – Alternative Investment Funds 2020*. The alternative investment space has seen much change over recent years, but rarely has this been combined with such an uncertain wider global environment. Yet, as we collectively stare down the barrel of a global downturn, the return potential offered by alternative investments remains of immense importance. The pensions and retirement plans of frontline workers the world over, along with millions of others, are more and more invested in the funds designed, created, operated and serviced by those who will read this book.

As practitioners, we play our part in ensuring that the industry runs efficiently, that it adapts to (and indeed helps to shape) the changing legal and regulatory landscape, and that new technologies and techniques are harnessed. Throughout, the evolving needs and preferences of investors must rightfully be placed front and centre. This guide offers a wealth of expertise on these issues across 20 jurisdictions, in addition to four expert chapters on a range of topics, and we would like to thank all of the contributors.

Gus Black & Mikhaelle Schiappacasse
Dechert LLP

ICLG.com

The Rise of ESG Investing

Dechert LLP

Mikhaelle Schiappacasse

Introduction

The idea that chasing alpha should not be the sole goal of investment activity is not in and of itself new; wherever an investor's values are stronger than pure profit motive, there has always been space for responsible investing. However, over the past three decades or so, the principle of responsible investment has crystallised around environmental, social and governance (**ESG**) criteria and in particular around the idea of environmentally sustainable investment in light of growing concerns regarding climate change. It has also moved from being a question of values to an understanding that the risks associated with environmental degradation, social inequality and weak corporate governance can have an adverse impact on financial returns and to a growing acceptance that the consideration of ESG factors is an integral part of the investment decision-making process and not synonymous with weaker economic return.

Historically, ESG investing has almost exclusively been driven by investor preference – at the individual and institutional level – and this investor demand has been increasing exponentially, with asset managers meeting the growing demand by raising funds pursuing ESG investment strategies. Both investors and managers, however, have found themselves suffering from a lack of consensus regarding what constitutes ESG investment and an absence of reliable and comparable information regarding portfolio companies and investment products in order to make informed investment decisions.

A number of international non-governmental organisations (**NGOs**) have sought to address this deficiency by proposing principle-based standards or providing guidelines on ESG analysis and reporting metrics, but these have yet to result in a harmonised approach to ESG investing. It is against this background that recent regulatory developments, in particular in the European Union (**EU**), but to some extent also in the United States and Asia, can be understood.

The European Sustainable Development Agenda

Development

The path to putting in place a regulatory framework for ESG investing in the EU began in earnest with the EU Commission's decision to make sustainable development a political priority in 2016. This followed the adoption in 2015 of the United Nations' (**UN**) 2030 Agenda for Sustainable Development and the UN Paris Agreement on Climate Change (**Paris Agreement**). The Agenda for Sustainable Development has at its core 17 Sustainable Development Goals (**SDGs**) which include, along with the core goals of ending poverty and hunger, goals such as combating climate change, ensuring responsible consumption and production and promoting sustainable economic growth, full and productive employment and decent work for all. The Paris Agreement was the first global climate deal and has the aim of adapting and building resilience to climate change and limiting global warming to below 2°C above pre-industrial levels.

The EU Commission appointed a High-Level Expert Group, which published its final report in January 2018, setting out two urgent imperatives: (1) improving the financial system's contribution to sustainable and inclusive growth by funding society's long-term needs; and (2) strengthening financial stability by incorporating ESG factors into investment decision-making. Building on this report, in March 2018 the EU Commission published its Action Plan on Sustainable Growth (**Action Plan**), which recognised that the financial system has a key role to play in sustainable development by re-orientating private capital to more sustainable investments and sets out 10 action points[1] with the key objectives of: (i) reorienting capital flows towards sustainable investment in order to achieve sustainable and inclusive growth; (ii) managing financial risks stemming from climate change, environmental degradation and social issues; and (iii) fostering transparency and long-termism in financial and economic activity.

Sustainable finance became part of the regulatory agenda in February 2020 when the European regulator for the asset management industry, the European Securities and Markets Authority (**ESMA**), published its Strategy on Sustainable Finance, which sets out how ESMA will place sustainability at the core of its activities by embedding ESG factors in its work. The key priorities for ESMA include transparency obligations, risk analysis on green bonds, ESG investing, convergence of national supervisory practices on ESG factors, taxonomy and supervision.

Legislative and regulatory initiatives

As early as 2016, Directive (EU) 2016/2341 on the activities and supervision of institutions for occupational retirement provision (**IORP II**), which applies to firms that manage employee pension schemes (**IORPs**), provided that IORPs should be (i) permitted to consider the potential long-term impact of investment decisions on ESG factors, and (ii) required to disclose where and how ESG factors are taken into consideration in investment decisions and risk management. As a result, European pension investors were early proponents of ESG investing and reporting in Europe.

Commencing in 2019 and continuing into 2020, the EU has pursued a significant number of legislative and regulatory initiatives aimed at integrating (i) ESG considerations into the

investment processes of EU-based investment managers and investors, and (ii) ESG factors into the non-financial data that is tracked and reported on by European businesses. These initiatives include:

- A proposed amendment to Delegated Regulation ((EU) 231/2013) under Directive 2011/61/EU (**AIFMD**) to require alternative investment fund managers (**AIFMs**) to take into account sustainability risks in their existing governance procedures and organisational structures, in their management of conflicts of interest, in their risk management policies and as part of their investment due diligence. Where the AIFM considers the principal adverse impact of investment decisions on sustainability factors under the Disclosure Regulation (see further below) these will also need to form part of their due diligence processes.
- A proposed amendment to the UCITS Commission Directive (2010/43/EU) to require UCITS management companies (**UCITS ManCos**) to comply with similar obligations to those set out above in relation to AIFMs and to require self-managed UCITS to also integrate sustainability risks into the UCITS' management, taking into account the nature, scale and complexity of the business of the investment company.
- A proposed amendment to the MiFID Commission Delegated Regulation ((EU) 2017/565) a delegated regulation under the Markets in Financial Instruments Directive (2014/65/EU) (**MiFID II**) that would require discretionary managers and non-discretionary advisors to determine their clients' ESG-related preference and to take these into account in making investments and evaluating conflicts of interest, to report on how any investment takes account of such preferences, and to integrate sustainability risks into the firm's risk management policies. There is also a proposed amendment to the MiFID Commission Delegated Directive (2017/593) relating to product governance, which would require discretionary managers and non-discretionary advisors to take account of sustainability factors and preferences in connection with their product governance obligations, including taking account of sustainability preferences when identifying a target market for a product or service.
- An amendment to Regulation (EU) 2016/1011 (**Benchmark Regulation**) by Regulation (EU) 2019/2089 (**Low Carbon Benchmark Regulation**), which introduces two new types of benchmarks:
  - (i) an EU Climate Transition Benchmark, being a benchmark with a "decarbonization trajectory" as evidenced by a measurable, science-based and time-bound movement towards alignment with the objectives of the Paris Agreement (e.g. the 2ºC limit on global warming); and
  - (ii) an EU Paris-Aligned Benchmark, being a benchmark where the resulting reference portfolio's carbon emissions are aligned with the objectives of the Paris Agreement (e.g. in essence the carbon emissions savings of each underlying asset exceeds its carbon footprint).
- A series of consultations on Directive 2014/95/EU amending Directive 2013/34/EU (**Accounting Directive**) as regards disclosure of non-financial and diversity information by certain large undertakings and groups (**Non-Financial Reporting Directive** or **NFRD**), which are consulting on, among others, whether the information required to be reported under NFRD provides the information that is actually needed, and whether such information is presented in a form that is suitable for use by managers in connection with the reporting obligations to be imposed by the EU's sustainable development initiatives. This is a particularly urgent question given the level of detail regarding ESG criteria relating to underlying investments that EU investment managers are being asked to provide pursuant to one of the most important ESG-related regulations to come out of the EU's Action Plan to date, the Disclosure Regulation.

At the heart of the EU's sustainable development agenda are the proposals for a unified EU classification system of sustainable economic activities (**Taxonomy Regulation**) and EU Regulation (EU) 2019/2088 (**Disclosure Regulation**), which provides disclosure standards for financial market participants relating to the integration of sustainability risks into their investment processes. These two regulations cannot be viewed in isolation. While the obligations imposed by the Taxonomy Regulations are limited, the implications of its text are broad, establishing, as it does, the vocabulary underlying the EU's sustainable development agenda and, in this context, informing the content of the disclosure obligations under the Disclosure Regulations.

While the entities in scope of the various Regulations and Directives are essentially financial firms active in the European Union, the impact will likely be felt much more broadly, not only because financial firms are frequently global or operate cross-border into the EU, but because the EU has moved first to define regulatory parameters in a space that is of growing global importance and relates to issues, such as global warming, which do not obey national boundaries.

The Disclosure Regulation

The Disclosure Regulation is the first piece of regulation that seeks to provide for (i) a harmonised understanding of what constitutes "sustainable investment",[2] and (ii) a uniform, mandatory set of disclosure and reporting obligations relating to sustainability issues in connection with investment activity.

The majority of the provisions under Disclosure Regulation will, barring any delay, apply from 10 March 2021 with certain provision becoming effective up through December 2022. The Disclosure Regulation is necessarily high level in its requirements, but the specific details are informed not only by the Taxonomy Regulation and the yet-to-be developed technical screening criteria provided for under that regulation, but also by a set of prescriptive regulatory technical standards (**RTS**) which are provided for under the Disclosure Regulation itself and which are, at the time of writing, under consultation. The impending March 2021 implementation date, the expectation that the RTS will not be in agreed form before the end of 2020 and the current unprecedented COVID-19 pandemic are causing firms and industry associations to voice concerns regarding the proposed time-line.

The Disclosure Regulation applies to "financial market participants" such as AIFMs, UCITS ManCos and MiFID managers providing segregated portfolio management services (**FMPs**)[3] and also to financial advisors providing insurance or investment advice – the focus of this chapter is on the obligations attaching to FMPs. It requires certain disclosure at both the level of the financial market participant (e.g. firm level) and the level of the relevant "financial product", which would include an alternative investment fund (**AIF**), UCITS or managed account mandate (**Product**).[4] The disclosure obligations apply regardless of whether the FMP manages Products with a sustainable investment strategy or not, with additional disclosure obligations attaching to a Product that "promotes, among other characteristics, environmental or social characteristics" or that has "sustainable investment as its objective".

The Disclosure Regulation requires that these disclosures be made: (i) on the FMP's website; (ii) as part of the Product's

pre-contractual disclosures (for example, in the prospectus for a UCITS); and (iii) in annual periodic reports (for example in the annual report for an AIF). The disclosures are essentially concerned with providing transparency regarding: (a) FMPs' policies on the integration of sustainability risks into their investment decision-making and due diligence processes; (b) FMPs' assessment of the adverse impacts of sustainability risks on the financial return of Products; and (c) the criteria underlying Products that promote environmental or social characteristics or that pursue a sustainable investment objective and the extent to which those criteria or objectives are met and the relative performance of the Product against the broader (non-ESG) market.

Policies and website disclosure

There are a number of different obligations relating to policies that FMPs are to put in place and publish on the FMP's website. An FMP must publish on their website:

- Information regarding the FMP's policies on the integration of sustainability risks[5] in its investment decision-making process.
- A statement regarding the FMP's due diligence policies in connection with the adverse impact of investment decisions on sustainability factors where such adverse impacts are considered by the FMP or, where they are not considered, a statement that the FMP does not consider such adverse impacts, why they are not considered and whether/when the FMP intends to consider them in the future. For an FMP that has, or is a parent of a group of companies that has, on average over 500 employees, this opt-out is not available after June 2021.

  The Disclosure Regulation requires that such statement includes: (i) information about the FMP's policies on the identification and prioritisation of principal adverse sustainability impacts and indicators; (ii) a description of the principal adverse sustainability impacts and of any actions in relation thereto taken or, where relevant, planned; (iii) brief summaries of engagement policies; and (iv) reference to their adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting.

  The RTS proposes, in connection with requirement (ii) above, a detailed disclosure matrix, with 32 mandatory adverse sustainability factors, including exposure to carbon emissions, deforestation, hazardous waste, gender pay gap, forced labour, anti-corruption and anti-bribery policies and quantitative calculation metrics, all of which are to be updated annually.

  FMPs planning to opt out will need to consider whether such an approach could have a negative impact on the Product's attractiveness to potential investors.
- A statement of how the FMP's remuneration policies (which also must be updated) are consistent with the integration of sustainability risks.
- Where a FMP has a Product that either promotes environmental or social characteristics or has sustainable investment as its objective, the FMP must provide a statement detailing those characteristics or objective, the methodologies used to assess, measure and monitor them as well as the pre-contractual and periodic disclosure required for such Products.

These obligations under the Disclosure Regulation will require FMPs to update their risk management, due diligence and remuneration policies and procedures and to source and track the information on portfolio companies necessary to meet the disclosure obligations.

Pre-contractual disclosures

Where the Product does not promote environmental or social characteristics and does not have sustainable investment as its objective, pre-contractual disclosure is limited to: (a) identifying the manner in which sustainability risks are integrated (or if not deemed to be relevant, a clear explanation of why not) into the investment decisions of the FMP in relation to the Product; and (b) the result of the FMP's assessment of the likely impact sustainability risks will have on the return of the Product. From year-end 2022, where the FMP does consider sustainability risks in relation to the Product, this disclosure will also need to include an explanation of whether, and if so how, the adverse impact on sustainability factors is considered (or where it does not consider such sustainability risks, a statement that the FMP does not consider these and why).

For those Products that promote environmental or social characteristics, the pre-contractual disclosures must, in addition to the above, also provide information regarding how the characteristics are met and, where a reference benchmark is used, how this benchmark is representative and where the calculation methodology for such benchmark can be found.

For those Products that have sustainable investment as their objective, in addition to the requirements for all Products, the pre-contractual disclosure needs to either disclose how the objective is to be achieved or, where a reference index has been designated, information on how that index aligns with the objective and how it differs from a broad market index. Where the objective is carbon emissions reduction, the alignment with the Paris Agreement needs to be disclosed.

The Disclosure Regulations state where these pre-contractual disclosures are to be made: for AIFs, the pre-contractual disclosure is to form part of the Article 23(1) disclosures required pursuant to AIFMD; for UCITS, it will need to be included in the prospectus; and for MiFID firms with the information to be provided pursuant to that directive prior to the firm undertaking investment activity on behalf of a client.

Managers will need to determine which of the three categories of Products – non-ESG, promoting environmental or social criteria or pursuing a sustainable investment objective – a Product falls into and update the Product's prospectus or other disclosure document before 10 March 2021.

Periodic reports

The obligation to provide periodic reporting only attaches to Products which promote environmental or social characteristics or have sustainable investment as their objective. This obligation includes reporting on the principal adverse impacts of the characteristics or objective on sustainability factors. FMPs of Products which promote environmental or social characteristics must also report on the extent to which the relevant environmental or social characteristics have been met. FMPs of Products which have sustainable investment as their objective must report on the sustainability-related impact of the Product measured against sustainability indicators, or, where an index has been designated as a reference benchmark, a comparison between the overall sustainability-related impact of the Product against the impact of the relevant index and a broad market index.

Periodic reporting must be included with the usual periodic reports for the relevant Product – for AIFs and UCITS in their annual reports and for MiFID managers with the periodic reporting they are required to provide their clients under that directive. Managers will need to gather the information necessary to make these reports commencing from 1 January 2022.

Marketing

The Disclosure Regulation makes it clear that marketing communications cannot be contrary to the disclosure made by the FMP under the Disclosure Regulation, meaning that care will need to be taken that marketing documentation does not imply that a Product is an ESG Product unless it meets at least the

requirements applying to those Products which promote environmental or social characteristics or have sustainable investment as their objective. Once managers have allocated their Products between the three different categories, they will need to confirm that the marketing documentation is not inconsistent with the disclosure obligations applying to the relevant category.

The Taxonomy Regulation

The Taxonomy Regulation "is the most important and urgent action" of the recent EU ESG-related proposals which, as noted previously, establishes an EU-wide classification system (or taxonomy) intended to provide FMPs and investors with a framework for determining what constitutes environmentally sustainable economic activity. The Taxonomy Regulation, which was adopted on 18 June 2020, will come into force on the 20th day following its publication in the Official Journal of the European Union.

Under the Taxonomy Regulation, an activity is environmentally sustainable if it:

- makes a substantial contribution (as outlined in the Taxonomy Regulation) to one of six listed environmental objectives, being:
  - climate change mitigation;
  - climate change adaptation;
  - sustainable use and protection of water and marine resources;
  - transition to a circular economy;
  - pollution prevention and control; and
  - protection and restoration of biodiversity and ecosystems;
- does no significant harm to any of those six objectives;
- meets minimum safeguards by reference to Organisation for Economic Co-operation and Development and UN guidelines and international standards such as the Declaration on Fundamental Principles and Rights at Work and the International Bill of Human Rights; and
- complies with technical screening criteria (for which delegated acts are to be adopted in order to enter into force between 2022 and 2023).

The interaction between the Taxonomy Regulation and other ESG legislative initiatives under the Action Plan is not always clear given that confirmation of this link is often not explicit. However, an example of how the Taxonomy Regulation interacts with the Disclosure Regulation includes the requirement under the Taxonomy Regulation that a Product with an environmentally sustainable investment as its objective must include in its pre-contractual disclosures under the Disclosure Regulation the environmental objective by reference to those listed in the Taxonomy Regulation (as listed above) and the extent to which the investments (including the proportion thereof) of the Product are in economic activities that qualify as environmentally sustainable (also as listed above). Products that promote environmental characteristics must, in addition to complying with the foregoing requirements, include a specific statement relating to the applicability of the "do no significant harm" principle to the Product's investments. Similar requirements apply in terms of periodic reports. In addition, the Taxonomy Regulation provides for the following mandatory pre-contractual disclosure for Products that do not promote environmental or social characteristics or have sustainable investment as their objective: "The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities."

The Taxonomy Regulation also amends NFRD by requiring entities subject to that directive to disclose the proportion of: (i) their turnover derived from products or services; or (ii) capital or operating expenditure related to assets or processes, in each case associated with economic activities that qualify as environmentally sustainable.

The EU legislative developments to date have addressed most of the core objectives of the Action Plan. On 11 December 2019, the European Commission adopted its Communication on a European Green Deal, which significantly increases the EU's climate action and environmental policy ambitions, and in April 2020, the European Commission commenced a consultation on a "Renewed Sustainable Finance Strategy". Building on the achievements of the Action Plan, it is proposed that this Renewed Sustainable Finance Strategy will continue to focus on the same broad themes but in more detail on company reporting, corporate governance, regulation of exchanges and market infrastructure, green finance and risk management. Sustainable finance will therefore remain a political and regulatory priority for the EU for the foreseeable future.

The United States and the ESG Question

While ESG investing is gaining popularity in the United States and there are a growing number of ESG-branded investment products, as is the case in much of the world, there is as of yet no consensus as to what constitutes ESG investing. US investment advisers wishing to evidence their ESG credentials have looked to international voluntary standards, such as the Principles for Responsible Investment developed by institutional investors in partnership with the UN (**PRI**), as indeed have ESG-focused investment managers the world over. In addition to becoming a signatory to the PRI, firms have looked to NGOs such as the Global Reporting Initiative (**GRI**) for standards on measuring and reporting on sustainability criteria.

When considering their approach to ESG investing, US investment advisers must comply with their fiduciary duties under the Investment Advisers Act of 1940, as amended, which requires investment advisers to act in the best interests of their client at all times. These fiduciary duties have been interpreted by the SEC as "following the contours of the relationship between the adviser and its client, and the adviser and its client may shape that relationship by agreement, provided that there is full and fair disclosure and informed consent". This provides scope for pursuing an investment strategy that may not be solely driven by financial return. However, when pursuing such an ESG-focused strategy, US investment advisers consistent with their fiduciary duties must ensure that the client has received adequate disclosures as to the investment strategy, understands the objective of the strategy and agrees to the pursuit of such an objective.

In addition, US investment advisers that manage assets pursuant to the Employee Retirement Income Security Act of 1974, as amended (**ERISA**), must consider whether the obligations of an ERISA fiduciary to act "solely in the interest" of the participants and beneficiaries of the plan and "for the exclusive purpose" of providing benefits under the plan are consistent with consideration of factors that are not solely driven by financial return, such as ESG criteria. While the United States Department of Labor (**DOL**), which is responsible for the regulation of ERISA plans, has, from time to time, issued guidance regarding the consideration of ESG factors by plan fiduciaries, whether consideration of ESG criteria has found favour or not tends to depend on whether a Democratic or Republican administration is in power. Perhaps the most that can be said is that if ESG factors are considered by an ERISA plan fiduciary they must be shown to positively affect investment performance or at a minimum not diminish returns.

The SEC's Office of Compliance Inspections and Examinations (**OCIE**) undertakes reviews of investment adviser's disclosures, and has recently conducted a series of "sweep"

examinations to review the ESG practices of investment advisers. These reviews have focused on the relationship between the investment adviser's claims and practices, including whether policies and procedures have been reasonably designed to ensure that investment decisions are made in a manner that is consistent with the disclosure. Other issues considered included whether the investment adviser has adhered to industry standards (such as the PRI), how the investment adviser uses third-party ESG data or ratings and whether the investment adviser engages in shareholder activism.

In recent years, the US Securities and Exchange Commission (**SEC**) has held advisory committee meetings on ESG, but has yet to take definitive steps toward adopting ESG disclosure standards. However, on 21 May 2020, the SEC's Investor Advisory Committee adopted a non-binding recommendation that the SEC update its reporting requirements for issuers to include material ESG factors, with the goal of making available to investors consistent, comparable and useful ESG data across issuers. In addition, the ESG Subcommittee of the SEC's newly created Asset Management Advisory Committee is currently developing recommendations related to ESG, including disclosure standards, which it aims to present to the full committee by the end of 2020. These initial steps could ultimately lead to the adoption of ESG disclosure standards in the United States.

While the United States has not reached the stage of actively regulating around ESG, as is the case in the EU, it is clear that there is increasing industry pressure to have some degree of guidance at a federal level regarding the approach to ESG investing.

ESG in Asia

While there is a spectrum of awareness and commitment to ESG investment across the major financial centres in Asia (i.e., Hong Kong, Singapore, Mainland China, South Korea, Japan and Taiwan), there is no single ESG standard set by law or regulation in any Asian jurisdiction. To date, the emphasis has been on best practices and good governance guides principally for listed companies, promulgated by the relevant stock exchanges or local regulator in, for example, Hong Kong, Japan and Singapore. Similarly, stewardship codes for investors in, for example, Hong Kong and Singapore, encourage a degree of engagement including in relation to ESG issues by investors *vis-à-vis* their investee companies, but stop short of being mandatory requirements.

Certain regulatory authorities in Asia, principally the Hong Kong Securities and Futures Commission (**SFC**) and the Monetary Authority of Singapore (**MAS**), have started to develop green finance initiatives which are clearly drawing on the EU regulatory standards. The MAS initiatives are mostly focused on the development of sustainable finance guidelines and Singapore's green bond market. The SFC, however, announced its Strategic Framework for Green Finance in September 2018, which will focus on: enhanced climate-related disclosure by listed companies; consultations on policies, codes and guidance relating to sustainable investment practices with a view to requiring asset managers to disclose the extent to which they consider ESG in their investment and risk analysis process; measures to facilitate development of green products (including disclosure and reporting requirements); investor education; and promotion of Hong Kong as a green finance centre.

Implementation of the SFC's framework is in its early consultative phase, but one of the first steps was to publish a circular to Management Companies of SFC-authorised Unit Trusts and Mutual Funds – Green or ESG funds (**Circular**) with the aim of improving disclosure by those management companies in order to permit comparisons between similar types of SFC-authorised "green" or "ESG" funds. It applies to SFC-authorised funds that incorporate one or more of the globally recognised green or ESG criteria (such as the UN Global Compact and the SDGs). The Circular requires the offering documents of ESG funds to include certain ESG-related disclosure, including the ESG criteria considered, the stock selection process, any exclusion criteria and the risks associated with the investment theme. The SFC will also launch a central database listing all ESG funds complying with the Circular.

While the ESG discourse in Asia is of shorter duration than in the United States and Europe, it is starting to become a point of focus. Asian regulators are looking towards Europe, as the jurisdiction with the most advanced sustainable development framework, in order to develop their own sustainable finance agendas.

Conclusion

ESG investing is moving from the periphery into the mainstream of investment management activity and, accordingly, onto the regulatory agenda. The EU, where sustainable investment is a political priority, is leading the way and shaping the dialogue, but other jurisdictions are beginning to join the conversation, including the United States and certain Asian jurisdictions. It is clear that we are only at the beginning when it comes to the development of a regulatory framework around ESG investing and can expect significant further development in the sustainable finance space in the coming years.

Endnotes

1. In summary, the 10 action points are: (1) establishing an EU classification system for sustainable activities; (2) creating standards and labels for green financial products; (3) fostering investment in sustainable projects; (4) incorporating sustainability when providing investment advice; (5) developing sustainability benchmarks; (6) better integrating sustainability in ratings and market research; (7) clarifying institutional investors' and asset managers' duties; (8) incorporating sustainability in prudential requirements; (9) strengthening sustainability disclosure and accounting rule-making; and (10) fostering sustainable corporate governance and reducing short-termism in capital markets.
2. "Sustainable investment" means an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.
3. "Financial market participant" means: (a) an insurance undertaking which makes available an insurance-based investment product (IBIP); (b) an investment firm which provides portfolio management; (c) an institution for occupational retirement provision (IORP); (d) a manufacturer of a pension product; (e) an alternative investment

fund manager (AIFM); (f) a pan-European personal pension product (PEPP) provider; (g) a manager of a qualifying venture capital fund registered in accordance with Article 14 of Regulation (EU) No 345/2013; (h) a manager of a qualifying social entrepreneurship fund registered in accordance with Article 15 of Regulation (EU) No 346/2013; (i) a management company of an undertaking for collective investment in transferable securities (UCITS management company); or (j) a credit institution which provides portfolio management.

4. "Financial product" means: (a) a portfolio managed in accordance with point (8) of Article 4(1) of MiFID II; (b) an alternative investment fund (AIF); (c) an "insurance-based investment product"; (d) a pension product; (e) a pension scheme; (f) a UCITS; or (g) a pan-European Personal Pension Product.
5. "Sustainability risk" means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment.

Mikhaelle Schiappacasse's practice focuses on the structuring, establishment, management, marketing, and restructuring of fund platforms and investment funds, including hedge, debt, real estate, private equity and fund of funds, across a broad range of asset classes and fund domiciles. Ms. Schiappacasse also advises on the establishment of asset management businesses, including the drafting and negotiation of shareholders' agreements and limited liability partnership agreements. She also acts for investment funds and their managers on general corporate, regulatory and compliance matters.

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The Global Subscription Credit Facility and Fund Finance Markets – Key Trends and Forecasts

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Introduction

The Subscription Credit Facility (each, a "Facility") and related Fund Finance markets continued their extensive growth and positive momentum in 2019. Like virtually every year since the 2008 financial crisis, lender ("Lender") Facility portfolios grew extensively this past year, albeit at perhaps a slightly slower rate of growth than in recent years. The market has matured, growing more dynamic and accustomed to frequent evolution and change. Yet few expected the sudden and monumental change caused by the COVID-19 global pandemic affecting all industry sectors at the time of this writing. This chapter summarizes the key developments in the Facility and Fund Finance markets in 2019, touches on recent trends we have observed in the time of coronavirus and forecasts our expectations for the coming year.

Cadwalader 2019 Representations

Because the Fund Finance market is not public, it remains challenging to find actual data to support anecdotal views. To help our clients address that, Cadwalader performs an annual data analysis where we evaluate every transaction in the United States in which we represented the lead Lender and compare the results to prior years. Our touch points with the market are extensive and as a result provide a relatively robust data set that is a good proxy for the U.S. market as a whole:

	2017	2018	2019	Change (%)
Number of Deals	111	185	315	+70%
Aggregate Lender Commitments ($bn)	$41.65bn	$58.28bn	$54.32bn	-7%
Number of Banks Participating in Our Deals	42	40	73	+83%
Number of Banks Represented by CWT	–	27	35	+30%
Average Deal Size ($mm)	375.23	315.04	172.43	-45%
Number of Sponsors	72	90	156	+73%

We draw on this data where relevant in this chapter.

Resilient, Tempered Growth

In 2018, there were a host of headwinds that only somewhat muted the growth of the Fund Finance markets, including a decline in fund formation, one-sided and negative articles in the press, the Abraaj insolvency and updated guidelines published by the Institutional Limited Partners Association ("ILPA") that took a skeptical view of Facilities. But those headwinds largely faded into the rear-view mirror in 2019. Fund formation, the fundamental driver of Fund Finance, rebounded materially last year. Fund sponsors raised nearly $900bn of committed capital, according to Pitchbook. The number of negative articles on Facilities declined significantly, and many investors were quoted in the press giving supportive views of the use of Facilities. The Abraaj insolvency has remained relatively quiet as to Facilities and the ILPA guidelines had a very limited effect on market practice. Thus, with calm waters, the market continued its expansion in 2019.

We estimate global Lender commitments increased by 15–20% in 2019, in line with or slightly exceeding our 12–17% estimate for the year. We now estimate the global market at around $575bn. Most of the data points in our portfolio and the business metrics we track (number of deals (up 70%), number of discreet engagements, volume of hours billed, revenue, etc.) support these growth estimates. (Our numbers do include some growth by acquisition, not just organic growth, in that we added our hedge fund lending book into our data project in 2019.) Anecdotal reports from Lenders in the market often exceeded 20% for 2019 as well.

While not completely universal, that growth was observed in most components of the market. Yes, some of the new Lender entrants did a terrific job of establishing themselves as serious market participants in 2019. Many large transactions were awarded to new entrants. But virtually all of the incumbent Lenders, even despite the law of large numbers, grew their portfolios meaningfully on a percentage basis last year.

Since the start of the pandemic, we have seen a tempered shift in the marketplace. Certain Lenders have taken a small step back from new transactions while others opportunistically stepped forward. A number of Lenders have heightened their focus on servicing existing clients, closing deals that were in development at the start of the outbreak at a faster-than-usual clip to provide Funds with quicker access to capital. Those Lenders were thus brought closer to their Fund Finance commitment caps sooner than anticipated. Credit terms have also tightened for some Lenders, as internal reporting to risk and credit officers increased. This has culminated in those Lenders slowing originations, with many of their peers picking up the slack. New deal openings across the market remained robust over the first few

months of the pandemic, with our March, April and May 2020 numbers substantially exceeding our rolling 12-month average. The slowdown by some Lenders on new originations has led to heightened activity with those and other Lenders on permanent and temporary facility increases, extensions of maturity dates, and "qualified borrower" and alternative investment vehicle borrower joinders. We are cautiously optimistic on continued deal volume even as we forecast deceleration later this year.

"Structural Drift"

Prior to this year, Jeff Johnston, Managing Director at Wells Fargo, had used the term "structural drift" to describe how Facility terms continued to creep incrementally in favor of borrowers. Examples included the continuing increases in concentration limits and relaxation around investor credit linkage. But such drift seemed to slow a fair bit in 2019, and Facility structures for commingled Funds stayed relatively consistent. While the market was increasingly competitive, we did not see any major changes in transaction structures. We did see an uptick in transactions using a coverage ratio *in lieu* of a borrowing base.

With the onset of COVID-19, there has been an incremental reversal of this "structural drift". The Federal Reserve, the FDIC and the OCC have been more assertive with informational requests on Lenders, and Lenders' internal credit requirements have narrowed. Lenders are therefore scrutinizing and strengthening terms in new deals with increased vigor as they seek to provide continued support to their existing client relationships.

Credit Performance

A. Abraaj. In a first for the modern Fund Finance market, an event of default on a Facility occurred in 2018 and was covered publicly in the press. But the press reports fell off in 2019 as new developments in the Abraaj matter stopped being reported and it has not had a material impact on the market.

B. Groundhog Day. While our portfolio grew extensively in 2019, outside of Abraaj, we were not consulted on any monetary events of default or institutional investor exclusion events last year.

C. Post-COVID-19 Sustainability. As of the time of this writing, credit performance in the Fund Finance market has remained positive since the start of the pandemic. Only a single (that's right, only one) default by an institutional investor on a capital call has been reported on the Fund Finance Association ("FFA") industry update calls. The public markets have largely rallied since their March lows, lowering the denominator effect on institutional investor holdings of private equity stakes. Transaction structures have appeared sustainable in the face of the COVID-19 disruption, much as they were during the last financial crisis.

Pricing and Tenor

Facility pricing held largely steady through 2019, with the average margin 8 bps lower in 2019 compared to 2018. We continued to see almost no correlation between the existence of an overcall limitation and Facility pricing—nearly 40% of our 2019 Facilities had some form of overcall limitation in their partnership agreement. Tenor was more variable. Our 2019 portfolio was split as follows: 45% 1 year; 12% 2 years; and 29% 3 years. Only a small handful of deals extended beyond three years on a committed basis.

Since the coronavirus outbreak, yields on asset classes throughout the finance industry have fundamentally changed, impacting the risk-adjusted pricing in the Fund Finance market. Within Fund Finance, Lenders have made moderate increases to pricing in new deals and amendments, and LIBOR floors above zero have become common. We expect pricing to remain marginally elevated until the pandemic peak is over and greater certainty in the economy is restored.

Industry Developments

A. Lender Hiring. Lenders continued to hire extensively in 2019, with experienced bankers in high demand. Longtime fund finance banker Jonathan Peiper joined Mizuho to lead their fund finance effort and Melanie Herald joined State Street in a leadership role. Many relationship managers joined new teams as well. The turnover has created a lot of career opportunities throughout the industry and upward pressure on Lender compensation.

B. Fund Finance Servicer Providers. The Fund Finance market had one of its first start ups in 2019 when long-time fund finance lawyers Zac Barnett and Richard Wheelahan formed Fund Finance Partners, headquartered in Chicago and Charlotte. Their company provides fund finance advisory and transaction management services to private equity fund sponsors.

C. Fund Finance Friday. Cadwalader's Fund Finance Friday weekly market intelligence and update newsletter expanded rapidly in 2019, now reaching a distribution list of over 7,000 readers. Not surprisingly, the job postings continue to lead the click count rankings. We also received great support from the market last year with submissions of third-party content, which we greatly appreciate. If you are interested in subscribing (there is no charge), visit https://www.cadwalader.com/fund-finance-friday.

D Publications. Global Legal Group Ltd., the publisher of this guide, published the fourth edition of *Global Legal Insights – Fund Finance 2019*, now known in the market as the "Pink Book". The guide includes 21 product-oriented chapters and 22 jurisdictional updates contributed by many of the world's preeminent Fund Finance law firms, a substantial improvement over the prior editions.[1]

E. FFA University. The FFA hosted its first "FFA University" training event on September 17–18, 2019, in New York. The two-day event was sold out and 115 attendees completed the course, which was taught by senior members of the fund finance community.

2020 Fund Finance Events

On February 12–14, 2020, the FFA hosted its 10th Annual Global Fund Finance Symposium in Miami, Florida at the Fontainebleau Hotel. Over 800 people attended the event, which was supported by nearly 100 distinct institutional sponsors. The headline speakers were tremendous: Hillary Rodham Clinton; Earvin "Magic" Johnson; Carlyle founder David Rubenstein; and Wells Fargo CFO John Shrewsberry. There were also a number of industry panels as well as more macro-oriented educational sessions, for example on the IPO market and Modern Monetary Theory. The 6th Annual European Fund Finance Symposium has currently moved to be held in London on October 22, 2020. The event's content committee is at work presently on the agenda. And the 4th Annual Asia-Pacific Fund Finance Symposium is moving from Hong Kong to Singapore this fall and will hopefully take place on November 11, 2020.

The FFA is also hoping to have some form of virtual FFA University in summer or fall 2020.

2020 Forecasts

At the start of 2020, we were forecasting a growth rate in Lender portfolios of 10–15% for the year. Our time accrued on prospective matters in January 2020 more than doubled that accrued in January 2019. Our new matters opened in January 2020 was up by 30%. This all built on similar significant accelerations we saw in Q4 2019.

Although activity and optimism remained relatively high among sector participants during Q1 and Q2 2020, we now forecast that the coronavirus's lingering effects will lower our previously anticipated growth during the second half of this year. We expect Lenders will on average reduce their hold levels and new subscription credit facilities will be impacted by a slowdown in fundraising by fund managers. Yet we expect plenty of liquidity to remain, as many Lenders view the possibility of overall reduction as an opportunity to increase their market share. We also foresee increased interest in NAV facilities, as Funds seek to increase investment capacity for lower-cost targets and to defend the value in any distressed portfolio assets.

Conclusion

Notwithstanding the current disruption, the Facility market appears poised for another solid year in 2020. We continue to believe that despite COVID-19, the credit profile of market-structured Facility transactions forecasts well for Facility performance. The dynamic nature and constant change in the market have made for an unexpected and challenging year for industry participants. We are hopeful that Fund Finance will be seen as a part of the solution for the greater good of our global economy.

Endnote

1. An electronic copy of *Global Legal Insights – Fund Finance 2019* can be accessed at https://www.globallegalinsights.com/practice-areas/fund-finance-laws-and-regulations.

Wesley A. Misson is a partner in Cadwalader, Wickersham & Taft's Finance Group. Wes's practice focuses on fund finance and he has represented financial institutions as lenders and lead agents in hundreds of subscription credit facilities and other fund financings, with his experience encompassing both subscription and hybrid facilities. Wes also works with fund-related borrowers on the negotiation of third-party investor documents with institutional, high-net-worth and sovereign wealth investors.

Wes has served as lead counsel on many of the largest and most sophisticated fund financings ever consummated, notably having assisted more than 37 banks as lead or syndicate lender during the past three years with transaction values totaling in excess of $35 billion. Many of the transactions he advises on are precedent setting, carrying unique structures and complex international components – whether that be foreign limited partners or funds, multi-currency advances or foreign asset investment.

Wes has been recognized as a "Rising Star" in the US in the area of Banking and Finance in the International Financial Law Review's *IFLR 1000 Legal Directory*, and is also a frequent speaker and an accomplished author in the area of fund finance. He has worked extensively with financial institutions to develop form agreements for fund finance transactions, many of which are the dominant forms used in the market today, and to educate bankers, internal legal counsel and credit officers on hot issues and trends affecting the fund finance market.

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Cadwalader, Wickersham & Taft LLP, founded in downtown New York in 1792, is proud of more than 200 years of service to many of the world's most prestigious financial institutions and corporations. With more than 450 attorneys practicing in New York, London, Charlotte, Washington and Brussels, we offer clients innovative solutions to legal and financial issues in a wide range of areas. As a longstanding leader in the securitization and structured finance markets, the Cadwalader team features lawyers with a broad range of experience in corporate, securities, tax, ERISA, bankruptcy, real estate and contract law. Consistently recognized by independent commentators and in the league table rankings, our attorneys provide clients unparalleled insight regarding fund finance, asset-backed and mortgage-backed securitization, derivatives, securitized and structured products, collateralized loan obligations, synthetic securities, swap and repo receivables, redundant insurance reserves, and other financial assets.

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CADWALADER

Bringing Foreign Investment Funds into Japan

Mori Hamada & Matsumoto

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1 Overview of Regulations for Foreign Investment Funds in Japan

While there are many varieties of investment vehicles in the world, in this chapter we discuss unit trust-type investment funds and partnership-type investment funds, as these are frequently used in bringing foreign investment funds into Japan.

Foreign unit trust-type investment fund

When conducting an offer in Japan, a foreign unit trust that is similar to a Japanese investment trust fund (*toshi shintaku*) is treated as a foreign investment trust in Japan and is subject to Japanese securities laws; specifically, the Financial Instruments And Exchange Act of Japan (the "**FIEA**") in respect of marketing, and the Investment Trust and Investment Corporation Act of Japan (the "**ITICA**") in respect of regulatory filings with the Financial Services Agency of Japan ("**FSA**").

Public offering of a foreign investment trust in Japan

Based on a survey conducted by the Japan Securities Dealers Association ("**JSDA**"), among foreign unit trust-type investment funds that publicly offered units in Japan, those domiciled in Luxembourg or the Cayman Islands had an aggregate market share of more than 80% in the first half of 2019 on a net asset value basis. These are followed by unit trusts domiciled in Ireland.

When units of a foreign investment trust are publicly offered in Japan, they must satisfy certain requirements imposed by JSDA, as detailed below.

JSDA requirements

JSDA is a self-regulating body of securities companies acting as distributors of foreign investment trusts. A member of the JSDA cannot engage in a public offering of units of a foreign investment trust that does not satisfy the JSDA requirements, the so-called standards of selection. The JSDA requirements do not apply to a private placement of units of a foreign investment fund.

The JSDA requirements for the public offering of units of a foreign investment trust include the following:

- The net asset value of the fund must be, or after the public offering in Japan is expected to be, greater than JPY 100 million.
- The net asset value of the management company of the fund, which is the issuer of units of the fund, must be greater than JPY 50 million.

It appears the JSDA requirements assume that the foreign investment trusts publicly offering units in Japan will be established by a bilateral trust agreement between a management company and a trustee. As a result, most foreign investment trusts publicly offering units in Japan are established by bilateral trust deeds, as opposed to unilateral declarations of trust.

Japanese courts must have jurisdiction over lawsuits relating to any transaction where a Japanese investor has acquired trust units.

An agent company for the fund must be appointed in Japan.

Usually, one of the distributors of the fund in Japan (*i.e.*, a Japanese securities company) is appointed as the agent company for the offer. The agent company is required to check whether the JSDA requirements have been satisfied before making the public offering, and will disclose the net asset value of the fund to the public after the public offering.

The amount of securities sold short must not exceed the net asset value of the fund.

As a general rule, the borrowings by the fund must be less than 10% of the net asset value of the fund.

The fund and other funds managed by the management company of the fund must not have voting rights in excess of 50% of the total voting rights in any company.

The exposure to derivative transactions must be calculated using a reasonable method determined in advance by the management company or the investment manager, and must not exceed the net asset value of the fund.

This requirement was introduced on December 1, 2014 with no grandfather provision.

The credit concentration risks borne by the fund must be managed using a reasonable method determined in advance by the management company or the investment manager.

This requirement was introduced on December 1, 2014. There is a grandfather provision, whereby the requirement will not apply, for a period of five years, to existing funds publicly offering units in Japan on or prior to December 1, 2014.

When a foreign investment trust is a master-feeder fund and units of the feeder fund are publicly offered in Japan, the question arises as to whether the JSDA requirements will be applicable only to the feeder fund or also to the master fund – in other words, whether the JSDA will look through to the master fund. Currently, the general practice is to apply the JSDA requirements to the feeder fund only, and not to look through to the master fund. The exception is the credit concentration restriction, which cannot be complied with without looking through to the master fund, due to all of the assets of the feeder fund being invested or concentrated in the master fund.

Disclosure – securities registration statement and prospectus

The issuer of a foreign investment trust, *i.e.*, the management company of the fund, must file a securities registration statement with the regulator in advance of the public offering via EDINET, a web-based disclosure system managed by FSA.

The securities registration statement is a disclosure document under the FIEA, for securities that are publicly offered in Japan, and is disclosed to the public through the internet. The securities registration statement becomes effective 15 days after filing. Solicitation of investments in the securities can be made before the securities registration statement becomes effective, but the investment cannot be made until the securities registration statement becomes effective and a mandatory prospectus (*kofu mokuromisho*) is delivered to the investor.

The prospectus of an investment trust consists of a mandatory prospectus and a prospectus upon request (*seikyu mokuromisho*). The contents of the prospectus upon request are substantially similar to those of the securities registration statement, but with minor adjustments and omissions. The mandatory prospectus is a summary of the prospectus upon request. The mandatory prospectus needs to be delivered to investors on or prior to the purchase of securities. The prospectus upon request is delivered to investors only when the investors specifically request.

FSA filing

Pursuant to the ITICA, the issuer of units of a foreign investment trust that is publicly offered in Japan must file an FSA statement with FSA immediately before the securities registration statement becomes effective. Most of the contents of the FSA statement overlap with those of the securities registration statement and, as a result, the FSA statement is usually prepared by extracting the necessary information from the securities registration statement.

The FSA statement is for administrative purposes only, and is not disclosed to the public.

Private placement of units of a foreign unit trust in Japan

Types of private placement in Japan

There are two categories of private placement of securities in Japan (minor variations aside): private placement to qualified institutional investors (“**QIIs**”) only; and private placement to a small number of investors.

In a private placement to QIIs only, investors are limited to QIIs. There is no limit on the number of QIIs who can invest in a private placement. However, the QIIs are prohibited from selling their securities to non-QIIs.

In a private placement to a small number of investors, the number of investors who are solicited for investment is limited to 49. The number of investors who are solicited for investment but did not actually invest is also counted in the investor number limitation. In addition, the number of investors who have been solicited for investment into securities with the same nature within the last six months is also counted in the investor number limitation. This is intended to avoid a situation where an offering is split into multiple offerings in terms of timing to circumvent the 49-investor limitation. These investors are prohibited from selling securities acquired in the private placement unless all such securities held by a transferor are transferred to a single investor. This restriction ensures that the cap on the total number of investors will not be breached.

No securities registration statement or prospectus

Neither a securities registration statement nor a prospectus is required if units of a foreign investment trust are offered in Japan by way of a private placement.

FSA filing

An FSA statement needs to be filed in the case of a private placement. Unlike an FSA statement in a public offering, which is filed after the securities registration statement is filed (*i.e.*, where solicitation has begun but before the securities registration statement becomes effective), the FSA statement in a private placement must be filed prior to any solicitation in Japan.

Registration requirement for self-solicitation

A solicitation of units in Japan by the issuer of a foreign investment trust (*i.e.*, the manager of a bilateral trust deed-type unit trust, or the trustee of a unilateral declaration of trust-type unit trust), is regarded as self-solicitation (*jiko boshu*) under the FIEA. The issuer will be required to register as a Type 2 financial instruments transaction business. However, if the issuer retains a distributor (usually a securities company) for the securities it will issue, and the issuer itself does not conduct any solicitation, registration will not be required.

Issuer – manager or trustee

Under Japanese law, the issuer of units of a Japanese investment trust is the trust settlor and, in that capacity, will also act as the trust manager.

As for the issuer of a foreign investment trust, it will be classified on the basis of the applicable governing law and documents. If a foreign investment trust is established by a bilateral trust deed between the manager and the trustee, and the governing law or document provides that the units of the trust are issued by the manager, the manager will be the issuer of the investment trust. If a foreign trust is established by a unilateral declaration of trust by a trustee, the trustee will be the issuer.

Foreign partnership-type investment fund

Public offering/private placement

A foreign partnership-type investment fund, such as a limited partnership, is usually treated as a collective investment scheme under the FIEA. Interests in a collective investment scheme are Type 2 securities under the FIEA, while ordinary securities, such as units of an investment trust, are Type 1 securities.

A different standard applies to determine if an offer of Type 2 securities in Japan is a public offering or private placement. An offering of Type 2 securities constitutes a public offering if the number of the investors that actually acquire the securities is 500 or more. In contrast, the limit of 49 investors for a private placement of Type 1 securities is based on the number of investors who are solicited, including those who do not acquire the securities. The reason for this is that a fund issuing Type 2 securities (such as limited partnership) is usually formed through discussions with potential investors. As far as we know, most foreign partnership-type investment funds are offered in Japan through private placement.

Self-solicitation (*jiko boshu*)

Solicitation by an issuer of interests in a foreign collective investment scheme, such as limited partnerships, is regulated as self-solicitation (*jiko boshu*) under the FIEA.

An issuer of interests in a foreign collective investment scheme who solicits investments in its own securities is required in principle to be registered as a Type 2 financial instruments transaction business. However, if the issuer retains a distributor for the securities it issues, and the issuer itself does not conduct any solicitation, registration will not be required.

In foreign collective investment schemes, the general partner of a limited partnership will be the issuer of the securities.

Self-management (*jiko un-yo*)

The management of assets by operators of foreign collective investment schemes, such as limited partnerships, is regulated as self-management (*jiko un-yo*) under the FIEA. A person offering

collective investment scheme management services is required to register if the fund to be managed invests more than 50% of its assets in securities or derivatives.

Prior to the enactment of the FIEA, which replaced the Securities and Exchange Act of Japan in 2007, the management of assets by such fund operators was regarded as management of the operator's own assets, and was outside the scope of the regulation. However, the FIEA now recognise this as management of investors' assets, extending the law to cover the management activities of fund operators.

Qualified institutional investors exemption (*tekikaku kikan toshika to tokurei gyomu*)

The registration requirements for carrying out: (i) a Type 2 financial instruments transaction business (for self-solicitation); and (ii) discretionary investment management (for self-management), are waived if the qualified institutional investors exemption (the "**QII Exemption**") under the FIEA is available.

The QII Exemption is available if the investors of a collective investment scheme consist of one or more QIIs and up to 49 non-QII specified investors. QIIs include banks, insurance companies, securities companies, and other operators carrying out a financial instruments transaction business. Business corporations can be QIIs if they: (i) have securities investments greater than JPY 1 billion; and (ii) make an additional filing with FSA.

The rationale for this exemption is that a QII usually has enough financial expertise and bargaining power against fund managers to prevent them from setting up and managing a fund that is one-sidedly disadvantageous to the investors. A QII under the QII Exemption is expected to monitor the fund manager on behalf of the non-QII investors.

The QII Exemption has been widely used for not only domestic collective investment schemes, such as *nin-i kumiai* partnerships and *tokumei kumiai* partnerships, but also foreign partnerships. However, it was sometimes abused, by putting in a sham QII, such as an affiliate of the general partner or another investment partnership managed by the general partner, which could not be expected to monitor the general partner. The FIEA was amended, and the requirements for the QII Exemption were strengthened, effective March 1, 2016.

Under the amended requirements: (i) if the QIIs only consist of (a) a limited liability investment partnership with assets under management, *less* the amount of borrowings, of less than JPY 500 million, or (b) an affiliate of the general partner, the QII Exemption is not available; (ii) non-QIIs must be sophisticated investors, such as listed companies, corporations with a capital amount or net assets of more than JPY 50 million, foreign corporations, and individuals with investment financial assets of more than JPY 100 million (and having a securities/derivatives account for more than one year); and (iii) if the general partner is a foreign entity, it must appoint a representative in Japan.

Where the QII Exemption is used to avoid registration as a Type 2 financial instruments transaction business, additional transfer restrictions apply so that: (i) the QIIs are prohibited from selling their interests in the collective investment scheme to non-QIIs; and (ii) the non-QII specified investors are prohibited from selling their interests unless all such interests held by a transferor are transferred to a single non-QII specified investor. In order to take advantage of the QII Exemption, a filing with the regulator needs to be made in advance. In a self-solicitation, the issuer of the collective investment scheme will make this filing, while in a self-management, the manager of the collective investment scheme will make the filing. Typically, in a limited partnership, the general partner will be the issuer or the manager (as the case may be). The filing is relatively simple and can be prepared in English.

The filing must identify all QIIs investing in the collective investment scheme so the regulator can check for abuse of the QII Exemption by putting sham QIIs. It may seem inconsistent to require QIIs to be identified in the filing, which is filed prior to solicitation. However, for practical reasons, the candidate QIIs need to be consulted in a manner not constituting a solicitation, so their names can be included in the filing. It is believed that limited partnership-type collective investment schemes can be organised through discussions with candidate large investors; such discussions are not considered solicitation because the details are not yet fixed.

Some information in the filing will be disclosed to the public by the regulator (and the applicant will also be required to do so), including the number, but not the names, of the QIIs. The applicant is also required to file with the regulator an annual management report, and disclose such report or its summary to the public. These can be written in English.

***De minimis* exception to self-management for foreign partnership-type investment funds**

If investments from Japan into a foreign partnership-type investment fund are limited, the management activity of the general partner of the foreign partnership investment fund is excluded from the scope of the collective investment scheme management services subject to regulation in Japan. Specifically, the exclusion applies if the following requirements are met:

- all Japanese investors investing in the foreign partnership-type investment fund are QIIs;
- the number of Japanese investors is less than 10; and
- the total contributions from such Japanese investors are less than one-third of the total contributions of all investors in the foreign partnership-type investment fund.

Exception to self-management by delegation of entire management authority

If a general partner of a collective investment scheme delegates its entire investment authority to a discretionary investment manager registered under the FIEA, the management activity of that general partner will be excluded from the scope of collective investment scheme management services subject to regulation in Japan and the registration requirement for discretionary investment managers will not apply. This exception would not be a viable option for a foreign limited partnership managed outside Japan.

Reverse solicitation – Investment from Japan into a foreign investment fund without any solicitation in Japan

If a Japanese investor, usually a sophisticated institutional investor, approaches a foreign investment fund (regardless of whether it is a unit trust-type or partnership-type) that has not conducted any solicitation in Japan, and makes an investment in the foreign investment fund, the fund is not subject to Japanese private placement regulations, as there is no solicitation in Japan. For unit trust-type foreign investment funds, an FSA statement is not required.

Whether or not there has been any solicitation in Japan is a factual matter; however, it should be emphasised that if the foreign investment fund has any involvement in Japan through a subsidiary, or an affiliate or representative office, there may be a risk that the activities of such entities will be regarded as soliciting investments in the foreign investment fund.

2 Taxation

Taxation of individual investors in Japan investing in a foreign investment trust

Foreign stock investment trust

As to individual investors of a foreign stock investment trust publicly offering units in Japan, distributions paid through a paying agent in Japan are treated as dividend income and subject to withholding tax at the rate of 20%, which rate has been tentatively increased to 20.315% from January 1, 2013 to December 31, 2037 due to an interim tax called the Special Reconstruction Income Tax (for the reconstruction of the area damaged by the Great East Japan Earthquake in 2011). If a foreign withholding tax is already imposed on the distributions, the amount after deducting the amount of foreign withholding tax will be subject to Japanese withholding tax. Individual investors will be able to choose among aggregate taxation, separate self-assessment taxation and not requiring self-assessment taxation. The tax credit for dividends, which is intended to avoid double taxation due to the imposition of corporate tax on the issuer and income tax on the dividends, is not available to foreign investment trusts.

Profits from the sale (including repurchase by the investment trust) of the units of a foreign stock investment trust are treated as capital gains and taxed at the rate of 20% (tentatively 20.315% for the reasons stated above). Losses from sale can be: (i) aggregated with (a) profits from sale, or (b) dividends of listed stocks or units of other publicly offered investment trusts; and (ii) carried forward for three years.

Foreign bond investment trust

A bond investment trust is an investment trust whose portfolio is strictly limited to bonds. An investment trust that does not meet the requirements of bond investment trust is classified as stock investment trust.

As to individual investors of a foreign bond investment trust publicly offering units in Japan, distributions are treated as interest income and subject to withholding tax at the rate of 20% (tentatively 20.315% for the reasons stated above). From January 1, 2016, individual investors are able to choose between separate self-assessment taxation and not requiring self-assessment taxation. If a foreign withholding tax is already imposed on the distributions, the amount of foreign withholding tax will be deducted from Japanese withholding tax.

Profits from the sale (including repurchase by the investment trust) of the units of a foreign bond fund were not subject to Japanese tax until December 31, 2015. Since January 1, 2016, the profits have been treated as capital gains and taxed at the rate of 20% (tentatively 20.315% for the reasons stated above). Losses from sale were not given any tax treatment until December 31, 2015. However, from January 1, 2016, such losses can be: (i) aggregated with (a) profits from sale, or (b) dividends of listed stocks or units of other publicly offered investment trusts; and (ii) carried forward for three years.

Taxation of investors in Japan investing in foreign partnership-type investment trust

Japanese partnerships are not subject to taxation. However, the partners will be subject to taxation on profits from the management of partnership assets.

In principle, a foreign partnership will not be subject to tax on profits from the management of partnership assets. However, in 2015, the Supreme Court of Japan ruled that a Delaware limited partnership should be classified as a corporation for tax purposes, generating concerns that Japanese residents investing in the U.S. through Delaware limited partnerships may not enjoy certain tax benefits under the U.S.-Japan Income Tax Convention; particularly, the reduced tax rate, or tax exemption, with respect to U.S. withholding tax on income, such as dividends or interest from investments in the U.S., which are not available if the limited partnership is treated as a corporation in Japan. On February 9, 2017, the National Tax Agency of Japan ("**NTA**") stated that it will treat U.S. limited partnerships as pass-through entities under Japanese tax law, seemingly to address the concerns generated by the Supreme Court decision. However, with the apparent conflict between the NTA statement and Supreme Court decision, it remains to be seen how this issue will be handled.

3 Co-Operation or Information-Sharing Agreements with Foreign Governments or Regulators

AIFMD

FSA entered into the "Memorandum of Cooperation concerning Consultation, Cooperation and the Exchange of Information related to the Supervision of Funds and Fund Managers" with European securities regulators on July 19, 2013. The memorandum is intended to set a framework of mutual cooperation among regulators, which is required by the Alternative Investment Fund Managers Directive. FSA and its counterpart foreign regulators are expected to exchange regulatory information upon request.

FATCA

The Japanese authorities, including the Ministry of Finance, NTA and FSA, and the U.S. Department of Treasury jointly issued the "Statement of Mutual Cooperation and Understanding between the U.S. Department of the Treasury and the Authorities of Japan to Improve International Tax Compliance and to Facilitate Implementation of the Foreign Account Tax Compliance Act" (the "**FATCA**") on June 11, 2013, which was amended on December 18, 2013. Japan is a Model 2 country, where financial institutions are required to provide information on accounts held by U.S. persons who agree to such provision of information to the U.S. Internal Revenue Service ("**U.S. IRS**"). As to information on accounts of U.S. persons who do not agree to such provision of information, the U.S. IRS may request NTA to provide such information pursuant to the treaty. NTA will obtain such information from the relevant financial intuitions pursuant to the local law implementing the treaty, and will provide such information to the U.S. IRS.

CRS

A law to implement the reporting requirement under the Common Reporting Standard (the "**CRS**") of the Organisation for Economic Co-operation and Development became effective from January 1, 2017. NTA collects account information of non-residents from Japanese financial institutions pursuant to the law and provides it to the competent foreign tax authorities under the CRS. As Japan is a Model 2 country under the FATCA, Japanese financial institutions are required to provide account information in a bifurcated manner: to the U.S. IRS as to U.S. persons under the FATCA; and to NTA as to non-residents under the CRS. NTA announced that they obtained the information of 1.89 million accounts from foreign tax authorities and provided the information of 0.47 million accounts for foreign tax authorities under the CRS as of November 2019.

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Private Fund Management Issues Arising From COVID-19

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The global COVID-19 pandemic is an unprecedented situation that will have a long-term impact on the private fund management industry, stretching beyond the current period of lockdown and altering the way in which private funds are raised and operated. Whilst there will be some market participants who have navigated prior economic downturns, the current crisis is throwing up challenges that few people will have prepared for. There will also be some within the industry (whether investors, general partners (GPs), service providers or advisers) who have only known a period of relatively steady growth over the last 10 years. There is little doubt that the period of calm is being replaced by a period of turbulence.

The private funds market has not stood still over the last 10 years and there are a number of recent innovations and developments that will now be tested, from the prevalence of subscription line facilities, to the way that valuations and fund reporting are carried out to the increasing interest in GP-led transactions as a form of liquidity. But this crisis will also give opportunity for new products and approaches to be developed and put into practice.

Set out below is an overview of the key issues that private fund managers should be considering in the short and medium term to best adapt to the new environment and to prepare for the future. This covers operational issues, effective investor relations during the market dislocation, liquidity and risk management and some considerations for future planning.

Operational Issues

1. Valuations

As the COVID-19 pandemic took hold during March 2020 and countries went into lockdown, there were obvious economic effects: productivity dropped quickly; developed economies, reliant on consumer spending, began to feel a sharp chill; and travel companies went into freefall. Given the reporting cycle, it was also a time when a large number of fund managers were about to issue 31 December year-end financial information for their funds. CFOs were in a quandary about what to report: the valuations as they stood at the end of 31 December, or take into account the impact that the lockdown was having on portfolio companies?

The consensus settled on valuing based on what was known as at 31 December rather than adjusting for what happened later, but the difficulty of valuing portfolios remained. For a number of private funds, including private equity, mark-to-market accounting (i.e. 'fair value') is a relatively recent development, having been implemented in Europe following the introduction of IFRS 13 in 2011. So, it is the first time that a large number of private fund managers will have had to value assets during a time of severe market dislocation. For private funds that use the International Private Equity and Venture Capital Valuation Guidelines, the issue was considered by the IPEV Board and special valuation guidance was provided. In particular, the following was highlighted in the guidance: strong valuation processes should continue to be followed; fair value is based on what is known and knowable at the relevant date; fair value does not equal a 'fire sale' price but rather represents the amount that would be received in an orderly transaction; and firms should take care not to 'double-dip' downwards on their valuations if performance metrics have already been adjusted to take account of lower-than-expected performance; however, it may not be appropriate to use a recent transaction price as a way of determining fair value.

At the time of writing, it remains to be seen how this revised guidance will affect the valuation process. It is also worth noting that the focus with valuations has, so far, been on the downside risk. However, there will be some portfolio companies that are experiencing unusually high revenues due to the changing behaviours resulting from the lockdown. As well as the risk of underplaying drops in value to maintain performance levels, there is also a risk of banking growth which may simply be a result of the crisis rather than reflective of underlying fundamentals of the business.

2. Substance requirements

In recent years, the concept of 'substance' has been a key theme for the fund management industry. In a tax context, the focus on substance has increased since the OECD's initiative relating to 'base erosion and profit shifting', or BEPS, which looks at ending tax avoidance strategies that exploit gaps and mismatches in tax rules to avoid paying tax. Given the significant cross-border element to fund structuring, fund managers need to carefully analyse the taxable presence of the funds as well as the fund management businesses themselves. In addition, because the management of private funds has become increasingly regulated over the last 10 years, there is a separate (and, sometimes, conflicting) requirement to ensure that any regulated activity is being appropriately carried out by the correct authorised entity. In this context, the concept of substance means being able to demonstrate that individuals in the relevant jurisdiction are taking the required actions and making decisions for regulatory purposes.

The International Air Transport Association (IATA) has noted that, as of early April 2020, the travel restrictions imposed by governments had resulted in the number of flights globally being down 80% compared to 2019. The IATA also noted that the most severe impact was likely to be in the second quarter of 2020.

As fewer people have travelled, different approaches are needed to demonstrate substance in particular jurisdictions. A number of key fund jurisdictions have relaxed (or it is expected will relax) aspects of these rules and/or have published temporary guidance on how to comply with substance-based rules. For example, in the United Kingdom, although the rules themselves have not been changed, in relation to tax substance HMRC has emphasised that it will view company residency and permanent establishment issues in the round and not by reference to a one-off decision in the 'wrong' place. Other fund jurisdictions have introduced emergency measures in order to mitigate the immediate effects of COVID-19 for the whole business community but have not provided specific tax or regulatory guidance. For example, a Grand Ducal decree in Luxembourg made it clear that shareholder and board meetings may be held without any participant attending in person, but as of the time of writing the Luxembourg tax authorities have not provided any specific guidance. Given the likely ongoing challenges with travel for the foreseeable future, fund managers will need to carefully assess these requirements, particularly in jurisdictions where clear guidance has not been provided.

3. Signing and closing logistics

Because of the lockdown restrictions, there is potential for disruption when signatories are forced to work remotely. This may relate to signing or witnessing key documents or holding fund closings through to more mundane matters such as providing Know Your Customer documents (including certified copies) or filing documents with statutory or regulatory bodies. Whilst it is usually possible to find solutions, particularly through the use of platforms like DocuSign, the process inevitably takes longer and requires more planning.

4. Limited partner (LP) defaults

It is to be expected that, when any financial crisis is looming, commentators will begin to predict widespread LP defaults within the private funds market. The truth is that there have been very few significant or publicised defaults at all in the private funds market, whether in times of boom or bust. This may be due in part to the fact that private funds tend to be more relationship-driven between the GP and LPs than other markets; it may be in part due to the expected returns, even during times of crisis; or it may be due to the relatively harsh penalties and remedies available to GPs. On this latter point, it would be usual for the fund documentation to allow the GP to have a range of options if an LP defaults, including charging interest on the default amount, or withholding distributions until the default is remedied (or setting off a future distribution against the default amount), forcing the LP to transfer its interest or forfeiting the interest entirely.

Despite the historically low incidence of defaults, clearly both GPs and LPs should carefully consider their obligations and plan accordingly. GPs should speak to investors about the timing and frequency of future capital calls as this will reduce surprises for both the GP and the LPs. If there is a risk that an investor may default, there are various strategies that can be implemented, for example putting in place a subscription line facility, delaying or reducing some investment activity, introducing voluntary pacing restrictions to proactively manage the deal pipeline or permitting LP transfers (the increasing size of the secondaries market is helpful in this regard). During the Global Financial Crisis, there were very few significant defaults by investors in private funds, partly because GPs and LPs worked together to get through the crisis. However, as the market has developed over the last 10 years, there are some additional points to consider. For some large institutional investors, it is more common to run an 'over-allocation' strategy with the expectation that distributions can be used to meet future capital calls. Given the current state of the market, this strategy may be put under strain. On the flipside, GPs have increasingly turned to subscription line facilities as part of their toolkit for effective cash management. But that also reduces to some extent the discretion that a GP will have with a potential default situation because the GP may need to involve the lender in any decision regarding action to be taken. If a GP has been using a subscription line facility, it should also consider whether the LPs have sufficient 'skin-in-the-game' to want to avoid a default, or whether a large part of the drawdowns have, to date, actually been funded by the lender.

Effective Investor Relations

1. Communications

The importance of letting LPs know how the investment portfolio is coping with the COVID-19 crisis should not be underestimated. Effective and timely communication between GPs and LPs will strengthen the relationship and allow for a more collaborative approach to dealing with the crisis. The push for transparency within the private funds market has resulted in more communication between GPs and LPs, but also more dialogue and coordination between institutional investors themselves. If GPs can demonstrate that they are communicating effectively, this is likely to enhance the brand and reputation of that GP not just within its own investor-base but also the wider investor community. It would also be prudent for a GP to discuss the likely cash requirements for the portfolio as this will help LPs with their own cash management. Whilst the direct and personal touch is always important, GPs should ensure they are being consistent with the types of information and responses that are being provided to investors to mitigate selective disclosure issues.

When considering effective communication, GPs also need to consider how to coordinate and hold investor meetings, for example meetings of the limited partner advisory committee, or LP meetings such as AGMs. These meetings are often viewed as a good opportunity for the GP and LPs to gather together and build the relationship by discussing issues and for LPs to obtain more information on the portfolio. Given the ongoing travel restrictions, meetings in person are very unlikely for the foreseeable future. Whilst its clearly possible to hold meetings online or over the telephone and discuss all the same issues and topics that would have been covered at an in-person meeting, it is clearly more difficult to have a two-way debate over video or the telephone. Both GPs and LPs will need to adapt to this changing situation and find other ways of giving all parties the opportunity to maintain the dialogue.

2. Fundraising planning

Analysis shows that alternative assets have generated strong returns both during and after previous economic downturns. There remains a degree of optimism among institutional investors about the investment opportunities over the next 18–24 months. GPs should, therefore, be carefully planning their next fundraising, laying the groundwork with investors and making sure there is an allocation for the next fund. However, raising

first-time funds is expected to be more difficult as LPs are likely to focus on existing relationships. This will be partly the natural reaction to concentrate on incumbent relationships but also will be a practical response to the difficulty of holding face-to-face meetings with new GPs.

Even for established managers, the timing of going to the market will be important. Different fundraising strategies will be needed to ensure momentum within the fundraising process, for example, early-bird discounts on fees, giving LPs access to funds that operate different strategies and strengthening the investor-protection package for LPs. New strategies will be needed to meet with potential investors, such as digital fund-raising roadshows and virtual due diligence visits.

Liquidity and Risk Management

1. Follow-on capacity and recycling

GPs should carefully consider what liquidity they are likely to need, both as the COVID-19 pandemic evolves and in its immediate aftermath. This is likely to include emergency funding for portfolio companies whose business has been hit by the pandemic as well as having sufficient firepower to make the most of investment opportunities over the coming months. GPs need to ask: is there sufficient liquidity in the fund as things stand?

Within a private fund context, it is common to have a fixed investment period followed by period of time (normally, a number of years) for the GP to work towards realising the portfolio. However, even within this 'harvesting' period, it would also be common for the GP to be permitted to make additional or 'follow-on' investments into the existing portfolio. It is likely that these powers will be restricted because LPs want the GP to focus on realisation rather than new investments: for example, the follow-on investments will need to be clearly linked to an existing portfolio company rather than a completely new investment; the GP may be limited to a making these investments during a period of two or three years after the end of the investment period; or the GP may only be permitted to draw-down a fixed percentage of total fund commitments (say, 20%) for follow-on purposes. Given the current COVID-19 situation, GPs and LPs should carefully consider these provisions and determine if they are relevant given the unprecedented situation and requirements on capital. Having an ability to inject extra cash into an investment may be better than allowing the business 'go to the wall' or the business being required to accept additional capital from another investor that has a dilutive effect on existing shareholders.

Most private equity funds will also permit some 'recycling' of distributions in order to make further investments. It has long been the case that if a private equity fund returns cash to investors within a short period from the original drawdown (for example, because the fund did not need to use the cash, or the investment was realised very quickly, or part of the investment was syndicated to a third party), it would be usual for the GP to be able to recall or reinvest those proceeds. In recent years, it has also become common for both GPs and certain institutional investors to want to reduce the cash drag created by the fees and expenses incurred by the fund by allowing the fund to recycle a larger proportion of distributions for investment purposes. These recycling powers can be usefully employed to increase the overall firepower of the fund, either for emergency situations, or follow-ons or additional investment opportunities. GPs should carefully look at what recycling is permitted under the fund documents. There may be some distributions that have been made historically which are, under the limited partnership agreement, recyclable. Clearly, any GP needs to approach this in a responsible manner and be sensitive to the reaction of the LPs, but it may be possible to generate some additional liquidity without needing extra sources of capital.

2. Alternative liquidity options

As well as looking at follow-on and recycling options, GPs should consider the developing markets of NAV facilities and preferred equity products, which are tailor-made for this situation. In very broad terms, NAV facilities involve fund-level borrowing provided by a third-party lender against the value of the asset(s) of the portfolio whereas a preferred equity solution involves injecting prior ranking third-party equity within the fund structure in return for priority claims over future distributions. Both of these liquidity options have developed over the last couple of years as part of a wider 'GP-led transactions' toolkit available to GPs, i.e., bespoke structuring options to introduce a secondary purchaser or lender into the fund structure or into a new vehicle managed by the same GP. The emergence of this toolkit is taking fund managers beyond the traditional private fund investment and divestment cycles and into constant and active portfolio and investor-base management. But the toolkit is also evolving as GPs assess the potential additional funding requirements of their existing portfolios to ensure the GP has sufficient firepower to inject cash where needed. Older vintage funds, where there is significant NAV at risk and (perhaps) little remaining by way of uncalled investor commitments, are particularly exposed but also particularly well-suited to a NAV facility or a preferred equity solution. However, from a practical perspective, it is unclear whether there will be enough capital available to cover the demand for these products, so first-mover advantage could be crucial.

Future Planning

1. Understanding the requirements within the fund documents

For any future planning, the GP needs to understand what is and is not possible with the existing fund. This requires a careful and detailed analysis of the fund documents and any related side letters. The following areas should be considered:

- Follow-on provisions and recycling. As noted above, the terms of the fund may allow the GP to make follow-on investments or to maximise available capital by recycling distributions. It would be usual for these powers to be restricted, so the GP should carefully consider and understand what flexibility there is within these powers.
- Fund extensions. Because of the market dislocation, it may be difficult for a GP to complete its investment programme within the proposed investment period, or more time may be required to allow for an orderly realisation of the remaining assets. The GP should examine if there is an ability to extend either the investment period or the overall term of the fund. In either situation, both the GP and the LPs should consider what the management fee arrangements should be. On any investment period extension, if the management fee is constructed so that the amount paid to the GP reduces at the end of the investment period, the LPs may require that any extension of the investment period is only allowed if they are put in the same position with regard to the management fee as if the extension had not occurred. For any extension of the

overall term of the fund, should the management fee be reduced further to take account of the additional time that the GP will be charging fees?

- Diversification limits. The fund documents may contain restrictions on how much can be invested in different assets or geographies. As funds adjust to the crisis, it will be important to know what and where the fund can invest to comply with these requirements.
- Amendments and waivers. Some of the mid-term planning for the fund may involve changes to fund documents or waiving existing restrictions. As a result, GPs should consider the process they will need to follow, such as the thresholds for approvals and which groups of investors will need to be 'on-board' to approve changes. The GP may want to signpost its proposals to amend the fund documents, for example with any limited partner advisory committee. Further, there may be third parties that would also need to give consent, for example lenders under a subscription line facility.

2. Proactive fund management

A number of important considerations are set out above for the proactive management of any private fund, from effective communication between GPs and LPs, to liquidity solutions (including follow-on capacity and recycling), to fund extensions. The viability of a number of additional structuring options that should be reviewed are as follows:

- GPs should consider whether it would be appropriate to sell particular investments or hive-off specific assets into other vehicles. These are normally structured as a 'GP-led transaction' so that the acquiring vehicle is controlled by the GP. One option could be a sale of a 'strip' of the fund's underlying portfolio, which means a fixed percentage of some or all of such assets. The acquisition vehicle is likely to be funded by a secondaries fund, which may also make additional follow-on capital available. Alternatively, the GP could 'sell' to another fund managed by the GP, for example a later vintage fund or a fund with a different strategy (such as selling assets from a venture fund to a growth fund).
- An alternative solution would be establishing an 'annex fund'. This is normally structured as a new fund that is offered *pro rata* to existing investors, with new investors only being admitted if there are additional capital requirements. The annex fund is used to invest into and support the existing portfolio without any particular preference.
- The GP may also consider the creation of a continuation fund as part of a GP-led transaction. Some or all of the existing portfolio is transferred to the continuation fund, with existing investors being given the option to 'exit' (i.e. cash-out) or 'rollover' into the continuation fund. The transaction is underwritten by one or more additional investors (such as a secondaries fund) and the continuation vehicle will also allow for further capital to be invested into the portfolio.

3. Investment opportunities may change

Looking even further ahead, it is likely that certain sectors will become more attractive to investors, such as healthcare, life sciences and logistics. Companies that provide tech-enabled solutions for social distancing policies will be highly valued, whilst there is also likely to be an increased focus on distressed debt and special situations funds (given the anticipated economic downturn). Conversely, certain sectors such as retail, leisure, travel and energy may be less appealing to investors. It is also worth noting that COVID-19 is not just an economic crisis but a socio-economic one. This is different from, for example, the Global Financial Crisis in 2007–2009, so it is likely that there will be a wider societal response rather than one that is focused on the financial markets. Fund managers should consider areas like impact investing and sustainability to ensure they are properly aligned with the society in which they operate.

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The Travers Smith LLP funds department comprises four partners and 15 other dedicated fee earners, based in London. The group focuses on funds, investors and intermediaries in the private equity, infrastructure, debt, real estate and listed equities sectors. It has constantly been at the forefront of developing market practice and thought on relevant changes for the investment funds industry, including the European Alternative Investment Funds Managers Directive and, more recently, the potential impact of Brexit. The funds tax group advises on the structuring of investment funds to maximise their tax efficiency for investors and managers. The funds department sits alongside the firm's market-leading private equity M&A practice, one of the largest transactional teams of private equity lawyers in the City. The funds finance practice combines expertise from the firm's fund formation and finance practices to advise lenders that provide subscription line and other facilities to real estate funds. Travers Smith also advises real estate funds on the borrower side. The funds department is best known for advising private funds and closed-end listed funds.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The establishment and operation of Alternative Investment Funds ("AIFs") is governed by Law 10/2008 regulating Andorran Collective Investment Schemes, dated 12 June 2008 ("Law 10/2008"). Law 10/2008 includes the constitution of collective investment schemes in the Principality of Andorra ("Andorra") and regulates their functioning and distribution. Depending on the type of investor, the purpose of the vehicle and the advertising involved, various schemes may be found from fully regulated collective investment vehicles to closed Alternative Investment Funds.

As Andorra is not a member of the European Union, Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers is not applicable. Consequently, the Andorran legal framework, dating from 2008, does not define AIFs as European regulations do. With the exception of undertakings for collective investment in transferable securities, "*organismes d'inversió col·lectiva en valors mobiliaris*" ("OICVMs"), which are aligned with the UCITS Directive, the definition of AIFs comprises other open-ended and closed-ended collective investment schemes ("*organismes d'inversió col·lectiva*" – "OICs"), such as alternative funds *per se* (also known as hedge funds), real estate funds and other OICs as a catch-all term for private equity entities or those which, because of the composition of their assets and diversification risk policies, cannot be included in any other regulated categories.

Obtaining a specific performance objective and fundraising are the distinguishing elements of AIFs.

In addition, the Andorran Financial Authority ("AFA") – the regulatory and supervisory authority of the Andorran financial system for banking and insurance sector, whose prior name was the Andorran National Finance Institute "*Institut Nacional Andorrà de Finances*" – is competent to issue technical communications and recommendations in order to develop regulations and standards regarding activity related to OICs. Furthermore, its constitutive law grants the AFA the ability to set the applicable fall-back of international standards for interpretational and prudential supervision purposes. The most relevant technical communications regarding AIFs and AIF management companies are the following:

- Technical Communication 189/09 of 27 July 2009, on registration of foreign collective investment undertakings.
- Technical Communication 7/SGOIC of 27 May 2011, on rules for ethics and behaviour.
- Technical Communication 20/SGOIC of 27 May 2011, on clarification regarding Law 10/2008.
- Technical Communication 23/SGOIC of 27 May 2011, on classification of OICs.
- Technical Communication 28/SGOIC of 29 November 2011, on transactions with related entities and individuals.
- Technical Communication 35/SGOIC of 31 July 2014, on publicly available tariffs.
- Technical Communication 44/SGOIC of 3 August 2018, on distribution to clients of OIC shares under the same investment policy.

As Andorra is not a member of the European Union ("EU"), the freedom to provide financial services in the European Economic Area does not apply (the so-called "community passport" is not recognised). Consequently, all financial activities directly carried out within the Andorran jurisdiction are subject to prior authorisation by the AFA.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Only Andorran financial entities that are authorised to manage OICs can be management companies of Andorran AIFs. OIC management companies are entitled to provide OIC management and OIC advisory services.

The AFA is the regulatory and supervisory authority of such entities. Accordingly, they must comply with licensing requirements.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

The AFA is responsible for authorising the establishment of Andorran AIFs through a two-tiered procedure comprising: (a) authorisation by; and (b) registration before, the AFA. They acquire the condition of OICs upon registration before the AFA.

The distribution of foreign AIFs, if this is considered active commercialisation, will also trigger registration obligations.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

There is no specific distinction between open-ended and closed-ended AIFs under Andorran legislation. The only categorisation

regulated by Law 10/2008 and the AFA's technical communications is as follows: (i) money market funds; (ii) fixed-income funds; (iii) mixed fixed-income funds; (iv) equity funds; (v) mixed equity funds; (vi) guaranteed funds; (vii) real estate funds; (viii) alternative funds; (ix) private equity funds; (x) securitisation funds; and (xi) other funds.

Notwithstanding the aforementioned, the different types of OIC are subsumed within two general categories: (i) "***OICVMs***"; and (ii) other undertakings for collective investment schemes "***Altres OICs***", which includes real estate OICs, alternative OICs and other OICs.

The Andorran regulatory regime does not distinguish between the different strategies of funds.

1.5 What does the authorisation process involve and how long does the process typically take?

Prior to the distribution of Andorran AIFs and their subscription, they must be registered before the AFA. Indeed, the regulation of funds is subject to the AFA's approval in the authorisation and registration process of the OIC, which takes around three months.

The documentation required in order to obtain authorisation, prior to the establishment of an Andorran AIF, is the following:

- The prospectus.
- The agreement between the management company and the depositary entity.
- A technical document detailing the particular features of the AIF and the specific investment programme.
- The depositary entity of the OICs being invested in (only for subordinated funds).
- An explanatory memorandum of the control levels conducted by the management company (only for alternative funds).
- A service delegation agreement.

The authorisation also requires the AFA's approval regarding the management company and the choice of the depositary entity.

1.6 Are there local residence or other local qualification or substance requirements?

As mentioned above, only Andorran financial entities that are authorised to manage OICs can be management companies of Andorran AIFs.

1.7 What service providers are required?

According to applicable law, there must be a depositary entity with which the securities, cash or any other asset, subject to the activity of any AIF, are deposited.

In the case of investment funds, they must be managed by a management company (in the case of investment companies, the appointment of a management company is optional). Functions of management, administration and control can be provided by the management company itself or by a third party.

Investment companies must also have a suitable administrative and accounting system and internal control procedures, including risk management procedures, together with IT control and safety procedures, money laundering bodies and procedures.

An AIF must be audited and can be marketed by the management company or by a local licensed distributor.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

All financial activities carried out in Andorra are reserved to local licensed entities that compose the Andorran financial system. Therefore, foreign managers or advisers wishing to manage, advise or otherwise operate funds in Andorra have to obtain prior authorisation from the AFA as stated in question 1.2.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

In June 2011, Andorra signed a Monetary Agreement with the EU. The Monetary Agreement not only recognises the euro as the official currency of the Principality of Andorra, the right to issue euro coins and the obligation to grant euro banknotes and coins with legal tender status issued by the Eurosystem and the Member States which have adopted the euro, but represents the cornerstone of the legal changes envisaged for the next 10 years. This is because the Monetary Agreement requires that Andorra adopts, within certain timeframes, a substantial part of all the EU banking/financial legislation.

Furthermore, in September 2013, the International Organization of Securities Commissions ("IOSCO") protocol for multilateral agreement on consultations was signed.

A Memorandum of Understanding ("MoU") was signed between Andorra and Spain on 4 April 2011. The MoU: (i) constitutes an agreement for consolidated cooperation in the supervisory framework between the AFA and the Bank of Spain; (ii) establishes the terms of the protocol for the relationship and collaboration between both authorities; and (iii) enables the supervisory authority of the country of origin to request information on consolidated risks of banking groups from the relevant authority of the country where the entity has subsidiaries.

Andorra signed, on 12 February 2016, the Multilateral Competent Authority Agreement with the European Union to automatically exchange information under the Common Reporting Standard.

Further, an Andorra-EU Association Agreement is being negotiated as of today's date, the outcome on key-negotiation areas (e.g. free movement of persons and services) of which still remains to be seen.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

It can be either an investment fund or an investment company. Investment funds can only be managed by a management company, whereas an investment company can be managed directly or by delegating management to an authorised institution, provided that the shareholders' meeting or the board of directors, by delegation, decides it.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Investors are liable for the debts of the AIF to the extent of their contributions. Consequently, under normal circumstances, an AIF's creditors cannot claim against the investors' assets.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Investment funds

As mentioned above, only Andorran financial entities that are authorised to manage OICs can be management companies of Andorran AIFs. Such entities must be established as an Andorran limited company. Management companies must have a minimum equity share capital of EUR 300,000, fully subscribed and paid-in. In addition, they must have a board of directors of at least three members. Management companies are obliged to comply with specific solvency/own funds requirements (for "*Altres OICs*", these provisions have been aligned with Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms – "CRR/CRDIV" – as, mainly, 0.01% of own funds and a civil liability insurance of 0.7% of the OIC's assets), core capital ratio provisions, and its board of directors' members, must comply with good governance/suitability requirements.

Investment companies

An investment company must be established as an Andorran limited company and can be self-managed or delegate to a management company the management of all or part of the assets of the institution.

Both the management company and the investment company may contract intermediaries or financial agents, who must have the relevant authorisation for rendering such services.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

In general, both subscriptions and redemptions are made on the basis of the net asset value, which is subject to the subscription/redemption fees and other possible costs borne by the investor. Moreover, subscriptions and redemptions (which set the value date of the request) are made through contributions or charges to the OIC. These circumstances must be set out in the prospectus.

Both the management company and the investment company can justifiably limit redemptions, according to the prospectus, which may establish certain limitations, including the provisional suspension of redemptions, in exceptional cases, in the investors' interests. In addition, the AFA may temporarily suspend subscription and redemption when value determination is not possible.

Regarding real estate funds, investors may subscribe or request the redemption of their units at least twice a year.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no Andorran legislative restrictions on transfers of investors' interests in AIFs.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

Andorran AIFs are composed by Common AIFs and AIFs for well-informed investors.

Common AIFs have to comply with some diversification requirements:

- they cannot invest more than 20% of its assets in financial instruments of the same issuer;
- they may be leveraged to up to 200% of its net asset value; and
- they are able to engage in short selling of securities with some restrictions.

On the other hand, AIFs for well-informed investors are only subject to limits established in their own prospectus.

In the Andorran funds law, there are no specific asset stripping limitations.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The production and offering of marketing materials are governed by Law 10/2008 and the Technical Communication 7/SGOIC, 27 May 2011, on rules for ethics and behaviour.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

Advertising must be clear, sufficient, objective and not misleading and must state explicitly that it is an advertisement.

Prior to the investment, the latest published reports and the simplified prospectus – and, if requested, the full prospectus – must be delivered free of charge to the investors.

Marketing materials should contain: (i) a reference to the full prospectus and where it can be consulted; (ii) information regarding the managing company, the custodian and their authorisations to operate; and (iii) relevant information about the product's main characteristics, which must not lead to confusion regarding its content.

Marketing materials may also contain past performance information, in which case they should: (i) include a disclaimer stating that past performance does not condition future performance, or similar; and (ii) designate where and how to access quarterly and annual reports. They should avoid any expression or argument that may lead the investor to believe that there is a guaranteed positive return, unless there is a minimum return guaranteed, in which case all its elements should be clearly exposed (object, duration, conditions, commissions, etc.).

Also, the typography, format and content of marketing materials should be transparent, clear and accurate; and should not be comparative or estimative.

When marketing activities are conducted through the internet, information shall be displayed in such a manner that the investors have access to the full prospectus prior to subscription.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

All marketing materials shall be registered before the AFA prior to its publication. Any marketing materials shall include the fund's registration number before the AFA.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Alternative Investment Funds for well-informed investors cannot be made available by any disclosure means not specifically addressed to this investor profile.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

Andorran OIC legislation does not provide for an express definition of "pre-marketing" nor recognises an equivalent concept. However, due to the power recognised by the AFA to apply international standards in the exercise of its supervisory activity, further legal developments in EU legislation could be taken into consideration in a factual way so as to build a "pre-marketing" or equivalent concept.

Specifically, following the EU Action Plan on the Capital Markets Union ("CMU"), the European Commission approved Regulation (EU) No 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment funds and amending Regulations (EU) No 345/2013 and (EU) No 346/2013 (the "Pre-marketing Regulation"). Among others reform aimed at enhancing the regulatory framework applicable to investment funds and to better protect investors, the Pre-marketing Regulation introduces a harmonised concept of pre-marketing, amending the Alternative Investment Fund Managers Directive ("AIFMD").

Specifically, "pre-marketing" is defined as "a direct or indirect provision of information on investment strategies or investment ideas by an AIFM or on its behalf to professional investors domiciled or registered in the Union in order to test their interest in an AIF which is not yet established".

3.6 Can Alternative Investment Funds be marketed to retail investors?

According to Law 10/2008, the AFA can restrict the marketing of AIFs to well-informed investors, in case of a low liquidity level or a high risk of loss for the AIFs. The marketing of AIFs which are limited to well-informed investors is prohibited to retail investors, whose definition is aligned with the Markets in Financial Instruments Directive ("MiFID").

3.7 What qualification requirements must be met in relation to prospective investors?

Investment in an AIF reserved for well-informed investors requires a limited level of protection. Pursuant to Law 10/2008, "well-informed" investors are those which meet the criteria of being either: (i) institutional investors; (ii) professional investors; or (iii) other investors who confirm in writing that they adhere to the status of "well-informed" investors and who either: (a) invest a minimum of EUR 50,000; or (b) have been assessed by a credit institution, an investment firm or a management company which certifies the investors' ability to understand the risks associated with investing in the AIF.

With the exception of those limited to well-informed investors, AIFs can be marketed to retail investors upon complying with any other regulatory requirements.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no specific restrictions on marketing to public bodies in the Andorran jurisdiction. National and regional governments, the AFA, public institutions, central banks and other international institutions are expressly recognised as professional investors.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

There are no specific restrictions thereof in the Andorran jurisdiction. However, any such fundraising activities carried out through intermediaries, if qualifying as financial activities falling under the activity reservation regime stated in question 1.2, should be carried out by local financial entities authorised to operate by the AFA.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

There are no specific restrictions on the participation of particular types of investors other than those that may be imposed by the investors' applicable regulation.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

AIFs in Andorra are divided into three categories: (i) Real Estate Investment Funds; (ii) common Alternative Investment Funds; and (iii) Alternative Investment Funds for qualified investors only.

A Real Estate Investment Fund shall invest at least 90% of the annual average of monthly balances of its real estate assets. Additionally: (i) any asset, including rights on such asset, can represent more than 35% of the total assets in the acquisition moment; (ii) real estate assets being part of the asset state of the fund, rented to legal entities that are part of the same group, cannot represent more than 35% of the assets of the AIF; and (iii) entities belonging to the same group can only acquire a real estate asset when it is a new construction, it is permitted by its bylaws, the managing company includes it on the prospectus and provides periodical information, and it does not represent more than 25% of real estate investment fund assets.

Overall, the other AIFs under Andorran legislation cannot invest more than 20% of their assets in securities or financial instruments from the same issuer, along with other investment restriction particulars.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Please see question 4.1 above.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Please see question 4.1 above.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Under Andorran legislation, there are no restrictions on borrowing by AIFs (OICMVs may not generally enter into loans, although they may acquire currencies through back-to-back lending).

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

Overall, the management company of an AIF must publish a prospectus of each of the AIFs it manages, as well as quarterly reports (for *Altres OICs* it is not necessary to report on a quarterly basis, according to the AFA criteria). The simplified prospectus and annual reports must also be disclosed.

Such information must be published in accordance with the prospectus.

Andorran AIFs and foreign AIFs that are going to be distributed in Andorra must be registered in the special AFA registry.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

There are no specific AIFMD Andorran legislation requirements to provide details of participants in AIF. However, AIF managers must keep details of participants' data (with no reporting obligations to AFA nor to any other authority).

On a side note, there is a register obligation which applies as per Act 14/2017 of 22 June 2017 on prevention of money laundering and terrorism financing "*Llei 14/2017, del 22 d'abril, de prevenció del blanqueig de capitals i finançament del terrorisme*" and related legislation regarding the register of beneficial owners, which follows that of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Overall, management companies (for each of their managed AIFs) and investment companies are obliged to prepare annual reports which shall be published and submitted to the AFA and to the investors. In addition, it is also compulsory to prepare quarterly reports which must be submitted to the AFA.

Management companies and investment companies must report to the AFA any decrease in net assets (if it is less than 10%).

Finally, as mentioned above, prior to the marketing of AIFs, management companies and investment companies must send to the AFA a copy of the marketing materials.

5.4 Is the use of side letters restricted?

There are no Andorran provisions regarding the use of side letters. However, using specific language to determine obligations and duties, mentioning their binding character, as well as their signing by the parties, is advisable.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

All the different forms of Alternative Investment Funds receive the same tax treatment. All of them are subject to and not exempt from corporate income tax, but the tax rate is 0%. Consequently, no tax burden is supported by the fund for any kind of income.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

The management company/investment manager does not receive any special tax treatment and it is subjected to corporate income tax at the standard rate of 10%.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

This is not applicable in Andorra.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

a) If the investor is an individual tax resident: (i) no tax on distribution of dividends; (ii) 10% for capital gains, unless the investor holds a stake of less than 25% or has maintained the investments for at least 10 years; and (iii) 10% if the shareholder is a resident legal person.

b) If the investor is a non-tax resident individual or legal person, Andorra does not apply any withholding tax either for income coming from dividends or capital gains distributed to non-residents.

c) This is not applicable, since pension funds are not regulated in Andorra as a special class of fund.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

No. This is not necessary in Andorra.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

The country itself did not sign any IGA, but all the banks assumed the commitments through the corresponding registration before the Internal Revenue Service (IRS).

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Andorra assumed the commitments on CRS/OECD on 18 June 2014 and made its first report in September 2018 for major value accounts and in September 2019 regarding the rest of the accounts.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

No tax-advantaged asset classes/structures are available under the current OIC legislation in Andorra.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

No, there are not.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No, there are not.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

As stated in question 1.9, the Monetary Agreement sets forth EU banking/finance pieces of legislation to be implemented progressively along with their respective deadlines.

Considering this, there are specific Directives which will impact on AIFs and its management companies, mainly crystallised through the implementation as the Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMD).

Despite AIFMD's implementation being foreseen for 31 March 2016, it has not taken place as at the time of writing.

Moreover, the full implementation of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments ("MiFID II") and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments ("MiFIR") legislation is foreseen by 31 December 2020 as per the latest Annex to the Monetary Agreement.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Activity involving the management, investment and marketing of Alternative Investment Funds (AIFs) is mainly regulated by the Undertakings for Collective Investment Law (*Regime Jurídico dos Organismos de Investimento Coletivo*), enacted by Presidential Decree no. 7/13, of 11 October (UCI Law).

Law no. 12/15, of 17 June – the Basic Law on Financial Institutions, and Law no. 1/04, of 13 February – the Commercial Companies Law, are also applicable.

The UCI Law is complemented by CMC Regulation no. 4/2014 on Undertakings for Collective Investment (Regulation no. 4/2014), which sets forth more specific rules regarding certain aspects of the UCI Law and the Angolan Securities Code (*Código dos Valores Mobiliários*), enacted by Law no. 22/15 of 31 August 2015, as amended from time to time.

Lastly, please note that venture capital merits a specific legal framework, set forth by Presidential Decree no. 4/15 of 16 September (Venture Capital Law) and in Regulation no. 2/19 of 5 February, on Venture Capital.

The Angolan Capital Markets Commission (*Comissão do Mercado de Capitais* or CMC) is the main regulatory body in relation to the aforementioned matters.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Yes. Fund managers, as non-banking financial institutions, are subject to the CMC's supervision, notably in respect of prudential matters and in what concerns most of the rules governing their management of AIFs' activity.

Therefore, the fund managers' authorisation procedure will be conducted before the CMC pursuant to Law no. 12/15, of 17 June, and thus any entity wishing to provide alternative fund management services ought to be authorised by and registered with the CMC. Provided the authorisation to provide fund management services has been obtained, financial institutions, as well as management companies of collective investment undertakings, may perform fund management services. In any event, this is without prejudice to the application of a registration with the CMC requirement, on top of the aforementioned authorisation requirement, prior to the beginning of the provision of management services.

On the other hand, the foregoing is also without prejudice to the possibility of an investment company (i.e. collective investment undertakings with legal personality) ensuring its own fund management.

The UCI Law does not foresee any *de minimis* exemption or fast-track authorisation procedure. Accordingly, all fund managers, regardless of the asset under management, need to comply, in general terms, with the same requirements.

Nonetheless, considering the type of AIFs the fund manager intends to manage, i.e. AIFs investing in securities or financial assets or real estate, there are some specific requirements to be met as regards investment policies, contracts with services providers, etc.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Yes. The setting up of any fund, including AIFs, is subject to authorisation by the CMC, which is the competent regulator to conduct the supervision of AIF management, ancillary service providers, distribution and compliance with the general rules applicable to AIFs, notably those relating to the protection of the investors' interests.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes. In general terms, the UCI Law distinguishes between AIFs investing (i) in securities or financial assets, and (ii) in real estate (real estate investment funds).

Both AIF types may be open- or closed-ended, but the real estate investment funds may also be of a mixed type, thus allowing the coexistence of both features in the same AIF.

In general terms, open-ended AIFs are addressed to the retail market, while closed-ended AIFs target affluent or professional investors, thus in open-ended AIFs the scrutiny of the CMC tends to be tighter.

Furthermore, depending on the type of AIF at stake and if such is open or closed-ended, different investing limits and portfolio composition limits apply.

1.5 What does the authorisation process involve and how long does the process typically take?

In a nutshell, the authorisation for the setting up of an AIF is filed with the CMC.

In requesting such authorisation, the relevant AIF's manager must provide the CMC with the AIF's documentation, notably the prospectus (if applicable) in simplified and full versions, which must also include the AIF's regulation, subscription form, and an announcement on the beginning and end of the subscription period.

In addition, the CMC must also be given copies of the agreements to be executed between the management company and (i) the depositary, (ii) the distributors or entities that will market the AIF, and (iii) any other entities that will render services to the AIF or to the AIF manager.

Documents evidencing the acceptance of the rendering of the relevant services by all entities involved in the AIF's activities must also be delivered to the CMC.

Furthermore, in the case of a closed-ended AIF, if applicable, the authorisation application for the public placement of the units/shares shall too be provided. On the other hand, in the case of open-ended AIFs, the fund manager shall provide a copy of a bank guarantee, in an amount no less than 20% of the AIF's net asset value (NAV), in order to secure the necessary liquidity to pay potential redemption requests placed by the investors.

An authorisation is given within 45 days of the receipt of either the application, with all necessary documentation having been provided in attachment thereto, or of any additional information or amendments to the documents required by the CMC. If at the end of such period the applicants have not yet been notified of the deferral of their application, the authorisation is considered to have been tacitly refused.

However, considering that CMC has discretion to request further information, which suspends the term for granting the authorisation, and that few AIFs are being established in Angola, the term for completing the process may vary significantly from case to case.

The CMC may refuse the authorisation, *inter alia*, if the applicant does not submit the required documentation or if the AIF manager at stake engages in irregular management of other investment funds.

After the authorisation has been granted, an AIF will be fully set up from the moment the first subscription is settled.

1.6 Are there local residence or other local qualification or substance requirements?

Considering that the vast majority of AIFs in Angola are set up under the contractual form with no legal personality, it is required that such AIFs be managed by a separate fund manager, which needs to be incorporated and have its centre of main interests and effective management located in Angola.

Furthermore, the fund manager must have in place several internal policies aimed at addressing the risk of its activity, remuneration issues, outsourcing, internal control and evaluation of the assets pertaining to the AIFs under management, all being subject to the control of the CMC and, to a certain extent, the depository, and entailing permanent record-keeping by the fund manager.

Lastly, the employees of the fund manager with technical functions, as well as the management, shall have the proper qualification and professional aptitude in accordance with high-level standards. Pursuant to Regulation no. 4/14, it shall be assumed that persons that have held office with similar functions within the financial sector have the necessary professional competence.

1.7 What service providers are required?

An AIF is legally required in Angola to have: a fund manager, except if it is endowed with legal personality, in which case such an AIF may perform its own management; a depository; an auditor; and, in the case of real estate AIFs, real estate appraisal experts.

Furthermore, the AIF may also have, but is not legally compelled to have, distributors or entities that will market the AIF, the existence of such entities being more usual in the case of open-ended AIFs.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

In accordance with the Banking Law, the same rules established for national managers apply to foreign managers.

However, foreign managers need to be properly authorised to conduct their activities in Angola and need to have a local establishment.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

There is no specific protocol or sharing agreement signed by the CMC with other governments or regulators in respect of AIFMs or AIFs.

However, the CMC signed a general (low-detail) understanding protocol with the Portuguese Securities Exchange Commission (*Comissão do Mercado de Valores Mobiliários* or CMVM) in January 2018, including some information-sharing provisions.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

An AIF may take one of two forms or structures, both subject to the licensing procedures described in question 1.5 above:

- Contractual structure with no legal personality. This is the classic structure and requires that the AIF be managed by a separate fund manager. The investors' or participants' interests in these funds are called units (*unidades de participação*).
- Collective investment company endowed with legal personality (*sociedade de investimento*). Collective investment companies which mainly invest in securities are classified as SIMs (*sociedades de investimento mobiliários*), while those which mainly invest in real estate are classified as SIIs (*sociedades de investimento imobiliário*). Both SIMs and SIIs may be self-managed or have appointed a third party as their manager, which must be a duly authorised investment fund manager. Participants in these collective investment companies will hold shares (*ações*).

In Angola, AIFs are usually set up under the contractual structure with no legal personality.

In an overall assessment of the pros and cons of both structures, it is possible to verify that the contractual structure has a longer track record in Angola, being the preferred choice for the setting up of AIFs as it offers an affordable, simple and well-known model for AIFs in Angola.

Conversely, the collective investment company endowed with legal personality is clearly a more complex model that allows, however, greater control for the investors over the management of the AIF.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Legally, the assets of an AIF are only liable for its debts, thus it will not be liable for the investors, fund manager, depository, distributors or other AIFs' debts. Likewise, investors are not personally liable for the AIF's debts and will therefore not, under any circumstances, be burdened by any of the AIF's debts.

As regards collective investment companies endowed with legal personality, they are also subject to the limited liability provisions applicable to commercial companies by special law.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

AIFs, which are not self-managed, will need to be managed by a:

- fund manager (non-credit financial institution) authorised to manage AIFs investing in securities and other financial assets or real estate investment funds (*sociedade gestora de fundos de investimento mobiliário*); or
- real estate fund manager (non-credit financial institution), which may only manage real estate funds (*sociedade gestora de fundos de investimento imobiliário*).

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

The UCI Law is silent in respect of the ability of the fund manager to restrict redemptions in open-ended funds, but considering that such types of AIFs in general target retail investors, the CMC will most certainly scrutinise this matter. In fact, such a possibility would need to be clearly set out in the AIF's regulation, which is analysed during the authorisation procedure.

Moreover, the minutes of the AIF regulation, provided by Regulation no. 4/14, contain a field where the conditions set out for redemptions need to be described, but only seem to refer to the applicable fees, settlement dates and the criteria for the determination of which units/shares will be redeemed. Likewise, Regulation no. 4/14 only seems to foresee conditions under which redemptions may be suspended, but not restricted.

As regards the restriction of transfers in open-ended funds, the same rationale described above in respect of the redemption shall apply.

Conversely, regarding closed-ended AIFs, mainly those targeting professional investors, we trust that it is possible to establish in the AIF's regulation restrictions on the transfer of units from investors to third parties.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

No. However, the limitations established on foreign investment, which place constraints on transfers abroad of profits or dividends obtained in Angola, should be borne in mind. Therefore, prior to the investment in an Angolan AIF being performed, the thresholds and requirements to be met by such an investment shall be assessed, on a case-by-case basis, as well as the provisions applicable to the transfer abroad of the profits or dividends obtained pursuant to the redemption of the units/shares or liquidation of the AIF.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The ability of the manager to manage its funds will be mainly limited by the investment policy established in the AIF's prospectus or regulation, as applicable, by the general investment limits by type of AIF, if any, established in the UCI Law and by the obligation to conduct its activity in the best interest of the investors.

The UCI Law has a list of acts that a manager cannot carry out, such as granting loans, executing certain transactions on its own account, executing transactions relating to the assets held by the AIF with related parties, e.g., entities of its group, the depositary, etc.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Please refer to question 1.1 above, plus the General Marketing Law, approved by Law no. 9/17 of 13 March 2017.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The UCI Law and Regulation no. 4/14 provide minutes that the legal documents of the AIF (prospectus and regulation) must abide by.

In respect of marketing materials, there are no minutes available; however, it is customary for the fund manager and other distribution entities to provide information on the investment policy, markets targeted, main features (identification of the relevant entities, terms and conditions of the investment, links to the legal documents) and historic returns of the AIF.

Pursuant to Regulation no. 4/14, the marketing material shall contain the following warnings:

- "Reading of the prospectus and regulation of the AIF is recommended, before investing in it."
- In cases where the marketing material discloses return figures, "past returns do not guarantee future returns" and "the disclosed returns are subject to taxation".
- In cases where the figures have a reference period of less than a year, "[t]his UCI has less than 12 (twelve) months. In order to analyse the performance of an UCI, it is recommended the analysis of at least 12 (twelve) months".

Lastly, as a general note, in accordance with Regulation no. 4/14, the information contained in the marketing materials must comply with the following principles: objectivity; identification; truthfulness; transparency; balance; timeliness; and comparability.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Yes. All marketing materials are subject to the CMC's prior approval.

3.4 What restrictions are there on marketing Alternative Investment Funds?

The marketing or distribution (*comercialização*) of AIFs under the UCI Law occurs when there is a collection of funds with the public in order to be channelled with the investment in the AIF, provided that the activity is: (i) addressed to undetermined investors; (ii) preceded or followed by prospection or gathering of investment intentions with undetermined investors; and (iii) addressed to at least 150 addressees.

Therefore, only this kind of marketing is caught by the regime set out in the UCI Law and Regulation no. 4/14.

Furthermore, the concept of reverse solicitation is not an official exemption from the UCI Law requirements, but rather a tolerated practice, which consists in the investor, on its own initiative and without any previous engagement on the part of the distributor, requesting information on the AIF at stake. However, a case-by-case assessment needs to be conducted, considering that the use of the reverse solicitation expedient may come under the scrutiny of the CMC.

Closed-ended AIFs shall register the performance of marketing/distribution activities with the CMC.

Lastly, the marketing/distribution of foreign AIFs in Angola is subject to the prior authorisation of the CMC.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

The concept of pre-marketing is not expressly recognised in the UCI Law.

Nevertheless, if the pre-marketing does not constitute one of the activities expressly referred to by the UCI Law as a marketing activity (please refer to question 3.4 above), there are grounds to sustain that it will not be facing marketing activity subject to the UCI Law requirements.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes. However, it must be noted that special AIFs investing in transferable securities or financial instruments (*organismos especiais de investimento coletivo em valores mobiliários*) are distributed within specific segments of the market. If it is intended for the distribution to be carried out with non-institutional investors, the fund manager shall provide the CMC with a training plan of the entities in charge of such distribution. Notwithstanding, the CMC may refuse to grant the authorisation for the AIF to be distributed within certain segments of the market, in case it considers that the investors are not sufficiently protected.

3.7 What qualification requirements must be met in relation to prospective investors?

There is no particular requirement to be fulfilled in relation to investors in AIFs.

Nonetheless, the fund manager shall ensure that the "know your customer and investment adequacy analysis" is properly carried out in relation to the investor, as well as that the anti-money laundering and terrorism financing procedures are respected.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no additional restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

No. However, the holding of units/shares in AIFs may have an impact, that needs to be assessed on a case-by-case basis, on the own funds and reserves of the credit and financial institutions.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

No. However, the relationship established between the intermediaries and the AIF shall be put in a written agreement and disclosed in the AIF's legal documents.

Furthermore, the intermediary, when carrying out the fundraising process, needs to act within its authorised scope of activities, i.e. if the fundraising process corresponds to marketing of the AIF under the UCI Law, the intermediary will need to be an authorised institution under the applicable legal terms to carry out the distribution of securities.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Yes. AIFs can only focus on investment activities and their management and investment shall comply with the general rules applicable to the financial instruments markets.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Yes. The assets eligible for the portfolio of the AIF will depend on its specific type.

Therefore, in general terms, an AIF investing in securities or financial assets may have in its portfolio: (i) securities admitted to trading in an Angolan regulated market; (ii) securities admitted to trading in a third country regulated market, provided that such is foreseen in the law, the AIF's legal documents or approved by the CMC; (iii) units/shares in other UCIs; (iv) bank deposits with a term of up to a year; (v) derivatives traded in regulated markets referred to in (i) and (ii) above; (vi) derivatives traded in OTC, provided that CMC regulations are complied with; (vii) money market instruments, which issue or issuer is subject to regulation for the purposes of investors' protection or savings schemes; and (viii) other instruments provided in the CMC's regulations.

As regards real estate investment funds, they may invest the majority of their assets in real estate, but may also invest in shares of real estate investment companies (*sociedades de investimento imobiliário*), derivatives, mainly for hedging purposes, units/shares of other real estate investment funds and liquidity instruments. The extent to which the investment in the referred assets is limited depends on whether the AIF is closed-ended,

open-ended or targeting a specific scope, i.e. real estate investment funds investing in house renting, agriculture, livestock, industrial exploration, etc.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

The derivatives may only be used for hedging purposes and naked short-selling is forbidden.

Loans originating from AIFs are not allowed under Angolan law.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Fund managers may obtain loans on behalf of AIFs under their management, but the loan period cannot exceed 120 days, consecutive or not, within a period of one year and up to a maximum of 10% of the AIF's NAV.

The loan to be granted under the terms described above shall be previously authorised by the CMC and the fund manager shall provide grounds for the reasoning for the loan, as well as provide the CMC with the loan's contractual conditions.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

The AIF's legal documents and their updates shall be available in a durable means or on an internet website. Considering that the legal documents shall describe the fund manager's identity, depository, auditor, distributors and other services providers to the AIF, the majority of the data in connection with the AIF will be made available to the public.

However, the identity of the investors in the AIF is not mandatorily subject to public disclosure.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

The fund manager shall implement AML/CTF proceedings in respect of the investors and their beneficial owners, and the relevant authorities may request information on the compliance by the fund manager of its obligations in this regard. However, there is no public record-keeping or register of beneficial owners.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

The fund manager must prepare, publish and send to the BCC the reports and accounts, as well as the corresponding auditor's reports. These shall be made available free of charge to investors and participants who request the following:

- The annual accounts within four months of the end of the previous financial year.
- Half-yearly accounts within two months of the end of the half-year in office.

5.4 Is the use of side letters restricted?

The use of side letters that set out particular terms and conditions in respect of governance, investment, etc. of the AIF is not specifically addressed by the UCI Law.

However, in the case of open-ended AIFs, considering that they usually target retail investors and/or a broader unrestricted scope of investors, the use of side letters which alter any relevant provision of the legal documents shall be deemed illegal, considering that, as a general principle, fund managers need to abide by the AIF's legal documents during the provision of their services.

In closed-ended AIFs, notably in AIFs targeting only professional investors, we trust that there is a wider margin to set out, namely through a side letter, specific provisions in respect of certain matters. However, in general terms, as the provisions of the UCI Law are imperative, any side letter providing for actions in breach of such legal provisions will be deemed illegal and may subject the fund manager to administrative offence proceedings.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

The Angolan tax regime for AIFs set up under the contractual structure with no legal personality and the collective investment company endowed with legal personality has been enacted by Presidential Decree no. 1/14 of 13 October 2014.

An AIF is subject to Corporate Income Tax (CIT or "*Imposto Industrial*") on the annual profit obtained on a worldwide basis in compliance with the accounting rules, including rents from real estate and investment income.

Capital gains and losses which are not realised are not taxed. The CIT rate is 7.5% for AIFs investing in securities or financial assets and 15% for AIFs investing in real estate.

An AIF is exempt from any other income tax, namely Investment Income Tax and Urban Property Tax. An AIF is also exempt from Stamp Duty and Consumption Tax on bank commissions, and Stamp Duty on capital increases.

Additionally, open-ended real estate AIFs are exempt from Property Transfer Tax and Stamp Duty on acquisition of real estate.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

There is no special tax treatment or rules applicable in Angola for investment managers or advisers.

As such, as Angolan-resident entities, they are subject to the general taxation regime: (i) 30% Industrial Tax on income obtained on a worldwide basis; and (ii) capital gains, interest and dividends are subject to Investment Income Tax under a withholding mechanism (rates may vary from 5% up to 15%).

Dividends paid between resident companies in Angola may be exempt from Investment Income Tax provided that a 25% stake is held for a minimum holding period of one year.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There are none.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

Income obtained by a resident, non-resident or pension fund AIF unit holder is exempt from Investment Income Tax and Industrial Tax on any income obtained, namely those from redemption or distribution of income, as well as gains from the sale of units.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

Yes, it is advisable, because there is still no track record or official guideline on how the Angolan Tax Authorities enforce the tax regime.

Moreover, the tax legislation is quite incipient in dealing with finance-structured investments.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

On 9 November 2015, the Intergovernmental Agreement (IGA) under Model I to improve international tax compliance with respect to the U.S. Foreign Account Tax Compliance Act (FATCA) was signed between Angola and the USA.

Following the approval of the IGA, Presidential Decree no. 1/17, of 20 June, released the Regime applicable to the Tax Reporting of Financial Data within the framework of the Foreign Account Tax Compliance Act. This Presidential Decree established the legal framework applicable to the disclosure of information by financial bodies to the tax authorities.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Angola is not a member of the OECD. Nonetheless, Angolan Representatives were present on 30 June–1 July 2016 in an OECD meeting that took place in Kyoto, Japan, with the intent to push forward ongoing efforts to update international tax rules to tackle BEPS. Following this meeting, Angola joined Inclusive Framework on BEPS, on 7 July, as its 83rd member. No further relevant developments have occurred so far on these topics.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

There are none, since venture capital investment funds benefit from the same tax regime applicable to AIFs.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

There are none.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

It is expected that the Industrial Tax Code will be amended in 2020, and possible that the tax rates applicable to investment managers/advisers will change.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

At the time of writing, the Angolan legal UCI framework is in the consolidation stage, considering that the legal documents at issue have been recently enacted.

Nevertheless, depending on the economic environment and political circumstances in the upcoming years, it may be necessary to update certain aspects of the Angolan legislation in light of developments and international experience, namely those stemming from the Alternative Investment Fund Managers Directive's implementation in EU Member States and new approaches adopted in the international AIF market.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The establishment and operation of investment funds in Bermuda ("investment funds" or "funds") is governed by:

- the Companies Act 1981, as amended (the "Companies Act");
- the Investment Funds Act 2006, as amended (the "IFA");
- the Investment Funds (Definition) Order 2019 (the "Definition Order");
- the Investment Fund Offering Document Rules 2019 (the "Fund Offering Document Rules"); and
- the Investment Fund Rules 2019 (collectively, with the Fund Offering Document Rules, the "Fund Rules").

The Bermuda Monetary Authority (the "BMA") is the principal body responsible for the regulation of investment funds, including those listed on the Bermuda Stock Exchange.

Investment funds in Bermuda may be structured and organised under Bermuda law in the following ways:

a) a company limited by shares;
b) a limited partnership;
c) a limited liability company ("LLC");
d) a segregated accounts company;
e) an incorporated segregated accounts company; and
f) a unit trust scheme.

An investment fund is defined in the IFA to include any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.

The arrangements must be such that the participants do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions. The arrangements must also have one or both of the following characteristics: (a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled; or (b) the property is managed as a whole by or on behalf of the operator of the fund.

Additionally, the Definition Order prescribes certain arrangements which fall outside the definition of "investment fund" in accordance with the IFA, for instance, a vehicle where the units of the participants confer rights in respect of only one asset. Any "arrangement" prescribed under the Definition Order is not be defined as an "investment fund" for the purposes of the IFA and will not need to apply for registration prior to its launch with the BMA.

The arrangements can be open-ended or closed-ended.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

The Investment Business Act 2003 (the "IBA") governs the regulation of "investment business" (described below) in Bermuda. Pursuant to the IBA, managers and advisors can be organised anywhere and act as managers and advisors to all forms of funds. There is no requirement for a manager or adviser to be licensed in Bermuda unless they have physical premises and employees in Bermuda. All managers of authorised funds (as described below), will be required to act in accordance with the IFA in all dealings concerning the fund. The BMA will evaluate whether the manager is a fit and proper person and will take into account the manager's experience and expertise in relation to the fund.

The Economic Substance Act 2018 (as amended) (the "ES Act") and the Economic Substance Regulations (as amended) (the "ES Regulations", together with the ES Act, the "ES Law"), became operative on 31 December 2018. The ES Law applies to any "relevant entity" that conducts a "relevant activity" in a "relevant financial period". A "relevant entity" includes a company incorporated or registered under the Companies Act, including a permit company and an overseas company, a Bermuda LLC and a Bermuda exempted partnership, exempted limited partnership or overseas partnership that has elected to have separate legal personality in accordance with section 4A of the Partnership Act, 1902. The ES Act does not apply to a "non-resident entity" which is resident for tax purposes in a jurisdiction outside Bermuda that is not on the EU "black list". Additionally, an entity that is not a "relevant entity" is out of scope and has no obligations under the ES Law.

Under the ES Law, "fund management" is a "relevant activity". Where a "relevant entity" is conducting "fund management" as a business, it must satisfy the economic substance requirements, as prescribed in section 3 of the ES Act and the ES Regulations.

Guidance Notes on the general principles relating to the economic substance requirements in Bermuda were issued on 24 December 2019. Sector-specific guidance has been issued in draft and remains subject in all respects to review by the EU Code of Conduct Group on Business Taxation and by the OECD Forum on Harmful Tax Practices.

For managers physically domiciled in Bermuda, there are exemptions available from the licensing regime if they fall within the scope of the Investment Business (Exemptions) Order 2004 (the "Exemption Order") further described below.

"Investment business" services are very broadly defined and include dealing in investments, arranging deals in investments, managing investments, providing investment advice and safeguarding and administering investments. To be deemed to

be carrying on investment business "in or from" Bermuda, a person must carry on investment business from a place of business maintained by such person in Bermuda with employees. Therefore, unless the manager maintains an office in Bermuda with employees or has an arrangement that the Minister of Finance by order determines will constitute the carrying on of business in Bermuda, the IBA will not apply.

Under the Exemption Order, a person (not being a "market intermediary" (described below)) carrying on investment business shall be exempt from the requirement to obtain a licence under the IBA where such person provides investment business services exclusively to:

a) High-income private investor: an individual who has had a personal income in the last two years in excess of US$200,000 in each of the two years preceding the current year or has had a joint income with that person's spouse in excess of US$300,000 in each of those years, and has a reasonable expectation of reaching the same income in the current year, meaning the year in which he or she purchases an investment.
b) High-net-worth private investor: an individual whose net worth or joint net worth with that person's spouse in the year in which he or she purchases an investment exceeds US$1 million, "net worth" meaning the excess of total assets at fair market value over total liabilities.
c) Sophisticated private investor: an individual who has such knowledge of, and experience in, financial and business matters as would enable him or her to properly evaluate the merits and risks of a prospective purchase of an investment, and who, in respect of each investment transaction, deals in amounts of not less than US$100,000.
d) Collective investment schemes approved by the BMA under the IFA (or any provision of law amending or replacing the IFA), and includes collective investment schemes established or registered outside Bermuda.
e) Bodies corporate, each of which has total assets of not less than US$5 million where such assets are held solely by the body corporate, or held partly by the body corporate and partly by one or more members of a group of which it is a member.
f) Unincorporated associations, partnerships or trusts, each of which has total assets of not less than US$5 million where such assets are held solely by such association, partnership or trust or held partly by it and partly by one or more members of a group of which it is a member.
g) Bodies corporate, all of whose shareholders fall within one or more of the categories of this list, except category f).
h) Partnerships, all of whose members fall within one or more of the categories of this list, except category f).

Trusts, all of whose beneficiaries fall within one or more of the categories of this list, except category f).

A "market intermediary" is defined as "a person who engages or holds himself out as engaging in the business of dealing in investments as principal or agent on an investment exchange".

Persons who provide investment services to not more than 20 persons at any time, and do not provide investment services to the public are also exempt from the IBA licensing requirement.

Fund administrators are required to obtain a licence under the Fund Administration Provider Business Act 2019 (the "Fund Administration Act") to carry on the business of a fund administrator in or from Bermuda. It should be noted that only certain classes of authorised funds require a Bermuda licensed fund administrator (see question 1.3).

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Due to the recent legislative amendments, which have been effective from 1 January 2020, all investment funds meeting the definition under the IFA must be authorised or registered with the BMA. Amongst others, the legislative changes brought closed-ended funds (arrangements in which the participants are not, at their election, entitled to have their units redeemed) into scope. Closed-ended funds (i.e. certain private equity funds) must now register with the BMA on or before 30 June 2020. Additionally, overseas investment funds managed or promoted in or from within Bermuda must be designated by the BMA as an overseas fund.

Under the IFA, designated funds, registered funds and authorised funds must now all receive the permission of the BMA, and are as follows:

1. **Designated Funds**

   Overseas Fund – is a fund incorporated outside Bermuda, that complies with the applicable rules and requirements of the overseas regulatory authority in the country or territory in which it is incorporated or established and complies with all the requirements of the IFA and any conditions imposed on it by the BMA.

2. **Registered Funds**

   a) **Private Funds** – are open-ended or closed-ended funds where the number of participants does not exceed 20 persons and the fund does not promote itself by communicating an invitation or inducement to the public generally. The operator of the fund is required to appoint a local service provider authorised and regulated by the BMA (which can be its corporate service provider). The operator, officers and service providers must be "fit and proper" to perform their particular functions. An open-ended private fund must appoint a custodian with regard to safekeeping of fund assets (although the BMA may waive this requirement if the fund meets certain criteria as determined by the BMA from time to time) and a fund administrator.

   b) **Professional Class A Fund** – is a fund that is open only to "qualified participants" (defined below) and the operator of the fund has appointed an investment manager for the fund who is either: licensed under the IBA; is authorised or licensed by a foreign regulator recognised by the BMA; or is carrying on business in or from Bermuda or in a jurisdiction recognised by the BMA and whose gross assets under management are of an amount that is not less than US$100 million or is a member of an investment management group that has consolidated gross assets under management of an amount that is not less than US$100 million. The fund must appoint an officer, trustee or representative resident in Bermuda who has authority to access the books and records of the fund. The fund must appoint a fund administrator, a registrar, an auditor and a custodian who are deemed "fit and proper" to perform that particular position and must prepare financial statements in accordance with the International Financial Reporting Standards ("IFRS") or Generally Accepted Accounting Principles ("GAAP").

   c) **Professional Class B Fund** – is a fund that is only open to "qualified participants". The fund must appoint an officer, trustee or representative resident in Bermuda

who has authority to access the books and records of the fund. The fund must appoint an investment manager, a fund administrator, a registrar, an auditor and a custodian who are deemed "fit and proper" to perform that particular position. Financial statements must be prepared in accordance with IFRS or GAAP.

d) **Professional Closed Fund** – is a "closed ended" investment fund that is only open to "qualified participants" and where all such "qualified participants" shall be provided with an investment warning prior to the time of the purchase of the units, containing such statements and information as the BMA deems appropriate. The fund must appoint a local service provider who is licensed by the BMA (which can be its corporate service provider) or an officer, trustee, or representative resident in Bermuda who is deemed "fit and proper" and who has authority to access the books and records of the fund. The fund must also appoint an auditor and a designate responsible for safekeeping the fund property, although these requirements may be waived upon application to the BMA in accordance with section 10D of the IFA and financial statements must be prepared in accordance with IFRS or GAAP.

3. **Authorised Funds**

a) **Institutional Funds** – are only open to "qualified participants" or require each participant to invest a minimum of US$100,000 in the fund.

b) **Administered Funds** – must have a fund administrator that is licensed in Bermuda by the BMA and requires that investors invest a minimum of US$50,000 in the fund or the fund is listed on a stock exchange recognised by the BMA.

c) **Specified Jurisdiction Funds** – are those funds where the Minister by Order recognises the jurisdiction outside of Bermuda in which the fund operates e.g. Japan or recognises a particular law, or set of laws of such jurisdiction, as applicable to the fund.

d) **Standard Fund** – is a fund that does not fall within any other class of fund and can be used for retail investors. The fund must have a Bermuda-based administrator or custodian.

All authorised funds must appoint an officer, trustee or representative resident in Bermuda who has authority to access the books and records of the investment fund. The fund must appoint an investment manager, a fund administrator, registrar, an auditor and a custodian who are deemed "fit and proper" to perform that particular position. The fund must prepare audited financial statements.

A "qualified participant" is defined under the IFA as:

a) High income private investor: an individual who has had a personal income in excess of US$200,000 in each of the two years preceding the current year or has a joint income with that person's spouse in excess of US$300,000 in each of those years, and has a reasonable expectation of reaching the same level of income in the current year.

b) High-net-worth private investor: an individual whose net worth or joint net worth with that person's spouse in the year in which he purchases an investment exceeds US$1,000,000, excluding the value of that person's residence.

c) Sophisticated private investor: an individual who has such knowledge of, and experience in, financial and business matters as would enable him to properly evaluate the merits and risks of a prospective purchase of investments.

d) Bodies corporate, each of which has total assets of not less than US$5,000,000, where such assets are held solely by the body corporate or held partly by the body corporate and partly by one or more members of a group of which it is a member.

e) Unincorporated associations, partnerships or trusts, each of which has total assets of not less than US$5,000,000, where such assets are held solely by such association, partnership or trust or held partly by it and partly by one or more members of a group of which it is a member.

f) Bodies corporate, all of whose shareholders fall within one or more of the above.

g) Partnerships, all of whose members fall within one or more of the above.

h) A trust, all of whose beneficiaries fall within one or more of the above.

i) Limited liability companies, all of whose members falls within one or more of the above.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes, the IFA does distinguish between open-ended and closed-ended Alternative Investment Funds and, as a result of the recent legislative amendments to the IFA, both open-ended and closed-ended funds are now regulated by the BMA. Existing closed-ended funds that fall in scope must register on or before 30 June 2020 (see question 1.3).

1.5 What does the authorisation process involve and how long does the process typically take?

An application for authorisation must be made by the operator or proposed operator of the fund. The application must: a) state the corporate name and registered or principal office of each service provider of the fund; b) be accompanied by a certificate signed by the operator to the effect that the fund complies, or will on authorisation comply, with section 14 of the IFA; c) contain or be accompanied by such information as the BMA may reasonably require for the purpose of determining the application; and d) be accompanied by an application fee.

Authorisation/approval is typically granted within five to seven days if the investment fund meets the requirements.

Authorised, Private and Professional Funds meet the definition of AML/ATF regulated financial institution (an "RFI"), and as such fall within the scope of the requirements of the Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing Supervision and Enforcement) Act 2008 ("POCA").

Under POCA, RFIs must appoint a Money Laundering Reporting Officer ("MLRO") and a Compliance Officer ("CO") satisfying "fit and proper" criteria. The operator of the fund is required to furnish the BMA with the contact information for the MLRO and the CO, and provide a copy of the Board approved AML/ATF Policies and Procedures for its records. Where a Bermuda fund has appointed an overseas fund administrator, the operator of the fund must ensure the controls that are in place for detecting and preventing money laundering and terrorist financing are of the same standard as those prescribed under POCA.

1.6 Are there local residence or other local qualification or substance requirements?

Bermuda investment funds that are structured as exempted companies, limited partnerships or LLCs must have:

- either a director, trustee, officer or resident representative who is ordinarily resident in Bermuda, and who has access to the books and records of the investment fund; and
- a registered office in Bermuda with certain records relating to the investment fund.

1.7 What service providers are required?

See question 1.3 with respect to each type of fund and the service providers required.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

See question 1.2 on the rules and relevant exemptions applicable to domiciled managers and advisors in Bermuda.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

To date, Bermuda has over 100 treaty partners around the world, has signed over 40 bilateral tax information exchange agreements ("TIEAs"), has signed MOUs with 27 countries and is a party to the OECD Multilateral Convention on Mutual Assistance on Tax Matters with all G20 countries.

Bermuda has joined the Global Financial Innovation Network ("GFIN"), adopted the OECD Common Reporting Standard ("CRS") and is a Model II jurisdiction for the purposes of FATCA.

In addition, Bermuda is a member of the Association of the Overseas Countries and Territories of the European Union through the Overseas Association Decision, has signed cooperation agreements with the majority of EU Members for the Alternative Investment Fund Managers Directive ("AIFMD") and has signed Country by Country Competent Authority Agreements with the United Kingdom and the United States.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

As noted in question 1.1, investment funds in Bermuda may be structured and organised under Bermuda law in five different ways:

a) companies limited by shares – a company limited by shares can be incorporated with, or without, mutual fund objects for the purpose of investing the moneys of its members for their mutual benefit and with both the company and the members having the power to redeem or purchase for cancellation its shares without reducing its authorised share capital and stating in its memorandum that it is a mutual fund;

b) partnership funds – a partnership fund is a fund under which the participants contribute funds to the partnership to be held on behalf of participating partners of the partnership. The funds are managed by the general partner or manager for the benefit of the participants. The general partner does not need to be registered in Bermuda to serve in such role. Partnerships can elect to have legal personality;

c) limited liability companies – the Limited Liability Company Act 2016 enables the formation of LLCs. LLCs are hybrid entities commonly used in the US for private-equity funds and other asset-management structures. Bermuda legislation is closely modelled on Delaware law so will be very familiar to US fund managers and legal counsel;

d) companies can be registered as a segregated accounts company where the assets and liabilities of one segregated account are statutorily ring-fenced and insulated from claims of creditors from other segregated accounts; or as an incorporated segregated accounts company which is a similar vehicle but each incorporated segregated account has its own legal personality; and

e) unit trusts – a unit trust fund is a fund under which the property is held on trust for participants. The formation and operation of unit trust funds is governed by the trust deed by which it is established and the IFA.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

An investor in a limited liability investment fund (company or LLC) is liable to the amount agreed to be paid for the investor's shares. An investor in a limited partnership fund is liable to the amount of its capital contribution and, depending on the terms of the limited partnership agreement, its capital commitment to the fund.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Managers and advisers of investment funds are primarily structured as companies, limited partnerships or LLCs established in Bermuda or in other jurisdictions.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Any restrictions on redemptions or transfers of investment funds would be imposed by the investment fund and provided for in its constitutional documents and offering document.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There is no legislative approval required for the transfer of investors' interests (non-voting) in investment funds. Any transfer of interests in the fund with voting rights requires an application to the BMA unless the fund is closed-ended or authorised under the IFA and therefore benefits from a general permission pursuant to the Notice to the Public of June 2005 under the Exchange Control Act 1972 and the Regulations thereunder.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

Any limitations on a manager's ability to manage its funds would be imposed by the investment fund and provided for in its constitutional documents and offering document.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The Companies Act, the IFA and the Fund Rules govern the production and offering of marketing materials.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The Fund Offering Document Rules provide that the offering document is required to disclose facts which would be considered material to a prospective investor, such as:

a) the name of the fund and the address of its registered or principal office in Bermuda;
b) a statement as to whether the fund is authorised or registered or has been given equivalent regulatory approval, as the case may be, or intends to be authorised or registered or given equivalent regulatory approval, in any jurisdiction or with any supervisory or regulatory authority, outside of Bermuda;
c) the date of incorporation or establishment of the fund (indicating whether the duration is limited);
d) where applicable, an indication of stock exchanges or markets where the securities are, or are to be, listed or dealt in;
e) the names, address, and other relevant particulars of directors, officers, resident representatives, auditors, fund administrators, custodians, registrars, promoters, legal advisers, investment managers, and other persons having significant involvement in the affairs of the fund;
f) a description of the fund's investment objectives, including its financial objectives, investment policy and any limitations on that investment policy and an indication of any techniques and instruments, and any borrowing power;
g) a description of the investment fund's material risks including, in relation to a mutual fund company registered under section 6 of the Segregated Accounts Companies Act 2000 or a unit trust fund operating segregated accounts, a statement on any potential risks associated with the operation of segregated accounts;
h) details of the capital of the fund including, where applicable, any existing initial or founder capital;
i) details of the principal rights and restrictions attaching to the units, including with respect to currency, voting rights, circumstances of winding up or dissolution, certificates, entry in registers and other similar details;
j) a description of the intentions with respect to the declaration of dividends or distribution of profits;
k) the procedures and conditions for the redemption and sale of interests and the circumstances in which such redemption may be suspended;
l) the procedures and conditions for the issue of units;
m) a description of the bases for the determination of the issue and redemption prices (including the frequency of dealings) and an indication of the places where information as to the prices may be obtained;
n) a description of the basis and frequency of valuation of the fund's assets;
o) particulars of any material provisions of any contract engaging the services of any and all directors, trustees, partners, service providers, and any other third parties receiving or likely to receive fees from the fund;
p) a description of the potential conflicts of interest between the fund, its directors, trustees, partners, and its service providers;
q) the date of the financial year end of the fund;
r) information on the nature and frequency of financial reports to be distributed to participants;
s) a statement of the place where copies of the constitution and any annual or periodic report may be inspected and obtained;
t) particulars relating to the main business activity of the custodian and any co-custodian;
u) in the case of a Professional Closed Fund or a Private Fund which is a closed-ended fund, the name of the designate responsible for segregation and safekeeping functions related to the investment fund property and the relevant provisions that set out the segregation and safekeeping arrangements; and
v) particulars of the experience of investment managers.

The Fund Offering Document Rules also contain prescribed disclaimers to be included in the offering document.

The Companies Act provides that companies that are offering shares to the public are required to publish and file an offering document with the Registrar (unless they fall within any of the circumstances where it is not necessary to publish and file an offering document under the Companies Act). The offering document should contain information showing:

a) the names, descriptions and addresses of the promoters, officers or proposed officers;
b) the business or proposed business of the company;
c) the minimum subscription which, in the opinion of the promoters, directors or provisional directors, must be raised;
d) any rights or restrictions on the shares that are being offered;
e) all commissions payable on the sale of the shares referred to in the offering document and the net amount receivable by the company in respect of the sale;
f) the name and address of any person who owns 5% or more of the shares of the company, provided that this paragraph shall not apply to an exempted company or a permit company;
g) any shareholding in the company of an officer of the company;
h) financial statements of the company prepared in such manner and containing such information as may be required by rules made under the Companies Act;
i) a report or statement by the auditor of the company prepared in such manner and containing such information as shall be required by rules made under the Companies Act; and
j) the date and time of the opening and closing of subscriptions lists.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

At the incorporation or formation stage of a fund, the legal documents which are required to be filed with the Registrar are:

- for companies – a memorandum of association, a notice of registered office, a register of directors and officers, certain extracts from the bye-laws, an annual declaration, and an economic substance reporting form; and
- for limited partnerships – a certificate of limited partnership, a certificate of exempted partnership and a notice of registered office.

Thereafter, companies that offer shares to the public are required to publish an offering document and file the same with the Registrar (unless they fall within any of the circumstances for which it is not necessary under the Companies Act).

Designated, registered and authorised funds must file their offering document with the BMA at registration or authorisation.

3.4 What restrictions are there on marketing Alternative Investment Funds?

No overseas investment fund can be promoted in or from within Bermuda unless designated by the BMA as an overseas fund (see question 1.3).

Any person marketing funds in Bermuda is also subject to the provisions of the Companies Act.

There is a general prohibition against exempted and overseas companies "carrying on business in Bermuda" under the provisions of the Companies Act and the IBA, which restricts the marketing of shares of a foreign fund in Bermuda by an exempted Bermuda company owned by non-Bermudians or an overseas company. However, there are limited means through which the marketing of a foreign fund in Bermuda can be achieved.

Where the shares are offered to Bermuda persons on a private basis by a foreign fund that does not have a place of business in Bermuda, that foreign fund is not required to obtain a licence under the Companies Act, provided the foreign fund does not market in or travel to Bermuda. Subject to being designated as an "overseas fund", the shares of a foreign fund could be marketed in Bermuda on a limited basis, in accordance with the "business visitor" policy as provided for in the Minister of Home Affairs Department of Immigration Work Permit Policy, which allows a business visitor representative to conduct pre-arranged meetings that are upon the invitation of a customer or potential customer. It is best practice that the representative have a letter of introduction from the Bermuda host and the visit should not exceed 21 consecutive calendar days. Such a visit must not give rise to an impression that the fund is operating from a place of business in Bermuda or making it known by way of advertisement or publication that a representative may be contacted at a particular address in Bermuda. There is also a "travelling salesman" exception pursuant to the Companies Act, which permits limited marketing in Bermuda provided the representative has been permitted to land in Bermuda pursuant to a periodic work permit.

Bermuda law does not restrict any overseas entity from approaching prospective Bermuda-based corporate clients for the purposes of marketing its investment products, provided that the approach is made from outside of Bermuda. In accordance with the IBA, no person shall in the course of or in consequence of an unsolicited call (personal visit or oral communication made without express invitation) made to an *individual* by way of business enter into an investment agreement with the person on whom the call is made or procure, or endeavour to procure, that person to enter into such an agreement. Any investment agreement which is entered into in the course of or in consequence of the unsolicited call shall not be enforceable against the person on whom the call was made.

Due to an exemption available under the Companies Act, a Bermuda fund is exempted from the prohibition on marketing its shares in Bermuda.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

No, it is not.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Standard funds (as detailed above in question 1.3) can be marketed to retail investors.

3.7 What qualification requirements must be met in relation to prospective investors?

See question 1.3 above. Due diligence must also be carried out on prospective investors. This task is normally delegated to the fund administrator.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no additional restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

There have been no restrictions imposed.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Except as discussed in question 3.4, there are no restrictions.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

There are no restrictions on the types of activities that can be performed by investment funds, subject to the fund not engaging in an activity which is:

a) prohibited under the Companies Act;
b) not otherwise illegal or in breach of public policy;
c) outside the powers of the fund's constitutional documents and offering document; and
d) not compliant with the requirements of the IFA.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Any limitations would form part of the investment fund's constitutional documents and/or offering document.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

There are no local regulatory requirements that apply to investing in particular investments.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Any restrictions would form part of the investment fund's constitutional documents and/or offering document.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

At the Registrar:

- the certificate of incorporation and memorandum of association/Certificate of Registration, as applicable;
- the address of the registered office;
- the register of directors;
- any offering document or offer document required to be filed pursuant to the Companies Act; and
- certain other filings required pursuant to the Companies Act, including prescribed bye-law excerpts.

At the Registered Office:

- details of directors and officers. The register of directors and officers is open for inspection during business hours; and
- in respect of companies, the register of members. The register of members for mutual fund companies is only open for inspection by a member in respect of its shareholding in the fund.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

By 30 April 2019, Bermuda companies, limited liability companies and partnerships were required to update or verify beneficial ownership information, pursuant to the Companies and Limited Liability Company (Beneficial Ownership) Amendment Act 2017 and the Partnership, Exempted Partnerships and Limited Partnership (Beneficial Ownership) Amendment Act 2018. This information is stored on the BMA's "Integra portal", which is a central and secure online registration and filing system. At present this information is not publicly available and until public beneficial registers become the standard globally, there is no indication that the relevant Bermuda legislation will change.

With regard to individuals, the minimum information required for the Integra portal includes:

a) Full name.
b) Residential address.
c) Nationality.
d) Date of birth.
e) Nature and extent of interest in the company or partnership.

Investment funds as defined under the IFA and investment providers licensed under the IBA are exempted from the requirements of the beneficial ownership legislation.

In accordance with the ES Law, relevant entities that are conducting a "relevant activity" and entities that are claiming "non-resident entity" status under the ES Law, in each case, in respect of the financial period from 1 January 2019 to 31 December 2019, are obliged to file their economic substance declarations as required on or before 30 June 2020. The Registrar launched the online portal for filing the electronic economic substance declarations and claims for non-resident entity status under the ES Act on 1 May 2020 and entities or their authorised representatives are now able to submit their filings.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

1. **Designated Funds (annually on or before 30 June)**
   Overseas Funds – the filing must include a Statement of Compliance from the overseas regulatory authority, an annual declaration form, inclusive of any material changes to the offering document and confirmation of the overseas funds continued compliance with the IFA.
2. **Registered Funds (annually on or before 30 June)**
   a) **Private Funds** – the filing must include audited/unaudited financial statements and an annual certification form, confirming that the registration requirements continue to be met and disclosing any material changes to the fund, the net asset value, and the amount of shares subscribed and redeemed.
   b) **Professional Class A Fund** – the filing must include audited financial statements and an annual certification form, confirming that the registration requirements continue to be met and disclosing any material changes to the fund, the net asset value, and the amount of shares subscribed and redeemed.
   c) **Professional Class B Fund** – the filing must include audited financial statements and an annual certification form, confirming any material changes to the fund, changes to the fund's directors and service providers, the net asset value and the amount of shares subscribed or redeemed.
   d) **Professional Closed Fund** – the filing must include audited financial statements (unless waived) and an annual certification form, confirming any material changes to the fund, changes to the fund's directors and service providers, the net asset value and the amount of shares subscribed or redeemed.
3. **Authorised Funds**
   a) **Institutional Funds, Administered Funds and Specified Jurisdiction Fund** – must file the net asset value, and the amount of shares subscribed and redeemed on a quarterly basis within 20 business day after the end of each calendar quarter. Additionally, the funds must file on an annual basis a statement of compliance, due within six months of the fund's financial year end.

b) **Standard Fund** – must file the net asset value, and the amount of shares subscribed and redeemed on a monthly basis within 20 business day month-end. Additionally, a standard fund must file on an annual basis a statement of compliance, due within six months of the fund's financial year end.

5.4 Is the use of side letters restricted?

There are no restrictions on the use of side letters but the ability for the investment fund to enter into side letters must be disclosed in its offering document. The terms of the side letters must not contravene any of the provisions in its bye-laws or offering document (where applicable).

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Bermuda is fiscally neutral. There are no corporation, profits, or capital gains taxes payable in Bermuda by an investment fund or its investors. After incorporation the investment fund may apply for, and is likely to receive, an undertaking from Government that in the event of any such taxes being imposed by Bermuda in the future, those taxes shall not apply to the fund until 31 March 2035 (the "Tax Assurance Certificate").

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

See question 6.1.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There are no establishment or transfer taxes payable in Bermuda.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

See question 6.1. There are no taxes payable in Bermuda in relation to such investors.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

Upon the incorporation of an investment fund company as noted in question 6.1, an application should be submitted for a Tax Assurance Certificate to the Registrar. This certificate, once granted, confirms that in the event Bermuda enacts legislation imposing tax computed on profits, income, any capital assets, gain or appreciation, or any tax in the nature of estate duty or inheritance, such tax will not apply to such fund or any of its operations, securities, debentures, or other obligations until 31 March 2035.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Bermuda is committed to being an integral part of the global financial services sector and reacted quickly to FATCA. Bermuda negotiated a Model II Inter-Governmental Agreement ("IGA") with the US Government and also signed a similar Model II IGA with the United Kingdom. Bermuda also passed amendments to its legislation in July 2015 to adopt the OECD's Standard for Automatic Exchange of Financial Account Information (or Common Reporting Standard ("CRS")). CRS came into effect in Bermuda on 1 January 2016.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Bermuda continues to work on next steps for OECD standards for Base Erosion and Profit-Shifting ("BEPS") compliance. In 2016, Bermuda became an early signatory to the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports, which puts in place an automatic exchange framework for exchanging country-by-country reports. Bermuda's tax information reporting portal (automatic exchange of information portal) was opened for accepting CRS and country-by-country reporting ("CbCR") notifications and report filings returns in 2017.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

See question 6.1. There are no corporation, profits, or capital gains taxes payable in Bermuda by an investment fund or its investors regardless of the asset class or structure.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

The stamp duties regime applies to Bermudian residents and local companies (owned and controlled by Bermudians 60/40). It does not apply to non-residents, exempted companies or exempted partnerships.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No changes are anticipated.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

The Bermuda Government continues to consider various initiatives as it is committed to working closely with the private sector and the BMA to further develop Bermuda's fund industry. The aim is to create an environment which is favourable for the quick, cost-effective and efficient establishment of investment enterprises to strengthen Bermuda's position in the international funds market.

Sarah Demerling is a Partner in the Corporate, Finance, Funds & Insurance Group. Sarah leads the investment funds practice and is co-lead of the (re)insurance and ILS practice, specialising in funds and investment services, insurance-linked securities, regulatory compliance (including fintech) and mergers and acquisitions.

Sarah has extensive experience in dealing with offshore structures and in providing advice to US, Canadian and UK lawyers, major investment managers, banks, insurers, reinsurers and principals on all aspects of Bermuda corporate law, most notably in the asset management and investment funds industry as well as the convergence of insurance and financial markets.

Sarah has been involved in the financial services industry in Bermuda for over 19 years.

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Melanie Fullerton joined the Walkers Bermuda office in September 2019 and is a member of the global regulatory & risk advisory practice, which is a dedicated practice group comprising a team of specialist lawyers strategically positioned across the Americas, Europe, and Asia to ensure the most comprehensive global coverage. Melanie advises on a wide range of Bermuda regulatory matters, not only advising clients on the existing regulatory framework in Bermuda, but also any changes to the legal framework in Bermuda or internationally, which effect the jurisdiction.

Prior to joining Walkers Bermuda, Melanie worked as a Senior Officer of the Legal Policy and Enforcement team of the Bermuda Monetary Authority.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Securities Laws

Canada has a federal system of government whereby the authority to enact legislation is divided between Canada's federal and its provincial and territorial governments. The Canadian securities laws applicable to Alternative Investment Funds ("**AIFs**") are currently regulated solely by the provincial and territorial governments. As a result, each of Canada's 10 provinces and three territories has its own legislative scheme for regulating the formation and operations of AIFs within its own provincial or territorial jurisdiction and its own securities commission or regulatory authority ("**Securities Regulator**") for administering and enforcing such legislation. Securities regulatory requirements therefore vary from jurisdiction to jurisdiction in Canada. In an effort to harmonise Canadian securities laws, the 13 Securities Regulators have, under rule-making authority granted by the provincial and territorial governments, established numerous rules, referred to as national instruments, that operate in a substantially identical manner in each province and territory.

Canadian securities legislation generally regulates the activities of an AIF within a province or territory by requiring:

(a) those who act as an investment fund manager of an AIF to become registered as such with the relevant Securities Regulator (the "**Investment Fund Manager Registration Requirement**");

(b) those who engage in, or hold themselves out as being engaged in, the business of trading in securities of the AIF to prospective investors to become registered or licensed as a dealer (the "**Dealer Registration Requirement**");

(c) those who engage in, or hold themselves out as being engaged in, the business of managing the investment portfolio of the AIF to become registered or licensed as an adviser (the "**Adviser Registration Requirement**"); and

(d) the AIF that distributes securities to investors to file a prospectus with, and obtain a receipt therefor from, the applicable Securities Regulator(s) (the "**Prospectus Requirement**"),

unless:

- the securities legislation provides for an express statutory exemption from the relevant requirement; or
- an order or ruling can be obtained from the applicable Securities Regulator which exempts a trade, a security or a person or company from the relevant requirement.

Other Laws

In contrast to securities laws, tax laws applicable to AIFs apply at both the federal and provincial levels. Securities and tax laws will always be engaged in the formation and operation of AIFs. It is also typical that corporation law, limited partnership law, anti-money laundering law, terrorist financing law and privacy law will apply.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

The manager of an AIF is the entity responsible for administering the day-to-day operations of the AIF and is generally considered to be the "operating mind" of the AIF. In several Canadian provinces, a manager of an AIF is subject to a duty of care of a fiduciary nature. AIF managers are subject to the Investment Fund Manager Registration Requirement.

An entity providing portfolio management services to an AIF is subject to the Adviser Registration Requirement and is also subject to a fiduciary duty of care. If the advice to be provided by the adviser would include advice in respect of exchange-traded commodity futures contracts and options, registration as an adviser under commodity futures legislation may also be required, depending on the province in which the AIF is established.

An entity in the business of trading securities of the AIF to prospective investors is subject to the Dealer Registration Requirement.

For purposes of the Dealer Registration and Prospectus Requirements of Canadian securities legislation, the term "trade" is broadly defined to include any sale or disposition of a security for valuable consideration, any receipt by a registrant of an order to buy or sell a security and any act, advertisement, solicitation, conduct or registration directly or indirectly in furtherance thereof. The term "distribution" is defined, with reference to the term "trade", to include a trade in the securities of an issuer that have not been previously issued.

For AIFs that operate as private equity funds, it may be possible under current law to structure the AIF in such a way

that the Investment Fund Manager Registration Requirement, Adviser Registration Requirement and Dealer Registration Requirement do not apply to the AIF and the offering of its securities.

If the AIF is formed outside Canada and the investment fund manager and adviser provide services to the AIF from outside Canada, the Investment Fund Manager Registration Requirement and Dealer Registration Requirement may be avoided by relying on exemptions available to non-residents. Ordinarily, the Adviser Registration Requirement will not apply to an adviser resident outside Canada who provides portfolio management services to an AIF domiciled outside Canada but offered to Canadian investors.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

The AIF is not itself licensed or registered but, as a market participant, an AIF is regulated by the applicable Securities Regulator(s).

AIFs that distribute their securities in Canada must either qualify the distribution pursuant to a prospectus prepared and filed in accordance with applicable Canadian securities laws or conduct the distribution in reliance upon a prospectus exemption. AIFs do not usually qualify their securities for distribution in Canada pursuant to a prospectus because the prospectus clearing process would require the AIF to adhere to rules that would materially restrict the ability to engage in numerous activities that AIFs ordinarily engage in, such as short selling, leveraging and investing in illiquid positions. Accordingly, AIFs typically distribute their securities to investors in reliance upon one of two private placement exemptions from the Prospectus Requirement described below.

Canadian securities laws provide an exemption from the Prospectus Requirement where a security is distributed to an accredited investor who acquires the AIF security as principal (the "Accredited Investor Exemption"). Accredited investors are purchasers who are considered to be sophisticated because of their status or financial well-being. Like the US version, Canadian accredited investors include: financial institutions; governments; pension funds; securities dealers and advisers; corporations, partnerships and trusts with net assets of $5 million; individuals who, alone or with a spouse, have net assets of at least $5 million; and individuals who meet a financial net worth test of $1 million or an income test of $200,000 in each of the last two years (or, together with their spouse, of $300,000) and a reasonable expectation of exceeding that amount in the current year.

Another exemption from the Prospectus Requirement is available where a purchaser is not an individual and purchases an AIF security as principal and the AIF security has an acquisition cost to the purchaser (other than individuals) of not less than $150,000 paid in cash at the time of the trade (the "Minimum Investment Exemption").

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes, there are significant differences between the regulation of open-ended and closed-ended funds. Closed-ended funds are usually publicly offered funds that have qualified their securities by prospectus and are traded over a stock exchange and available to retail investors. Accordingly, closed-ended funds tend to be much more regulated by securities laws and stock exchange requirements than open-ended funds unless the open-ended funds are also qualified by prospectus and available to retail investors, which is not usually the case for an AIF.

Closed-ended funds that operate as private equity funds typically do not engage the Investment Fund Manager Registration Requirement or the Adviser Registration Requirement.

1.5 What does the authorisation process involve and how long does the process typically take?

The authorisation process differs for the registration of each of the investment fund manager, adviser and dealer. However, each category of registration involves the filing of a Form 33-109F6 for the firm and a Form 33-109F4 for applicable individuals. There are minimum capital, financial statement, insurance and proficiency requirements associated with the authorisation process. The Securities Regulator reviews the filed materials and provides comments or questions on the applications for registration that usually take between eight and 12 weeks to resolve.

1.6 Are there local residence or other local qualification or substance requirements?

Each of the investment fund manager, adviser and dealer categories of registration is available to non-residents of Canada. Non-residents are usually required to satisfy Canadian proficiency requirements and will have to submit to the jurisdiction of the Securities Regulator. Some categories of registration such as investment dealer require (pursuant to the rules of the Investment Industry Regulatory Organization of Canada – the Canadian equivalent of FINRA) the applicant to be incorporated pursuant to Canadian law but are not otherwise required to be resident in Canada.

1.7 What service providers are required?

Most AIFs will utilise the services of an investment fund manager, adviser, dealer or prime broker, registrar and transfer agent, fund accountant, custodian, auditor and lawyer.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

For investment fund managers, advisers and broker-dealers located outside Canada, there are exemptions from the applicable registration requirements that permit these firms to do business with Canadian clients that qualify as "permitted clients", which is a category of client that is similar to, but slightly more restricted than, the accredited investor category of client discussed above.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The Securities Regulator has, for many years, entered into different forms of reciprocal regulatory oversight arrangements with foreign

securities regulatory bodies. These arrangements, frequently called memoranda of understanding or "**MOUs**", are intended to facilitate the sharing of information about firms and individuals under common regulatory oversight, support collaboration on investigation and enforcement matters, and generally assist in the global integration of securities regulatory oversight. The pace of entering into, and the general interest in, MOUs has increased considerably since the onset of the 2008 financial crises. Today, the Securities Regulator has approximately 20 MOUs in place with foreign regulators including the United States Securities and Exchange Commission ("**SEC**"), Commodity Futures Trading Commission ("**CFTC**"), Financial Industry Regulatory Authority ("**FINRA**"), United Kingdom Financial Conduct Authority and Bank of England, European Union, International Organization of Securities Commissions ("**IOSCO**") and securities regulators in Australia, China, France, Hong Kong and Italy.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

The principal legal structures used in the formation of AIFs are limited partnerships, unit trusts and corporations.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Investors in a corporation have liability limited to the value of their investment. Investors in a limited partnership also have liability limited to the value of their investment, provided they do not take part in the control of the business of the partnership. Investors in a trust are likely to have limited liability but there may be some uncertainty which may be addressed by providing where possible, in contracts of the trust, that no recourse is to be had to the personal assets of investors. Some provinces have adopted a statutory limited liability regime for investors in certain public trusts.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Managers and advisers of Canadian AIFs are usually organised as corporations but are sometimes organised as partnerships.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Provided the AIF is not offered by prospectus, there are usually no limits on the manager (other than, in certain cases, for tax reasons) to restrict redemptions in open-ended funds or transfers in closed-end funds.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

Yes, most investors acquire AIF securities pursuant to exemptions from the Prospectus Requirement. Any resale of the AIF security would also have to comply with an exemption from the Prospectus Requirement such as the Accredited Investor Exemption or the Minimum Investment Exemption (these exemptions are discussed above).

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

If the adviser is registered in Canada or the AIF is formed in Canada, there are several legislative restrictions that pertain to self-dealing and conflicts of interest. If the adviser is not registered in Canada and the AIF is not formed under Canadian law, there are no legislative restrictions on how the manager/adviser manages the AIF.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

All marketing activities intended to solicit purchase orders of an AIF security would likely be considered an act in furtherance of a trade of a previously unissued security under applicable securities laws and would therefore be subject to the Prospectus Requirement and the Dealer Registration Requirement. The exemptions from the Dealer Registration Requirement are not generally available to intermediaries in the business of selling AIF securities. Accordingly, the marketing intermediary must ordinarily become registered in one of the three dealer categories: investment dealer; exempt market dealer; or mutual fund dealer (if the AIF is an open-ended mutual fund).

Generally, securities law of the provinces and territories of Canada does not differentiate between oral, electronic or documentary communication. As matter of procedure, electronic and documentary communication is to be preferred and oral communications are to be made only in a manner entirely consistent with the electronic and documentary materials.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

If an offering document is to be used to solicit sales of AIF securities that are to be distributed in Canada in reliance upon either the Accredited Investor Exemption or the Minimum Investment Exemption, the offering document will probably be considered an offering memorandum under Canadian securities laws. Generally speaking, any material prepared in connection with such a private placement, other than a "term sheet" that is limited to describing the terms of the securities being issued rather than describing the business and affairs of the issuer, will be considered an offering memorandum. Purchasers who receive an offering memorandum have a statutory right of action for rescission or damages for any misrepresentation in the offering memorandum. The statutory right of action must be described in the offering memorandum. The term "misrepresentation" is broadly defined to mean: (a) an untrue statement of material fact; or (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

The offering memorandum must be delivered to the relevant Securities Regulator within 10 days of the distribution of an AIF security. If a foreign prospectus is used as an offering

memorandum, it is common to attach a stand-alone Canadian "wrapper" to describe the statutory rights of action and to address other related disclosure requirements. The Securities Regulator does not review or approve the offering memorandum.

If the securities of an AIF are distributed into a province or territory of Canada in reliance upon certain prospectus exemptions, including the Accredited Investor Exemption or the Minimum Investment Exemption, the AIF must file a completed Form 45-106F1 exempt trade report with the applicable Securities Regulator within 30 days of the end of the calendar year in which the distribution occurred, and the filing of the report must be accompanied by the payment of a prescribed filing fee that varies from jurisdiction to jurisdiction.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Provided the marketing of the AIF is done pursuant to an offering memorandum in accordance with the Accredited Investment Exemption or Minimum Investment Exemption through registered dealers, there are no other material restrictions applicable to the marketing of AIFs.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

In Canada, the term "pre-marketing" is used with reference to certain types of prospectus qualified offerings of securities and does not have application to the offering of AIF securities in Canada.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Retail offerings in Canada are usually made by way of prospectus. Most AIFs are offered pursuant to exemptions from the Prospectus Requirement. Some AIFs are offered to high-net-worth individual clients in reliance upon the Accredited Investor Exemption. If an AIF is offered to certain categories of such high-net-worth individuals, the AIF must provide standard form risk disclosure as prescribed by Form 45-106F9.

3.7 What qualification requirements must be met in relation to prospective investors?

When relying on the Accredited Investor Exemption, AIFs and intermediaries should take reasonable steps to ensure that the terms of the Accredited Investor Exemption are met, including requiring prospective investors to certify that they are accredited investors.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

Some institutional investors such as regulated pension funds have internal and statutory restrictions that restrict the level of investment in, and control over, an AIF.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

Intending to restrict the role of financial institutions in AIFs, like most jurisdictions around the world, Canadian regulators have responded to the financial crisis with numerous macro-prudential and micro-prudential initiatives and measures designed to address various systemic risks revealed as a result of the financial crisis. In particular, in Canada, we have seen a mixture of federal and provincial initiatives, that have resulted in, for example, designation of domestically significant financial institutions, new bank capital rules, higher bank capital thresholds, proposed requirements relating to the clearing and reporting of OTC derivatives, new residential mortgage insurance rules, new regulation of the government mortgage insurer and proposed bail-in policies.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Intermediaries assisting in the fundraising process will usually be subject to the Dealer Registration Requirement.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Provided the AIF is not offered by way of prospectus and the adviser is properly licensed, there are no restrictions on the types of activities that can be performed by the AIF other than, in certain cases, to comply with tax requirements.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Provided the AIF is not offered by way of prospectus and the adviser is properly licensed, there are no restrictions on the types of investments that can be included in the AIF's investment portfolio other than, in certain cases, to comply with tax requirements.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Regulatory requirements applicable to AIF investments are largely harmonised across Canadian jurisdictions. The Province of Quebec has in place a legislative regime that governs licensing, trading and advising activities by participants in that province's derivatives market.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Provided the AIF is not offered by way of prospectus and the adviser is properly licensed, there are no restrictions on borrowing by the AIF.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

Provided the AIF is not offered by way of prospectus, the only public disclosure that an AIF must make is annual audited financial statements and semi-annual unaudited financial statements. It is possible to obtain an exemption from the requirement to file these financial statements with the Securities Regulator provided that the financial statements are delivered to investors. If the AIF is not formed in Canada, there are no public disclosures other than the Form 45-106F1 discussed in question 3.3 above.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

Yes, the Form 45-106F1 requires disclosure to the relevant Securities Regulator of the investors in the AIF securities. The investor information provided to the Securities Regulator in Form 45-106F1 is not placed on the public file of the Securities Regulator. However, freedom of information legislation (“**FOI**”) may require the Securities Regulator to make this information available if requested. Securities Regulators have given guidance that an FOI request for investor information contained in a Form 45-106F1 would be opposed by Securities Regulators. Where a Form 45-106F1 identifies an Ontario purchaser, the Securities Regulator in Ontario places on the public file a monthly summary of the following information contained in the Form 45-106F1: the name of the issuer; the date the Form 45-106F1 was submitted; the first distribution date; the dollar amount raised in Ontario; and the number of Ontario purchasers. FOI legislation varies from jurisdiction to jurisdiction in Canada.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Provided the AIF is not offered by way of prospectus, the key reporting requirements in relation to AIFs are:

- audited annual and unaudited semi-annual financial statements of the AIF discussed above;
- Form 45-106F1 trade reports to the Securities Regulator by the AIF discussed in question 3.3;
- trade confirms from the dealer to the investor reporting on the trade of the AIF security to the investor;
- alternative monthly reports (the “**AMR System**”) from the adviser and an AIF (if it is an open-end investment fund) to the Securities Regulator where the adviser exercises control or direction over 10% or more of a class of securities of a Canadian public company and subsequent reports when investment goes above or below 10%, 12.5%, 15% or 17.5%;
- early warning reports (the “**EWR System**”) from the AIF (if it is not an open-end investment fund) to the Securities Regulator where the AIF acquires 10% or more of a class of securities of a Canadian public company and subsequent reports in respect of any 2% increases or decreases thereafter; and
- insider reports to the Securities Regulator where the AIF acquires 10% or more of a class of securities of a Canadian public company.

5.4 Is the use of side letters restricted?

There are no prescriptive restrictions on the use of side letters, but investment fund managers and advisers are subject to a fiduciary duty of care and side letters must be examined carefully to ensure that the arrangements contemplated thereby do not breach the fiduciary duty of care owed to all investors. The Securities Regulator has been known to focus on the use of side letters and take action when it is evident that the fiduciary duty of care has been compromised.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Canada imposes tax on the worldwide income of persons that are resident in Canada.

Only 50% of capital gains are taxable and 50% of capital losses are deductible but only against the taxable portion of capital gains. Dividends received from a Canadian corporation are subject to special tax treatment to reflect the fact that they are paid out of after-tax income of the corporation. Such dividends received by a Canadian corporation are generally deductible in computing taxable income, while those received by an individual are “grossed up” and a dividend tax credit is given. Other forms of income (interest, income/loss from transactions in derivatives that are not considered to be hedges of capital property, etc.) are taxed at regular rates. Income or loss must generally be computed in Canadian dollars.

An AIF that is a partnership is generally fiscally transparent for Canadian tax purposes. Canadian-resident partners should be entitled to treaty benefits on a look-through basis.

An AIF that is a Canadian-resident trust is treated as a taxpayer but, in computing its income, is generally entitled to deduct that portion of its income that is payable in the year to its investors who are required to include such amounts in income. A special tax may be payable by a Canadian-resident trust (other than a “mutual fund trust” for tax purposes which, among other conditions, requires that its activities be limited to investing its funds in property) if it has non-resident investors and “designated income” (comprised of income from Canadian real property, resource property and businesses carried on in Canada and capital gains from the disposition of “taxable Canadian property” (see below)). While a trust should be treated as a resident of Canada for the purposes of Canada’s tax treaties, subject to limitation on benefits provisions, some countries in the past have denied treaty benefits.

An AIF that is a Canadian corporation is treated as a taxpayer and pays tax on its taxable income. If it qualifies as a “mutual fund corporation” for tax purposes which, among other conditions, requires that its activities be limited to investing its funds in property (but which, in practice, is given a broad meaning), tax on capital gains is refundable to the corporation. Dividends from Canadian corporations received by a mutual fund corporation are subject to a 38⅓% tax which is refundable when the corporation pays taxable dividends to its investors. An AIF that is a Canadian corporation will generally be treated as a resident of Canada and beneficial owner of income for the purposes of Canada’s tax treaties, subject to limitation on benefits provisions.

Canada also imposes tax on non-residents that carry on business in Canada, that dispose of certain capital properties referred to as "taxable Canadian property" (generally Canadian real property and resource property and certain securities that derive more than 50% of their value from such properties) or that derive certain income from Canadian sources (dividends, rents, royalties, etc.). A non-resident AIF that engages a Canadian investment adviser with authority to trade on its behalf would be considered to carry on business in Canada unless the requirements of a safe-harbour rule are satisfied.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

A manager that is a Canadian corporation is treated as a taxpayer and pays tax on its taxable income. Management fees and performance fees will be treated as ordinary business income.

A manager that is a partnership must calculate its income or loss as if it were a separate person resident in Canada. Management fees and performance fees will be treated as ordinary business income. Income or loss of the partnership is allocated in accordance with the partnership agreement to its partners, who include or deduct the relevant amounts as if they earned them directly.

If the AIF is a partnership, the manager or an affiliate of the manager may be a partner of the partnership in order to be entitled to a carried interest. In such case, a share of income and gains of the partnership would be allocated to the manager or affiliate and the character of the allocated amount as ordinary income or capital gain is expected to be respected for tax purposes under current tax rules.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

No establishment or transfer taxes are imposed on investors. The disposition of an investor's interest may give rise to a capital gain or capital loss (or to ordinary income/loss if not capital property) that must be taken into account in computing income. See below regarding the treatment of a disposition of an interest in an AIF.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

(a) A resident investor in an AIF that is treated as a partnership for Canadian tax purposes, whether established in Canada or a foreign jurisdiction, must take into account its share of the income or loss of the partnership that is allocated to it in accordance with the partnership agreement. The partnership must calculate its income or loss as if it were a separate person resident in Canada. The "at-risk" rules restrict the deductibility of losses from a business or property allocated to a limited partner to the limited partner's "at-risk amount". In determining how an AIF established in a foreign jurisdiction should be treated for Canadian tax purposes, the primary attributes of the AIF under the foreign law are determined and compared with the primary attributes of a partnership, trust or corporation under Canadian law.

A resident investor in an AIF that is a Canadian-resident corporation must include, in computing income, dividends received from the corporation. If the investor is a Canadian corporation, such dividends are generally deductible in computing taxable income. Dividends received by an individual are "grossed up" and a dividend tax credit is given. If the AIF is a "mutual fund corporation" for tax purposes, it may pay dividends that it elects to pay out of capital gains which are taxed as capital gains in the hands of investors.

A resident investor in an AIF that is a Canadian-resident trust must include in income its share of the trust's income that is payable in the year to the investor. The tax character of capital gains, dividends from Canadian corporations and income from foreign sources and related foreign tax credits will generally be preserved in the hands of the investor if appropriate tax designations are made by the trust.

A resident investor that invests in an AIF that is, or is treated for Canadian tax purposes, as a non-resident corporation will be required to include dividends received in income. If such an AIF is treated as a "foreign affiliate" of the investor (because the investor and/or certain connected persons own more than 10% of the shares of any class or series) and the AIF is a "controlled foreign affiliate" of the investor (because the AIF is controlled by the investor and/or certain specified persons with a connection to Canada), the investor must include in income, on an accrual basis, the investor's share of the AIF's "foreign accrual property income". Recent amendments to the Income Tax Act (Canada) (the "**ITA**") may extend this treatment to certain sub-funds within an umbrella investment company.

If this rule does not apply, it is necessary to consider whether the resident investor's investment in shares of the AIF is an "offshore investment fund property". In general, two conditions must be satisfied. First, the share must reasonably be considered to derive its value, *directly or indirectly*, primarily from portfolio investments of the corporation or any other non-resident entity in certain properties including shares, indebtedness, interests in one or more corporations, trusts, partnerships, organisations, funds or entities and real estate or any combination thereof. Secondly, it is necessary that it can reasonably be concluded, having regard to all the circumstances, that that one of the main reasons for the investor acquiring, holding or having the share was to derive a benefit from portfolio investments in such assets in such a manner that the taxes, if any, on the income, profits and gains from such assets for any particular year are significantly less than the tax that would have been applicable under Part I of the ITA if the income, profits and gains had been earned directly by the investor. If so, the investor must include a notional amount in income calculated with respect to the "designated cost" of its investment less dividends actually received.

Special rules apply in relation to investments by Canadian residents in non-resident trusts. Depending on the structure of the trust, the trust could be treated as a resident of Canada for certain purposes of the ITA and liable to tax in Canada. Alternatively, the trust could be an "exempt foreign trust" in which case the interest in the trust could be an "offshore investment fund property"; if not, the investor would generally be subject to tax on the income of the trust (calculated in accordance with the ITA) as is payable to the investor.

A resident investor must also take into account the gain or loss arising on a disposition of an interest in the AIF which, if the interest is a capital property, will be a capital gain or capital loss.

(b) A non-resident investor in an AIF that is a partnership will be liable to tax on the investor's share of the partnership's income from a business carried on in Canada and the investor's share of capital gains from the disposition by the partnership of "taxable Canadian property" (generally Canadian real property and resource property and certain securities that derive more than 50% of their value from such properties). By reason of having a non-resident investor, the partnership will be subject to a 25% withholding tax on certain income from Canadian sources (dividends, rents, royalties, etc.). Under the current administrative policy of the Canada Revenue Agency ("**CRA**"), the 25% withholding tax need only be applied in respect of the non-resident partner's share of the relevant income.

A non-resident investor in an AIF that is a Canadian-resident trust will be subject to a 25% withholding tax on distributions of income (including 50% of capital gains) by the trust. If the trust is a "mutual fund trust" for tax purposes, capital gains distributed by the trust will generally not be subject to withholding tax.

A non-resident investor in an AIF that is a Canadian-resident corporation will be subject to a 25% withholding tax on dividends paid or credited to the investor by the corporation (other than "capital gains dividends" paid by a mutual fund corporation).

A non-resident investor is liable to tax on the gain arising on a disposition of an interest in the AIF held as capital property if more than 50% of the value of the interest at any time in the 60-month period ending at the time of the disposition is derived from "taxable Canadian property" (see above). A tax clearance certificate may be required from the CRA in advance of the disposition in order that a purchaser does not withhold a prescribed amount (currently 25%) from the purchase price.

Canada's ability to impose tax on a non-resident may be affected by a bilateral tax treaty between Canada and the non-resident's country of residence. For example, a tax treaty may reduce the withholding rate from 25% to rates between 0% and 15%, depending upon the relevant income.

(c) A Canadian pension plan that is a "registered pension plan" under the ITA is generally exempt from income tax under the ITA on income derived from, and gains derived from the disposition of an interest in, an AIF.

In the case of non-resident pension investors, certain of Canada's tax treaties provide exemptions from Canadian withholding tax on interest and dividends. In such cases, dividends from a Canadian AIF structured as a corporation would not be subject to withholding tax. In the case of an AIF treated as a partnership, Canada would view the partnership as transparent and grant treaty benefits on a look-through basis. In the case of an AIF structured as a Canadian resident trust, there would be no relief from withholding tax on distributions of income to a non-resident pension plan even if the income were derived from Canadian-source interest and dividends.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

No. Rulings are generally not sought unless there is a specific tax concern.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Canada entered into an Intergovernmental Agreement ("**IGA**") with the United States relating to the implementation of FATCA which is substantially in the form of the Model 1 IGA, and the ITA was amended to provide for the due diligence and reporting regime contemplated by the IGA. The definition of "Canadian financial institution" in the ITA is narrower than that in the IGA. An AIF that is managed by a Canadian financial institution will generally itself be a Canadian financial institution. Canadian financial institutions (other than those that are treated as non-reporting Canadian financial institutions) will report information about US account holders to the CRA, which will exchange such information with the US Internal Revenue Service ("**IRS**"). Withholding agents will not be required to withhold the 30% tax on payments to reporting Canadian financial institutions (and certain "exempt beneficial owners" such as registered pension plans). A variety of registered accounts are excluded from the definition of "financial account" and do not have to be reported on. The rules in FATCA relating to recalcitrant accounts are suspended.

Canada also signed the Organisation for Economic Co-operation and Development ("**OECD**") Multilateral Competent Authority Agreement and Common Reporting Standard ("**CRS**"). The ITA has been amended to provide for the due diligence and reporting regime contemplated by the CRS.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Canada signed the MLI in June 2017 and listed 75 of its 93 tax treaties as Covered Tax Agreements. It originally adopted only the minimum standard provisions and the binding mandatory arbitration provision and registered reservations on all other optional provisions. As part of the ratification process, Canada announced that it would adopt a number of optional provisions including (i) imposing a 365-day holding period for shares of Canadian companies held by non-resident companies to access the lower treaty-based rate on dividends, and (ii) imposing a 365-day test period for non-residents who realise capital gains on the disposition of shares or other interests that derived their value from Canadian immovable property. The MLI was ratified in 2019 and entered into effect for Canada's tax treaties with many countries on January 1, 2020 for withholding taxes, and will enter into force for other taxes (including capital gains taxes), for tax years beginning on or after June 1, 2020 (which for calendar year taxpayers would be January 1, 2021).

Canada has amended the ITA to provide for country-by-country reporting for large multinational enterprises. The CRA is applying revisions to the OECD Transfer Pricing Guidelines recommended as part of the BEPS project.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Generally, there are no tax-advantaged asset classes or structures available.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Canada imposes a 5% Goods and Services Tax ("**GST**"); the provinces of Ontario, Nova Scotia, New Brunswick and Newfoundland and Labrador impose Harmonized Sales Tax ("**HST**") which varies from 8 to 10% and the province of Quebec imposes Quebec Sales Tax ("**QST**") at a rate of 9.975% (essentially value-added taxes) on certain supplies. Management and performance fees for services provided to a Canadian AIF will generally be subject to GST/HST/QST and no refund will be available to the AIF. An AIF that is a limited partnership may also be required to pay GST/HST/QST on the distribution, or a portion thereof, paid to the general partner.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

It is expected that rules to limit interest deductibility as part of BEPs will be introduced.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

There are currently no reforms proposed.

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Cayman Islands

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The Mutual Funds Law (2020 Revision) (the "**MF Law**") provides for the regulation of open-ended investment funds and mutual fund administrators. Responsibility for regulation under the MF Law rests with the Cayman Islands Monetary Authority ("**CIMA**").

The Private Funds Law, 2020 (the "**PF Law**") provides for the regulation of closed-ended investment funds. Responsibility for regulation under the MF Law rests with CIMA.

In addition, the Retail Mutual Funds (Japan) Regulations (2018 Revision) (the "**Japan Regulations**") provide a regulatory regime for retail mutual funds that are marketed to the public in Japan.

Although not Cayman Islands law, the broad scope and extra-territorial effect of the EU Directive on Alternative Investment Fund Managers ("**AIFMD**") will capture most types of Cayman Alternative Investment Funds, regardless of whether they are open-ended or closed-ended and regardless of their legal structure and investment strategy, with very few exceptions, to the extent that they are being marketed or managed in Europe (as such terms are defined for the purposes of the AIFMD). Legislation for AIFMD-consistent regimes for Cayman Islands funds and their managers was introduced in 2019, which enable Cayman Islands AIFs and AIFMs to "opt-in" to take full advantage of the AIFMD if and when the AIFMD passport is extended to the Cayman Islands. The legislation also contemplates a CIMA notification regime for CIMA licensed managers and any fund managed by a manager registered in an EU Member State or being marketed to investors in an EU Member State.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

A manager or adviser which is established in or, in the case of a foreign company, registered in the Cayman Islands and which conducts "securities investment business", whether or not that securities investment business is carried on in the Cayman Islands, will fall within the scope of the Securities Investment Business Law ("**SIBL**").

"Securities investment business" is defined as being engaged in the course of business in any one or more of the activities set out in Schedule 2 to SIBL. Those activities include managing securities belonging to another person on a discretionary basis and advising in relation to securities, but only if the advice is given to someone in their capacity as investor or potential investor or in their capacity as agent for an investor or a potential investor and the advice is on the merits of that person (whether acting as principal or agent) buying, selling, subscribing for or underwriting a particular security or exercising any right conferred by a security to buy, sell, subscribe for or underwrite a security. "Securities" are defined to include most forms of shares and stock, debt instruments, options, futures, contracts for differences, and derivatives.

Schedule 3 to SIBL specifically excludes certain activities from the definition of securities investment business, although those exclusions are unlikely to apply to a person conducting discretionary investment management or investment advisory activities.

Any person within the scope of SIBL conducting securities investment business must be licensed by CIMA, unless that person is registered as a "Registered Person" under the SIBL Law. A licence may be restricted (meaning that securities investment business may only be transacted with particular clients) or unrestricted. A licence may also be issued subject to conditions or may be unconditional.

A person carrying on securities investment business may be exempt from the requirement to obtain a licence but will still be required to be registered as a "Registered Person" under the SIBL. In the case of Registered Persons, which is likely to apply to fund managers or advisers, they are required to register with CIMA by filing a declaration and paying a fee of CI$5,000 (approximately US$6,097.56), prior to carrying on securities investment business and annually thereafter, confirming that they are entitled to rely on the relevant exemption.

An "Excluded Person" includes:

(a) a company carrying on securities investment business exclusively for one or more companies within the same group;

(b) a person, whose registered office in the Cayman Islands is provided by a licensee under the law, carrying on securities investment business exclusively for one or more of the following classes of person:

  (i) a sophisticated person (a person regulated by CIMA or a recognised overseas regulatory authority or whose securities are listed on a recognised securities exchange or who by virtue of knowledge and experience in financial and business matters is reasonably to be regarded as capable of evaluating the merits of a proposed transaction and participates in a transaction with a value or in amounts of at least US$100,000 in each single transaction); or

  (ii) a high-net-worth person (an individual whose net worth is at least US$1,000,000 or any person that has any assets of not less than US$5,000,000); or

(iii) a company, partnership or trust of which the shareholders, limited partners or unitholders are all sophisticated persons or high-net-worth persons; or

(c) a person who is regulated by a recognised overseas regulatory authority in the country or territory (other than the Cayman Islands) in which the securities investment business is being conducted.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

An investment fund qualifies as a "mutual fund" and is required to be regulated under the MF Law if:

(a) it is a company, partnership or unit trust carrying on business in or from the Cayman Islands;

(b) it issues "equity interests" to investors (i.e. shares, partnership interests or trust units that carry an entitlement to participate in profits or gains and which may be redeemed or repurchased at the option of those investors prior to winding up); and

(c) its purpose or effect is the pooling of investor funds with the aim of spreading investment risks and enabling investors to receive profits or gains from investments.

There are four categories of mutual funds:

1. a licensed fund under section 4(1)(a) of the MF Law;
2. an administered fund under section 4(1)(b) of the MF Law;
3. a registered fund under section 4(3) of the MF Law; and
4. a limited investor fund under section 4(4) of the MF Law.
    1. A mutual fund licence will be granted if CIMA considers that the promoter is of sound reputation, there exist persons of sufficient expertise to administer the fund, who are of sound reputation, and that the business of the fund and any offer of equity interests will be carried out in a proper way. Detailed information is required concerning the directors, trustee or general partner ("**GP**") of the mutual fund (as the case may be) and the service providers. However, few investment funds are fully licensed under the MF Law, as this is generally only necessary for retail funds.
    2. Registration as an administered fund requires the designation of a Cayman Islands licensed mutual fund administrator as the fund's principal office. The administrator must satisfy itself that the fund's promoters are of sound reputation, that the fund's administration will be undertaken by persons with sufficient expertise who are also of sound reputation and that the fund's business and its offering of equity interests will be carried out in a proper way. The administrator is obliged to report to CIMA if it has reason to believe that a mutual fund for which it provides the principal office (or any promoter, director, trustee or GP thereof) is acting in breach of the MF Law or may be insolvent or is otherwise acting in a manner prejudicial to its creditors or investors. This imposes a quasi-regulatory role and an obligation to monitor compliance on the administrators themselves, and generally higher fees charged by administrators in relation to this category of investment fund.
    3. Mutual funds registered under section 4(3) of the MF Law are divided into three sub-categories:
        (a) where the minimum investment per investor is at least US$100,000;
        (b) where the equity interests are listed on a recognised stock exchange; or
        (c) where the mutual fund is a "master fund" (as defined in the MF Law) and either:
            (i) the minimum investment per investor is at least US$100,000; or
            (ii) the equity interests are listed on a recognised stock exchange.
    4. Limited investor funds registered under section 4(4) of the MF Law have 15 or fewer investors, a majority in number of whom have the power to appoint and remove the fund's directors, GP or trustee, as applicable.

A master fund is a Cayman Islands entity that issues equity interests to at least one feeder fund (either directly or through an intermediate entity established to invest in the master fund) that is itself regulated by CIMA under the MF Law that holds investments and conducts trading activities for the principal purpose of implementing the overall investment strategy of the regulated feeder.

An investment fund qualifies as a "private fund" and is required to be regulated under the PF Law if it is a company, unit trust or partnership whose principal business is the offering and issuing of its investment interests (being interests that are *not* redeemable or repurchasable at the option of the investor), the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risks and enabling investors to receive profits or gains from such entity's acquisition, holding, management or disposal of investments, where:

(a) the holders of investment interests do not have day-to-day control over the acquisition, holding, management or disposal of the investments; and

(b) the investments are managed as a whole by or on behalf of the operator of the private fund, directly or indirectly, for reward based on the assets, profits or gains of the company, unit trust or partnership, but does not include:
    (i) a person licensed under the *Banks and Trust Companies Law (2020 Revision)* or the *Insurance Law 2010*;
    (ii) a person registered under the *Building Societies Law (2020 Revision)* or the *Friendly Societies Law* (*1998 Revision*); or
    (iii) any non-fund arrangements.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes; open-ended funds are governed by the MF Law and closed-ended funds are governed by the PF Law. The key distinction between open-ended and closed-ended funds is the ability of investors to voluntarily redeem or repurchase some or all of their investment prior to winding up.

1.5 What does the authorisation process involve and how long does the process typically take?

CIMA has established an online e-business portal, CIMAConnect, which enables the online submission of mutual fund and private fund applications and documentation. An application for a section 4(3) mutual fund, limited investor and private fund involves the submission of:

(a) the fund's offering document, other than (i) in the case of a master fund, which will often not have an offering document separate from that of its feeder fund(s), and (ii) in the case of a private fund and a limited investor fund, a short-form term sheet may be submitted;

(b) the relevant statutory application form;
(c) consent letters from the fund's auditor and administrator (except in respect of a private fund that does not engage an external administrator);
(d) the relevant fees (currently a registration fee of US$4,268, initially and annually, and a separate application fee of US$366, other than (i) in the case of a master fund which has a registration fee of currently US$3,049 initially and annually, and (ii) in the case of a private fund or limited investor fund that is registered by 7 August 2020, where the initial registration fee is waived);
(e) for section 4(3) mutual funds only, an affidavit relating to the authorisation of submission of the online application; and
(f) a structure diagram for private funds.

CIMA's practice with these funds is to make the effective date of the application the date on which all application requirements have been submitted and applications must be completed prior to a fund launching in order to be compliant with the MF Law or PF Law (as applicable).

The authorisation process is more involved for licensed and administered mutual fund applications.

1.6 Are there local residence or other local qualification or substance requirements?

Each Cayman Islands regulated mutual fund and private fund must appoint a local auditor approved by CIMA.

The Directors Registration and Licensing Law, 2014 (the "**DRLL**") requires that the directors (both natural persons and corporate directors) of a corporate mutual fund or private fund regulated by CIMA or a certain type of "Registered Person" registered with CIMA under SIBL be either registered or licensed with CIMA. The registration process is undertaken online at the "CIMA Director Gateway".

1.7 What service providers are required?

Every regulated mutual fund and private fund must have an approved local auditor and will generally have an investment manager/adviser and, more so for mutual funds, an administrator (which, for an administered mutual fund, must be a licensed mutual fund administrator).

Although not required, it is becoming market practice for corporate regulated investment funds to appoint independent directors. Such independent directors are not required to be based in the Cayman Islands but often are, due to the depth of the Cayman fiduciary services industry.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Provided that the activities of a foreign manager/adviser, including any transactions entered into, have not been and will not be carried on through a place of business in the Cayman Islands, or the fund is not subject to the Japan Regulations, there are no additional rules.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The Cayman Islands has Tax Information Exchange Agreements and similar bilateral arrangements with 36 countries as of April 2020 and is on the OECD "white list" with respect to the exchange of tax information. In addition, CIMA has entered into bilateral regulatory cooperation agreements pursuant to the AIFMD with the competent authorities of 27 of the EU and EEA Member States. Please also see the description of FATCA/CRS under question 6.6 below.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

Three types of vehicle are most commonly utilised by Cayman Islands investment funds: exempted companies; exempted limited partnerships ("**ELPs**"); and exempted unit trusts. The term "exempted" in this context means that the vehicle is eligible to apply to the Cayman Islands government for an undertaking (lasting 20 or 50 years depending on the type of vehicle) that if any taxation is introduced in the Cayman Islands during the period to which the undertaking applies, such taxation will not apply to the vehicle in question.

Cayman Islands introduced limited liability companies ("**LLCs**"), which broadly operate in a similar manner to Delaware limited liability companies, may be used in fund structures; however, we have not seen them used extensively to date in such capacity.

Exempted companies are by far the most common vehicle for open-ended funds (including master funds).

However, it is not common to see closed-ended funds established in the Cayman Islands as exempted companies. The ELP is usually the vehicle of choice for closed-ended or private equity funds.

The Cayman ELP concept is similar to that which applies in the United States and indeed the Exempted Limited Partnership Law (2018 Revision) (the "**ELP Law**") is based substantially on the Delaware equivalent (although a Cayman Islands partnership is not a separate legal person). Whilst exempted companies are extremely flexible in the extent to which voting and economic rights can be mixed and matched across separate classes of shares, companies have certain limitations that do not apply to ELPs. Fewer statutory rules govern the approvals processes within an ELP, which makes them generally more flexible and suitable for closed-ended vehicle purposes.

Unit trusts are the vehicle primarily used for investors in Japan, where the demand is driven by familiarity with the unit trust structure and historical local tax benefits relating to trust units as opposed to other forms of equity interest.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

The limited liability of investors in a Cayman Islands investment fund depends upon the nature of the vehicle used and whether the investor has agreed to contribute additional funds to that vehicle pursuant to the terms of the governing documentation.

With exempted companies limited by shares, the liability of the investors is limited to the amount unpaid on their shares pursuant to the constitutional documents of the company and in accordance with the Companies Law (2020 Revision).

Limited partners ("**LPs**") of an ELP shall not be liable for the debts or obligations of the ELP under the ELP Law, (a) save as provided by the terms of the applicable partnership agreement, and (b) subject to the provisions of the ELP Law (i) providing that an LP who takes part in the conduct of the business of the ELP may lose its limited liability with respect to a third party

who deals with that ELP and who reasonably believes such LP to be a GP of such ELP, and (ii) providing for clawback of capital distributions (together with interest) made to an LP within six months of the ELP becoming insolvent where the LP had actual knowledge of the insolvency.

Investors who are unitholders of an exempted trust must look to the wording of the relevant declaration of trust to provide them with limited liability status and protection.

Despite the limited liability nature of an equity interest purchased by an investor, it is common practice for the subscription and certain transaction documents of Cayman Islands investment funds to impose payment obligations on investors over and above the obligation to pay for their investment. Such additional obligations regularly include indemnification for misrepresentations and the requirement to repay excess redemption or withdrawal proceeds which were calculated and paid on the basis of unaudited data.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

The principal structures are exempted companies and LLCs.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Not as a general matter of Cayman Islands law; the ability to redeem or transfer equity interests in a fund and any restrictions thereon will be governed by the governing documents.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

Not as a general matter of Cayman Islands Law; subject to restrictions on the assignment of certain liabilities by LPs pursuant to the ELP Law or the transferee meeting any minimum investment requirements that may apply. Proposed transferees will need to satisfy applicable Know Your Client and Anti Money Laundering requirements.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

Not as a general matter of Cayman Islands law (assuming that the fund is not subject to the Japan Regulations).

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The MF Law requires that every regulated mutual fund issue an offering document which must describe the equity interests in all material respects and contain such other information as is necessary to enable a prospective investor to make an informed decision whether or not to invest.

To supplement this requirement, CIMA has issued a rule in relation to the content of offering documents for licensed funds, which is generally applied to the offering documents of all regulated funds. Japan Regulations also set out additional disclosure requirements for the prospectus of a retail mutual fund, which are more onerous.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The minimum disclosure requirements for offering documents for regulated mutual funds generally include the following:

(a) details of the date of establishment of the fund, its registered office, fiscal year and its operator together with biographies;
(b) a description of the fund's investment objectives, policy, and restrictions;
(c) a description of the fund's investment manager or adviser, together with biographies of the portfolio managers and information regarding remuneration;
(d) the names and addresses of the fund's other service providers, together with details of the services to be performed and remuneration;
(e) the classes of interests available for investment or issue, together with descriptions of any minimum investment, eligibility requirements and subscription procedures;
(f) details of the principal rights and restrictions attaching to the fund's equity interests, including with respect to currency, voting, circumstances of winding up or dissolution and the procedures and conditions for repurchases, redemptions or withdrawals of such equity interests, including suspensions;
(g) the NAV calculation policy; and
(h) details of the fund's material risks and potential conflicts of interest.

A private fund's offer document or term sheet (required for registration under the PF Law) should contain, as a minimum, the name of the fund, the name of the general partner (if the fund is an ELP), the biographies of the principals of the operators of the fund, the name of the manager, the minimum subscription, the applicable audit principles, the financial year end, the term, the investment strategy, the name of the Cayman Islands legal adviser and registered office service provider.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

The offering document of a registered mutual fund must be filed with CIMA as part of the initial application; however, it is not technically subject to approval by CIMA prior to its circulation to prospective investors. An amended offering document or supplement must be filed with CIMA within 21 days in the event of material changes, where there is a continuing offering.

A private fund is required to submit an offer document or a short-form term sheet for registration under the PF Law. Details of any material changes to the information submitted on the registration of a private fund must be filed with CIMA within 21 days of such change (or becoming aware of such change).

3.4 What restrictions are there on marketing Alternative Investment Funds?

Generally, no offer or invitation to subscribe for equity interests in a Cayman Islands investment fund may be made to the "public in the Cayman Islands". The range of persons that may be considered excluded from the "public in the Cayman Islands" will depend upon the fund's legal structure and whether or not the fund is regulated under the MF Law or the PF Law, but it is generally likely that Cayman Islands exempted companies, LLCs, ELPs and exempted trusts engaged in offshore business and

foreign companies registered in the Cayman Islands will not be considered part of the "public in the Cayman Islands".

Prior to the filing for registration of a private fund with CIMA, the private fund may only be marketed to high-net-worth or sophisticated persons.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

No, it is not.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes, in respect of section 4(1)(a) or section 4(1)(b) funds. In respect of section 4(3) mutual funds, yes, subject to the US$100,000 minimum investment or the equity interests being listed on a recognised stock exchange. There is no statutory minimum investment amount for a private fund.

3.7 What qualification requirements must be met in relation to prospective investors?

Potential investors will be subject to due diligence and sanction checks in accordance with the Cayman Islands' anti-money laundering regime.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

No, there are not.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

No, there are not.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

No, there are not.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

There are no such restrictions on investment strategy subject to applicable local regulatory laws.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

No, there are not.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

No, there are not.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

No, there are no such restrictions (assuming that the fund is not subject to the Japan Regulations).

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

There are no public disclosure requirements for exempted companies or trusts. Although such vehicles are required to maintain statutory registers and make certain filings with the Cayman Islands Registrar and CIMA, those registers and filings are not available to inspection by the general public.

The register of limited partnership interests of an ELP is required by the ELP Law to be open to inspection during all business hours by all partners, subject to any express or implied term to the contrary of the limited partnership agreement, or by any other person with the consent of the GP.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

The Cayman Islands beneficial ownership regime ("**BOR**") requires certain exempted companies and LLCs (but not ELPs) to maintain non-public registers of beneficial owners at their Cayman Islands registered offices, which are then submitted to a competent authority designated by the Cayman Islands Government. However, BOR does not apply to CIMA regulated mutual funds and entities that are managed, arranged, administered, operated or promoted by an "approved person" (generally a regulated or listed person or subsidiary of such person) as a special purpose vehicle, private equity fund, collective investment scheme or investment fund.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Regulated mutual and private funds are required to file, in electronic format, audited financial statements, an annual Key Data Elements Form (containing a summary of the basic information about the fund) and a Fund Annual Return ("**FAR**"), in each case within six months of the financial year end. The FAR provides general, operating and financial information relating to such regulated funds. Certain additional requirements apply to funds subject to the Japan Regulations.

A manager registered as a "Registered Person" pursuant to SIBL is required to make an annual filing confirming its status with CIMA but does not otherwise have any reporting requirements.

5.4 Is the use of side letters restricted?

No. Side letters are commonly used by Cayman Islands investment funds although certain legal considerations should be borne in mind in order to ensure that such letter agreements are compliant with Cayman Islands law.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

The Cayman Islands imposes no taxation on the income or capital gains of investment funds or their investors and no transfer taxes on the transfer of interests in investment funds. As discussed above, "exempted" companies, ELPs, unit trusts and LLCs can obtain undertakings from the Cayman Islands government that if any taxation is introduced during the period of the undertaking, such taxation will not apply to the entity to which the undertaking is given.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

Please see question 6.1 above.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

No, there are none.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

There is no distinction from a Cayman Islands perspective – please see question 6.1 above.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

No, it is not.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

The Cayman Islands has signed an inter-governmental agreement to improve international tax compliance and the exchange of information with the United States (the "**US IGA**"). The Cayman Islands has also signed, along with over 80 other countries, a multilateral competent authority agreement to implement the OECD Standard for Automatic Exchange of Financial Account Information – Common Reporting Standard ("**CRS**" and together with the US IGA, "**AEOI**").

Cayman Islands regulations have been issued to give effect to the US IGA and CRS (collectively, the "**AEOI Regulations**"). Pursuant to the AEOI Regulations, the Cayman Islands Tax Information Authority (the "**TIA**") has published guidance notes on the application of the US IGA and CRS.

All Cayman Islands "Financial Institutions" are required to comply with the registration, due diligence and reporting requirements of the AEOI Regulations, unless they are able to rely on an exemption that allows them to become a "Non-Reporting Financial Institution" (as defined in the relevant AEOI Regulations) with respect to one or more of the AEOI regimes, in which case only the registration requirement would apply under CRS.

The AEOI Regulations require funds to, amongst other things (i) register with the Internal Revenue Service ("**IRS**") to obtain a Global Intermediary Identification Number (in the context of the US IGA only), (ii) register with the TIA, and thereby notify the TIA of its status as a "Reporting Financial Institution", (iii) adopt and implement written policies and procedures setting out how it will address its obligations under CRS, (iv) conduct due diligence on its accounts to identify whether any such accounts are considered "Reportable Accounts", and (v) report information on such Reportable Accounts to the TIA. The TIA will transmit the information reported to it to the overseas fiscal authority relevant to a reportable account (e.g. the IRS in the case of a US Reportable Account) annually on an automatic basis.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Country-By-Country Reporting

As part of the Cayman Islands' ongoing commitment to international tax transparency, the Tax Information Authority (International Tax Compliance) (Country-By-Country Reporting) Regulations, 2017 (the "**CbCR Regulations**") were issued on 15 December 2017, with the Department for International Tax Cooperation releasing its Guidance on the Country-by-Country Reporting ("**CbCR**") requirements of entities that are resident in the Cayman Islands on 29 March 2018.

The CbCR Regulations essentially implement in the Cayman Islands the model legislation published pursuant to the OECD's Base Erosion and Profit Shifting Action 13 Report (Transfer Pricing Documentation and Country-by-Country Reporting). The CbCR Regulations also reflect the Cayman Islands' obligations under the OECD Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (the "**CbC MCAA**").

Pursuant to this initiative, qualifying multinational enterprises ("**MNEs**") are required to report annually the information set out in the model legislation for each tax jurisdiction in which they operate. The TIA will automatically exchange such reports prepared by MNE Groups in the Cayman Islands with partner jurisdiction competent authorities in all jurisdictions that the MNE Group operates, provided that the jurisdiction is a co-signatory to the CbC MCAA or a tax information exchange agreement is in place between the Cayman Islands and each

relevant jurisdiction. The information reported will be subject to confidentiality restrictions compliant with the requirements of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

Pursuant to the CBCR Regulations, any business unit or permanent establishment of an MNE Group "resident in the Cayman Islands" that are "Constituent Entities" will have registration and/or reporting requirements in the Cayman Islands. An MNE Group means, broadly, with respect to any fiscal year of the Group, a Group that has two or more enterprises for which the tax residence is in different jurisdictions or that has an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax through a permanent establishment in another jurisdiction and, in both cases, that has a total consolidated group revenue of equal to or more than US$850 million during its preceding fiscal year.

Lack of Tax Treaties

As a Cayman Islands fund will not be claiming access itself to a tax treaty, Action 6 is not directly relevant to it. However, a Cayman Islands fund can be set up in a variety of different legal forms, either as legally transparent or opaque, which facilitate cross-border fund structures, whereby either the fund investors may rely on their own treaty or through investment entities that may be able to rely on their own treaty.

Economic Substance

In response the BEPS standards on geographically mobile activities, on 27 December 2018, the Cayman Islands published The International Tax Co-operation (Economic Substance) Law, 2018 and The International Tax Co-operation (Economic Substance) (Prescribed Date) Regulations, 2018 (together, the "**Initial Law**"). The Initial Law was amended on 22 February 2019 by the publication of The International Tax Co-operation (Economic Substance) (Amendment of Schedule) Regulations, 2019 (the "**Regulations**" and, together with the Initial Law, the "**Economic Substance Law**") and supplemented by the issuance of the related Guidance on Economic Substance for Geographically Mobile Activities (the "**Guidance**").

The Economic Substance Law introduces certain reporting and economic substance requirements for "relevant entities" conducting "relevant activities". Such entities will be required to report certain information on their relevant activities on an annual basis to the TIA, the first such annual report being due no later than 12 months after the last day of the relevant entity's financial year commencing on or after 1 January 2019.

The definition of "relevant entity" is set out in the Regulations. It expressly recognises that, among other things, an entity that is an "investment fund" is not within the classification of a "relevant entity" and therefore not subject to the requirements of the Economic Substance Law.

The definition of "investment fund" includes an "entity through which an investment fund directly or indirectly invests or operates".

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Not applicable – please see question 6.1 above.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

No, there are not.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No, there are not.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

The Cayman Islands continuously keeps its laws under review to ensure that the jurisdiction remains the leading domicile for alternative investment funds and remains responsive to stakeholders' needs.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The UK is regarded as one of the leading global asset management centres, with an investment funds industry covering both traditional and alternative asset classes. In the case of funds with alternative investment strategies such as private equity, real estate and infrastructure funds, both the fund manager and the fund itself tend to be domiciled in the UK.

Prior to the Alternative Investment Fund Managers Directive ("AIFMD"), supplemented by its Level 2 Delegated Regulation ("Delegated Regulation") and guidelines from the European Securities Markets Authority ("ESMA"), the framework for Alternative Investment Funds was derived from the Financial Services and Markets Act 2000 ("FSMA") and the principal regulatory authority, the Financial Conduct Authority ("FCA"). However, AIFMD has ushered in a new regulatory environment for many investment fund managers, including private equity firms and managers of hedge funds.

AIFMD offers the lofty ideal of pan-European harmonisation of the regulatory and supervisory framework for the non-UCITS ("Undertakings for Collective Investment in Transferable Securities") fund sector, together with the associated freedom to passport management and marketing activities on a cross-border basis. However, no passport is ever free and for Alternative Investment Fund Managers ("AIFMs"), there will be significant costs and burdens; and in common with other Directives, the creation of freedoms within Europe can come at the price of newly erected barriers to truly international business.

As noted above, AIFMD applies to the non-UCITS sector. Broadly speaking, UCITS funds have not been used to implement alternative investment strategies and therefore are generally outside the scope of this chapter. Some hedge fund managers may be able to launch products under the UCITS brand if the proposed investment strategy fits into the framework and the UCITS requirements will offer investors greater regulatory safeguards and protections. However, the fact that UCITS funds are subject to mandated investment and borrowing powers means that they are likely to lack the investment flexibility which is available to private funds.

AIFMD has been implemented in the UK by various implementing measures – primarily the Alternative Investment Fund Managers Regulations 2013 (SI 2013/1773), the Alternative Investment Fund Managers (Amendment) Regulation 2013 (SI 2013/1797) and the Alternative Investment Fund Managers Order 2014 (SI 2014/1292). The majority of these implementing measures have been introduced by way of updates to the FCA Handbook. The FCA created a new investment fund sourcebook, called "FUND", as part of its Handbook and this contains most of the FCA's rules and guidance for UK AIFMs, which adds an additional component to the general regulatory framework set out under FSMA.

The European Venture Capital Funds Regulation ("VCF Regulation") provides what is essentially "AIFMD Lite" for EU venture capital fund managers. The regime was broadened in 2018, with the aim to make it more attractive following a lacklustre take up.

The Regulation on cross-border fund distribution ("Omnibus Regulation") and the Directive on the cross-border marketing of funds ("Omnibus Directive") entered into force on 1 August 2019. The majority of the Omnibus Regulation applies as from 2 August 2021 and Member States must also implement the Omnibus Directive as from that date. The legislation relates to areas which have previously been identified as problematic by fund managers, particularly in the context of the inconsistent national implementation of the AIFMD by individual EU Member States. In addition, a new set of obligations will be imposed on the marketing and distribution process. The measures will amend the existing marketing rules under AIFMD, the VCF Regulation, the EuSEF Regulation and the UCITS Directive.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Many Alternative Investment Funds will be AIFs for the purposes of AIFMD. An AIF is a collective investment undertaking which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors. Even if a vehicle does not fall within the definition of an AIF, it may be categorised as a collective investment scheme ("CIS") under FSMA (a CIS is similar, but not identical, to the European concept of a collective investment undertaking). An example of this is likely to be carried interest arrangements structured through a limited partnership, which are unlikely to be AIFs due to the employee participation scheme exclusion from AIFMD, but which are likely nevertheless to be unregulated CISs for the purposes of domestic legislation.

The FCA authorises and regulates persons carrying out specific "regulated activities" in the UK. Acting as the manager of an AIF is a regulated activity, as is establishing, operating (which includes managing) and winding up an unregulated

collective investment scheme. A suitably authorised person must therefore be appointed to carry out these activities on behalf of an Alternative Investment Fund.

In the UK, only appropriately authorised persons can carry on a regulated activity by way of business. It is a criminal offence to breach this requirement. Any agreement entered into by a person carrying on a regulated activity in contravention of this provision is unenforceable against the other party and the other party is entitled to recover any money paid and to compensation for any loss sustained.

AIFMD contains a partial exemption for AIFMs whose total assets under management do not exceed certain thresholds. These sub-threshold firms will not have to comply with the full provisions of AIFMD, unlike those firms which are "full-scope" AIFMs. The relevant thresholds are: (i) €500 million, provided the AIF is not leveraged and investors have no redemption rights for the first five years; or (ii) €100 million (including assets acquired through leverage). The exemptions do not remove the requirement for authorisation, and sub-threshold firms will need to apply to the FCA to become a "small authorised AIFM" or, in certain limited circumstances, a "small registered AIFM". The latter category imposes the lowest regulatory burden on firms but is only available for internally managed AIFs and certain types of real estate scheme. Sub-threshold AIFMs can opt into AIFMD to be treated the same as full-scope AIFMs, so as to benefit from the AIFMD passporting regime.

A regulated entity which conducts all of its activities in its capacity as the manager/operator of an Alternative Investment Fund – whether an authorised AIFM or not – will be exempt from the EU Markets in Financial Instruments Directive ("MiFID").

Historically, though, many UK resident managers or advisers of off-shore hedge funds would have been subject to MiFID as the manager/operator of the fund was off-shore and the UK regulated entity was merely its delegate in respect of relevant investment management services. This analysis, however, has been somewhat muddied by the "letterbox" test imposed under AIFMD. The consequence of this test is that in some cases the entity which is designated as the manager of an AIF under the fund documentation is not regarded as the AIFM for the purposes of AIFMD (because it is a letterbox). The exact analysis of the letterbox test applicable to any situation is very fact-specific, but the risk is likely to arise from one of the tests set out in the Delegated Regulation, which provides that a manager of an AIF is likely to be deemed a letterbox if it delegates the performance of investment management functions (i.e. investment management and risk management) to an extent that exceeds by a substantial margin the investment management functions performed by the manager itself. The consequence of this is that an on-shore manager of a hedge fund may, depending on the exact structure and division of powers, now find itself as the AIFM for the purposes of the Directive even if it feeds its services into an off-shore manager.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Generally speaking, under the current UK framework, an Alternative Investment Fund itself is not required to be authorised or licensed by the FCA. AIFMD broadly supports the traditional position that it is the manager (or AIFM), rather than the Alternative Investment Fund, which is subject to regulation. However, whilst historically there have been very few operational requirements imposed at the level of the fund itself, to the extent AIFMD applies, the AIFM must now ensure that certain requirements are imposed upon the fund, such as: the appointment of a depositary to have custody of certain assets and/or verify title to privately held assets; organisational controls (relating to risk management, compliance and valuation); conduct-of-business rules (relating to due diligence, execution of orders and reporting); and rules relating to companies in which the fund has a substantial stake.

This will not be the case if the fund manager is looking to implement an alternative investment strategy through a retail fund (meaning those which are approved by the FCA to be marketed to identified categories of investors, including, in the case of UCITS and non-UCITS retail schemes, the general public). In the case of non-UCITS retail schemes, the fund itself, as well as the manager, will require FCA authorisation. Where a closed-ended investment fund is to be launched (such as an investment trust or real estate investment trust) and its shares listed, the listing on the London Stock Exchange of any such fund, as well as the manager, would need to be authorised by the FCA.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The UK regulatory regime, broadly speaking, does not differentiate between open-ended and closed-ended private funds, assuming that the fund is domiciled within the UK, although, as noted above in the context of sub-threshold firms, the partial exemption from AIFMD will bite at a higher level for non-leveraged closed-ended funds.

However, the regulatory categorisation of UK fund managers advising or managing off-shore structures may be different to that which would apply if the entire structure is on-shore.

Other regulatory requirements which might apply to a manager of Alternative Investment Funds are linked with the investment strategy being pursued, rather than whether the fund is open-ended or closed-ended (although the relevant strategy might be linked with a particular type of fund). For example, further requirements of UK legislation which are particularly relevant to hedge funds include: rules relating to market abuse and insider dealing; disclosures of interests in shares and related derivatives above certain levels; and disclosures of net economic short exposures to certain financial-sector companies and companies subject to a rights issue.

1.5 What does the authorisation process involve and how long does the process typically take?

An application for authorisation under FSMA involves the applicant submitting a considerable volume of information to the FCA. This will include information on the proposed business activities of the applicant, its controllers and individuals who will be undertaking certain core controlled functions, its systems and controls including those relating to the manner in which the applicant monitors its compliance with applicable FCA Rules, its group structure and reporting lines and financial projections for the first year of trading. For those applicants applying for authorisation to manage an AIF, the FCA will require further information about the AIF itself (such as details of the AIF's risk profile and its use of leverage).

Once a complete application has been submitted (together with the requisite application fee), the FCA currently has six months

to review the application (this is reduced to three months in the context of applications by AIFMs). During the review process, the FCA is likely to raise additional queries in relation to the information submitted.

The FCA has made available a suite of forms for use by UK AIFMs in order to apply for the various permissions and authorisations required from a UK AIFM. Further applications will also need to be made in relation to any "material changes" to the information submitted as part of the authorisation application.

Following authorisation, a successful applicant will need to comply with the applicable conduct of business and prudential rules of the FCA which are relevant to its business. In the context of AIFMs, particular focus is likely to be given to the capital adequacy requirements of, and remuneration principles imposed by, AIFMD.

1.6 Are there local residence or other local qualification or substance requirements?

A fund manager applying for authorisation under FSMA (whether or not as an AIFM) must meet certain threshold conditions. One of these is that the head office of the applicant must be in the UK. Although the FCA will judge each application on a case-by-case basis, the key issue in identifying the head office of a firm is the location of its central management and control.

In December 2018, the Department of Business, Energy and Industries Strategy of the UK Government indicated that it will introduce various reforms in respect of UK limited partnerships, following its consultation earlier in 2018. The reforms include requirements for a proposed "principal place of business" ("PPoB") to be included in the application for the limited partnership's registration. On an ongoing basis, the limited partnership will then need to demonstrate that it maintains an ongoing connection to the UK. The UK Government is still considering what evidence will be required to demonstrate the ongoing connection and how these requirements shall apply to existing limited partnerships. In terms of timing, the UK government has only committed to the required legislation "when parliamentary time allows".

1.7 What service providers are required?

Historically, there have been no formal requirements to appoint external service providers to private funds domiciled in the UK (although a manager may have engaged service providers as a matter of choice). However, this is another area of change under AIFMD. One of the most significant changes under AIFMD is the requirement to have a depositary, who will have the responsibilities set out under AIFMD (which include custody, cash movement reconciliations and monitoring certain processes such as issues and redemptions of units and valuations). Independent valuers may also be appointed pursuant to the provisions of AIFMD.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

AIFMs authorised in their EEA ("European Economic Area") home Member State (i.e. EEA AIFMs) should be able to exercise management and marketing passport rights in the UK in relation to EEA AIFs. In order to exercise these rights, the EEA AIFMs home Member State competent authority will send the relevant notification forms to the FCA, the UK's competent authority for these purposes. At the time of writing, however, it is unclear whether such passporting rights will continue to be enjoyed following Brexit.

Firms based in non-EEA jurisdictions wishing to market AIFs in the UK are required to comply with the National Private Placement Regime ("NPPR"), as well as the UK's financial promotion rules

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

One of the key determinants in the context of a non-EEA manager's ability to market a non-EEA fund within Europe will be whether information exchange arrangements are in place between the jurisdiction (i.e. Member State) in which the marketing takes place and the jurisdiction in which the fund manager and the fund itself are established. The information exchange arrangements that the FCA has entered into can be found at https://www.esma.europa.eu/document/aifmd-mous-signed-eu-authorities – updated, but this includes all of the primary fund jurisdictions including the British Virgin Islands, the Cayman Islands, the Channel Islands and the United States.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

There are a wide variety of fund vehicles available in the UK. Certain of these are only available for retail funds, such as the authorised unit trust and the open-ended investment company. Others, such as the investment trust company, are likely to be used for closed-ended structures implementing a traditional investment strategy.

However, a private fund domiciled in the UK and implementing an alternative investment strategy will usually take one of two forms. Closed-ended private funds (in particular, those investing in asset classes such as private equity, real estate and infrastructure) are most commonly structured as limited partnerships. This is a form of partnership governed by statute under the Limited Partnerships Act 1907 ("LP Act"). In April 2017, the LP Act was the subject of extensive reform by the UK Government in respect of private funds by way of the Legislative Reform (Private Fund Limited Partnerships) Order 2017 ("PFLP Order"). The reforms have been introduced with a view to simplifying the pre-existing law, reducing uncertainty and administrative costs and burdens, and ensuring that the UK remains an attractive and competitive location for private funds in comparison to other jurisdictions. The reforms apply only to a limited partnership that is "designated" as a Private Fund Limited Partnership ("PFLP"). The new regime is not mandatory: it is open to a limited partnership that satisfies the conditions to be a PFLP to choose not to apply to be designated as a PFLP, in which case the pre-existing limited partnership will apply.

In common with other jurisdictions, the limited partnership (including the PFLP) will have one or more general partners and one or more limited partners. The general partner is responsible for the management of the limited partnership (although whether it fulfils this role will largely depend on the regulatory issues described above), but has unlimited liability for the debts and obligations of the partnership over and above the partnership assets. Conversely, the liability of a limited partner will be limited to the amount of capital it contributes to the partnership (and, in the case of PFLPs, there is no requirement for a limited

partner to make a capital contribution), provided such limited partner takes no part in the management of the partnership: to the extent the limited partner does take part in management, it will be treated as a general partner and will lose the protection of limited liability. The LP Act contains a white list of matters ("White List") which limited partners of a PFLP can take part in without jeopardising their limited liability status. A limited partnership (including a PFLP) registered in England & Wales does not have any legal personality separate from its partners and is not a body corporate.

One of the fundamental attractions in the UK of a limited partnership structure for private closed-ended funds is that the limited partnership is a flexible vehicle in terms of internal governance and control. The constitutional document (the limited partnership agreement) is a freely negotiable document between the fund manager and the investors.

The statutory framework in the UK requires that a limited partnership is registered as such. This entails providing an application for registration to the Registrar for Limited Partnerships, providing certain details including the name of each limited partner and the amount of capital contributed by each limited partner. Any changes to these details during the continuance of the limited partnership must be similarly registered within seven days of the relevant change. There are also formalities that must be followed on assignments of limited partnership interests, such as advertising the transfer in specific publications. In respect of the new PFLP regime, either a new or an existing limited partnership may choose to apply for PFLP status if it fulfils the criteria to qualify as a PFLP. Unlike limited partnerships, there is no obligation to provide details of the partnership's general nature, capital contribution amounts or term of the partnership (or to notify of any changes to such details).

It is also possible for a private closed-ended fund in the UK to be structured as a unit trust. The English law concept of a trust has no equivalent in some other jurisdictions. It is a structure under which title to the fund's assets is held by a person with legal personality (the trustee) for the benefit of the fund's investors (the beneficiaries). The document constituting the trust (the trust deed) governs the relationship between the trustee and the beneficiaries and, in addition, strict fiduciary duties are owed by the trustee as a matter of law.

As noted above, although the UK is the primary European hedge fund centre, the usual hedge fund structure will generally not include the actual hedge fund being domiciled in the UK, because to set up the fund on-shore would lead to tax inefficiencies since the fund would be treated as "trading" rather than "investing" for UK tax purposes. Instead, hedge fund structures will invariably include a company or limited partnership established in an off-shore jurisdiction.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

In respect of funds structured as limited partnerships, under statute the liability of a limited partner for the debts and obligations of the partnership is limited to the amount of capital it contributes to the partnership, subject always to the caveat that the investor does not become involved in the management of the structure.

This does not relieve the investor of its contractual obligation to advance money, and therefore Alternative Investment Funds operating "just-in-time" drawdown structures will be able to draw the full amount the investor has committed to advance to the fund, notwithstanding the statutory limitation on liability. The UK limited partnership will generally be structured so that the commitment of investors comprises a nominal amount of capital contribution, with the balance being advanced by way of a loan. This structure should avoid amounts distributed to investors being subject to return in the event of the insolvency of the limited partnership.

The other fund vehicles available will provide for the limited liability of investors, such that they will not be required to contribute more than the amount which they have committed to invest in the fund.

In respect of PFLPs, as there is no requirement for a limited partner to contribute any capital, the entire funding to be contributed by a limited partner in a PFLP can be in the form of capital which can be contributed and repaid at any time without affecting the extent of the liability. This removes the need for the capital/loan split described above.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

There are no formal requirements as to the legal structure used for managers and advisers of Alternative Investment Funds. However, the two most common structures seen in the market are the private limited company and the limited liability partnership (LLP). LLPs have been seen as the preferred structure for asset managers for some time now, as they offer the tax transparency of a traditional partnership whilst giving limited liability to the members of the LLP. Although an LLP is a body corporate, it is inherently a more flexible vehicle than a limited company and therefore can be adapted to suit the particular circumstances of the fund manager's business and preferred governance structure. Since April 2016, LLPs (together with UK unlisted companies) are subject to a new requirement to maintain a register of people with significant control; such register is to be available for public inspection at their registered offices.

Historically, each member of an LLP has been treated as being self-employed for tax purposes. This has meant that LLPs have not needed to pay employer's national insurance contributions ("NICs") on the remuneration of members, and it has also kept members of an LLP outside of the UK employment-related securities ("ERS") legislation.

Since the introduction of the "salaried member" rules in 2014, however, the position is no longer quite so straightforward. Under these rules, a member of an LLP will be treated as an employee if, broadly: (a) at least 80% of the amount payable by the LLP for the services they perform for it is "disguised salary" (broadly, remuneration which is not dependent on the firm's profitability); (b) they do not have "significant influence" over the LLP's affairs; and (c) they make a capital contribution to the LLP which is less than 25% of their annual "disguised salary". If a member meets all three conditions, they will be deemed to be an employee for income tax and national insurance contribution purposes (such that the LLP will need to pay employer's NICs on their remuneration and the member will be brought within the scope of the ERS legislation).

In addition, employees remain outside of the scope of the income based carried interest rules (see question 6.2), whereas self-employed LLP members must consider the potential application of these rules to their carried interest returns.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Generally, there are no statutory or regulatory limitations on the ability of managers of private funds to restrict redemptions or transfers in either open-ended or closed-ended funds, although contractual restrictions may be imposed.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no legislative restrictions on the transfer of investors' interests. However, in the case of UK limited partnerships, certain filing requirements will need to be met, and details of the transfer advertised, before it is deemed to be effective. These filing requirements do not apply to PFLPs.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The AIFMD provisions relating to the asset stripping have been transposed into UK legislation. The provisions covers situations where an AIF managed by an AIFM subject to full authorisation holds a significant proportion of the shares in, or acquires control of, a private company or an issuer of traded securities, imposing requirements relating to the provision of information to the company or issuer, shareholders, employers and employees. The provisions also contain restrictions on distributions, capital reductions, share redemptions and acquisitions by companies or issuers of their own shares for two years after the AIF acquires control.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Following the implementation of AIFMD, marketing has become one of the more difficult issues a manager of Alternative Investment Funds has to grapple with, as managers need to consider both domestic and pan-European legislation. Marketing restrictions are imposed by AIFMD and the Delegated Regulation. UK AIFMs wishing to market a UK AIF or EEA AIF to retail or professional investors in the UK are required to apply to the FCA to do so. The FCA permits the marketing of a private fund to a wider group of participants than the category of "professional investors" referred to in AIFMD, provided the financial promotion rules referred to at question 3.2 below are complied with throughout the entire marketing process.

The Omnibus Directive will amend the existing regimes for cross-border marketing of AIFs and UCITS, and the Omnibus Regulation will introduce new standardised requirements for cross-border fund distribution in the EU.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

Under domestic legislation, there are limited content requirements applicable to marketing materials, although there is an overarching obligation to ensure that marketing materials are "clear, fair and not misleading". AIFMD has changed the rules somewhat by including prescribed pre-investment disclosures which must be made to prospective investors. Whilst many of these disclosures (set out in Article 23 of AIFMD) are largely consistent with information that has historically been included in marketing materials for private funds, there are specific components of the disclosure regime which were either new or enhanced the level of detail previously provided.

The requirements of the EU Prospectus Regulation which catch "offers to the public" will generally not apply to the marketing of Alternative Investment Funds on the basis that the requirements can be avoided if, the total consideration of offers in the EU, calculated over a 12-month period, is between EUR1 million and EUR8 million (with Member States having the ability to set their own national threshold within these limits). The EU Prospectus Regulation will also not catch open-ended vehicles, so most hedge funds, for example, would not be caught in any event.

The Omnibus Regulation will introduce new requirements for all marketing communications made to investors by an AIFM. These communications must: (i) be identifiable as marketing communications; (ii) be fair, clear and not misleading; and (iii) present risks and rewards of producing units or shares of an AIF in an equally prominent manner.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Outside of AIFMD, there is no requirement to register marketing or legal documentation with the FCA. However, an AIFM must submit certain marketing information to the FCA 20 working days prior to marketing and must obtain pre-clearance for any material planned changes to the information provided (the AIFM must give at least one calendar month's notice of the changes). Material unplanned changes must be notified to the FCA immediately. The notification must include a declaration from the AIFM that the management of the AIF complies with the relevant conditions in the UK AIFM Regulations. Since September 2019, notifications must be submitted by the AIFM using the FCA's online system, Connect. AIFMs using the online system for the first time must therefore allow for the time taken to set up its online account with the FCA.

The Omnibus Regulation will empower national regulators in EU Member States to require notification of marketing communications which: (i) UCITS managers intend to use directly or indirectly in their dealings with investors; and (ii) AIFMs intend to use directly or indirectly in their dealings with retail investors (within the MiFID II definition).

3.4 What restrictions are there on marketing Alternative Investment Funds?

For the purposes of AIFMD, marketing is a direct or indirect offering or placement at the initiative or on behalf of the AIFM to or with investors domiciled within the EU. This is a narrower concept than that of a financial promotion under domestic regulation, which is an offer or inducement to engage in investment activity. The FCA has provided guidance on when it considers an AIFM to be marketing in the UK; neither pre-marketing (as detailed at question 3.5 below) nor reverse solicitation will be regarded as marketing. In respect of reverse solicitation, the FCA guidance states that a confirmation from the investor that the approach was made at its own initiative should be sufficient to rely on this approach. The guidance, however, also states that it must be received prior to making the offer or placement. In addition, "marketing" does not include general public statements, the issuance of capital calls or secondary trading.

From 22 July 2014, an authorised AIFM is able to market to professional investors only on the basis of the AIFMD passport.

Marketing by small AIFMs (i.e. sub-threshold firms) will be subject to a lighter-touch regime; broadly, UK small AIFMs will be able to market all sub-threshold AIFs in accordance with the domestic financial promotion regime.

Off-shore managers of off-shore Alternative Investment Funds may market into the UK on the basis of the financial promotion regime. However, they will be required to comply with the transparency and (if relevant) private equity disclosure requirements imposed under AIFMD.

Finally, the Omnibus Directive will insert a new provision into AIFMD to clarify the circumstances where an AIFM will be considered to have ceased marketing in a Member State. Specific rules will govern a "de-notification" of marketing in EU jurisdictions for EU AIFMs – except in the case of closed-ended AIFs they must make a blanket offer to repurchase units from investors and in all cases re-activation will be restricted.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

In its guidance, the FCA has stated that pre-marketing is not regarded as constituting marketing by an AIFM for the purposes of AIFMD. The pre-marketing will be permissible where it is based on draft documentation and the offer document, or other information, is not sufficiently detailed to enable the recipient to make an investment decision or submit a subscription request; for example, a pathfinder document should not amount to marketing. The Omnibus Directive will, however, for the first time, introduce a new definition of "pre-marketing" into AIFMD. The intention of the proposal is that if a promotional activity does not fall within the definition of "pre-marketing", it should be treated as "marketing". These new requirements mean that the circulation of draft offering documents (e.g. draft versions of a limited partnership agreement) will constitute AIFMD marketing. EU AIFMs will be required to send an "informal letter" to their home State regulator notifying it of the pre-marketing within two weeks. This will be a significant change from the current approach in the UK.

Pre-marketing activities will be subject to the UK's financial promotion regime. Under FSMA, the communication of financial promotions is restricted. Generally, financial promotions are permitted if they are made or approved by an entity authorised by the FCA. However, in the context of unregulated collective investment schemes (which will catch most private funds), there are further restrictions which limit even the scope for authorised persons to make financial promotions.

Units in unregulated collective investment schemes will, to the extent made by an entity which is not authorised by the FCA, need to be marketed in accordance with the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("FPO") or, to the extent made by an entity which is authorised by the FCA, need to be marketed in accordance with either the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) Order 2001 or the provisions of the conduct-of-business rules contained as a component part of the FCA Rules.

3.6 Can Alternative Investment Funds be marketed to retail investors?

AIFMD effectively leaves the question of marketing to retail investors to the discretion of Member States (although this is subject to change, as detailed below). The UK has retained provisions which allow marketing to retail investors. If an AIFM is permitted to market to professional investors, it can also market to certain types of retail investors (effectively qualifying high-net-worth or sophisticated investors), provided it does so in accordance with the UK financial promotion regime.

The financial promotion regime has changed recently with the effect that, where the promotion is being made in accordance with the conduct-of-business rules contained in the FCA Rules, in addition to the investors having to fall within the terms of the exemptions themselves, the issuer of the financial promotion must undertake a suitability assessment to ensure that the investment is appropriate for the prospective investor. This suitability assessment needs to be undertaken prior to the point at which the financial promotion is issued.

The Omnibus Directive will insert new requirements into AIFMD where any AIFM is marketing to retail investors. The AIFM will be required to put in place "facilities" in the relevant Member State that must perform certain tasks. As the definition of "retail investor" is as defined in MiFID II, this will include investors such as high-net-worth individuals or local authorities who cannot be opted-up to MiFID professional status.

From 1 January 2018, alternative investment funds being made available to retail investors must also provide a standardised, short disclosure document – a key information document ("KID") – to investors under the PRIIPS Regulation. The KID must comply with certain detailed technical standards.

3.7 What qualification requirements must be met in relation to prospective investors?

There are no "across the board" qualification requirements which apply in relation to prospective investors, although certain bases on which marketing is made under the financial promotion regime (or, where applicable, AIFMD) will require an analysis of the circumstances of the prospective investor.

AIFMD introduces a passport which facilitates marketing to professional investors on a pan-European basis. For the purposes of AIFMD, a professional investor is one who could be so regarded under MiFID. Although most institutional investors are likely to be professional investors *per se*, it may prove difficult to opt people into professional status (it is a higher bar than most UK managers are used to). Investors who are not professional investors will be retail investors.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

Under MiFID II, from January 2018, local government pension schemes ("LGPS") are classified as retail investors which can lead to certain additional restrictions on marketing and distributing interests in such schemes. Following lobbying by the industry, however, LGPS are able to utilise a standardised opting-up procedure, such that LGPS can be opted-up to an elective professional status in a relatively straightforward manner.

There are no additional restrictions to those which otherwise apply under the financial promotion regime.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

Under the current legislative and regulatory regime, there are no firm restrictions on the participation in Alternative Investment Funds – however, there may be regulatory capital costs to financial institutions in respect of their investment positions.

Under AIFMD, AIFMs are limited in terms of the additional activities they are able to undertake, and therefore certain financial institutions may need to restructure their operations to ensure that they are compliant with the provisions of AIFMD.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

There are no restrictions on the use of intermediaries, although if the intermediary is itself carrying on regulated activities for the purposes of the UK regulatory regime, it will need to be authorised by the FCA.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Generally speaking, there are no restrictions, although the fund manager will need to ensure that the activities it is carrying out in respect of the Alternative Investment Fund are consistent with the scope of permission it has to carry out regulated activities (and with the contractual investment policy of the Alternative Investment Fund).

However, AIFMD does impose certain restrictions relating to asset stripping, as described at question 2.6 above.

In addition, although not restrictions, there are certain deal disclosure requirements under AIFMD. In this regard, an AIFM must notify the FCA when an AIF's voting interest in an unlisted company passes through certain thresholds. There are additional disclosure obligations when an AIF acquires "control" of an EU company (the test as to control varies according to whether the investee company is listed or unlisted). Investments by an AIF may also trigger a requirement to make certain information available to the FCA, the investee company and remaining shareholders (including, for unlisted companies, intentions as to the company's future business and the likely repercussions on employees). In the context of unlisted companies, relevant information must be passed to employee representatives (subject to limited exceptions).

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

There are no such limitations.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

There are no such limitations.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

In the context of private funds, there are currently no statutory or regulatory limitations on borrowing, although contractual restrictions are common. In the context of AIFs covered by AIFMD, certain of the pre-investment disclosures relate to the use of leverage. In particular, an AIFM must disclose: the circumstances in which the AIF may use leverage; the types and sources of leverage permitted and the associated risks; any restrictions on the use of leverage and any collateral and asset re-use arrangements; and the maximum level of leverage the AIFM is entitled to employ on behalf of the AIF.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

Alternative Investment Funds structured as limited partnerships will need to comply with the registration requirements under the 1907 Limited Partnerships Act. Limited partnerships designated as PFLPs need only disclose basic details (essentially the fund's name and address). There may be a requirement on the general partner of a UK limited partnership to file the partnership's accounts on the basis of the Partnership Accounts Regulations.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

From July 2017, fund houses that have any Scottish limited partnerships ("SLPs") in their fund structures (commonly used as feeder and carry vehicles) need to make filings under the Persons of Significant Control ("PSC Regime"). The PSC Regime also applies to SLPs designated as private fund limited partnerships, registered under the Limited Partnerships Act 1907. Failure to comply with the PSC Regime requirements carries criminal penalties. The PSC Regime has applied to LLPs since April 2016. English limited partnerships are not affected by these changes and remain outside the scope of the PSC Regime.

The PSC Regime requires SLPs to deliver to Companies House information relating to people with significant control ("PSCs") in relation to the SLP. The rules are complex but, in broad terms, a SLP's PSCs could include its general partner, any manager/operator and any limited partner whose interest in the partnership represents more than 25% of total interests.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

AIFMD and the Delegated Regulation require AIFMs to comply with a range of detailed regulatory reporting obligations. Reporting obligations also apply to non-EEA AIFMs seeking to market their funds under national private placement regimes.

Broadly, AIFMs will be required to make periodic reports to the FCA in accordance with AIFMD using a set of prescribed forms set out in the Delegated Regulation and in line with ESMA's final guidelines. The EMSA guidelines, published in November 2013 and finalised in August 2014, were accompanied by a number of electronic reporting templates in XML format, together with guidance on the preparation of systems capable of generating XBRL reports. In addition to the annual reports in respect of each managed AIF, an AIFM will need to provide periodic reports relating to the AIFM itself and in respect of each AIF that it manages (including information in relation to investment strategies, main instruments traded, principal exposures, risk profiles and (where relevant) leverage).

The FCA has published various guidance papers and Q&As on periodic reporting, setting out what information is required and how, and when, it should be reported. The FCA has an online reporting system, GABRIEL, which assists UK AIFMs with meeting their requirements.

The UK government has indicated, as part of reforms to the UK limited partnerships regime, that it will introduce a requirement for an annual confirmation statement to be filed, confirming that all information on the register at Companies House is correct. A transitional period will be included for existing limited partnerships to provide additional information to cover all relevant requirements. An original proposal made in April 2018 to require limited partnerships to file annual reports and accounts has been dropped and replaced by the less onerous requirement for an annual confirmation. In terms of timing, the UK government has only committed to introducing legislation "when parliamentary time allows".

5.4 Is the use of side letters restricted?

There are no firm restrictions on the use of side letters. However, AIFMD requires disclosures as to how an AIFM ensures the fair treatment of investors and, if side letters are used to provide preferential treatment to investors, a description of the preferential treatment and the type of investors to whom the treatment is made available will need to be disclosed. If the AIFM operates a general most-favoured nations ("MFN") mechanism, this is unlikely to be an issue; however, if no or a limited MFN process is in place, an AIFM will need to consider its use of side letters in the light of the disclosure requirements under AIFMD.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

UK limited partnerships are not taxable entities for UK direct tax purposes (although they do submit tax returns) and are instead fiscally transparent. This fiscal transparency means each limited partner is treated for UK tax purposes as owning its proportionate share of the assets of the partnership and is subject to tax on the income and gains allocated to it under the limited partnership agreement (whether or not they are distributed).

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

The tax treatment of the manager or adviser will depend on whether it is constituted as a company or an LLP. If a company, it will be subject to corporation tax on the fees paid by the fund (at 19%). The management team takes its remuneration in the form of salary (taxed at the highest applicable income tax rates, with national insurance contributions due too) and the excess profit can be extracted as dividend income. If the manager is an LLP, it is fiscally transparent, so the profit arising from the fees paid to the manager is automatically taxed in the hands of its members. As noted above, the salaried member rules will be used to ascertain whether a member should be taxed as a self-employed person or an employee. The apparatus of an LLP is likely to mean that it constitutes a UK permanent establishment of its non-resident members such that all of the members, regardless of where they are resident, must pay UK tax on their share of the LLP's profits arising from its UK trade as an investment manager/adviser.

Under anti-avoidance rules introduced in 2015, amounts arising to an individual involved in fund management are taxed as trading income, unless such amounts are already taxed as trading income or employment income or fall into exceptions for carried interest or co-investments. Where amounts from the fund arise to another person – such as a priority profit share/fee income arising to the general partner or manager – these amounts can be potentially imputed to the individual fund managers and taxed in their hands if certain conditions are met.

In terms of funds structured as limited partnerships, where the general partner appoints a manager to manage the partnership, the fee payable to the manager will in principle attract value-added tax ("VAT"). This is most often managed by ensuring that the manager and the general partner are in the same VAT group. The Court of Justice of the European Union ("CJEU") in the *Fiscale Eenheid X* case (C-595/13) outlined broad criteria for what constitutes a "special investment fund" ("SIF") for the purposes of the VAT exemption applicable in relation to SIF management services. It was also strongly suggested by the CJEU that AIFs which satisfy certain qualification criteria can be SIFs. This is a changing area of law and, in March 2020, the UK government announced that it would undertake a review of the VAT treatment of fund management fees. It is therefore possible that the UK's current position on the VAT treatment of management services supplied to AIFs, which satisfy the relevant SIF criteria, will change.

The UK is not typically used as a domicile for hedge funds, but it is a popular location for investment managers of hedge funds, and this is in part because of the Investment Manager Exemption ("IME"). Provided certain conditions are met, the IME ensures that a UK investment manager managing a non-UK fund will not constitute a permanent establishment of the fund in the UK. The IME enables a non-UK resident fund that is trading for UK tax purposes to appoint a UK-based investment manager without the risk of that part of the fund's profit that is attributable to the activity of the investment manager in the UK becoming subject to UK tax.

The UK rules on the taxation of carried interest have been subject to significant change since 2015 and the general "tax transparency" principle is now overlaid with: (i) a minimum charge of 28% for carried interest (compared with 20% for most other types of gains); and (ii) new rules which can recharacterise carried interest receipts as trading income, taxable at the highest marginal rates, where the fund in question has a short average holding period (the "income based carried interest" rules, or "IBCI"). The IBCI rules are complex, but broadly, where the average holding period of fund investments is less than 36 months, the carried interest returns will be treated as trading income. Where the average holding period is 40 months or more, the returns will be treated as investment gains or income. Where the average holding period is at least 36 months and less than 40 months, the returns are treated as a mix of investment return and trading income. There is an exception from the IBCI rules for carried interest awarded to employees. The new rules do not affect the taxation of the fund itself or external investors.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There are no establishment taxes levied in connection with an investor's participation in an Alternative Investment Fund. Stamp duties may be payable on the transfer of limited partnership interests if the partnership property includes stock or marketable securities, although there are a number of methods of mitigating the effect of such taxes. Stamp duty land tax may be payable where the partnership property includes land.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

The use of tax-transparent limited partnerships as the primary vehicle for Alternative Investment Funds means that income and gains received by the fund are treated as if they had been received by the fund's investors directly. The taxation of the returns depends on whether the fund is treated as trading or investing.

The question of whether or not a fund is carrying on a trade in the UK is largely a question of fact. In practice, this is determined by applying various criteria derived from case law – often referred to as "badges of trade" – to a fund's transactions. For example, churning investments and investing and divesting opportunistically would be likely to be indicative of a trading activity, whereas holding long for income and capital would be more likely to be considered as an investment activity.

Private equity funds (the main users of the limited partnership structure) usually intend to buy and hold securities for the medium to longer term in order to achieve long-term capital appreciation. Consequently, they are more likely to be considered as investing rather than trading.

If the limited partnership is treated as investing then, as a result of its tax transparency, profit distributions from the limited partnership retain their character as capital gains or investment income and are taxed accordingly. The tax payable by a particular investor will depend upon its own tax profile. For example, if the fund receives dividend income, this would be taxed in the hands of a UK-resident individual but a UK pension fund investor should not be subject to UK tax on such investment income. Most non-resident investors will only be subject to UK tax on UK-source investment income to the extent that it is subject to withholding tax. Withholding taxes are potentially relevant to both UK interest and UK rental income (but generally not dividends), but there are reliefs from withholding. Generally, non-resident investors should not be subject to UK tax on capital gains unless: (i) they hold their interest for the purposes of a UK trade; or (ii) they fall into specific rules relating to UK property (and property related) holdings (see below).

If the limited partnership is treated as trading for UK tax purposes, UK resident investors and non-UK resident limited partners will be subject to income tax (or corporation tax on trading income) on their share of the partnership's trading profits. This will be of particular concern for UK pension fund investors (who are only exempt from UK tax on investment income and gains). Non-UK resident investors will be caught because the partnership (or the fund manager) will constitute a taxable presence in the UK through which the non-resident is carrying on a trade, but in many cases the IME may be applicable.

The UK regime for taxation of gains arising to a non-resident from interests in UK land has expanded in scope significantly from 6 April 2019. Before that date, the UK only taxed non-residents on gains from UK residential property (subject to important exemptions in the context of investment funds). Broadly, the general position is now that non-resident investors are subject to tax on gains arising from disposals of UK land and also on the disposal of substantial interests in relevant entities that derive at least 75% of their market value from UK land. However, the general position is significantly modified by complex specific provisions relating to collective investment vehicles.

Investors should also be aware of the annual tax on enveloped dwellings ("ATED") and this should be considered carefully when a fund invests in UK residential property.

Where a UK limited partnership receives income from non-UK jurisdictions that levy withholding tax, or receives capital proceeds from the sale of an asset situated in a jurisdiction which might tax that gain, then limited partners may seek to rely on the terms of a double tax treaty in order to obtain relief. Whether such relief is available will depend, in part, upon whether that non-UK jurisdiction treats a UK limited partnership as fiscally transparent.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

Generally speaking, it is not necessary to obtain tax rulings prior to establishing an Alternative Investment Fund.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

The UK entered into a Model 1 Intergovernmental Agreement ("IGA") with the US in September 2012 in relation to FATCA and subsequently introduced domestic legislation to implement FATCA reporting. Relevant Alternative Investment Funds established in the UK therefore have to carry out the required due diligence procedures and report prescribed information about relevant investors to Her Majesty's Revenue and Customs.

In addition, the Organisation for Economic Co-operation and Development ("OECD") Common Reporting Standard for Automatic Exchange of Financial Account Information ("CRS") and the EU Directive on Administrative Cooperation in the Field of Taxation ("DAC") have also been implemented into UK law. In relation to the DAC, the UK legislation implementing the provisions of the directive relating to mandatory automatic exchange of information in relation to reportable cross-border arrangements (often called "DAC 6") is due to come into force in the second half of 2020. This legislation will be retrospective in that it will require the reporting of arrangements the first step in the implementation of which was made on or after 25 June 2018.

Accordingly, UK funds will need to consider these information reporting rules in order to ensure that they are compliant.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Following the publication of the OECD's final BEPS reports on 5 October 2015, the UK has taken the lead in the development and implementation of new rules relating to BEPS. For example, legislation having effect from 1 January 2017 was introduced in order to neutralise the effect of hybrid mismatch arrangements and legislation to restrict the tax deductibility of corporate interest came into force from 1 April 2017. In addition, the UK has implemented Country-by-Country Reporting.

The UK signed the multilateral instrument ("MLI") in June 2017 and it entered into force for the UK on 1 October 2018. As expected, the UK has adopted the principal purpose test in relation to its covered treaties, but has not narrowed its definition of

an independent agent or extended the definition of permanent establishment, other than adopting the provisions which prevent a permanent establishment being avoided by means of the fragmentation of activities.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

If there is appetite to establish a listed fund, then a UK investment trust ("ITC") (or real estate investment trust ("REIT")) should be considered. Provided certain conditions are met, ITCs are exempt from corporation tax on capital gains, can benefit from the general corporation tax exemptions from dividend income and can potentially deduct dividends paid to investors which represent interest income from their interest receipts.

Provided certain conditions are met, REITs are exempt from corporation tax on the income profits of their property rental business and on gains arising on disposals of assets used in such business (potentially including interests in certain entities that are UK real estate rich) and can benefit from the general corporation tax exemptions from dividend income.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

The tax position of an investor in a UK Alternative Investment Fund will inevitably depend upon its own tax profile – accordingly investors should always seek independent advice on the tax implications of participating in the fund, and managers should advise investors of this fact.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

In March 2020, the UK government announced that it would undertake a review of the UK funds regime, including from a tax perspective. The review includes a consideration of whether UK holding companies utilised by investment funds could be more attractive from a tax perspective. However, the review process is in its early stages and no specific tax changes have been announced at this stage.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

The UK left the EU on 31 January 2020. The UK now has a transitional period until 31 December 2020 in which to agree a deal with the EU on the future relationship. During the transition period, the revised withdrawal agreement provides that the UK will continue to be treated as an EU Member State.

The UK would continue to implement new EU investment funds legislation which takes effect during that time. This means that the UK may potentially be required to implement some very significant measures which are currently being negotiated, including resultant legislation from the upcoming reviews of the AIFMD and the PRIIPs regime, in addition to the Omnibus Directive and Omnibus Regulation.

Funds should not abandon their efforts to prepare for a no-deal Brexit outcome. Those most affected by a no-deal Brexit would be UK full-scope AIFMs relying upon a managing or marketing passport. As the UK will immediately become a third country in the event of a no-deal Brexit, these AIFMs will no longer be able to rely upon passporting regimes and will instead only be able to market under NPPR. Full-scope AIFMs established in other EEA Member States would no longer be able to manage a UK AIF or to market to UK investors under the AIFM passport in the event of a no-deal Brexit. To address this, the FCA has proposed a temporary permissions regime. Sub-threshold AIFMs will not be affected to the same extent as full-scope AIFMs; having never had access to the AIFM directive passport, they will continue to market under the NPPR. Similarly, non-EEA AIFMs would also continue to market under NPPR.

The London Interbank Offered Rate ("Libor") is expected to be discontinued by the end of 2021 and there has been increased pressure from the regulators (including the FCA) to ensure that market participants cease to use this benchmark well in advance of this date. Most funds are likely to be affected by the Libor discontinuation; funds might use Libor as benchmark or performance targets, and its administrators, managers and custodians as an input to their valuations and risk assessments. Also, Libor might feature across a fund's investments, as it is commonly referenced in funding arrangements, interest rate derivatives transactions, as well floating rate notes and securitisations.

The Omnibus Directive and Omnibus Regulation, which will make a number of direct amendments to AIFMD regimes entered into force on 1 August 2019. The majority of the Omnibus Regulation applies as from 2 August 2021 and Member States must also implement the Omnibus Directive as from that date. By August 2021, the UK will no longer be a member of the EU and (unless extended) the EU withdrawal transitional period will have ended. It therefore remains to be seen to what extent UK fund managers will be affected, at least directly. To the extent that the regime amends the operation of the EU cross-border fund marketing passport regimes, the UK may simply decide to revoke the directly applicable Omnibus Regulation. It is possible, however, that even with such a revocation and no implementation of the Omnibus Directive, there may nonetheless be legislation "onshoring" certain aspects of the regime into the UK. At the very least, UK and other non-EU fund managers may find that they are affected by consequential amendments that individual EU Member States may decide to make to their national private placement regimes.

The AIFMD contains provisions requiring the European Commission to start a review of the application and scope of AIFMD by 22 July 2017. Following its review, the Commission is permitted to propose appropriate legislative amendments to AIFMD to address any identified issues – such revisions are commonly referred to as "AIFMD 2". For the purposes of assisting in the review, the Commission appointed KPMG to conduct the market study and impact assessment. In January 2019, the firm's report on the operation of AIFMD was published. The report represents the first step in the Commission's review process. It will continue its review and said in its press release accompanying the publication of the report that it will report to the European Parliament and the Council "next year" – i.e. 2020. The timeline for any subsequent legislative proposals therefore remains uncertain for the time being and any concrete changes that may result and impact upon firms is (compared to other things) likely to be some considerable way off.

The senior domestic managers and certification regime (SMCR), which previously only applied to UK banks, was extended in December 2019 to include all non-bank firms, including UK fund managers, authorised under the Financial Services and Markets

Act 2000. The aims of the regime are to ensure greater clarity about the responsibilities of senior individuals within firms, as well as greater individual accountability. However, there is a one-year transitional period as regards certain aspects of the regime so that firms have until 9 December 2020 at the latest to: (i) complete their fitness and propriety assessments; (ii) to train all those employees (other than ancillary staff) who are not Senior Managers or Certification Staff, but who are nonetheless within the scope of the relevant conduct rules; and (iii) to upload via Connect all the data about individuals that they are required to provide for the purposes of the FCA's new Directory. In response to the COVID-19 pandemic, in April 2020 the FCA published its expectations of firms in complying with their SMCR obligations.

As to English limited partnerships, the introduction of the PFLP regime has been welcomed as a positive step and should allow the UK to compete with other similar vehicles offered in other jurisdictions. Further (relatively minor) reform proposals for all UK limited partnerships are to be introduced following a response paper published by the UK government in December 2018. The proposals are designed to build in effective controls into the life cycle of a limited partnership to combat such vehicles being used for illegal activities. At the time of writing, no draft legislation has been published, with the government only committing to legislation "when parliamentary time allows".

Since January 2018, the PRIIPs Regulation has required that retail investors are provided with a standardised, short disclosure document containing key information about the product (the Key Information Document or "KID") where it is made available to them in the EU. Consequently, many manufacturers of the types of funds who have routinely been targeted at the professional market in the past are likely to have tightened up on measures designed to ensure that distribution does not reach any retail investors. A consultation on possible changes to the PRIIPs Regulation, most notably to the contents of the Key Information Document, was published by the European Supervisory Authorities ("ESAs") in 2019 and closed in January 2020. The ESAs are expected to submit their final proposals to the European Commission during the first half of 2020.

In July 2019, the UK government launched its "Green Finance Strategy", which aims to create a greener financial system which supports cleaner and more environmentally sustainable investment and growth. The government intends that climate and environmental factors be fully integrated into mainstream financial decision-making across all sectors and asset classes. The initiative is still in its early stages but is likely to have an impact on AIFMs in the future.

In short, practitioners within the industry will need to ensure that they keep abreast of developments and consider whether they should be engaging with the industry in lobbying to try and ensure that any proposed regulatory excesses can be curbed.

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The Travers Smith LLP funds department comprises four partners and 15 other dedicated fee earners, based in London. The group focuses on funds, investors and intermediaries in the private equity, infrastructure, debt, real estate and listed equities sectors. It has constantly been at the forefront of developing market practice and thought on relevant changes for the investment funds industry, including the European Alternative Investment Funds Managers Directive and, more recently, the potential impact of Brexit. The funds tax group advises on the structuring of investment funds to maximise their tax efficiency for investors and managers. The funds department sits alongside the firm's market-leading private equity M&A practice, one of the largest transactional teams of private equity lawyers in the City. The funds finance practice combines expertise from the firm's fund formation and finance practices to advise lenders that provide subscription line and other facilities to real estate funds. Travers Smith also advises real estate funds on the borrower side. The funds department is best known for advising private funds and closed-end listed funds.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The establishment and operation of alternative investment funds is governed by the *Kapitalanlagegesetzbuch* – KAGB, which is the Alternative Investment Fund Manager Directive – AIFMD transposition legislation in Germany introduced in 2013.

Certain activities in connection with a fund, like solicitation services, are regulated in the MiFID transposition legislation (*Kreditwesengesetz*, *Wertpapierhandelsgesetz*) or additional domestic law like the *Gewerbeordnung*.

In addition, the European legislation like the European Venture Capital Fund Regulation and the European Long-Term Investment Fund (**ELTIF**) regulation apply.

Before the introduction of the KAGB, it was possible to establish and operate closed-ended AIFs without triggering regulation in Germany.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Following the AIFMD, it is required to register or license an alternative investment fund manager. Germany provides for a small-AIFM regime with stricter requirements than the AIFMD.

Advisors do not *per se* fall under the KAGB as long as they do not perform outsourcing services, but investment advisory services may fall under the *Kreditwesengesetz* transposing the MiFID rule on such advice into German law.

The supervisory body is in both cases *Bundesanstalt für Finanzdienstleistungsaufsicht* – BaFin.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

AIFs which address also retail investors need several approvals from BaFin to be marketable in Germany.

If the AIFs only address so-called semi-professional and professional investors to qualify as a Spezial-AIF, technically no further steps are required, but BaFin requests a(n) (informal) notification on their raising. Professional investors are defined under the AIFMD. Semi-professional investors are defined under domestic law as sophisticated investors with a minimum commitment of EUR 200,000 (different threshold of EUR 100,000 under European Venture Capital Fund Regulation).

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The KAGB contains substantial distinctions. The definitions open-/closed-ended follow European regulations.

Before the KAGB, the distinction open-ended/closed-ended was decisive on the regulation, as the management of open-ended fund was subject to regulation, whereas closed-ended funds could be managed without regulation.

Nowadays, the distinction matters as it decides:

(1) which regulatory regime the AIFM can be subject to. The small AIFM regime is only available to managers of closed-ended funds. All other funds trigger a AIFM licence under the KAGB; and

(2) the KAGB provides for fund-related product regulation on open-ended funds generally, but only for closed-ended funds addressing also retail investors, whereas closed-ended funds addressing semi-professional and professional investors are minimally regulated if not providing debt.

1.5 What does the authorisation process involve and how long does the process typically take?

The authorisation process on AIFM follows the AIFMD. Although the AIFMD deadline of three months applies, prospective fund managers should consider a duration of the BaFin process of more than three months.

The approval times on AIFs vary as well. The KAGB provides for various deadlines; due to additional demands by and discussions with BaFin, often these deadlines are not met.

1.6 Are there local residence or other local qualification or substance requirements?

The local residency requirements under German follow the AIFMD.

1.7 What service providers are required?

German law does not provide for additional service providers to the AIFMD. A depositary and an external valuer may be required beside an auditor, dependent on the regulatory regime to be applied (exemptions for small AIFMs).

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Funds domiciled in Germany can be managed from abroad following the AIFMD cross-border rules. Germany has transposed these generally following the AIFMD. The regulatory requirements are therefore on a level playing field with domestic fund managers. Please note that in practice these structures are rare due to deficiencies of the German tax system (mainly management fee may be subject to VAT).

The advice to funds domiciled in Germany can be subject to regulation as investment advice (see above).

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

Germany historically has a widespread network of regulatory co-operation or information-sharing agreements with most relevant jurisdictions. In the course of the AIFMD transposition, AIFMD agreements have also been entered into. With some jurisdictions like Mauritius, no agreements exist. For further information, see https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Merkblatt/WA/mb_130722_internat_koopvereinbarungen_kagb_en.html.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

The fund structures vary on open-/closed-ended funds:

Open-ended funds are traditionally arranged as *Sondervermögen* (contractual funds), but can also be arranged as investment stock corporations.

Closed-ended funds are, due to tax reasons, most often structured as limited partnerships. Since 2018, corporate forms are also tax-efficient and may be used in future more often.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

The limited liability is generally ensured by the legal form of the AIFs. The German regulator would not allow legal forms with unlimited liability of investors.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Traditionally, most firms are established as corporations. Regulatory law also allows the use of limited partnerships which are also sometimes used for tax planning reasons.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

The closed-ended fund concept also allows a restriction on transfers (redemptions are typically not foreseen).

Open-ended funds generally provide for a regular redemption right which can only be suspended in limited cases defined in the fund agreement and provided applicable minimal capital requirements are met. Interests in open-ended funds are generally transferable, but certain restrictions can be implemented.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

Yes, the two main restrictions are:

- If a fund qualifies as a Spezial-AIF, the fund agreement needs to contain a transfer restriction to semi-professional and professional investors.
- If a fund qualifies for tax purposes as a *Spezialinvestmentfonds*, a restriction on transfers to individuals needs to be implemented and the number of investors needs to be limited to 100.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The KAGB provides for various requirements on assets to be invested is dependent on the type of the funds which can be categorised as follows:

- Funds addressing also retail investors are subject to detailed asset rules excluding also certain investments.
- The asset allocation rules on open-ended funds focus on ensuring the liquidity of the fund assets and therefore focus on fungible assets and limit other assets. Dependent on the investor and fund status (Spezial-AIF) releases can be agreed.
- Closed-ended Spezial-AIFs are generally flexible on assets beside rules on debt investments.
- Germany introduced detail rules on loan origination which distinguish between open- and closed-ended funds and whether shareholder loans, loan notes or plain loans are issued. Reliefs are granted on secondary loan acquisitions.
- Closed-ended one-asset funds are generally possible, but open-ended funds need to comply with diversification rules.

The KAGB transposed the AIFMD asset stripping rules with the intention of a 1:1 transposition.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The production and offering of marketing materials by the AIFM is governed by the KAGB, which transposes the AIFMD concept on AIFs focused on semi-professional and professional investors. Detailed domestic rules apply on funds which also address retail investors.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

On funds that also address retail investors, detailed rules on fund terms, as well as on the disclosure of the investment strategy and assets, exist. BaFin has issued certain guidance which needs to be adhered to in order to receive approval.

For Spezial-AIFs, the rules are more liberal. Regarding open-ended funds, the documentation follows standards agreed with

the fund industry, whereas for closed-ended funds, a large variety of offering documents can be found in the market. The focus is on disclosure to reduce liability issues.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Documents on funds addressing retail investors also need to be approved for marketing. For other domestic funds with domestic managers, no such approval is required.

Please note that cross-border marketing approvals do not technically require a registration or approval of documents, but the documents are to be provided in the marketing approval application.

3.4 What restrictions are there on marketing Alternative Investment Funds?

The restrictions vary depending on the home jurisdiction and the investors to be addressed. To summarise briefly, the main restrictions are:

- Retail investors: marketing is allowed, but only by licensed AIFMs and it is subject to compliance with the detail retail fund rules.
- Semi-professional and professional investors: Marketing is generally allowed, but full AIFMD compliance may be required on funds addressing semi-professional investors.
- Small AIFMs: No relief for third country AIFMs. EU AIFMs can be approved if their home jurisdiction also allows marketing by small German AIFMs.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

Yes, the concept of pre-marketing is acknowledged by way of guidance issued by BaFin and is also mirrored in the AIFMD amendment to be transposed in August 2021. It is expected that the pre-marketing definition in the German transposition legislation will not deviate from current practice, but certainly further restrictions introduced by the AIFMD amendment are to be considered.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes, but this is subject to restrictions (see above).

3.7 What qualification requirements must be met in relation to prospective investors?

Yes, but this is subject to restrictions (see above).

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

Semi-professional and professional investors need to be identified and documents whereby semi-professional investors also require a constitutive confirmation by the AIFM.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

Besides outsourcing cases, intermediaries should consider whether their services are subject to financial market regulation. Solicitation is generally regulated in Germany.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Banks are subject to the European banking supervisory rules. Germany provides for additional separation rules which in most cases do not apply.

Insurance companies are to asset-related requirements under German insurance regulations and Solvency II.

Many pensions schemes are subject to asset-related requirements under German domestic law (*Anlageverordnung*).

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Generally, AIFs need to restrict their activities to investing. AIFs other than Spezial-AIFs are subject to detailed product regulation. Debt funds can be established subject to certain restrictions (see question 4.3).

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Open-ended funds are subject to diversification rules and also limitations on eligible investments. Closed-ended funds can generally be operated as single asset funds. Retail closed-ended funds are subject to restrictions on eligible assets. Specific rules apply on loan origination.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Following extensive discussions, the regulator acknowledged that the German legislation did not prohibit debt funds from being established in 2015 (BaFin, *Änderung der Verwaltungspraxis zur Vergabe von Darlehen usw. für Rechnung des Investmentvermögens*, 12.5.2015, WA 41-Wp2100-2015/0001). In 2016, legislative amendments were made. On the one hand, these amendments clarified that debt funds can be established, but on the other hand also implemented certain restrictions on open-ended and closed-ended funds originating debt. While open-ended Spezial-AIFs are further not allowed to originate debt other than shareholder loans, closed-ended Spezial-AIFs are generally allowed to originate debt subject to certain limitations (e.g. they are not allowed to issue consumer loans). Retail funds are also limited on their ability to originate loans.

Spezial-AIFs can invest into derivatives subject to certain restrictions, but retail funds are only allowed to consummate such investments for hedging purposes. Please note that German investor regulation imposes substantial restrictions on derivative investments as well.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

The KAGB does not provide for a general leverage limit, but special types of funds like retail closed-ended funds are subject to leverage caps. Also the regulatory status of AIFs and loan originating funds varies in case of leverage.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

AIFMs and the AIFs are subject to the AIFMD reporting and public disclosure requirements.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

Germany has implemented the transparency register pursuant to AML regulations. In addition, limited partners in a limited partnership need to be registered with the commercial register.

In AIFMs, such persons may be disclosed in shareholder lists to be published or via the transparency register.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

German AIFMs and AIFs are subject to the AIFMD reporting and public disclosure requirements. In addition, a report to Bundesbank needs to be made on a monthly basis. Foreign AIFMs and AIFs are subject to the AIFMD reporting requirements.

5.4 Is the use of side letters restricted?

Within the limits of the AIFMD, the use of side letters is not restricted.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

The treatment depends on the legal form of the AIF:

- Partnerships are taxed under the ordinary partnership taxation rules; the fund is generally transparent, but can be subject to trade tax if the fund is seen as trading.
- All other AIFs fall under the Investment Tax Act assuming an opaque treatment of the AIF. The AIF is taxable, but only with a limited number of income items (e.g. German dividends, German real estate-related income). The income is subject to corporate income tax of 15% and under certain conditions also to trade tax.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

A corporation as management or advisory entity is subject to German corporate and trade tax (tax burden up to 33%).

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

No such taxes are levied.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

Funds falling under the Investment Tax Act:

- Resident investors: private individuals are subject to the flat tax on investment income (25% plus solidarity surcharge plus church taxes, all other investors are fully taxable); investors need to calculate based on the minimum tax base (*Vorabpauschale*) and taxation on gross amount of distribution.
- Non-resident investors: not subject to taxation.
- Pension funds: mostly tax-exempt.

Partnerships:

- Resident investors: subject to taxation on income realised from the fund, but there is a tax exemption on potentially achievable capital gains and dividends.
- Non-resident investors: in case of trading activity, they are taxed like German investors; in case of non-trading, German taxation only occurs in limited cases, subject also to treaty protection.
- Pension funds: in case of trading activity, they are taxed like German investors; in case of non-trading, German taxation occurs only in limited cases, subject also to treaty protection.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

The German authorities are issuing rulings, but are restrictive on certain questions.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Germany has concluded a model 1 intergovernmental agreement with the US. CRS was implemented in Germany in 2017.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Germany had already implemented anti-abuse provisions in its treaties and domestic law (BEPS Action 6) and limitations

on avoiding permanent establishment and profit attributions (BEPS Action 7). It is currently revising its tax rules on BEPS Action 2/ATAD I/II.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

No. Please note that certain asset types require diligent structuring to avoid pitfalls.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

The main issue for managers is that management services are not *per se* VAT-exempt.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

The German tax authorities are currently revising the German Foreign Tax Act as part of the ATAD transposition, which may also have a substantial impact on fund and investor taxation. Besides this, there are no concrete plans at the moment, but the German government may tighten the rules for the taxation of investment income and may also limit the German participation exemption further.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

No significant reforms are expected.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Alternative Investment Funds (AIFs) that are offered in Hong Kong are primarily subject to the Securities and Futures Ordinance (SFO) regarding offers of securities ("securities" is widely defined in the SFO including forms of collective investment schemes). Relevant requirements apply to funds to be offered to the public which are subject to authorisation by the Securities and Futures Commission (SFC), and there are also applicable provisions relating to private placement offers including to "Professional Investors" as defined in the SFO.

The conduct of business in regulated activities relating to securities and futures market is subject to potential licensing requirements under the SFO. Persons engaged in the business of offering AIFs are required to be licensed by the SFC to carry on the Type 1 regulated activity of dealing in securities, unless any relevant exemption applies. Hong Kong managers of AIFs are required to be licensed by the SFC to conduct Type 9 regulated activity of asset management, and are thereby subject to regulation by the SFC in conducting its business of managing the AIFs, including applicable requirements under the SFC Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) and the SFC Fund Manager Code of Conduct (FMCC).

AIFs that are marketed or offered to the public in Hong Kong must be authorised by and are subject to the applicable requirements of the SFC, including requirements under the SFC Code on Unit Trusts and Mutual Funds (UT Code). AIFs may be authorised for public offer under the UT Code as "specialised schemes", expressed to cover any scheme whose primary objective is not investment in equities and/or bonds, or any scheme whose features do not meet general requirements of the UT Code on investment restrictions or limits, or which fall under the categories in the UT Code which are regarded as "specialised schemes". AIFs "specialised schemes" may be hedge funds, fund of hedge funds, structured funds or funds that invest primarily or extensively in financial derivative instruments, subject to complying with the requirements of the UT Code and authorised by the SFC for offer to the public. Investments in commodities are not permitted unless otherwise approved by the SFC on a case-by-case basis, subject to the liquidity of the relevant physical commodities and the availability of appropriate safeguards as necessary, while under the UT Code. Under the UT Code, unlisted index funds and index tracking exchange traded funds ("passive ETFs") may be authorised for retail offer while index tracking strategies may be by full replication, representative sampling or synthetic replication using financial derivative instruments, or a combination thereof, while the index may track securities (equities or bonds), commodities or interest rates, subject to meeting relevant requirements.

Under the updated UT Code (effective 1 January 2019, the transition period was to 31 December 2019), there is now greater flexibility for "plain vanilla retail funds" to invest in derivatives, subject to the limit that the scheme's net exposure relating to financial derivative instruments does not exceed 50% of its total net asset value. Further innovative fund types are also now possible to be authorised as retail funds under the UT Code, such as listed open-ended funds ("active ETFs"), and also "closed-ended funds" that may have some flexibility to invest in illiquid investments subject to consultation with and specific approval of the SFC, further blurring the line between funds that may be regarded as alternative investments.

Retail AIFs are prohibited under the UT Code from investing in any type of real estate (including buildings) or interests in real estate (including options or rights, but excluding shares in real estate companies or real estate investment trusts (REITs)), whereas the establishment and operation of REITs in Hong Kong that are offered to the public and listed on the Hong Kong Stock Exchange are subject to prior authorisation by the SFC pursuant to and subject to the requirements under the SFC Code on REITs.

On the other hand, private AIFs that are offered by way of private placements only (and hence not authorised by the SFC) are not directly subject to specific legislation that governs their establishment and operation, but as mentioned above, intermediaries that offer AIFs or the managers or advisers to such AIFs are subject to licensing and regulation.

AIFs formed as Hong Kong domiciled open-ended fund companies (OFC) with variable capital would be subject to the detailed rules and code for open-ended fund companies promulgated by the SFC (OFC Rules and Code).

Hong Kong has also introduced new legislation on the Hong Kong limited partnership fund (LPF) structure, making available a new Hong Kong domiciled fund type for alternative investment funds. The Hong Kong Limited Partnership Fund Ordinance (LPFO) will be effective from 31 August 2020, along with tax exemptions that may be available to encourage adoption of the structure.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

As noted in question 1.1, Hong Kong managers of AIFs are required to be licensed by the SFC to conduct Type 9 regulated

activity of asset management, and are thereby subject to regulation by the SFC in conducting its business of managing AIFs. AIFs that are not managed in Hong Kong are not subject to specific requirements by the SFC, other than the securities offering restrictions and the requirements for persons engaged in the marketing of the AIFs to hold a licence by the SFC to conduct Type 1 regulated activity of dealing in securities.

Hong Kong advisers to AIFs are required to be licensed by the SFC to carry on business in the Type 4 regulated activity of advising on securities, unless any relevant exemption applies, subject to applicable conditions. A Hong Kong adviser may provide the relevant advisory services solely to its group company under a group company exemption.

It is noteworthy that a firm that deals in, advises on or manages a portfolio of "private equity" or "venture capital" which does not involve securities (the definition of which excludes shares or debentures of a company that is a private company within the meaning of section 11 of the Companies Ordinance (Cap.622)) may not by itself attract a licensing requirement. In many other cases, however, where a firm deals in, advises on or manages shares or debentures of private offshore companies that fall outside the definition of a "private company" under the Companies Ordinance, it is likely that the firm in question will be required to be licensed, unless any relevant exemption applies. In January 2020, the SFC issued a Circular to stamp out previous doubts as to the applicability of licensing requirements to private equity fund managers, noting it will consider the composition of the investment portfolio, which may trigger licensing requirements if the underlying specific purpose vehicles or underlying investments of the private equity fund under management fall within the definition of "securities".

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

AIFs are not themselves required to be licensed or authorised unless they are marketed or offered to the public in Hong Kong. AIFs that are marketed or offered to the public in Hong Kong must be authorised by the SFC, such as AIFs falling within one of the categories of funds or specialised schemes to be authorised in accordance with and subject to the applicable requirements of the UT Code, as mentioned in question 1.1.

Besides, AIFs that are established in the form of Hong Kong domiciled OFCs, whether public or private, will be subject to registration with and regulation by the SFC under the OFC Rules and Code. Public OFCs are also subject to SFC authorisation under the UT Code.

Effective from 31 August 2020, AIFs to be structured as Hong Kong LPFs may apply to the Hong Kong Registrar of Companies to be established subject to the applicable requirements under the LPFO.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The regulatory regime in Hong Kong does not distinguish between open-ended and closed-ended AIFs or otherwise differentiate between different types of funds or strategies, as AIFs are generally falling within the definition of "securities" as "collective investment schemes". For AIFs that are to be offered to the public in Hong Kong, to be authorised by the SFC, the AIFs would need to comply with the relevant requirements of the SFC under the UT Code which may be specific to the type of funds or strategies, such as those mentioned under question 1.1 above, and also as noted there, it is possible for "closed-ended funds" to be authorised under the UT Code.

AIFs to be established in the form of a Hong Kong-domiciled OFC structure are subject to prescribed requirements under the OFC Rules and Code, including such as for private OFCs, at least 90% of the gross asset value of a private OFC must consist of (1) those asset types the management of which would constitute a Type 9 (asset management) regulated activity, and/or (2) cash, bank deposits, certificates of deposit, foreign currencies and foreign exchange contracts, with a maximum of 10% of gross asset value of the private OFC in other asset classes (10% *de minimis* limit). Given such limit, the OFC structure will likely be more suitable for open-ended funds (*vis-à-vis* closed-ended funds) and hedge funds (*vis-à-vis* private equity funds), although the possibility is not necessarily excluded.

For private equity funds, typically structured as limited partnership funds, Hong Kong has introduced the Hong Kong LPF structure that may be established from 31 August 2020 under the new LPFO.

1.5 What does the authorisation process involve and how long does the process typically take?

As noted in question 1.3, AIFs that are not marketed or offered to the public in Hong Kong are not required to be licensed or authorised by the SFC. The authorisation process for AIFs that are offered to the public in Hong Kong involves the review by the SFC of the funds themselves and the offering documents in respect of the funds, as well as the key operators of the funds pursuant to the requirements set out in the UT Code.

A new fund application for the authorisation of SFC is generally expected to take one to three months from the date the application is taken up by the SFC, depending on factors such as whether the fund under application is a sub-fund under an existing SFC-authorised umbrella fund, whether the fund is managed by existing approved managers managing other existing SFC-authorised funds with good regulatory records, the extent of the fund's use of derivatives and any material issues or policy implications relating to the application. The application will be subject to a six-month period from the SFC take-up date, at the expiry of which the application will in general lapse.

For establishing private AIFs in the form of Hong Kong domiciled OFCs, an application for registration would first need to be made to the SFC with a specified form and provide prescribed information (including the instrument of incorporation and the profile of key operators) to be submitted to the SFC, and upon the SFC approval on the registration, the incorporation can then be made with the Companies Registry. The offering document of the fund shall be filed as soon as practicable with the SFC upon issuance.

For establishing private AIFs in the form of Hong Kong LPFs, from 31 August 2020, an application shall be made to the Registrar of Companies, identifying the proposed address, place of business and investment scope, the proposed general partner and proposed investment manager, as well as a proposed "Responsible Person", which must be an authorised institution, licensed corporation, accounting person or legal professional, with responsibility to carry out anti-money laundering/counter-terrorist financing functions for the LPF. The LPF will be registered if the Registrar of Companies is satisfied the application contains the necessary documents and information and the requisite application fee is paid. Unlike the OFC, the LPF is not subject to prior approval or (direct) regulation by the SFC.

1.6 Are there local residence or other local qualification or substance requirements?

Hong Kong managers are not restricted under any local requirements to form or establish Hong Kong-domiciled investment funds, and the SFO does not differentiate between local funds or offshore funds in the conduct of regulated activities of licensed persons or offers of securities (which may hence cover collective investment schemes or AIFs of any jurisdiction).

Private AIFs may be formed as a Hong Kong domiciled unit trust or a Hong Kong domiciled open-ended fund company. However, AIFs are not restricted to Hong Kong domiciled funds and may be domiciled in other jurisdictions by adopting legal vehicles available in the relevant jurisdiction. Hong Kong managers of AIFs quite commonly adopt fund vehicles in the form of an open-ended or closed-ended fund company or limited partnership structure in an offshore tax neutral jurisdiction.

This is also the case for retail AIFs where the regulations do not prescribe whether the funds are Hong Kong domiciled or foreign funds to be authorised by the SFC for offers to the public in Hong Kong. For example, Cayman domiciled funds may and have been established and authorised by the SFC as retail funds offered to the public in Hong Kong, subject to the SFC authorisation process and complying with the requirements of the UT Code. Foreign funds may also be authorised in Hong Kong, broadly speaking under two available schemes: (1) schemes established in recognised jurisdictions (the "Recognised Jurisdiction Schemes" (RJS) (the majority of which are UCITS funds domiciled in Luxembourg, Ireland and the United Kingdom)); and (2) schemes to be authorised under the mutual recognition of funds (MRF) arrangements currently with jurisdictions including Mainland China, France, Switzerland, United Kingdom and Luxembourg.

Under the UT Code, the management company of a retail AIF can be based outside Hong Kong in one of the acceptable inspection regimes published by the SFC provided that the retail AIF, if non-Hong Kong based, is required to appoint a Hong Kong representative. Similarly, there is no local domicile or local qualification requirements on the manager of a private AIF, who can be based in or outside Hong Kong.

However, under the OFC Rules and Code, where an AIF, whether retail or private, is structured as a Hong Kong domiciled OFC, it must appoint at least one Hong Kong licensed manager (see question 1.7). For a Hong Kong LPF, the investment manager must be a Hong Kong resident over the age of 18 years, a Hong Kong company or a non-Hong Kong company registered with the Hong Kong Companies Registry, whereas the general partner may be one of those categories of persons, or may be a domestic or foreign limited partnership. Where the general partner is a domestic or foreign limited partnership, the LPF must have an authorised representative that is a Hong Kong resident who is at least 18 years old, a Hong Kong company or a registered non-Hong Kong company. As noted in question 1.5, the LPF must also appoint a "Responsible Person", which must be an authorised institution, licensed corporation, accounting person or legal professional, with responsibility to carry out anti-money laundering/counter-terrorist financing functions for the LPF.

1.7 What service providers are required?

The service providers that are typically required for AIFs would include the fund manager, the investment manager or investment advisor (if distinct from the fund manager), the trustee (if established as a unit trust structure)/custodian (in the case of mutual fund corporations), fund administrator, valuation agent (if distinct from the fund administrator), auditor, prime broker (in the case of hedge funds) and marketing agent/distributor.

Having said that, Hong Kong law and regulations do not specifically prescribe requirements for having specific service providers or the qualifications of service providers of AIFs, unless the AIFs are to be offered to the public in Hong Kong which would then be subject to the requirements under the UT Code applicable to the service providers, including on the fund manager, investment manager, trustee/custodian and auditor. Besides this, under the OFC Rules and Code, there are specific requirements on the board of directors of OFCs, on the investment manager (at least one investment manager licensed or registered to conduct Type 9 (asset management) regulated activity must be appointed), and also on the custodian and auditor of OFCs.

For HK LPFs, there must be a general partner and an investment manager that meet the respective requirements as noted in question 1.6, as well as a proposed "Responsible Person", which must be an authorised institution, licensed corporation, accounting person or legal professional, with responsibility to carry out anti-money laundering/counter-terrorist financing functions for the LPF. The application to register an LPF must be submitted on behalf of the fund by a registered Hong Kong law firm or a solicitor in Hong Kong admitted to practise Hong Kong law. There is also the requirement to appoint an independent auditor to audit the financial statements of the LPF annually.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

The SFO governs funds offered in Hong Kong or targeted to the Hong Kong public, or the conduct of businesses relating to regulated activities in securities or futures that are carried out in Hong Kong or the active marketing to the public in Hong Kong (whether in Hong Kong or from a place outside Hong Kong), of any services which would constitute a regulated activity if provided in Hong Kong. Foreign managers or advisers that engage in any activity falling within the aforesaid may be subject to licensing requirements and would need to be properly licensed by the SFC if required for the conduct of relevant regulated activities.

Foreign managers or advisers wishing to manage, advise or otherwise operate AIFs for public offer in Hong Kong would be subject to the applicable requirements of the SFC, such as under the UT Code regarding the management company (or its delegates) of SFC authorised funds.

Foreign managers or advisers that may consider to manage, advise or otherwise operate retail or private AIFs to be established in the form of a Hong Kong domiciled open-ended fund company or a Hong Kong LPF should note the relevant local requirements noted in question 1.6.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

Over the years, the SFC has signed a number of bilateral or multilateral agreements with local, Mainland China and overseas regulatory bodies.

To ensure a consistent regulatory approach, the SFC has entered into memoranda of understanding (MOU) with local

regulatory bodies such as the Hong Kong Monetary Authority, Insurance Authority, Mandatory Provident Fund Schemes Authority, Hong Kong Exchanges and Clearing Limited, the Stock Exchange of Hong Kong Limited, etc.

The SFC has signed agreements with the regulators of Mainland China including the China Securities Regulatory Commission (CSRC), Administration and Supervision Department of the State Administration of Foreign Exchange, China Banking Regulatory Commission, China Insurance Regulatory Commission (now part of the China Banking & Insurance Regulatory Commission), People's Bank of China, Shanghai Stock Exchange, Shenzhen Stock Exchange, setting out co-operative frameworks, including investigatory assistance, exchange of information, and market or product-related arrangements.

The SFC has also entered into co-operative arrangements for investigatory assistance, exchange of information, and market or product-related arrangements in the form of memoranda of understanding, confidentiality undertakings, memoranda regarding administrative arrangements and memoranda of regulatory co-operation, and the IOSCO Multilateral Memorandum of Understanding (MMOU) (which was the first global information-sharing arrangement among securities regulators) with overseas regulators such as the UK Financial Conduct Authority.

In the context of authorised funds, the SFC has also entered into mutual recognition of funds arrangements with jurisdictions such as Mainland China, France, Switzerland, United Kingdom and Luxembourg, establishing framework for retail funds in one jurisdiction to seek authorisation to be offered as retail funds in the other jurisdiction.

Co-operation or information-sharing agreements for tax purposes including with respect to the Common Reporting Standard are discussed in section 6 on taxation.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

AIFs in Hong Kong may be formed as a Hong Kong domiciled unit trust constituted under a trust deed governed by Hong Kong law, or for open-ended AIFs, as a Hong Kong domiciled OFC which shall be subject to the OFC Rules and Code. Effective from 31 August 2020, AIFs may also be formed as a Hong Kong LPF subject to the Hong Kong LPFO.

However, AIFs are not restricted to Hong Kong domiciled funds or specific forms and may be, and quite commonly are, established by adopting legal vehicles domiciled in other jurisdictions such as the Cayman Islands, subject to considering ease and costs of establishing and operating, applicable legal and regulatory requirements in the jurisdiction of the fund domicile, familiarity to investors and other factors such as tax implications.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

The limitation of liability of investors or any exception thereto must be clearly provided for in the constitutive document of the AIFs and disclosed to investors in the offering document. An investor generally shall not be liable to make any further payment after the investor has paid the monies agreed to be paid by such investor in respect of the units, shares or interests held by such investor and no further liability can be imposed on the investor in respect of the units, shares or interests held by such investor.

For retail AIFs (e.g. hedge funds), the UT Code requires that the liability of holders must be limited to their investment in the fund and that this must be clearly stated in the offering document.

AIFs that adopt the Hong Kong OFC structure are a form of company with limited liability, and also segregated liability between sub-funds where the OFC is an umbrella fund structure with multiple sub-funds. Under the Hong Kong LPF structure, the general partner has ultimate responsibility for the management and control of the LPF and has unlimited liability for all the debts and obligations of the LPF, whereas if an authorised representative has been appointed by the general partner, the general partner and the authorised representative are jointly and severally liable and share ultimate responsibility for the LPF. A limited partner has the benefit of limited liability under the LPF, and is not liable for debts and obligations of the LPF beyond the amount of the limited partner's agreed contribution, but this is provided the limited partner does not take part in the management of the fund. The LPFO specifically outlines certain activities or conduct that a limited partner may engage in that will not be regarded as taking part in the management of the fund, such as involving decisions around actual or potential conflict of interest, although those activities are not intended to be exhaustive circumstances through the exercise of which a limited partner may not be regarded as taking part in the management of the fund.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Hong Kong fund managers and advisers tend to be companies incorporated in Hong Kong with limited liability and are subject to be licensed by the SFC to conduct the relevant regulated activities (usually at a minimum Type 9 regulated activity of asset management and/or Type 4 regulated activity of advising on securities).

As it is quite common for Hong Kong fund managers or fund promoters to establish AIFs that are domiciled in an offshore jurisdiction, when doing so, such as when establishing an offshore (e.g. Cayman) limited partnership fund, a Hong Kong manager or adviser (or its parent company) may establish an offshore company as the general partner of the limited partnership fund. Similarly, from 31 August 2020 when the Hong Kong LPF will be available, a Hong Kong company or non-Hong Kong company may be incorporated or registered in Hong Kong to be the general partner of a Hong Kong LPF.

Depending on the management and operational arrangement of the particular fund management group, as well as the investment strategies or investment process, the parent company or subsidiary of the Hong Kong managers or advisers may also form, or be formed as, an overseas manager or an investment adviser in the particular jurisdiction(s) where a fund shall invest. Such manager or investment adviser would need to comply with any requirements including registration or licensing that may apply in the relevant jurisdiction where it is established or operates.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

For retail hedge funds, the UT Code requires that there must be at least one regular dealing day per month except for a closed-ended fund authorised pursuant to the UT Code. The maximum interval between the lodgement of a properly documented

redemption request for redemption of units/shares (whether a notice period is required or not) and the payment of redemption money to the holder may not exceed one calendar month (unless the fund is a closed-ended fund where the permitted period is 90 calendar days or unless a substantial portion of the investments is in a market that is subject to foreign currency control). The manager may restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds only in certain circumstances, such as during massive redemption, and there should be full disclosure in the offering documents on permitted circumstances.

For private AIFs, there are no specific limits or restrictions on managers' ability to restrict redemptions or transfers under Hong Kong law or regulations. However, according to the revised FMCC effective from November 2018 (Revised FMCC), Hong Kong managers who are responsible for the overall operation of a fund would need to adopt appropriate liquidity management measures including the redemption policy of the fund; the liquidity risks of the fund, the liquidity management policies and an explanation of any tools or exceptional measure that could affect redemption rights would also need to be disclosed to fund investors. These requirements are relevant to open-ended funds as well as closed-ended funds.

Under the Revised FMCC, there are also specific provisions relating to the use of any side pocket by a Hong Kong fund manager who is responsible for the overall operation of a fund, and to provide clear disclosure to fund investors on the creation, features and implications of a side pocket including the impact or lock-up on redemption for a side pocket.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

Generally speaking, transfers of investors' interests in AIFs would be subject to the specific provisions in the constitutive document, and would be subject to such process as prescribed in the constitutive document (typically transferable by the appropriate instrument of transfer signed by the transferor and the transferee and registered in the register of members of the fund), subject to the applicable anti-money laundering laws and policies, and may be subject to consent or approval requirement (if any) of the relevant fund governance body. For Hong Kong OFCs, transfer of shares should also comply with the specific provisions on the procedures and requirements stipulated in the OFC Rules of the SFO.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

There are certain investment restrictions that apply under the UT Code on retail funds covering spread of investments and diversification limits, restrictions on certain types of instruments or assets, and limits on short selling. Private AIFs are not subject to specific investment limits or restrictions. AIFs should have a set of clearly defined investment and borrowing parameters in its constitutive and offering documents and the offering document should clearly explain the types of investments or financial instruments in which the fund will invest; the extent of diversification or concentration of investments or strategies; the extent and basis of leverage (including the maximum level of leverage); and the related risk implications of the investment and borrowing parameters.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The SFO governs the offers of securities (including collective investment schemes as widely defined) in Hong Kong including the production and issue of marketing materials relating to offers of funds. The Companies (Winding Up and Miscellaneous Provisions) Ordinance (CWUMPO) governs the offer of shares in the Hong Kong corporate structure.

For retail AIFs, the SFC Advertising Guidelines Applicable to Collective Investment Schemes Authorised under the Product Codes (Advertising Guidelines) are applicable to all forms of product advertisements for SFC-authorised collective investment schemes.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The key content requirements for marketing materials for SFC-authorised funds are set out in the Advertising Guidelines. The general principles that govern the content of advertisements for SFC-authorised funds are that the advertisements should (1) not be false, biased, misleading or deceptive, (2) be clear, fair and present a balanced picture of the fund with adequate risk disclosures, and (3) contain information that is timely and consistent with its offering document, and that the advertisements may not refer to unauthorised funds except as otherwise permitted. Detailed requirements are set out in the Advertising Guidelines on the content of advertisements including language and graphics, performance information, warning statements, etc.

The Advertising Guidelines do not apply to marketing materials for private funds. However, the FMCC provides that where the advertisements and marketing materials are not required to be authorised by the SFC (which is the case for private funds), a fund manager should nonetheless ensure that marketing materials are accurate and not misleading and only contain performance claims that can be verified.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

The marketing or legal documents relating to offers of SFC-authorised retail funds are subject to the prior approval or authorisation of the SFC before they can be issued; although advertisements or marketing materials issued by intermediaries licensed by the SFC to conduct Type 1 (dealing in securities) regulated activity, Type 4 (advising on securities) regulated activity, and Type 6 (advising on corporate finance) regulated activity are exempted from prior authorisation by the SFC. However, if the marketing documents relate to certain funds, such as mandatory provident fund schemes and their constituent funds, occupational retirement schemes and insurance contracts, then the prior vetting of SFCs is still required.

The marketing or legal documents relating to the offer of private funds that are offered in Hong Kong on a private placement basis will not need to be approved by or registered with the SFC, such as AIFs that are primarily offered to "Professional Investors" as defined under the SFO.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Private AIFs do not need to be authorised in order to be marketed in Hong Kong. Retail AIFs, on the other hand, must be authorised by the SFC pursuant to the requirements under the UT Code before they can be marketed to the public in Hong Kong.

Persons engaged in the business of offering investment funds, whether retail or private, are required to be licensed by the SFC to conduct Type 1 regulated activity of dealing in securities, unless any relevant exemption applies.

Private funds should not be offered to the public in Hong Kong, and under Hong Kong securities offering laws, an offer to a section of the public may constitute an offer to the public. An offer may be made to "Professional Investors" as defined in the SFO only (unlimited in number) and/or no more than 50 people by way of private placement, among other circumstances that may be relevant to be exempted or excluded as a public offer. For private funds in Hong Kong corporate form, another exemption is where an offer involves a minimum investment of at least HK$500,000 per investor or not exceeding a specific overall size of HK$5 million.

When a licensed person is engaged in the offer of any investment funds, whether retail or private, the licensed person needs to satisfy applicable suitability requirements and other know-your-customer (KYC) requirements as set out in the Code of Conduct in the offering of funds. Effective from July 2019, a licensed person is required to determine whether the AIF it is marketing is a complex product, and more stringent suitability requirements apply, such as being restricted from selling to any individual investor (including any individual professional investors) unless the AIF satisfied to be suitable for such investor. The licensed intermediary marketing an AIF is expected to exercise due care, skill and diligence to determine whether the AIF is a complex product, and should consider several elements including whether the AIF is a derivative product/fund, the liquidity (illiquid or restricted liquidity likely to be complex) and any particular features or terms that increases the risk profile of the product.

Under the UT Code effective on 1 January 2019, subject to transition arrangements, a fund with a net derivative exposure of more than 50% of its net asset value would be a "derivative fund". The SFC has issued a "Guide on the Use of Financial Derivative Instruments for Unit Trusts and Mutual Funds" which includes guidance on calculating net derivative exposure, which are instructive for retail AIFs and relevant to be considered for private AIFs.

Intermediaries are likely to refer to the categorisation of a retail fund as a "derivative fund" or not, in determining whether a fund is a complex product subject to the stricter suitability and derivative knowledge assessment under the new conduct requirements (5.1A and 5.3) of the Code of Conduct effective July 2019.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

There is no concept of "pre-marketing" or equivalent under Hong Kong law.

3.6 Can Alternative Investment Funds be marketed to retail investors?

An AIF (e.g. a hedge fund) can be marketed to retail investors in Hong Kong provided that they are authorised by the SFC in accordance with the UT Code, such as the various types of schemes that may be AIFs for retail offer as outlined in question 1.1.

Where AIFs are offered in Hong Kong on a private placement basis, it is primarily to "Professional Investors" as defined in the SFO.

3.7 What qualification requirements must be met in relation to prospective investors?

As noted in question 3.5, a licensed person engaged in the offering of funds to prospective investors should satisfy applicable suitability requirements and other know-your-customer requirements in relation to prospective investors, pursuant to the Code of Conduct.

When offering to "Professional Investors" as defined in the SFO, the licensed person would need to put in place procedures to limit offers to "Professional Investors" only and to verify the qualification of "Professional Investors". The licensed person should also comply with the relevant know-your-customer and suitability requirements under the Code of Conduct, to the extent such requirements apply, depending on the category of the "Professional Investors".

Broadly speaking, "Individual Professional Investors" or "Corporate Professional Investors" mean individuals or corporates, respectively, that meet the relevant minimum-net-worth or net assets requirements (broadly speaking, individuals with a portfolio of at least HK$8 million, or a trust corporation, corporation or partnership with a portfolio of at least HK$8 million or net assets of HK$40 million), while "Institutional Professional Investors" refer to financial institutions and specific bodies as prescribed in the SFO.

A licensed person may be exempted from certain requirements of the Code of Conduct including the suitability requirements, when dealing with (1) "Corporate Professional Investors" as defined in the Code of Conduct who have satisfied the relevant assessment criteria as set out in the Code of Conduct in relation to relevant products and/or markets, and (2) "Institutional Professional Investors".

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

Among the categories of financial institutions and intermediaries that are specified in the definition of "Professional Investor" in the SFO, any registered mandatory provident fund scheme or its constituent fund (or an approved trustee, service provider or investment manager of such scheme or constituent fund), any occupational retirement schemes, as well as any government or institution which performs the functions of a central bank all fall to be categorised as "Institutional Professional Investors". Accordingly, funds may be marketed to such bodies on a private placement basis, and in respect of which a licensed person is exempted from the suitability requirement and certain other investor protection requirements under the Code of Conduct.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

Where an AIF is offered on a private placement basis only, the qualifications, restrictions and requirements outlined in question 3.7 should be noted. Other than that, there are no specific restrictions on the participation in AIFs by particular types of

investors, and the fund manager or operator and other service providers are not restricted from participating in the funds; however, any conflict of interests should be properly disclosed to investors.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

There are no specific restrictions on the use of intermediaries to assist in the fundraising as long as the intermediary is properly licensed by the SFC (unless any relevant exemption applies).

Under the Revised FMCC, Hong Kong licensed managers will be subject to additional specific requirements where the Hong Kong manager is responsible for the overall operation of the fund. In respect of marketing/fundraising activities, a fund manager should ensure that any representations made by it or its representatives to a client are accurate and not misleading, and that all advertisements and marketing materials are accurate and not misleading where such materials are not required to be authorised by the SFC. This should apply even where the fund manager has appointed intermediaries to assist in the fundraising.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Retail AIFs (e.g. hedge funds) that are authorised by the SFC would be subject to certain core requirements and restrictions contained in the UT Code covering areas such as prohibition on real estate investments, limitations on making loans, and acquiring assets that involve the assumption of unlimited liability.

There are no specific restrictions on the types of activities that can be performed by private AIFs. However, under the Revised FMCC, Hong Kong licensed managers of private funds will be subject to additional specific requirements where the Hong Kong manager is responsible for the overall operation of the fund, specifically covering several areas that are considered risk areas and for managing systemic risks, such as in relation to use and disclosure of leverage, cross trades, liquidity management, risk management, use of side pockets, and managing conflicts of interest.

For example, the Revised FMCC requires that where the fund manager is responsible for the overall operation of a fund, it should disclose to fund investors (i) the expected maximum level of leverage which it may employ on behalf of the fund, and (ii) the basis of calculation of leverage which should be reasonable and prudent.

For cross trades, according to the Revised FMCC, a fund manager cannot undertake sale and purchase transactions between client accounts (i.e. cross trades) unless: (a) the sale and purchase decisions are in the best interests of both clients and fall within the investment objective, restrictions and policies of both clients; (b) the trades are executed on arm's length terms at current market value; (c) the reasons for such trades are documented prior to execution; and (d) such activities are disclosed to both clients.

With respect to liquidity management, the Revised FMCC requires that a fund manager that is responsible for the overall operation of a fund should establish, implement and maintain appropriate and effective liquidity management policies and procedures to monitor the liquidity risk of the fund, taking into account the investment strategy, liquidity profile, underlying assets and obligations, and redemption policy of the fund, and consider the appropriateness of using liquidity management tools and exceptional measures, taking into account the nature of assets held by the fund and its investor base.

Regarding conflicts of interest, a fund manager should maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to identify, prevent, manage and monitor any actual or potential conflicts of interest, including conducting all transactions in good faith at arm's length and in the best interests of the fund on normal commercial terms. Where an actual or potential conflict arises, the conflict should be managed and minimised by appropriate safeguards and measures to ensure fair treatment of fund investors, and any material interest or conflict should be properly disclosed to fund investors.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

The UT Code sets out certain investment restrictions including on the spread of investments that apply to SFC-authorised retail funds depending on the type of retail funds, and different requirements or restrictions may apply to specific types of retail funds that are specialised schemes, or hedge funds or other types that may be in the nature of AIFs, as noted in question 1.1. For retail hedge funds, the UT Code requires that the fund must have a set of clearly defined investment parameters in its constitutive and offering documents. The offering document must clearly explain: the types of financial instruments in which the fund will invest; the extent of diversification or concentration of investments or strategies; the related risk implications of the investment parameters; the extent and nature of use of financial derivative instruments; net exposure; and leverage.

There are no specific limits on the types of investments that can be included in a private AIF's portfolio whether for diversification reasons or otherwise. However, under the Revised FMCC, Hong Kong licensed managers of private funds will be subject to additional specific requirements where the Hong Kong manager is responsible for the overall operation of the fund, specifically covering several areas that are considered risk areas and for managing systemic risks, such as securities lending, repo and reverse repo transactions. The Revised FMCC requires that the fund manager should put in place a collateral valuation and management policy and a cash collateral reinvestment policy governing securities lending, repo and reverse repo transactions and any cash collateral reinvestments in respect of collateral received by the funds managed by the fund manager. Further, the fund manager should have in place an eligible collateral and haircut policy in determining the types of acceptable collateral and their corresponding haircut in connection with securities lending, repo and reverse repo transactions. The fund manager of a fund that engages in securities lending should stress test the ability of a cash collateral reinvestment portfolio to meet foreseeable and unexpected calls for the return of cash collateral on an ongoing basis.

For private AIFs established in the form of Hong Kong domiciled OFCs, as stated in question 1.4, the portfolio of such AIFs would be subject to the 10% *de minimis* limit.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Specific requirements may apply depending on whether an AIF is an SFC authorised retail fund and subject to the UT Code,

or if it is a private AIF subject to the FMCC, including requirements relating to use of derivatives for hedging or investing purposes, borrowing, loans or leverage, as noted in questions 4.2 and question 4.4.

For SFC-authorised funds, together with the updated UT Code effective 1 January 2019 which expanded the flexibility for retail funds to invest in derivative instruments, the SFC has issued its Guide on the Use of Financial Derivative Instruments for Unit Trusts and Mutual Funds (FDI Guide), which provides guidance on the use of financial derivative instruments (FDIs), including the calculation of the net derivative exposure of an SFC-authorised fund. All SFC-authorised funds must in their key facts statement (KFS) disclose the purpose of and the expected maximum net derivative exposure arising from FDIs. Pursuant to the FDI Guide, fund managers shall determine/categorise whether their SFC-authorised fund is or is not a derivative fund, based on the net exposure arising from the fund's investments in FDI and enhance relevant disclosures in the offering documents. The SFC has included in its public register of authorised funds a new column indicating whether an SFC-authorised fund is or is not a derivative fund.

Intermediaries are likely to refer to the categorisation of a retail fund as a "derivative fund" or not, and may also make reference to the FDI Guide in considering the use of derivatives by private funds, in determining whether a fund is a complex product subject to the stricter suitability and derivative knowledge assessment under the new conduct requirements (5.1A and 5.3) of the Code of Conduct effective July 2019.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

The UT Code contains certain borrowing restrictions that apply to SFC-authorised retail funds. The maximum borrowing of an SFC-authorised retail fund generally may not exceed 10% of its total net asset value (back-to-back loans do not count as borrowing), although this restriction does not apply to retail hedge funds. For retail hedge funds, the UT Code requires that the fund must have a set of clearly defined borrowing parameters in its constitutive and offering documents. The offering document must clearly explain the extent and basis of leverage (including the maximum level of leverage) and the related risk implications of the borrowing parameters.

There are no specific restrictions on borrowing by private funds.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

AIFs that are SFC-authorised retail funds must issue an up-to-date offering document containing the required information as listed in the UT Code and a product KFS, deemed to form part of the offering document and serve as a summary of key fund features and risks. The offering document must be accompanied by the retail fund's most recent audited annual report and accounts together with its semi-annual report if published after the annual report. The UT Code also requires that the front cover of the offering document must display prominently certain prescribed warning statements, and the offering document must disclose all relevant matters relating to the investment operations and risk management aspects of the fund and give lucid explanations of the investment strategy of the fund and the risks inherent in the fund. The manager of the retail fund must disclose the measures and safeguards put in place for the management of conflicts of interest in relation to the operation of the fund.

There are no specific legal or regulatory requirements on the disclosure to be made by private AIFs that are offered in Hong Kong on a private placement basis, except where the fund manager or the fund distributor is subject to relevant requirements under the FMCC or the Code of Conduct, or where disclosure requirements under the OFC Code apply in the case of private AIFs structured as Hong Kong OFCs. Where a fund is a complex product, pursuant to new conduct requirements of the Code of Conduct effective July 2019, a licensed intermediary providing services in or offering complex products should ensure that sufficient information on the key nature, features and risks of a complex product is provided so as to enable the client/investor to understand the complex product before making an investment decision. For private funds structured as Hong Kong OFCs, the OFC Code requires that disclosure shall be clear, concise and effective, containing information necessary for investors to be able to make an informed judgement and be kept up-to-date. The offering documents issued by a private OFC should be filed with the SFC as soon as practicable following issuance and in case of changes, within seven days from the date of issuance of the revised offering document.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

There are currently no such requirements to provide details of participants in AIFs or managers established in Hong Kong to the regulator or record-keeping agency.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

SFC-authorised retail funds must publish at least two financial reports each financial year, being the annual reports and accounts published and distributed to holders within four months of the end of the fund's financial year, and the interim reports within two months of the period they cover. These reports will need to be filed with the SFC. For retail hedge funds, the SFC has published the Guidelines on Hedge Funds Reporting Requirements (Appendix H to the UT Code) setting out the minimum amount of information that is required to be disclosed in regular reporting to investors. Retail hedge funds are required to publish quarterly reports in addition to the annual reports and semi-annual reports.

There are no specific legal or regulatory requirements on the reporting to be made by private AIFs that are offered in Hong Kong on a private placement basis. However, under the Revised FMCC, Hong Kong licensed managers of private funds will be subject to additional specific requirements where the Hong Kong manager is responsible for the overall operation of the fund. Requirements include having appropriate policies and procedures for the valuation of fund assets and calculation of net asset value, independent review of the valuation policies, procedures and process, and also a requirement to ensure an independent auditor is engaged to perform an audit of the financial statements of the fund in order to prepare an audited report at

least annually, which should be made available to fund investors upon request. Where the fund engages in securities lending, repo or reverse repo transactions, the Hong Kong fund manager who is responsible for the overall operation of the fund is also required to provide to the fund investors, at least on an annual basis, certain prescribed minimum information on the fund's securities lending, repo and reverse repo transactions.

A Hong Kong fund manager is required to appoint an independent auditor to perform an audit of the financial statements of the fund manager, and the audited accounts should be filed in accordance with applicable statutory requirements and be made available to the fund upon request. There are also reporting obligations to the SFC, and specifically, a Hong Kong fund manager would be subject to requirements to provide appropriate information to the SFC upon request such as on fund assets, leverage, liquidity, securities lending, repo and reverse repo transactions, and to respond to requests and enquiries from the SFC promptly and in an open and co-operative manner.

5.4 Is the use of side letters restricted?

There is no restriction on the use of side letters by private funds or their fund managers/operators. Therefore, Hong Kong managers are able to use side letters to supplement or modify the terms of a fund's offering document, subscription agreement or constitutive document for the purpose of granting strategic investors certain preferential treatment; however, a relevant disclosure should be made in the fund's offering document that side letters may be entered into and that certain investors may be given preferential terms.

In a circular previously issued by the SFC and addressed to managers of hedge funds, the SFC indicated that to ensure fair treatment of investors, it is good practice to disclose material terms to all existing and potential investors, and highlight where applicable that side letters have been entered into only with investors with significant shareholding or interest. Further, the Revised FMCC contains a general requirement that where a fund manager is responsible for the overall operation of a fund, it should make adequate disclosure of information (as well as any material changes to the information) on the fund which is necessary for fund investors to be able to make an informed judgment about their investment into it. Specifically, the Revised FMCC provides that where a fund manager has granted preferential treatment (e.g. side letters) to certain investors, it should disclose such fact and the material terms in relation to redemption in the side letters to all relevant potential and existing fund investors.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Under Hong Kong's tax framework (and more specifically, the general charging principles under the Inland Revenue Ordinance (IRO)), profits derived from the carrying on of business, trade or profession in Hong Kong would be subject to Hong Kong profits tax at the rate of 16.5% (a lower rate of 8.25% applies for the first HK$2 million of profits under the "two-tiered" profits tax regime introduced from 1 April 2018).

In principle, profits sourced outside Hong Kong are not chargeable to tax in Hong Kong, and Hong Kong does not levy tax on the basis of remittance or receipt in Hong Kong or apply worldwide taxation on foreign-sourced profits or income of Hong Kong tax residents. A non-resident or overseas company is potentially liable to Hong Kong profits tax if it carries on a trade, profession or business in Hong Kong and has profits derived from Hong Kong from such trade, profession or business. Accordingly, where an AIF derives Hong Kong sourced profits from carrying on a business in Hong Kong (in respect of its investment activities), it may be subject to Hong Kong profits tax.

AIFs may be exempted from Hong Kong profits tax, as outlined in question 6.8.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

The taxation of a Hong Kong investment manager or adviser would be subject to the general charging principles of the IRO. Where management fees are regarded as Hong Kong-sourced (i.e. if the services giving rise to the investment manager's income are performed in Hong Kong), the (net) income will be held liable to profits tax in Hong Kong. On the other hand, where the investment manager derives service fee income from services performed outside Hong Kong (e.g. marketing, fundraising, investor relations, maintaining relationships with investees, etc.), such income will be regarded as offshore-sourced and thus potentially fall outside the charge to profits tax in Hong Kong.

The investment advisor's taxability in Hong Kong is also determined under the (same) general taxation principles of the IRO. Where the investment advisor performs investment advisory activities in Hong Kong and receives fees from the investment manager for providing such services, it will be held liable to profits tax in Hong Kong on the profits arising from the provision of such services in Hong Kong. There are potential charge to tax where the Inland Revenue Department (IRD) regard certain income or receipts of the investment manager or adviser as (part of the) management/performance fees that are Hong Kong-sourced, and considered as derived from asset management services rendered in Hong Kong.

The IRD has issued practice notes which explains the IRD's interpretation and practice in relation to the taxation of management fees and carried interest. In particular, the IRD reiterated that funds operating in Hong Kong should ensure that true arm's length fees are paid to the Hong Kong manager and/or advisor for the risks and functions performed. Furthermore, the IRD noted that any performance fee or "carried interest" arrangement would be closely examined by the IRD if it considers that the Hong Kong investment manager or advisor is not adequately remunerated for its level of services, after considering the functions, assets and risks attributable to the operations in Hong Kong. However, with the LPF structure available from 31 August 2020, Hong Kong is looking at introducing tax concessions for carried interest for private equity funds that operate in Hong Kong, the details of which are to be further issued.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

The transfer of interests in an AIF domiciled in Hong Kong is subject to Hong Kong stamp duty, unless exempted. Stamp duty is chargeable at the rate of 0.1% of the consideration or value of the instrument of transfer of Hong Kong stock (the definition of which covers shares of Hong Kong companies, also units in unit trusts) or in certain circumstances at a nominal fixed duty.

An exemption exists for both the *ad valorem* stamp duty and the nominal stamp duty in respect of a transfer by the authorised

manager(s) of a unit trust fund if it is effectuated by selling the units back to the said manager(s) who, in their turn, either extinguish the units or resell the units to another investor(s) within two months. The allotment, transfer and redemption of shares in qualifying open-ended fund companies may *vis-à-vis* be treated as if they are units under unit trust schemes in respect of the above-explained exemption.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

There is no Hong Kong withholding tax on any dividends or distributions or other gains to be paid to fund investors, regardless of the category of investors. However, where the payments from the AIFs are actually income such as fees or salaries derived by an investors in connection with any business, trade or profession carried out in Hong Kong, the investor may be subject to salaries tax or profits tax on such income or profits, and this, in the case of a corporate, is regardless of its location of central management and control, its size or the purpose that it serves.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

As the Hong Kong tax framework in general and the application of the profits tax exemptions for funds are consistent, it is usually not necessary to obtain an advance tax ruling from the IRD prior to (and for the purpose of) establishing an AIF. For AIFs investing in private equity, venture capital, real estate or in an unusual structure or instrument, it is advisable to obtain specific advice on the potential tax implications.

Where considered necessary, such as in circumstances involving related party transactions between associated entities, it is possible to seek an advance pricing arrangement (APA) with the IRD. A Formal regime for APAs has also been established (as of July 2018), which facilitates taxpayers entering into unilateral or bilateral APAs. As noted in question 6.2, where the investment manager and investment advisor are closely-connected parties for Hong Kong profits tax purposes, consideration has to be given to whether the fees charged by the former to the latter are arm's length. This has been one of the most contentious tax matters in respect of the taxability of funds in Hong Kong in recent years.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Hong Kong has signed Model II IGA for FATCA, which is supplemented by an agreement with the United States for exchange of information relating to taxes; this forms the necessary basis for Hong Kong to provide for the exchange of information upon requests made in relation to the information reported by financial institutions in Hong Kong to the US under FATCA.

Hong Kong has implemented the Common Reporting Standard (CRS) and the automatic exchange of financial account information in tax matters (AEOI) on a reciprocal basis with all of the CRS partners, in respect of which the first exchanges started in 2018. Currently, Hong Kong has concluded comprehensive avoidance of double taxation agreements with 40 jurisdictions and tax information exchange agreements with seven countries.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

In June 2016, Hong Kong accepted the invitation of the OECD to join the inclusive framework for global implementation of the Base Erosion and Profit Shifting (BEPS) measures, and in June 2017, China signed the "Multi-lateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Sharing" (MLI) on behalf of Hong Kong, although with rights reserved with respect to most articles of the MLI.

Hong Kong has expressed its commitment to the implementation of the four minimum standards of the OECD's BEPS Action Plan, namely: (i) countering harmful tax practices (Action 5); (ii) preventing treaty abuse (Action 6); (iii) imposing country-by-country reporting (Action 13); and (iv) improving the cross-border dispute resolution regime (Action 14). To implement these BEPS Actions, the Inland Revenue (Amendment) (No.6) Bill 2017 was published in the Gazette on 29 December 2017 and passed on 4 July 2018. In particular, the codification of OECD transfer pricing rules and, in this connection, the new provisions (i) empowering the IRD to adjust profits or losses where a transaction between related parties is considered not arm's length and has created a Hong Kong tax advantage, and (ii) applying the arm's length principle also to dealings between different parts of an enterprise (such as the head-office and a permanent establishment) may have potential tax implications for AIFs and operators of AIFs as of the year of assessment 2018/19, respectively, 2019/20 onwards.

Hong Kong has also taken into account the EU Council's concerns about the (at that time existing) profits tax exemption regimes for (privately offered) offshore funds and onshore open-ended fund companies having ring-fencing features and other elements which may potentially constitute harmful tax practice in the EU's opinion. As of 1 April 2019, Hong Kong has a new profits tax exemption regime for investment funds (as described in question 6.8), regardless of their location of central management and control, their size or the purpose that they serve, to be able to enjoy tax exemption for transactions in specified assets subject to meeting certain conditions. A fund may enjoy the tax exemption in connection with its investment in both overseas and local private companies.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

SFC-authorised retail funds are generally exempt from Hong Kong profits tax. Profits tax exemption may also apply to a mutual fund, unit trust or investment scheme which is a *bona fide* widely held investment scheme, and which complies with the requirements of a supervisory authority within an acceptable regulatory regime.

For privately offered funds operating in Hong Kong, as noted in question 6.7 above, Hong Kong has a new profits tax exemption regime effective since April 2019. Essentially, any vehicle which meets the definition of "fund" under the IRO (which mirrors the definition of "collective investment scheme" in the SFO) can potentially enjoy the tax exemption in connection with its investment in both overseas and local private companies.

Furthermore, the said profits tax exemption also requires that the qualifying transactions for the tax exemption are carried out through or arranged by a "specified person", meaning a corporation licensed or registered for carrying out specified regulated activity under the SFO and which would include Hong Kong licensed managers.

Last but not least, the investments have to be made in qualifying assets, incidental transactions (subject to a 5% limit) or in non-qualifying transactions. Broadly speaking, qualifying transactions are transactions in specified asset classes including securities, future contracts, foreign exchange contracts, bank deposits, foreign currencies, certificates of deposits and OTC derivative products. With respect to the said tax exemption, the "non-qualifying assets" also covers investments in (both Hong Kong and overseas) private companies (or interposed special purpose vehicles) provided that certain tests can be met. Hence, subject to meeting relevant conditions and falling within the prescribed scope, private equity funds may also avail the exemption.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

As explained under questions 6.2 and 6.7, a Hong Kong investment manager or adviser would be subject to Hong Kong profits tax on its income derived from carrying on its business, trade or profession in Hong Kong. The new provisions in the IRO empowering the IRD to make transfer pricing adjustments to transactions which they consider not being arm's length for Hong Kong profits tax purposes can potentially trigger material tax issues for associated entities within a group of companies, particularly in respect of the fund promoter, manager or adviser, for the management or advisory fees charged, respectively, paid.

Another material issue, as mentioned under question 6.2, is the manner or form in which managers of AIFs may receive performance fees or carried interest from the fund and also the remuneration of fund executives, which may become subject to profits tax, respectively, salaries tax in Hong Kong. The IRD has indicated that general anti-avoidance provisions may be applied to distributions of management fees or carried interest to fund executives from a general partner limited partnership, or carried interest limited partnership, if the distributions are genuine investment returns.

However, with the LPF structure available from 31 August 2020, Hong Kong is looking at introducing tax concessions for carried interest of private equity fund managers of private equity funds that operate in Hong Kong, the details of which are to be further issued.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

As noted above, Hong Kong has introduced a new fund structure for AIFs, which is the limited partnership fund structure typically adopted by private equity funds. The new Hong Kong LPF will be available from 31 August 2020, while the industry anticipates that there would be tax concessions for carried interest of private equity fund managers to further encourage private equity fund operators to establish Hong Kong domiciled LPFs and to operate in Hong Kong; details are to be further issued.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

In April 2019, the SFC issued a Circular to management companies of SFC-authorised unit trusts and mutual funds to address green or environmental, social and governance (ESG) funds, with the aim to enhance disclosure and comparability of SFC-authorised Green or ESG funds and their transparency and visibility in order to facilitate investors making informed investment decisions in this evolving investment areas. The SFC has now published on its website a specific list of SFC-authorised Green or ESG funds that have enhanced disclosures further to the requirements of the said Circular. The SFC will keep international market and regulatory developments in view, and may provide further guidance or impose additional requirements for green or ESG funds, where appropriate.

On digital or virtual assets, in November 2018, the SFC issued a statement and accompanying details on its regulatory approach to virtual assets (encompassing "cryptocurrency", "crypto-assets" or "digital token"), clearly indicating its regulatory attention on investments, portfolio management or distribution of investment products that involve virtual assets, and expressly stated to include virtual assets that may fall outside the definition of "securities" or "futures contract" under the Securities and Futures Ordinance. Additional conditions shall apply to licensed managers that manage portfolios that invest solely in virtual assets or that involve virtual assets above a 10% threshold. There are also additional specific requirements that apply to licensed intermediaries distributing virtual assets funds. In October 2019, the SFC published a *pro forma* set of terms and conditions that apply to virtual asset portfolio managers as an extension to the 2018 statement, to be imposed on licensed corporations that manage or plan to manage funds (or portion of funds) where there is a stated investment objective to invest in virtual assets, or where the intention of the fund is to invest 10% or more of its gross asset value in virtual assets. A virtual asset portfolio manager is subject to a higher minimum liquid capital requirement, and may only provide its services to "professional investors". There is also a requirement to assess a client's knowledge of investing in virtual assets or related products, or, alternatively, any investment experience in private equity, venture capital or start-ups, prior to providing its services. If the client does not possess any such knowledge, the virtual asset manager may only provide services to the client if it would be acting in the best interests of the client. The SFC also published a position paper in November 2019 on its regulatory framework on virtual assets trading platform operators, following a year-long assessment of operators currently in operation.

Vivien Teu is the founding and managing partner of Vivien Teu & Co LLP. She has extensive and in-depth experience as a corporate and commercial lawyer specialising in the financial services sector, funds and wealth management. Vivien has a diverse legal practice with top-tier and Magic Circle firms in the areas of tax, trusts, banking and financial services, investment funds, securities regulatory and financial institutions set-up as well as mergers & acquisitions. Along with a significant in-house counsel experience at a global investment firm, Vivien brings unique insights and practical commercial approaches in her practice, and with extensive China knowledge.

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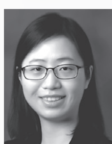

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Sarah currently specialises in asset management and financial services, focusing on the structuring, formation and operation of private funds, and regulatory matters related to investment funds and fund managers. Sarah has advised Asian fund sponsors on the formation of various types of funds, including private equity fund, co-investment fund, project fund, hedge fund, real estate fund and fund of funds structured in different forms. She has also represented investors in funds pursuing private equity investment strategies.

Sarah's experience also covers the SFC's authorisation of retail funds in Hong Kong, in particular, the SFC's authorisation of Mainland retail funds under the Mainland-Hong Kong Mutual Recognition of Funds, (MRF) arrangement and the post-authorisation compliance issues of SFC-authorised retail funds.

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Vivien Teu & Co LLP is a Hong Kong corporate and commercial law practice established with the philosophy of a boutique law firm, with particular focus on investment funds, asset management and financial services, private wealth, tax and trusts. The lawyers at Vivien Teu & Co LLP carry in-depth Hong Kong and international legal practice experience, combined with deep and broad knowledge of China and regional markets.

The asset management practice of Vivien Teu & Co LLP serves local and international clients who are establishing or operating asset management platform in Hong Kong, or otherwise accessing investors or investment opportunities in the Greater China region and beyond.

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Besides an enviable corporate and institutional client-base including global and regional investment management firms and financial institutions, the firm is also increasingly serving private clients and high net worth entrepreneurs, in its wider financial services, private wealth, tax and trusts practice. The firm has also strengthened the ESG and sustainability focus of its investment funds and corporate practice, as well as advising and working with family offices, charities, foundations and social enterprises in the areas of philanthropy and impact investing.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

In India, alternative investment funds ("**AIF**") are licensed and regulated by the Securities and Exchange Board of India ("**SEBI**"), India's securities market regulator, pursuant to the provisions of SEBI (Alternative Investment Funds) Regulations, 2012 ("**AIF Regulations**") and various notifications issued thereunder from time to time.

The AIF Regulations allow the establishment of an AIF in the form of a trust or a limited liability partnership ("**LLP**") or a company. Therefore, in addition to the AIF Regulations, depending on the form of establishment, the AIF will additionally be subject to:

- for private trusts, the provisions of the Indian Trusts Act, 1882 ("**Trusts Act**");
- for LLPs, the Limited Liability Partnership Act, 2008 ("**LLP Act**"); and
- for companies, the Companies Act, 2013 ("**Companies Act**").

Kindly refer to question 2.1 for further details.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

As elaborated under question 1.3 below, an AIF is required to be registered with SEBI.

SEBI, pursuant to the SEBI (Investment Advisers) Regulations, 2013 ("**IA Regulations**") and the SEBI (Portfolio Managers) Regulations, 2020 ("**PMS Regulations**"), regulates investment advisory and portfolio management activities in India; however, the investment manager entity of an AIF is not required to register under these regulations and is instead regulated under the extant provisions of the AIF Regulations.

The AIF Regulations require the investment manager entity ("**Manager**") to have a key investment team with at least one key personnel having not less than five years of experience: in advising or managing pools of capital; in fund, asset, wealth or portfolio management; or in the business of buying, selling and dealing in securities or other financial assets and having a relevant professional qualification (in finance). SEBI, *inter alia*, has the right to inspect, call for information and take disciplinary action against the Manager entity of an AIF. Given the role of the Manager *vis-à-vis* an AIF and the supervision which SEBI exercises on such Manager, the Manager is understood to be regulated by SEBI under the AIF Regulations, even though it is not separately registered/licensed with SEBI.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Yes, for an entity to act as an AIF, it is required to mandatorily seek a licence from SEBI under the AIF Regulations.

In general, as the AIF Regulations allow for the establishment of an AIF in the form of a trust, LLP or company, along with SEBI, an AIF may be subject to additional licensing as follows:

- for private trusts set up under the Trust Acts, there is no separate licensing or regulation; however, the instrument of the Trust Deed is required to be registered as elaborated upon under question 1.5 below; and
- for companies and LLPs, incorporation under the Companies Act and LLP Act respectively, and regulation by the applicable Registrar of Companies ("**RoC**") as per the respective place of incorporation.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The AIF Regulations provide for three categories under which an AIF can choose to register:

- Category I AIF: AIFs such as venture capital funds (which includes angel funds), small and medium enterprises funds, social venture funds and infrastructure funds.
- Category II AIF: AIFs such as private equity funds, debt funds, real estate funds and such other residual funds not falling under either Category I or Category III.
- Category III AIF: AIFs such as hedge funds, public market funds, funds trading with a view to make short-term returns and other such similar funds.

The chosen category of the AIF would determine the investment norms, diversification requirements, etc. applicable to it. Further, Category I AIFs and Category II AIFs are required to be mandatorily closed-ended having a minimum tenure of three years; however, a Category III AIF may be either open-ended or closed-ended.

1.5 What does the authorisation process involve and how long does the process typically take?

Prior to seeking registration as an AIF, the vehicle that shall seek

registration would need to be formed. Depending on the structure adopted, this may entail:

- for private trusts, a settlor would appoint a trustee by entering into an instrument of the trust, and registering the instrument in accordance with the terms of the Registration Act, 1908; and
- for companies and LLPs, they would be incorporated in accordance with the provisions of the Companies Act and LLP Act, respectively. This may take three to six weeks for both companies and LLPs.

In order to seek registration as an AIF, the applicant would first be required to obtain a Permanent Account Number (for tax purposes) and pay an application fee on the online SEBI intermediary portal. Upon the receipt of the application fee, SEBI would grant access to the portal, and the proposed AIF is then required to complete the application therein by submitting all the requisite information, declarations and documents as prescribed in the First Schedule to the AIF Regulations which, *inter alia*, include:

a) KYC and financial documents about the AIF, its Manager, its sponsor, etc.;
b) the private placement memorandum ("**PPM**") and the constitutive document of the AIF as applicable; and
c) declarations pertaining to, *inter alia*, disciplinary history.

SEBI reviews the information so provided in the application to ascertain whether the proposed AIF and its Manager/sponsor meets the eligibility criteria and other requirements prescribed under the AIF Regulations, and may call for further information, if required.

Usually, it takes two to three months for getting the final approval from SEBI if it is satisfied that the proposed AIF fulfils the required criteria prescribed under the AIF Regulations.

Upon receipt of the approval, the proposed AIF is required to pay the registration fee as specified under the Second Schedule of the AIF Regulations, pursuant to which SEBI grants a certificate of registration.

An AIF is allowed to launch multiple schemes, with each scheme having its own investment objective/strategy, set of investors, underlying investments, etc.

1.6 Are there local residence or other local qualification or substance requirements?

The AIF Regulations do not contemplate registration of funds incorporated outside India. The Manager entity of an AIF also has to be an entity incorporated in India. A sponsor of an AIF can be an Indian entity/individual or can also be a non-Indian entity/individual. Under the AIF Regulations, there is no prescription on having a minimum number of Indian residents as team members or a minimum number of days such team member/s of the Manager have to spend in India.

It is to be noted that if the Manager or sponsor of an AIF: (A) is an entity that is (i) not owned and not controlled by resident Indian citizens, or (ii) is owned or controlled by persons resident outside India; or (B) is/are individuals other than resident Indian citizens, then as per the provisions of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 ("**NDI Rules**"), the investments made by such an AIF into an Indian entity shall be reckoned as an indirect foreign investment for the investee Indian entity. Such indirect foreign investment must comply with the sectoral caps, pricing guidelines and other conditions as applicable for foreign investments prescribed under the NDI Rules.

For more details on foreign-owned Managers or advisers operating AIFs, kindly refer to question 1.8 below.

1.7 What service providers are required?

The AIF Regulations mandate the appointment of a custodian for safekeeping of securities, by the following categories of AIFs: (a) Category III AIFs; and (b) any Category I AIF or Category II AIF with a corpus of more than INR 500 crores.

The AIF Regulations further require an annual audit of books of accounts of the AIF by a qualified auditor and also mandate the valuation of the AIF's investment by an independent valuer annually or, with requisite investor approval, semi-annually.

An internal or external auditor/legal professional is required to audit the compliance of the terms of the PPM on an annual basis.

The aforesaid engagements are regulatory in nature but there are a few customary engagements which are not prescribed under any law, such as appointment of legal advisors, tax advisors, etc.

In case an AIF is structured in the form of a trust, it needs to have a trustee as required under the Indian Trusts Act, 1882. The trustee is appointed to administer the affairs of the trust, which further delegates its powers and functions to the Manager.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

The Manager entity of an AIF has to be an entity incorporated in India.

Non-resident persons may, however, set up an entity in India to act as a Manager to an AIF. It may be relevant to note that since the Manager of an AIF is understood to be regulated by SEBI, foreign investment in Managers of AIFs would be under the automatic route as per the NDI Rules, and is a streamlined process.

As elaborated upon in question 1.6 above, the ownership and control of the Manager may affect the treatment of the investments of the AIF under the NDI Rules.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

SEBI is a member of the International Organization of Securities Commissions ("**IOSCO**") and a signatory to the IOSCO Multilateral Memorandum of Understanding. SEBI has also entered into bilateral memoranda of understanding concerning consultation, cooperation and the exchange of information related to the supervision of the alternative investment fund/Managers with several nations including the United States and most members of the European Union.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

Trusts are by far the most prevalent structure used for AIFs (more than 95% of AIFs are registered in the form of a trust) as it is highly flexible, has relatively fewer compliance requirements in comparison to other structures and ensures confidentiality of the investors as their details are not available in public domain unlike other AIF structures like an LLP. An LLP structure may be explored in specific circumstances as it may offers certain benefits, specifically pertaining to taxation. A comparative overview of the possible legal structures is provided below:

Criteria	Private Trust	LLP	Private Company
Key parties involved	**Settlor:** Settlor executes the instrument of the trust and appoints the trustee. The Settlor would need to be a resident in India. **Trustee and Manager:** Trustee administers the trust (AIF) and in turn (by executing an investment management agreement) appoints the Manager who manages the trust assets including schemes launched thereunder.	**Designated partners and Manager:** Designated partners administer the affairs of the LLP (AIF). In practice, the designated partners may outsource to the Manager the management for the LLP by executing an investment management agreement. An LLP would require at least two designated partners who are individuals (whether acting in their individual capacity or as nominee of a body corporate) and at least one of them shall be a resident in India.	**Directors and Manager:** Directors administer the company (AIF) and have a fiduciary duty towards the company in respect of the powers conferred upon them. In practice, the directors, on behalf of the company, can outsource to the Manager the management of the company by executing an investment management agreement. A private company would require a minimum of two directors with a minimum of one director who stays in India for a total period of not less than 182 days during the financial year.
Compliance requirements	Low	Moderate	High
Client confidentiality	High	Low	Moderate
Ease of operations	High	Moderate	Low
Reporting requirements	Low	Moderate	High
Tax efficiency	Moderate	Moderate	Low
Acceptability with investors and distributors	High	Moderate	Low

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Since an AIF may be set up under different legal forms, the governing statutes of such legal structures would play a pivotal role in determining the extent of liability of an investor:

a) Company: Under the Companies Act, the liability of a shareholder is limited to the extent of unpaid share capital of such shareholder.

b) LLP: Under the LLP Act, the liability of a partner for the debts and obligations of the LLP is restricted to the unpaid capital it has agreed to contribute to the LLP as per the terms of the LLP agreement.

c) Trust: No statutory limitation on the liability of a beneficiary of trust is provided for, and any limitations would be as contractually agreed with a beneficiary.

Therefore, while certain statutory limitations of liability are provided in respect of companies and LLPs, the common practice amongst AIFs is to strictly impose a limitation on liability of any investor to the extent of such investor's capital commitment or distributions received by the investor from the AIF. The members of LPACs do not carry any fiduciary liability towards the investors in the AIF and are accorded contractual protections to that effect in the AIF documents.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

LLPs and companies are the prevalent legal structures for the Managers of AIFs. A generalised overview of key factors that may be helpful whilst deciding the structure to proceed with are provided below:

a) LLPs: Relatively less compliance requirements; distributions are not taxed in the hands of the partners; higher tax rate compared to a Company; may be preferred where the stakeholders of the Manager wish to regularly extract accrued income as income from an LLP received by its partners is tax-free in their hands.

b) Companies: Relatively higher compliance requirements; lower corporate tax rate compared to an LLP; may be preferable where the stakeholders of the Manager do not wish to regularly extract accrued income/dividends since the dividend is taxable in the hands of recipient shareholders.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

SEBI prescribes that suspension of redemption in open-ended Category III AIFs shall be justified only in exceptional circumstances provided that such suspension is exclusively in the best interest of investors of the AIF or if the suspension is required under the AIF Regulations or required by SEBI.

It is possible to incorporate the following in the AIF documents: (i) lock-in periods; (ii) provisions to suspend redemptions (circumstances for delay/suspension of redemption and procedure to be followed on occurrence thereof need to be disclosed); and (iii) gating of redemptions depending on the volume of redemption requests received.

It is possible for the Manager to stipulate restrictions on transfers in the case of both open-ended and closed-ended funds.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no legislative restrictions on the transfer of an investor's interest in the AIF prescribed under the AIF Regulations, except that the transferee should not hold a capital commitment of less than INR 10,000,000 and the transferor should either transfer its entire interest in the AIF or continue to hold a capital commitment of at least INR 10,000,000 even post such a transfer.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The Manager of a Category I AIF or a Category II AIF cannot invest more than 25% of the investible funds of such AIF in one portfolio entity (the limit is 10% in case of a Category III AIF). Please also refer to question 4.2 below for the investment norms to be followed by Managers of different categories of AIFs.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The AIF Regulations govern the production of the PPM, which is used by the Manager as a marketing/commercial cum regulatory document, for seeking investors' interest in the AIF. The AIF Regulations require any placement of AIF units to be strictly on a private placement basis and to that extent any marketing material of the AIF (including any investor pitchbook) has to contain requisite disclaimers to that effect. An AIF cannot have more than 1,000 investors.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The PPM discloses material facts and information that an investor may need to know before making a decision to invest in the AIF. SEBI has also issued standardised templates of the PPM for different categories of AIFs, which stipulate the minimum standard of disclosures required under the PPM, including, *inter alia*:

a) Investment objective and investment process of the AIF.
b) The process of distribution of investment proceeds to the investors.
c) The contractual terms applicable to investors including any fees or expenses to be charged.
d) Track record of the Manager and its key personnel.
e) Conflicts of interest and mitigation procedures.
f) Disciplinary history of the key constituents of the AIF.
g) Risks and legal considerations pertaining to investments in the AIF.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

The PPM is submitted to, and examined by SEBI at the time of applying for AIF registration. Any changes to the PPM are required to be periodically notified to SEBI and investors and for material changes to be carried out, prior investor approval (per the prescribed thresholds) as well as a SEBI approval (in certain circumstances) is required.

3.4 What restrictions are there on marketing Alternative Investment Funds?

AIFs are only permitted to raise funds by way of private placement and the Manager cannot publicly advertise the investment offering.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

It is possible to apply for an in-principle approval for an AIF; however, in most instances this route may be less efficient than applying for a licence upfront. This should not be considered as an equivalent to "pre-marketing" in other jurisdictions such as the European Union. In practice, pre-marketing in India is carried out by incorporating adequate disclaimers in the pre-marketing pitchbooks/presentations.

3.6 Can Alternative Investment Funds be marketed to retail investors?

SEBI considers AIFs to be a non-retail product, and any solicitation of funds must only be on a private placement basis. Having said that, SEBI does not specify any criteria for investors other than as discussed under question 3.7 below.

3.7 What qualification requirements must be met in relation to prospective investors?

There are no eligibility criteria for investors for most categories of AIFs; however, each investor needs to commit a minimum of INR 10,000,000.

Angel funds are an exception to the aforementioned rule, where a lower minimum commitment of INR 250,000 per investor is stipulated; however, investors in an angel fund need to qualify as an "angel investor" as per the prescribed criteria.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no additional restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

The minimum investment criteria as applicable to an investor in an AIF has been elaborated under question 3.7 above. The AIF Regulations also mandate that a person or entity be designated as the "sponsor" of an AIF (sponsor is meant to be a person/entity instrumental in setting up of the AIF). The manger can fulfil the obligations of being the sponsor as well. The sponsor is mandated to commit as a continuing interest to the AIF, which for Category I AIFs and Category II AIFs is 2.5% of the corpus or INR 50,000,000, whichever is lower; and for Category III AIFs is 5% of the corpus or INR 100,000,000, whichever is lower. SEBI examines the credentials of the sponsor while granting registration to the AIF, and the sponsor has certain additional obligations (other than maintaining the continuing interest) and is also subject to the oversight of SEBI. Residency and citizenship, or ownership of the sponsor, as applicable, may cause certain additional conditions to be applicable to the investments of the AIF as elaborated under question 1.6 above.

The NDI Rules do not permit the citizens of or entities incorporated in Bangladesh or Pakistan to invest into AIFs.

As of May 2020, India has introduced certain restrictions regarding foreign investment coming in, directly or indirectly, from a country that shares a land border with India and such investments may require the Indian Government's approval.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

There are no such restrictions.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

AIFs are primarily permitted to invest in Indian securities. The definition of 'securities' would generally be as provided for under the Securities Contracts (Regulation) Act, 1956 ("**SCRA**"), which include a wide variety of equity and debt instruments (compulsorily/optionally/partially/non convertible), derivatives, mutual fund units, etc.

In general, a large variety of investment activities are permissible, and most commercial requirements may be appropriately structured. As discussed in question 1.4 earlier, read along with question 4.2 below, depending upon the category of AIF, certain investment norms will have to be complied by the AIF.

AIFs can also invest up to 25% of their investible funds in equity and equity-linked instruments of overseas venture capital undertakings (being unlisted companies) with an Indian connection, with prior SEBI approval. Overseas investments for all AIFs are subject to an aggregate limit as notified from time to time.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

The AIF Regulations prescribe different investment norms depending on the category under which an AIF registers.

For example, a venture capital fund, being a prominent sub-category of Category I AIFs, *inter alia*, has to invest at least two-thirds of its investible funds in unlisted equity shares or equity-linked instruments of a venture capital undertaking (which are unlisted operating Indian companies) or in companies listed or proposed to be listed on a SME exchange or SME segment of an exchange.

Category II AIFs offer more flexibility than Category I AIFs since the only equivalent investment norm is that they need to invest more than 50% of their investible funds in unlisted Indian securities. In certain cases, while the investment strategy may commercially fit under one of the sub-categories of Category I AIFs, it may make sense to seek a licence as a Category II AIF given the additional flexibility it offers including: (i) the ability to invest in a mix of unlisted and listed securities; and (ii) no norms stipulating a break-up between equity and debt instruments.

Category III AIFs are suitable for AIFs intending to substantially invest in listed securities (the option to invest in unlisted securities may be retained). Similarly, a Category III AIF licence may be suitable if there is an intent to invest in derivatives (in India, the only permissible derivative contracts are those that qualify as a security and are traded on a recognised exchange) and/or utilise leverage (Category I and II AIFs only permit borrowings to meet temporary funding requirements and cannot take leverage).

Investment in 'associates' by AIFs is permitted only with the approval of 75% of the investors (by value of their investment) of the AIF (except angel funds, which are not permitted to invest in associates).

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

AIFs are permitted to invest in securities as per the SCRA. Loans are not securities, and therefore the granting of loans is not permitted for AIFs. This may be resolved through structuring the transaction as a permissible security, i.e. in the form of a debenture or another loan instrument falling within the definition of 'securities'.

As discussed in question 1.6, if the ownership or control of the Manager or sponsor is foreign, downstream investment by the AIF may be subject to additional norms. Notably, in such a situation, equity and certain types of equity-linked investments may be subject to additional regulatory requirements such as sectoral caps, pricing guidelines, etc. as per the NDI Rules.

Further, if a Category III AIF receives any foreign investment, it shall make portfolio investment in only those securities or instruments in which a foreign portfolio investor is permitted to invest as per the NDI Rules.

Exposure to derivatives is considered as a form of leverage which has been elaborated upon under question 4.4 below.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Category I and II AIFs are not permitted to borrow other than to meet temporary funding requirements for not more than 30 days, on not more than four occasions in a year and not more than 10% of the investible funds.

Category III AIFs are permitted to borrow or utilise leverage (which shall also take into account exposure to derivatives) not exceeding two times their net asset value.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

As touched upon under question 3.2 above, in addition to the disclosures to be made in the PPM, the Manager and sponsor are required to disclose their: (i) investment in the AIF to the investors; and (ii) all conflicts of interests to the investors. For reporting to SEBI and investors, please refer to the details provided in question 5.3 below.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

While SEBI retains the power to request any information regarding an AIF or its Manager, in practice they do not generally

ask for the details of investors. Details about the Manager are shared with SEBI as elaborated upon in question 1.5 above.

There is no such requirement to disclose the details of beneficiaries in case an AIF is established as trust, which is usually the preferred and followed structure in India.

In case the AIF is set up in the form of company, the details of shareholders and directors are required to be filed with the RoC. Similarly, where an AIF is structured as an LLP, the details of designated partners and partners must be filed with the RoC. The RoC permits access to such details online.

In the event any investor is a non-resident, there are certain reporting obligations to the Reserve Bank of India. Further, in an unlikely scenario, other regulators may call for information on certain investors (or their underlying beneficial owners/controllers) from the Manager, pursuant to Indian anti-money laundering laws, taxation laws, etc.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Key reporting requirements to investors include:

a) An annual report to the investors including, *inter alia*, the financial information of investee companies.
b) Six-monthly consolidated reporting of any changes to the PPM.
c) Periodic reporting of: (a) detailed information regarding fund investments; (b) any fees paid to the Manager or sponsor; and (c) any fees charged to the AIF or any investee company by an associate of the Manager or sponsor. Additionally, Category III AIFs would need to periodically disclose information regarding utilisation of leverage.
d) As and when they occur: (a) any inquiries or legal actions by regulatory bodies in any jurisdiction; (b) any material liability arising during the AIF's tenure; (c) any breach of PPM or any other fund documents; (d) chance in control of the Manager or sponsor or investee company; and (e) any significant change in the key investment team.

Key reporting to SEBI includes:

a) For Category I and II AIFs, a quarterly report; for Category III AIFs, a monthly report.
b) Six-monthly consolidated reporting of any changes to the PPM.
c) Any violations of the AIF Regulations.
d) Findings, along with corrective steps, if any, of the annual audit of the PPM.

On receipt of any foreign investment or if the investments of the AIF are to be treated as indirect foreign investments due to the ownership of the Manager or sponsor, additional reporting under the NDI Rules will be applicable.

5.4 Is the use of side letters restricted?

The use of side letters is permitted; however, side letter terms should not have any adverse impact on the economic rights or any other rights of other investors. Differential rights or side letter terms on certain matters may not be possible to be extended to any investor which are in nature of providing preferential exit, favourable indemnification or giveback/clawback terms.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Category I and II AIFs

Under the Indian Income Tax Act, 1961 ("**ITA**"), a tax pass-through status has been accorded to Category I and II AIFs with respect to any gains/income (other than "business income") earned by them, which shall be exempt from tax in the hands of such Category I or II AIF and taxed directly in the hands of the investors. Further, any loss incurred by the AIF (other than "business loss") may be allowed as pass-through to the investors subject to certain conditions. Please refer to question 6.4 for more information. In case the income of the AIF is characterised as business income, then income in the nature of profits and gains of business would be subject to tax at the AIF level at the applicable maximum marginal rate and would be exempt from tax in the hands of the investors.

An AIF would be required to deduct tax at the rate of 10% on any income, with respect to which it is eligible for tax pass-through, at the time of credit or payment of such income in the name of the resident investors. However, in case of non-resident investors, the AIF should be required to deduct tax at 'rates in force' on any non-business income paid to/credited in the name of such nonresident investors. Further, in case of non-resident investors, no deduction of tax shall be made in respect of any income which is not chargeable to tax under the ITA.

Category III AIFs

Category III AIFs do not have a pass-through status under law; however, in respect of closed-ended Category III AIFs, it may be possible to structure them as a determinate private trust and achieve a simulated pass-through status for them (in which case taxation would be similar to that of Category I and II AIFs as discussed above). Taxation in respect of Category III AIFs is relatively complicated and may require specialised advice.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

Taxation of the Manager would depend on the form as well as the stream of revenue under contention.

In general, the primary streams of revenue are the management fees or carried interest. Management fees would be subject to a goods and services tax ("**GST**") of 18%. In practice, this is generally borne by the Fund. In addition, since the management fee would be an income for the Manager, it would be subject to income tax as per the ITA.

Unlike other jurisdictions, Indian taxation laws do not recognise "carried interest" as a specialised stream of revenue from a taxation perspective. Therefore, "carried interest" would be subject to taxation under one of the other possible streams of revenue. In general, Managers attempt to qualify their revenue from "carried interest" as capital gains (at a rate of up to 23.296%) by structuring it as a return on their continuing interest investment maintained in the AIF. However, tax authorities may dispute such claim and seek to classify "carried interest" as a fee income, thereby subject it to a higher taxation as for management fees.

It may be noted that, for Category III AIFs, often *in lieu* of a "carried interest", a performance fee is charged, taxation of which would be similar as for management fees.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There is no concept of an establishment tax in India with respect to AIFs. Transfer of an investor's interest would be treated as a transfer of a "capital asset" and may be subject to capital gains tax. Please refer to question 6.4 for more information.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

As stated in question 6.1 above, Category I and Category II AIFs are tax pass-through vehicles (an open-ended Category III AIF does not enjoy a tax pass-through status and is taxed at the applicable rates). A generalised overview of local Indian taxation with respect to various securities and investor types is provided below under the two broad headings of capital gains and other income.

Capital gains

Capital assets are classified as long-term assets ("**LTA**") or short-term assets ("**STA**") based on the period of holding of these assets computed from the date of acquisition to the date of transfer, and as per which, the gains may be taxable as short-term capital gains ("**STCG**") or long term capital gains ("**LTCG**").

Nature of asset	STA	LTA
For assets being shares in a company or any other security listed on a recognised stock exchange in India	Held for not more than 12 months	Held for more than 12 months
For assets being shares of a company (other than shares listed on a recognised stock exchange in India)	Held for not more than 24 months	Held for more than 24 months
Other assets	Held for not more than 36 months	Held for more than 36 months

In general, capital gains may be chargeable to tax as follows:

Type of investor	Companies		Firms/LLPs		Others	
Description	**Resident (%)**	**Non-resident (%)**	**Resident (%)**	**Non-resident (%)**	**Resident (%)**	**Non-resident (%)**
STCG on transfer of listed equity shares on a recognised stock exchange/to be listed equity shares or units of equity oriented mutual fund and on which Securities Transaction Tax ("**STT**") has been paid	17.472	16.380	17.472	17.94	17.940	17.940
STCG on other securities	34.944	43.680	34.944	42.744	42.744	42.744
LTCG on transfer of listed equity shares on a recognised stock exchange/to be listed equity shares or units of equity oriented mutual fund and on which STT has been paid	11.648	10.920	11.648	11.960	11.960	11.960
LTCG on transfer of listed bonds and listed debentures	11.648	10.92	11.648	14.248	14.248	14.248
LTCG on transfer of unlisted securities	23.296	10.92	23.296	14.248	28.496	14.248

Additional indexation benefits may be available in certain instances on STCG and LTCG.

Other income

Type of investor	Companies		Firms/LLPs		Others	
Description	**Resident (%)**	**Non-resident (%)**	**Resident (%)**	**Non-resident (%)**	**Resident (%)**	**Non-resident (%)**
Interest income	34.944	43.68	34.944	42.744	42.744	42.744
Dividend income	34.944	21.84	34.944	23.92	35.88	23.92

Tax treaty benefits
As per Section 90(2) of the ITA, the provisions of the ITA would apply to the extent they are more beneficial than the provisions of the Double Taxation Avoidance Agreement ("**DTAA**") between India and the country of residence of the offshore investor to the extent of availability of DTAA benefits to the offshore investors. This would be subject to the investor furnishing the requisite information and documentation including a tax residency certificate.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

It is not necessary to obtain a tax ruling.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

According to the Inter-Governmental Agreement between the USA and India read with the FATCA provisions, foreign financial institutions in India are required to report tax information about US account holders to the Indian Government. The Indian Government has enacted rules relating to FATCA reporting in India. A statement is required to be provided online in Form 61B for every calendar year by 31 May as per the ITA. The Reporting Financial Institution (including an AIF) is expected to maintain and report the requisite information with respect to each reportable account. Further, there exist specific guidelines for conducting due diligence of reportable accounts, *viz.* US reportable accounts and other reportable accounts. SEBI also requires all AIFs to adhere to the applicable FATCA compliances.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

India has notified the provisions of BEPS Multilateral Instrument under section 90(1) of the ITA and has specified the date of entry into force as 1 October 2019.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

In India, any pooling of monies by a Manager from third parties on a private placement basis with an underlying objective to earn a fee by making investments under any pre-defined strategy requires a prior AIF registration. There are certain other pooling structures like SEBI regulated collective investment schemes (CIS) and RBI regulated non-banking financial companies (NBFC), but these are not preferred over AIFs from a tax perspective and serve different purposes. Similarly, there are various managed account structures permitted under the PMS Regulations and IA Regulations as described under question 1.2 above, but they do not permit pooling of investor securities and other flexibilities that an AIF structure provides.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Please refer to our observations about the availability of pass-through status for Category III AIFs and taxation of "carried interest" under questions 6.1 and 6.2 respectively.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

A tax pass-through is expected for Category III AIFs.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

SEBI had constituted a standing committee 'Alternative Investment Policy Advisory Committee' ("**AIPAC**") in March, 2015. AIPAC has since then made various recommendations to SEBI, some of which have already been implemented. India's first international financial services centre ("**IFSC**") was also notified in Gujarat at the Gandhinagar Fin-Tech City ("**GIFT City**") to welcome the setting up of offshore, India-focused pooling vehicles on Indian soil as an alternative to setting up such vehicles in traditional offshore jurisdictions like Mauritius and Singapore. Several tax reforms and regulatory changes have been proposed from time to time and more are being offered to make the IFSC attractive for Managers and foreign investors. Notably, the Central Government has recently announced the establishment of a unified regulator, namely the International Financial Services Centre Authority, to accelerate the development of GIFT City. SEBI has also recently suggested reforms on the governance front whereby, going forward, AIFs investing in listed securities will have to mandatorily adopt a Stewardship Code.

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IC Universal Legal is a leading financial services law firm, comprising a team of 125+ lawyers including 18 partners, across seven offices in India. The Investment Funds department, ever since the inception of the AIF regulatory regime in India, has continued to maintain a leadership position, enjoying a significant market share amongst Indian law firms. The Firm represents some of the largest AIFs, domestic and offshore asset and wealth management players and is well known for its expertise in providing end-to-end solutions to funds, right from the setting up of the investment fund, obtaining regulatory licences, limited partnership negotiations and then assisting in investing/deploying the funds in investee companies. The Firm and its partners have been recognised and ranked by the likes of *Chambers & Partners*, *IFLR*, *Who's Who Legal*, *Lexology*, *IBLJ* and several other reputed international law firm ranking agencies/publications in the Private Equity/Venture Capital, Regulatory and Investment Funds space.

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Ireland

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Irish Funds Legislation, which governs the establishment and operation of Irish AIFs authorised by the Central Bank of Ireland (the "**Central Bank**"), is set out in question 1.3 below. Additionally, Irish AIFs structured as European long-term investment funds ("**ELTIFs**") are impacted operationally by Regulation (EU) No 2015/760 (the "**European Long-term Investment Funds Regulation**").

The governing legislation of Irish AIFs not subject to authorisation by the Central Bank depends on the legal form of those AIFs; e.g. the Companies Act, 2014 will apply to corporate AIFs not established as investment companies with variable capital.

All Irish AIFs are impacted operationally by:

- the European Communities (Alternative Investment Fund Managers) Regulations 2013 (S.I. 257 of 2013) as amended (the "**Irish AIFM Regulations**"), which transposed Directive 2011/61/EU (the "**AIFM Directive**") into Irish law; and
- Commission Delegated Regulations and Commission Implementing Regulations adopted by the EU Commission in specified areas in order to ensure that the AIFM Directive is implemented consistently across the EU, the principal one of which is the Commission Delegated Regulation (EU) No 231/2013 supplementing the AIFM Directive with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (the "**Commission Delegated Regulation**").

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

AIFMs

Irish AIFMs managing Irish AIFs established under Irish Funds Legislation are required to be authorised under the Irish AIFM Regulations. However, an Irish registered AIFM may manage an Irish AIF marketed to qualifying investors (a "**QIAIF**") for a two-year start-up period during which the Central Bank will not require the QIAIF to have an authorised AIFM. After the start-up period, an authorised AIFM must be appointed.

Non-Irish EU AIFMs managing Irish AIFs are required to be authorised in their home jurisdiction and to have availed of the passporting provisions pursuant to Article 33 of the AIFM Directive.

Although non-EU AIFMs currently have no passporting rights under the AIFM Directive and will not have such rights until such time as they are extended to non-EU AIFMs by the European Commission, non-EU AIFMs may avail of transition benefits allowed by the Central Bank for such entities and consequently may manage an Irish QIAIF, provided they are designated by the QIAIF as the AIFM and certain rules as set out in question 1.8 below are complied with. However, in such circumstances, the non-EU AIFM must be approved by the Central Bank to act as an investment manager of Irish authorised collective investment schemes (see below).

An Irish AIF constituting a collective investment scheme authorised and supervised by the Central Bank under Irish Funds Legislation and marketed to retail investors (a "**RIAIF**") must have an authorised AIFM. Consequently, a non-EU AIFM cannot avail itself of the transition benefits allowed by the Central Bank as referred to above and manage a RIAIF on the basis that it is designated by the RIAIF as the non-EU AIFM.

Non-AIFM Irish Management Companies/General Partners

RIAIFs and QIAIFs, depending on their legal form, may be required to appoint a management company/general partner to carry out the management of those AIFs. Where such a management company/general partner is not acting as the AIFM, it must be approved by the Central Bank and meet the requirements relating to such entities as set out in the Central Bank's AIF Rulebook (the "**AIF Rulebook**"), e.g.:

- a minimum capital requirement of at least EUR 125,000 or one quarter of its total expenditure taken from the most recent audited accounts (whichever is higher);
- organisational requirements such as the appointment of a compliance officer who must be located in the State, policies and systems to identify, control and monitor risk, accounting policies and procedures, maintenance of records, etc.; and
- adequate management resources.

Investment Managers

Investment managers or sub-investment managers, which are one of the following entities, will not usually be subject to an additional regulatory review process by the Central Bank:

- UCITS management companies;
- MiFID investment firms;
- EU credit institutions; and
- externally appointed authorised AIFMs.

Investment managers which are not one of the entities listed above may only be appointed where (i) a Memorandum of Understanding ("**MoU**") is in place between the Central Bank and the competent authority in the home jurisdiction of the

investment manager, and (ii) the Central Bank has approved the investment manager following receipt of a completed Investment Manager Clearance Form.

Investment Advisors

The Central Bank does not apply an approval process to investment advisors in order for such entities to provide investment advice in relation to a RIAIF/QIAIF, provided that the managers/directors of the RIAIF/QIAIF confirm that the advisors in question will act in an advisory capacity only and will have no discretionary powers over any of the assets of the RIAIF/QIAIF.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Irish AIFs authorised under "Irish Funds Legislation" as detailed below are required to be authorised by the Central Bank, which has the power to impose conditions on them. The current conditions that the Central Bank imposes are contained in an AIF Rulebook:

(a) unit trusts under the Unit Trusts Act 1990;
(b) investment companies under Part 24 of the Companies Act 2014;
(c) investment limited partnerships ("**ILPs**") under the Investment Limited Partnerships Act 1994;
(d) common contractual funds ("**CCFs**") under the Investment Funds, Companies and Miscellaneous Provisions Act 2005; and
(e) Irish collective asset-management vehicles ("**ICAVs**") under the Irish Collective Asset-management Vehicles Act 2015, (collectively referred to as the "**Irish Funds Legislation**").

In addition, Irish AIFs structured as ELTIFs must be authorised by the Central Bank pursuant to the European Long-term Investment Funds Regulation.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The Central Bank allows RIAIFs/QIAIFs to be structured as follows:

(a) Open-Ended
An AIF is considered open-ended by the Central Bank where it:
- provides redemption facilities on at least a (i) monthly basis in the case of a RIAIF, and (ii) quarterly basis in the case of a QIAIF;
- redeems, when requested, at least (i) 10% of net assets in the case of a RIAIF/QIAIF that redeems on a monthly basis or more frequently, or (ii) 25% in the case of a QIAIF that redeems on a quarterly basis; and
- does not impose a redemption fee in excess of (i) 3% of the net asset value per unit in the case of a RIAIF, or (ii) 5% in the case of a QIAIF.

An AIF, which provides for a period of greater than 30 days in the case of a RIAIF and 90 days in the case of a QIAIF between the dealing deadline and the payment of redemption proceeds, will not be subject to the above requirements provided it classifies itself as open-ended with limited liquidity.

(b) Open-Ended with Limited Liquidity
A RIAIF/QIAIF is classified as open-ended with limited liquidity if it does not meet one or more of the requirements for an open-ended AIF but does permit the redemption of units throughout the life of the AIF.

(c) Closed-Ended
The Central Bank considers a closed-ended RIAIF/QIAIF to be one which does not facilitate the redemption of units at the request of the unitholders during the life of the AIF.

1.5 What does the authorisation process involve and how long does the process typically take?

RIAIFs/QIAIFs

The application for authorisation of a RIAIF/QIAIF must be made by (i) the AIFM, together with (ii) the corporate AIF or management company/general partner in the case of a non-corporate AIF, and (iii) the depositary, in the case of a unit trust or CCF.

All parties to a RIAIF/QIAIF must have been authorised or otherwise deemed acceptable to the Central Bank prior to the application for authorisation (e.g. the management company, general partner, AIFM, directors in the case of a corporate AIF, depositary, other service providers such as the fund administrator, investment manager, etc.).

The directors of any entity authorised by the Central Bank (including, *inter alia*, the directors of a corporate RIAIF/QIAIF) are required to meet certain standards of fitness and probity. As part of the Central Bank's fitness and probity requirements, any director proposed to be appointed must be pre-approved by the Central Bank. In this regard, an individual online questionnaire must be completed by the proposed director and validated and submitted on behalf of the appointing entity by a certain time period in advance of the proposed authorisation date for the RIAIF/QIAIF (i.e. at least 20 working days in the case of a RIAIF and at least five working days in the case of a QIAIF).

A RIAIF/QIAIF is not subject to any minimum capital requirements unless it is internally managed and therefore constitutes the AIFM.

In relation to the authorisation of QIAIFs, there is no prior filing of QIAIF documentation for review by the Central Bank. Instead, there is a self-certification regime (i.e. certification has to be given that the Central Bank's disclosure requirements relating to the QIAIF documentation are met). Because there is no prior review by the Central Bank, the timeframe for authorisation of a QIAIF is within the control of the relevant parties based on the length of time it takes to negotiate and agree the QIAIF documents (subject to the pre-clearance of any persons or parties required by the Central Bank). Once the documentation is filed online by 5pm on the business day prior to the date for which authorisation is sought, a QIAIF will be authorised on the requested date without a prior review. The Central Bank may carry out a "spot check" post-authorisation review.

This contrasts with the authorisation process for RIAIFs, as the Central Bank requires certain documents (e.g. the prospectus) to be submitted for review and cleared of comment by the Central Bank in advance of the formal application for authorisation being submitted. As a result, a RIAIF with an externally appointed AIFM can take approximately eight to 10 weeks to be authorised by the Central Bank from the date of submission of applicable documents for review.

Internally Managed RIAIF/QIAIF Constituting the AIFM

Where it is proposed that a RIAIF or QIAIF will be internally managed and constitute the AIFM, a separate application for

authorisation of an AIFM must be submitted to the Central Bank (together with other supporting documentation, including, *inter alia*, a programme of activity) and such authorisation must be obtained before formal application for authorisation of the RIAIF/QIAIF may be submitted to the Central Bank.

Any such RIAIF/QIAIF is required to meet the minimum capital requirements of an AIFM as set out in Regulation 10 of the Irish AIFM Regulations (equivalent to Article 9 of the AIFM Directive).

The Central Bank is obliged to inform the AIFM in writing as to whether or not authorisation has been granted, within three months of a complete application. However, the Central Bank may extend this period for another three months where it considers it necessary because of the specific circumstances of the case.

1.6 Are there local residence or other local qualification or substance requirements?

Directors

A minimum of two directors in a corporate RIAIF/QIAIF, or in any entity which is authorised by the Central Bank and provides non-AIFM fund services to such an AIF (e.g. non-AIFM management company, general partner, fund administrator or depositary), must be Irish-resident. In the case of a RIAIF/QIAIF, an Irish resident is a person present in Ireland for the whole of 110 business days per year.

In the case of an Irish AIFM authorised by the Central Bank which has a Central Bank PRISM impact rating of Medium Low or above, the AIFM must have at least:

(i) three directors resident in Ireland or, at least, two directors resident in Ireland and one designated person (i.e. a person designated by the board to carry out one or more managerial functions) resident in Ireland;
(ii) half of its directors resident in the European Economic Area ("EEA"); and
(iii) half of its managerial functions performed by at least two designated persons resident in the EEA.

In the case of an Irish AIFM authorised by the Central Bank which has a PRISM impact rating of Low, the AIFM must have at least:

(i) two directors resident in Ireland;
(ii) half of its directors resident in the EEA; and
(iii) half of its managerial functions performed by at least two designated persons resident in the EEA.

As part of the Central Bank's fitness and probity requirements, a proposed director/designated person is required to confirm (via the individual questionnaire as referred to in question 1.5 above) his/her time commitment in days that will be provided per year in respect of that directorship or role as designated person. In addition, the appointing entity, in validating the questionnaire, is required to confirm its expectation regarding the proposed director's/designated person's time commitment per year.

Fund Governance Code

Corporate RIAIFs/QIAIFs or the management companies/general partners of non-corporate RIAIFs/QIAIFs are recommended to adhere to a voluntary corporate governance code for funds put in place by the Irish Funds Industry Association at the request of the Central Bank. Such code provides, *inter alia*, for a majority of non-executive directors and at least one independent non-executive director.

Fund Service Providers' Governance Code

Irish fund service providers such as fund administrators and depositaries are recommended to adhere to a voluntary corporate governance code put in place by the Irish Funds Industry Association at the request of the Central Bank. Such code provides, *inter alia*, for at least one independent non-executive director.

Non-Irish Parties

Local requirements regarding the appointment of a non-Irish AIFM, investment manager or investment advisor are detailed in question 1.2 above.

1.7 What service providers are required?

The service providers involved in a RIAIF/QIAIF will depend on:

- the legal structure of the AIF as detailed in question 1.3 above (e.g. a management company/general partner will be required to be appointed in the case of a non-corporate AIF);
- the services which the AIFM will itself provide (e.g. whether it will be necessary to appoint an external valuer, an administrator, transfer agent, distributor, etc., if these services are not provided by the AIFM);
- the investment strategy relating to the AIF (e.g. whether a prime broker is required to be appointed in the case of an AIF with a hedge fund strategy); and
- the marketing strategy relating to the AIF (e.g. any local service providers required to be appointed in the jurisdiction where the AIF is marketed).

The appointment of an AIFM and depositary is required under the Irish AIFM Regulations.

A RIAIF/QIAIF must appoint auditors and a money laundering reporting officer and, if a corporate AIF, will need to appoint a secretary. In addition, if it is intended to list the units of the AIF on Euronext Dublin, it will be necessary to appoint an Irish listing sponsor. It is also customary for Irish legal advisers to be appointed.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

AIFMs

The rules applying to non-Irish AIFMs depend primarily on whether they are EU- or non-EU (third country)-based.

Non-Irish EU AIFMs managing Irish RIAIFs/QIAIFs are not subject to any additional rules imposed by the Central Bank.

As stated in question 1.2 above, non-EU FMs may currently avail of the transition benefits allowed by the Central Bank for such entities and act as AIFM of QIAIFs. However, the non-EU AIFM and the QIAIF it manages must comply with the provisions of the Central Bank's AIF Rulebook that apply in the case of QIAIFs with registered AIFMs, e.g. certain provisions of the AIFM Directive relating to delegation, liquidity management, valuation and transparency obligations.

Investment Managers

Non-Irish investment managers approved by the Central Bank to act as an investment manager of RIAIFs/QIAIFs, the process for which is detailed in question 1.2 above, are not subject to any rules imposed by the Central Bank. However, any proposed change in the legal/regulatory status or name of the investment manager must be advised to the Central Bank.

Investment Advisers
Non-Irish investment advisers providing advice in relation to a RIAIF/QIAIF are not subject to any rules imposed by the Central Bank.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The Central Bank has entered into numerous national, bilateral and international memoranda of understanding. In particular, the Central Bank has entered into 45 supervisory co-operation arrangements with non-EU competent authorities as part of the implementation of the AIFM Directive. Separately, Ireland has signed comprehensive Double Taxation Agreements with 74 countries, 73 of which are in effect.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

The principal legal structures of RIAIFs/QIAIFs are set out in question 1.3 above, the main features of which are set out below:

(a) unit trusts are contractual arrangements created under a trust deed made between a management company and a depositary. Unit trusts do not have their own legal personality and contracts are entered into by the management company and, in certain cases, by the trustee. A unit represents an undivided beneficial interest in the assets of the unit trust;

(b) investment companies are public limited liability companies incorporated with variable capital, i.e. the actual value of the paid-up share capital is equal at all times to the value of the net asset value of the company. Shares issued do not represent a legal or beneficial interest in the company's assets;

(c) ILPs are partnerships between one or more general partners and one or more limited partners, constituted by written agreements between the parties known as partnership agreements. A general partner is personally liable for the debts and obligations of the partnership and a limited partner contributes or undertakes to contribute a stated amount to the capital of the partnership;

(d) CCFs are funds constituted under contract law by means of a deed of constitution executed under seal by a management company. The CCF is an unincorporated body and does not have a legal personality and therefore may act only through the management company. Participants in the CCF hold their participation as co-owners and each participant holds an undivided co-ownership interest as a "tenant in common" with other participants; and

(e) ICAVs are corporate bodies with limited liability where the actual value of the paid-up share capital is at all times equal to the net asset value of the ICAV and the share capital is divided into a specified number of shares without assigning any nominal value to them. The assets of the ICAV belong exclusively to the ICAV and no shareholder has any interest in the assets of the ICAV.

Each of the above-referenced AIFs may be established as an umbrella fund with separate sub-funds.

It is also possible to have unauthorised AIFs (i.e. AIFs that are not authorised by the Central Bank under Irish Funds Legislation), the principal legal structures of which are companies, trusts and limited partnerships.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

In investment companies and ICAVs, the liability of the shareholders is limited to the amount, if any, unpaid on the shares held by them.

In unit trusts, the limited liability of the unitholders under the trust deed will depend on the contractual provisions in the trust deed.

In ILPs, the liability of the limited partners is limited to the stated amount of capital they have contributed or undertaken to contribute and, except in limited circumstances set down in the Investment Limited Partnerships Act 1994, does not extend to the debts of the partnership beyond the amount contributed.

In CCFs, the liability of a unitholder is limited to the amount agreed to be contributed for the subscription of units.

The statutory limited liability of investors based on the legal structure of the AIF applies in respect of any fund type established using such legal structure.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

The principal legal structure used for managers and advisers of RIAIFs/QIAIFs is a private company incorporated with limited liability.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Although RIAIFs/QIAIFs may apply redemption gates if provided for in the applicable fund documentation, the Central Bank currently imposes limits on an AIF's ability to restrict redemptions on any one dealing day in the context of open-ended funds. These limits are detailed in question 1.4 above.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no legislative restrictions on transfers of investors' interests in RIAIFs/QIAIFs other than in ILPs. A limited partner may only assign his partnership interest subject to the consent of all general partners to the assignee being admitted to the partnership as a limited partner.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

Other than the investment restrictions and limitations imposed by the Central Bank on RIAFs/QIAIFs as referred to in section 4 below and the limitations imposed under the AIFM Directive (e.g. relating to asset stripping), there are no limitations on an AIFM's ability to manage RIAIFs/QIAIFs.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The Irish Funds Legislation and AIF Rulebook govern the production and offering of a prospectus by a RIAIF/QIAIF. Regulation (EU) No. 1286/2014 (the "**PRIIPS Regulation**") governs the production and offering of the key information document ("**KID**") by a RIAIF/QIAIF where units are to be offered to retail investors in the EU.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

There are prescriptive requirements relating to the content of a prospectus and, where applicable, a KID issued by or on behalf of a RIAIF/QIAIF. These are set out in the AIF Rulebook and PRIIPS Regulation, respectively.

The prospectus of a closed-ended Irish AIF must comply with the content requirements in the Irish Prospectus Directive Regulations (where applicable).

An AIF marketing in Ireland to retail investors must comply with the Consumer Protection Code. In addition, where a non-Irish AIF has been approved by the Central Bank to market in Ireland to retail investors (see question 3.6 below), certain wording prescribed by the Central Bank must be included in the non-Irish AIF's prospectus and in any marketing material distributed in Ireland for the purposes of promoting the AIF to retail investors.

The European Communities (Markets in Financial Instruments) Regulations 2017 (the "**Irish MiFID Regulations**"), which transposed the MiFID II Directive into Irish law, require authorised "investment firms" providing "investment services" (including, *inter alia*, investment advice and certain distribution services) to ensure that information provided to potential clients about, *inter alia*, "financial instruments" (such as units in an AIF) meets certain prescribed requirements.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

In relation to a QIAIF, a dated prospectus, constitutional document and material contracts must be submitted to the Central Bank for noting in advance of the date of authorisation. In relation to a RIAIF, the prospectus must be submitted for review and clearance by the Central Bank in advance of seeking the authorisation of the RIAIF from the Central Bank.

The prospectus of a closed-ended Irish AIF must be submitted to the Central Bank for approval in accordance with the Irish Prospectus Directive Regulations (where applicable).

The Central Bank does not currently require a KID to be filed with it.

Details of the arrangements for the marketing of shares in Ireland must be submitted to the Central Bank by a non-Irish AIF in support of any application for approval to market in Ireland to retail investors (see question 3.6 below).

3.4 What restrictions are there on marketing Alternative Investment Funds?

Marketing in Ireland to Retail Investors

A non-Irish AIF must be approved by the Central Bank to market in Ireland to retail investors (see question 3.6 below).

Marketing in Ireland to Professional Investors

Notification to the Central Bank pursuant to the Irish AIFM Regulations is required in advance of any marketing in Ireland to professional investors of:

- EU AIFs by Irish AIFMs;
- non-EU AIFs by EU AIFMs; and
- AIFs by non-EU AIFMs.

Marketing may only commence once the Central Bank has informed the AIFM that it may commence marketing and is conditional on the applicable requirements set out in the AIFM Directive having been complied with. For example, a non-EU AIFM must comply with the substantive transparency and other requirements set out under Articles 22, 23, 24 and, for private equity funds, 26–30, of the AIFM Directive:

- Article 22: each AIF must be audited in accordance with the prescribed standards.
- Article 23: sets out disclosure requirements such as disclosing to investors the current risk profile of the AIF.
- Article 24: provides requirements to "regularly" report to each Member State in which the AIF is marketed. Member States may require more information on a periodic as well as an *ad hoc* basis.
- Articles 26–30: set out detailed rules applicable to private equity funds only on the acquisition of control, including rules regarding asset stripping.

Non-Irish EU AIFMs marketing EU AIFs to professional investors in Ireland must only comply with their local rules.

Non-Irish registered EU AIFMs (as opposed to non-Irish authorised EU AIFMs that can avail of the passport pursuant to Article 33 of the AIFM Directive) cannot market AIFs that they manage to professional investors in Ireland.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

The concept of pre-marketing has not to-date been recognised by the Central Bank in Ireland. However, that will change as a result of a new harmonised regime for pre-marketing AIFs in the EU which has been introduced at EU level via the EU Cross Border Distribution of Collective Investment Undertakings Directive 2019/1160. That Directive, which amends the AIFM Directive, entered into force on 1 August 2019 and must be transposed into law by EU Member States before the 2 August 2021.

In the Directive, pre-marketing is defined as the "*provision of information or communication, direct or indirect, on investment strategies or investment ideas by an EU AIFM or on its behalf, to potential professional investors domiciled or registered in the Union in order to test their interest in an AIF which is not yet established, or in an AIF which is established, but not yet notified for marketing in accordance with Article 31 or 32, or in compartments of such AIFs, in that Member State where the potential investors are domiciled or have their registered office, and which in each case does not amount to an offer or placement to the investor to invest in the units or shares of that AIF or compartment*".

3.6 Can Alternative Investment Funds be marketed to retail investors?

RIAIFs/QIAIFs

QIAIFs may be only be marketed to retail investors where they constitute qualifying investors as detailed in question 3.7 below. RIAIFs may be marketed to retail investors.

Non-Irish AIFs

Non-Irish AIFs which propose to market their units in Ireland to retail investors must be authorised by a supervisory authority set up in order to ensure the protection of unitholders and which, in the opinion of the Central Bank, provides an equivalent level of investor protection to that provided under Irish laws, regulations and conditions governing RIAIFs.

A non-Irish AIF which proposes to market its units in Ireland to retail investors must make an application to the Central Bank in writing, enclosing certain prescribed information.

AIFs established in:

- Guernsey and authorised as Class A schemes;
- Jersey and authorised as recognised funds; and
- the Isle of Man as authorised schemes,

will receive approval to market their units in Ireland to retail investors on completion of the information and documentation required by the Central Bank. Other AIFs must demonstrate an equivalent level of investor protection to that provided under Irish laws, regulations and conditions governing RIAIFs.

The marketing of units in Ireland to retail investors is subject to the requirements set out in questions 3.2 and 3.4 above and may not take place until the AIF has received a letter of approval from the Central Bank.

3.7 What qualification requirements must be met in relation to prospective investors?

RIAIFs

A RIAIF has no regulatory minimum subscription requirement and no investor qualification requirements.

QIAIFs

A QIAIF may only be sold to qualifying investors and a minimum subscription of at least EUR 100,000 applies. A qualifying investor is:

(i) an investor who is a professional client within the meaning of MiFID;

(ii) an investor who receives an appraisal from an EU credit institution, a MiFID firm or a UCITS management company to the effect that the investor has the appropriate expertise, experience and knowledge to adequately understand the investment in the QIAIF; or

(iii) an investor who certifies that they are an informed investor by providing the following:
  - confirmation (in writing) that the investor has such knowledge of, and experience in, financial and business matters as would enable the investor to properly evaluate the merits and risks of the prospective investment; or
  - confirmation (in writing) that the investor's business involves, whether for its own account or the account of others, the management, acquisition or disposal of property of the same kind as the property of the QIAIF.

Qualifying investors must self-certify in writing to the QIAIF that they: (i) meet the minimum initial investment per investor and appropriate expertise/understanding tests; and (ii) are aware of the risk involved in the proposed investment and of the fact that inherent in such investment is the potential to lose all of the sum invested.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no additional restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

There are none in the context of RIAIFs/QIAIFs.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

No, there are no such restrictions. However, any intermediaries used to fundraise in Ireland must be regulated where required pursuant to Irish laws. This will depend on the specific activity being carried out by the intermediary in Ireland.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

The investment activities of a loan originating QIAIF (other than instruments which are held for treasury, cash management and hedging) are limited to the business of issuing loans, participating in loans, investment in debt/credit instruments, participations in lending and to operations relating thereto, including investing in equity securities of entities or groups to which the loan originating QIAIF lends. Such QIAIFs may not originate loans to natural persons, other collective investment schemes, the AIFM or depositary of the QIAIF or delegates or group companies of these, financial institutions or related companies except in the case where there is a *bona fide* treasury management purpose which is ancillary to the primary objective of the loan originating QIAIF, and persons intending to invest in equities or other traded investments or commodities.

Pursuant to the European Long-term Investment Funds Regulation, an ELTIF (which may be structured as a RIAIF or a QIAIF) may not undertake: (a) short selling of assets; (b) taking direct or indirect exposure to commodities; (c) entering into securities lending, securities borrowing, repurchase transactions, etc. if more than 10% of the assets of the ELTIF are affected; and (d) using financial derivative instruments, except where the use of such instruments solely serves the purpose of hedging the risks inherent to other investments of the ELTIF.

A RIAIF/QIAIF may not acquire any shares carrying voting rights which would enable it to exercise significant influence over the management of an issuing body. This requirement does not apply to investments in other investment funds or where the AIF is a venture capital, development capital or private equity AIF, provided its prospectus indicates its intention regarding the exercise of legal and management control over underlying investments.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Although the RIAIF is a higher-risk option than an Irish UCITS fund authorised by the Central Bank, and although concentration limits are imposed by the Central Bank on RIAIFs (e.g. 20% of the net asset value ("**NAV**") issuer limit, 30% of the NAV limit on deposits with an acceptable credit institution, 30% of the NAV limit in any one open-ended fund, etc.), such limits are generally more flexible than those applicable to UCITS funds.

In relation to QIAIFs, the Central Bank does not impose any limits on the investment objectives, the investment policies or the degree of leverage which may be employed.

However, for money market QIAIFs and QIAIFs that invest more than 50% of NAV in another fund, the Central Bank does impose certain requirements in relation to the underlying assets.

A loan originating QIAIF must ensure the adequate diversification of its credit positions with regard to its target market and overall strategy. A risk diversification strategy must be included in its prospectus which must limit exposure over a specific timeframe to any one issuer or group to 25% of net assets. If the risk diversification strategy is not met within the disclosed timeframe, unitholders must give approval to continue to operate, otherwise the QIAIF must be terminated.

An Irish AIF structured as an ELTIF may only invest in certain eligible investments as prescribed in the European Long-term Investment Funds Regulation. Furthermore, it is subject to portfolio composition and diversification limits as set out in the European Long-term Investment Funds Regulation.

Finally, in relation to investment companies authorised as QIAIFs, there is a statutory requirement to spread investment risk.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Regulatory Requirements Applicable to Investing in Loans

RIAFs/QIAIFs

RIAIFs/QIAIFs may invest in loan participations and loan assignments but may not grant loans (except for loan originating QIAIFs). This is without prejudice to the right of such a RIAIF/non loan originating QIAIF to acquire debt securities and it does not prevent such an AIF from acquiring securities which are not fully paid.

In relation to loan originating QIAIFs, the Central Bank imposes prescriptive requirements in addition to the prescriptive investment activities and persons to whom loans may be issued referred to in question 4.1 above and the issuer diversification limit referred to in question 4.2 above. Such additional requirements include (i) the appointment of an EU authorised AIFM, (ii) must be closed-ended and established for a finite period, (iii) must not be leveraged in excess of 100% of its net asset value, (iv) must have policies and procedures in respect of, *inter alia*: its risk appetite; the assessment, pricing and granting of credit; credit monitoring, renewal and refinancing; collateral management, concentration risk; valuation; and forbearance; (v) must have a comprehensive stress testing programme; and (vi) must ensure that any access to its records/staff given to any one investor for the purposes of a due diligence process has been made available on a non-discriminatory basis to all unitholders.

Regulatory Requirements Applicable to Investing in Derivatives

RIAIFs

RIAFs may invest in derivatives provided certain prescriptive requirements of the Central Bank are complied with, including implementing a risk management process to ensure that the use of derivatives in accordance with regulatory requirements is monitored, managed and controlled on an ongoing basis. Such regulatory requirements include, *inter alia*: (i) global exposure arising from the use of derivatives using the commitment approach must not exceed 100% of the RIAIF's net asset value; (ii) direct and indirect exposure (through derivatives) to an underlying asset must not exceed issuer regulatory limits; (iii) eligibility criteria for OTC derivative counterparties; (iv) OTC derivative counterparty exposure must not exceed 10% of the RIAIF's net assets in the case of an eligible credit institution and 5% of net assets in all other cases; and (v) sufficient liquid assets must be held to cover any commitments the RIAIF may have in respect of the use of derivatives.

QIAIFs

There are no regulatory requirements imposed by the Central Bank on QIAIFs that invest in derivatives.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

A RIAIF may not borrow in excess of 25% of its net assets at any time. QIAIFs are not subject to any regulatory borrowing limits.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

Pursuant to Article 23 of the AIFM Directive, the AIFM of a RIAIF/QIAIF must disclose certain prescribed information to prospective investors in advance of any investment and any material changes to such information on an ongoing basis. Such disclosure requirements are met by including such disclosure in the prospectus of the AIF or in certain cases by referring to where such information may be obtained in the prospectus. In addition, the Central Bank requires additional disclosure in the prospectus of a RIAIF/QIAIF, e.g. disclosure of relevant parties, fees and expenses payable out of the assets of the AIF, maximum remuneration of the AIFM and investment manager (if any), maximum redemption fee, maximum leverage that may be generated, valuation methodologies, dealing arrangements, investment objective, policy and strategy, investment restrictions, ability to create side pockets, etc. Furthermore, there are certain circumstances where investors must be notified of certain incidents, e.g. where there has been a non-material change in investment policy or an increase in the remuneration payable to the AIFM within the maximum amount disclosed in the prospectus, etc.

Pursuant to Article 24 of the AIFM Directive, an AIFM must regularly report to the competent authorities of its home Member State certain prescribed information in the form of a template reporting template as set out in Annex IV of the Commission Delegate Regulation 231/2013, e.g. the principal

markets and instruments in which it trades on behalf of the AIFs it manages. In addition, an AIFM must, for each of the EU AIFs that it manages and for each of the AIFs that it markets in the EU, periodically disclose to investors:
(a) the percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature;
(b) any new arrangements for managing the liquidity of the AIF; and
(c) the current risk profile of the AIF and the risk management systems employed by the AIFM to manage those risks.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

Article 30 of the Fourth EU Anti-Money Laundering Directive (EU) 2015/849), as amended by the Fifth EU Anti-Money Laundering Directive (EU 2018/843), obliges EU Member States to ensure details of beneficial owners of corporate and legal entities incorporated within its jurisdiction are held on a central register. Such registers must be made publicly available.

The definition of beneficial owner is set out in Article 3 of Directive 2015/849 and means any natural person who directly or indirectly owns or controls the corporate or legal entity. This can be through having a sufficient percentage of the voting rights, ownership interest, controlling the company by other means such as through a shareholders' agreement, by the exercise of dominant influence, or via the power to appoint senior management

Article 30 of Directive 2015/849 requires corporate and legal entities to maintain their beneficial ownership details, independent of the central register, and to provide these details to a central register when required.

In Ireland, the Companies Registration Office is responsible for maintaining a central beneficial ownership register in respect of companies such as AIFs established as variable capital companies and the Central Bank will be responsible for establishing a central beneficial ownership register in respect of the following AIF legal structures; ICAVs, Unit Trusts, Common Contractual Funds and Investment Limited Partnerships.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Annual and Half-Yearly Reports

(a) RIAIFs/QIAIFs

A newly established RIAIF/QIAIF must submit to the Central Bank a set of accounts (whether an interim report or an annual report) within a certain period of the launch date (i.e. within nine months for a RIAIF and 12 months for a QIAIF) and publish it within two months if it is an interim report or six months if it is an annual report. The first annual reports must be made up to a date within 18 months of incorporation/establishment and published within six months.

On an ongoing basis, a RIAIF/QIAIF must publish an annual report within six months of the end of the financial year. In addition, a QIAIF (established as a unit trust or CCF) and a RIAIF must publish, within two months of the reporting period, a half-yearly report covering the first six months of the financial year.

(b) AIFMs/Non-AIFM Management Companies/Administrators/Depositaries

Where an AIFM, a non-AIFM management company, administrator or depositary is authorised by the Central Bank, such entity must publish and file with the Central Bank (i) an annual report within four months of the end of the financial year, and (ii) half-yearly reports within two months of the half year end.

However, where an AIFM is an internally managed RIAIF/QIAIF, the annual audited accounts must be published within six months (as opposed to four months) of the year end. Furthermore, internally managed corporate QIAIFs are not required to produce half-yearly financial accounts.

Prudential Reports

(a) RIAIFs/QIAIFs

A RIAIF/QIAIF is obliged to file the following prudential reports with the Central Bank:
- a monthly return setting out prescriptive information relating to the AIF;
- a quarterly Survey of Collective Investment Undertakings returned within 10 working days of the end-quarter to which it refers; and
- a Funds Annual Survey of Liabilities return filed with the latter return.

A RIAIF or a QIAIF structured as a money market fund that meets the definition of a "monetary financial institution" in the Regulation of the European Central Bank (EU) No 883/2011 is also obliged to file statistical information on a monthly and quarterly basis with the European Central Bank.

(b) AIFMs/Non-AIFM Management Companies/Administrators/Depositaries

Where an AIFM, a non-AIFM management company, administrator or depositary is authorised by the Central Bank, such entity must file with the Central Bank a minimum capital requirement report when filing its half-yearly and annual reports.

Other Reports

(a) RIAIFs/QIAIFs

A RIAIF/QIAIF may be obliged to file reports on a periodic basis with the Central Bank depending on the composition of its portfolio, e.g. where the AIF has side pocket assets, an annual report is required confirming whether or not the Central Bank's parameters continue to be respected and the prospects and/or plans for the side pocket assets must be outlined.

(b) Depositary

A depositary of a RIAIF/QIAIF must enquire into the conduct of the AIFM and the management company, investment company, ICAV or general partner in each annual accounting period and report thereon to the unitholders via a depositary report included in the annual report of the AIF.

(c) Irish AIFMs/Non-EU AIFMs Marketing in Ireland

A non-EU AIFM marketing an AIF in Ireland without a passport and an Irish-authorised AIFM are required to file reports with the Central Bank in accordance with Regulation 25 of the Irish AIFM Regulations, e.g. reports on the principal markets and instruments in which they trade on behalf of the AIFs they manage, etc.

5.4 Is the use of side letters restricted?

There is no express statutory or regulatory restriction on the use of side letters. However, a RIAIF/QIAIF is required, subject to certain exceptions as set out in the AIF Rulebook, to treat all unitholders in the same class equally and all unitholders in different classes fairly.

Furthermore, an AIFM is subject to certain operating conditions, including, *inter alia*, an obligation to treat all AIF unitholders fairly and to ensure that no unitholder in an AIF obtains preferential treatment unless such preferential treatment is disclosed in the relevant AIF's constitutional document.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

RIAIFs/QIAIFs are not subject to any taxes on their income (profits) or gains arising on their underlying investments. While dividends, interest and capital gains that an AIF receives with respect to its investments may be subject to taxes, including withholding taxes, in the countries in which the issuers of investments are located, these foreign withholding taxes may, nevertheless, be reduced or eliminated under Ireland's network of tax treaties to the extent applicable.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

Compensation paid to Irish managers and advisors (such as management/advisory fees, as well as performance fees) of RIAIFs/QIAIFs is generally subject to corporation tax at the trading rate (i.e. 12.5%).

With regard to carried interest, aside from a regime introduced in 2009 for certain venture fund managers in respect of qualifying venture capital funds (which must be structured as partnerships and which are quite limited in their activities), Ireland does not have specific legislation dealing with carried interest. Nevertheless, generally speaking it should be possible to structure funds such that carried interest could be treated for Irish tax purposes as a capital gains tax receipt subject to tax at the standard rate (currently 33%) in the hands of an individual manager. It should be noted, the aforementioned venture fund managers regime (where applicable) reduces the capital gains tax rates even further to 15% (as opposed to 33%) for an individual and 12.5% (as opposed to an effective 33% rate) for a company.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There are no such establishment taxes. Furthermore, there are no transfer taxes payable in Ireland on the issue, transfer, repurchase or redemption of units in a RIAIF/QIAIF (aside possibly from units in an IREF, see question 6.4 below). Where any subscription for or redemption of units is satisfied by the *in specie* transfer of securities, property or other types of assets, Irish stamp duty may arise on the transfer of such assets.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

RIAIFs/QIAIFs are not subject to any taxes on their income (profits) or gains arising on their underlying investments.

RIAIFs/QIAIFs (other than CCFs & ILPs)

Non-Residents

There are no Irish withholding taxes in respect of a distribution of payments by such AIFs to investors or in relation to any encashment, redemption, cancellation or transfer of units in respect of investors who are neither Irish-resident nor ordinarily resident in Ireland, provided the AIF has satisfied and availed of certain equivalent measures or the investors have provided the AIF with the appropriate relevant declaration of non-Irish residence.

Irish Residents

Exempt Investors (which includes pension funds) – Again, no Irish withholding taxes apply in respect of a distribution of payments by the AIF to such investors (which would include approved pension schemes, charities, other investment funds, etc.) or any encashment, redemption, cancellation or transfer of units in respect of investors that have provided the AIF with the appropriate relevant declaration.

Non-Exempt Investors – If an investor is an Irish resident and not an exempt Irish investor, tax at the rate of 41% (25% where the unitholder is a company and an appropriate declaration is in place) is required to be deducted by the AIF on distributions (where payments are made annually or at more frequent intervals). Similarly, tax at the rate of 41% (25% where the unitholder is a company and an appropriate declaration is in place) will have to be deducted by the AIF on any other distribution or gain arising to the investor on an encashment, redemption, etc. of units by an investor who is Irish-resident or an ordinary resident in Ireland. While this tax will be a tax liability of the AIF, it is effectively incurred by investors out of their investment proceeds.

RIAIFs/QIAIFs (established as CCFs or ILPs)

For Irish tax purposes, a CCF and an ILP (authorised on or after 13 February 2013) are treated as "tax transparent". This means that the income and gains arising or accruing to the AIF are treated as arising or accruing to its unitholders/partners either (i) in the case of a CCF, in proportion to the value of the units beneficially owned by them, or (ii) in the case of an ILP, in accordance with the apportionment terms of the partnership agreement. The income and gains are treated as if it did not pass through the hands of the CCF or ILP. Consequently, for tax purposes, the profits that arise to this type of AIF are treated as being profits that arise to the unitholders/partners themselves. Currently, natural persons cannot invest in a CCF without negatively affecting its Irish tax transparent status. This may change in the future.

Irish Real Estate Funds

Ireland has recently introduced a new withholding tax regime in respect of certain Irish property-related distributions and redemptions made by Irish real estate funds ("**IREFs**") to certain unit holders. An IREF is a non-UCITS authorised fund where (i) 25% or more of the market value of its assets is derived from certain types of Irish real estate related assets ("**IREF Assets**"), or (ii) it would be reasonable to consider that the fund's main purpose (or one of its main purposes) was to acquire IREF Assets or carry on an IREF business (that is, activities involving IREF assets the profit or gains of which would, but for the general tax exemptions applied to funds, be

within the scope of Irish taxation). Where a fund is an umbrella fund, the new rules will be applied at the sub-fund level. In summary, subject to certain exceptions, a 20% withholding tax will be imposed on distributions and redemptions made out of IREF profits, which are essentially the accounting profits of the IREF with certain exclusions (e.g. distributions/dividends made by unquoted companies which derive the greater part of their value from Irish relevant assets).

Finance Act 2019 introduced certain anti-tax avoidance measures in respect of excessive debt financing of IREFs and expenses not wholly and exclusively incurred for the purposes of the IREF business (both of which could be used to reduce the profits of the IREF and thus the amount of withholding tax suffered on a distribution). It is important to note that the anti-avoidance provisions do not apply to genuine third-party debt.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

No. Once a RIAIF/QIAIF has received its authorisation from the Central Bank and for so long as such authorisation remains in place, the taxation treatment detailed above applies.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Foreign Account Tax Compliance Act ("***FATCA***") – The Irish and US Governments signed a Model 1 intergovernmental agreement ("**Irish IGA**") on 21 December 2012 and provisions were included in the Irish Finance Act 2013 for the implementation of the Irish IGA and also to permit regulations to be made by the Irish Revenue Commissioners with regard to registration and reporting requirements arising from the Irish IGA. Subsequently, the Irish Revenue Commissioners (in conjunction with the Department of Finance) issued Regulations S.I. No 292 of 2014 which were effective from 1 July 2014. Supporting Guidance Notes have also been issued by the Irish Revenue Commissioners and are updated on an *ad hoc* basis. RIAIFs/QIAIFs that are Irish Reporting Financial Institutions for FATCA purposes will have certain registration, due diligence and reporting requirements. Compliant RIAIFs/QIAIFs will not be subject to, nor will they have to operate, FATCA withholding taxes.

Intergovernmental Agreements – Aside from the Irish IGA, Ireland has not entered into any other IGAs.

*Common Reporting Standards ("**CRS**")* – As Ireland was one of the early adopter countries, the legislation to implement the CRS in Ireland was introduced in the Finance Act 2014 by inserting Section 891F of the Taxes Consolidation Act 1997, and Regulations (Statutory Instrument 583 of 2015) came into effect on 31 December 2015. The legislation to implement the Revised EU Directive on Administrative Cooperation in the Field of Taxation (DAC2 – which essentially imports the CRS into EU legislation) in Ireland was introduced in the Finance Act 2015 by inserting Section 891G of the Taxes Consolidation Act 1997. Section 891F will not apply where Section 891G applies. RIAIFs/QIAIFs that are Irish Reporting Financial Institutions for CRS purposes will have certain registration, due diligence and reporting requirements.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Since the initiation of the BEPS project, the Irish Government has been very active in the area, having launched a consultation in May 2014 and published a detailed paper in the same year, where they explored the potential impacts of the project.

In recent years, it has implemented various domestic tax legislation in line with BEPS and the related EU Anti-Tax Avoidance Directives (as detailed below). They continue to liaise with various interested parties (including the Irish Fund's industry) in relation to the various ongoing "Actions" provided for under BEPS and, indeed, the EU Anti-Tax Avoidance Directives (see below).

EU Anti-Tax Avoidance Directives

The implementation into Irish tax law of Council Directive (EU) 2016/1164 (commonly referred to as the Anti-Tax Avoidance Directive or ATAD), as subsequently amended by Council Directive (EU) 2017/952 (ATAD 2), addresses a number of the BEPS Actions.

Anti-Hybrid Rules

As part of the implementation of ATAD and ATAD 2, anti-hybrid rules have been recently introduced into Irish tax legislation. Broadly speaking, these rules are intended to prevent arrangements that exploit differences in the tax treatment of a financial instrument or an entity under the tax laws of two or more jurisdictions to generate a tax advantage. The new legislation is effective for relevant payments made or arising on or after 1 January 2020 (although the provisions on reverse hybrid mismatches for which implementation can be postponed to 31 December 2021, have not yet been transposed into Irish legislation).

It is important to note that these rules generally only apply to particular cross-border arrangements between associated enterprises and to certain "structured arrangements". Given that AIFs are not subject to any Irish taxes on their income or gains, it is expected that the Irish anti-hybrid rules should have little impact for AIFs.

Interest Limitation Rules

Also as part of the requirements of ATAD, Ireland is currently in the process of developing interest limitation rules which are expected to be implemented into Irish tax legislation from 2021. As required by ATAD, these rules are designed to limit the ability to deduct borrowing costs when calculating taxable profits. It operates by limiting the allowable tax deduction for 'exceeding borrowing costs' (in broad terms, net interest costs) in a tax period to 30% of Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA).

Nevertheless, Member States may exclude financial undertakings (which in an Irish context would include AIFs) with respect of the aforementioned interest limitation rules and, on that basis, AIFs are not expected to fall within scope.

Multilateral Instrument (Actions 15, 6, 7 and other actions of BEPS)

Ireland signed up to the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**MLI**") which was subsequently ratified by Ireland through the Finance Act 2018 and Ireland formally deposited its Instrument of Ratification with the OECD on 29 January 2019.

In respect of Action 7 (permanent establishments), Ireland has confirmed that it will adopt Option B under Article 13 of the MLI, such that only some of the permanent establishment exceptions listed in Article 5 of the OECD Model Tax Convention must meet the test of being preparatory or auxiliary in character. In line with this, Ireland has also adopted the anti-fragmentation rules in the MLI which are designed to prevent the fragmentation of operations and/or splitting of contracts in order to avail of the permanent establishment exceptions.

The MLI came into force in Ireland on 1 May 2019. The treaties that will be modified by the MLI will be those treaties to which Ireland is a party, and where Ireland's treaty partner has already ratified the MLI.

As a general rule, it will begin to have effect for Ireland's tax treaties (i) with respect to taxes withheld at source, from 1 January 2020, and (ii) with respect to all other taxes levied by Ireland, for taxes levied with respect to taxable periods beginning on or after 1 November 2019.

The Irish Revenue Commissioners have confirmed that they will publish guidance to facilitate the interpretation and application of the treaties as modified by the MLI on an ongoing basis.

The full impact that the MLI may have on QIAIF/RIAIFs going forward remains to be seen.

Mandatory Disclosure Rules (Action 12 of BEPS)

Council Directive (EU) 2018/822 (amending Directive 2011/16/EU), commonly referred to as "DAC6", was enacted in response to Action 12 of BEPS and became effective on 25 June 2018. Relevant Irish tax legislation has since been introduced to implement this Directive in Ireland.

DAC6 creates an obligation for persons referred to as "intermediaries" to make a return to the relevant tax authorities of information regarding certain cross-border arrangements with particular characteristics, referred to as "hallmarks" (most of which focus on aggressive tax planning arrangements). In certain circumstances, instead of an intermediary, the obligation to report may pass to the relevant taxpayer of a reportable cross-border arrangement.

There is still a certain amount of ambiguity in respect of the implementation of DAC6 in Ireland – in particular, its exact scope as it relates to AIFs. Revenue guidance is currently in the process of being drafted, which should provide clarity on a range of matters.

Country-by-Country Reporting (Action 13 of BEPS)

Ireland introduced Country-by-Country Reporting legislation in the Finance Act 2015, followed by accompanying regulations published on 23 December 2015. The legislation applies for accounting periods commencing on or after 1 January 2016.

Asset managers and AIFs should monitor the potential impact of BEPS/ATAD on their structures.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Whether a tax advantage exists for a particular asset class or structure depends on numerous factors, some of which will be non-Irish factors and so in order to obtain the optimum structure for a particular asset type, counsel advice should be sought on a case-by-case basis. That said, there are a few strategies/structures available in Ireland that may assist in obtaining an optimum result.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Management fees are generally subject to VAT at the current rate of 23%. However, under the harmonised VAT legislation, an exemption applies to the management of investment funds as defined by the EU Member States which, in Ireland, includes all authorised investment funds. Therefore, the VAT exemptions are wide-ranging with regard to the provision of services to funds (for example, fund administration, transfer agency, investment management, etc.).

RIAIFs/QIAIFs must adhere to the relevant rules on due diligence and information reporting under the CRS and FATCA, for instance (assuming they are Irish Reporting Financial Institutions). Furthermore, RIAIFs/QIAIFs will also need to monitor the OECD BEPS project and its possible effects on their investment structures (see question 6.7 above).

A tax concern which may arise is whether Irish AIFs managed by a non-Irish AIFMs lose their Irish tax residency due to the AIFM being established abroad and are thus taxed according to the laws of the seat of the AIFM. This, however, depends on the content of the laws of the jurisdiction of the AIFM. On the other hand, Irish tax law has provided that a non-Irish AIFM will not be liable to tax in Ireland by reason only of having an Irish AIFM.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

See question 6.7 above with regard to ATAD and also continual monitoring of BEPS and BEPS-related legislation is a necessity.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

The Investment Limited Partnerships (Amendment) Bill was published in 2019 and is expected to progress through the houses of the Irish parliament once a new Irish Government is formed following the General Election held in February 2020. The investment limited partnership ("**ILP**") is the conventional structure for investment in real economy investments and consequently the overhaul of the ILP legislation in Ireland is a timely development given the growth in the real economy investment space, with estimated assets under management of approximately $4.5 trillion, growing by over 30% in the past five years and continued focus on non-banking finance.

It is expected that the AIF Rulebook, which sets out the Central Bank's requirements for RIAIFs and QIAIFs, will be updated in the form of regulations by the Central Bank in 2020.

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Dillon Eustace is one of Ireland's leading law firms, focusing on financial services, banking and capital markets, corporate and M&A, litigation and dispute resolution, real estate and taxation.

Headquartered in Dublin, Ireland, the firm's international practice has seen it establish offices in Tokyo (2000), New York (2009) and Cayman Islands (2012) where the firm advises on both Cayman and Irish law matters.

In tandem with Ireland's development as a leading international financial services centre, Dillon Eustace has developed a dynamic team of lawyers representing international and domestic asset managers, investment fund promoters, insurers, banks, corporates, TPAs and custodians, prime brokers, government and supranational bodies, as well as newspapers, aviation and maritime industry participants and real estate investors and developers. Dillon Eustace has been the leading Irish legal advisor to Irish domiciled funds for over 20 years as confirmed by Monterey.

The Dillon Eustace financial services team is recognised internationally by legal directories *IFLR 1000*, *The Legal 500* and *Chambers* as a top-tier firm in asset management and investment funds.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The Financial Instruments and Exchange Act (Act No. 25 of 1948; the "FIEA") and the regulations promulgated thereunder primarily govern the marketing, investment management and disclosure of Alternative Investment Funds in Japan.

Alternative Investment Funds which are categorised as investment trusts or investment corporations are also subject to the Investment Trusts and Investment Corporations Act (Act No. 198 of 1951; the "ITICA") and the regulations promulgated thereunder as well as rules of the Investment Trusts Association, Japan ("ITA"), which is a self-regulatory body for an investment manager of investment trusts and investment corporations.

A person engaging in the business of marketing interests in investment trusts or investment corporations is required to be licensed as a Type I Financial Instruments Business Operator ("Type I FIBO") and a person engaging in the business of marketing interests in a collective investment scheme such as a limited partnership ("CIS") is required to be licensed as a Type II Financial Instruments Business Operator ("Type II FIBO") in accordance with the FIEA by the Financial Services Agency of Japan ("FSA"), unless some relevant exemption applies.

A person engaging in the business of discretionary investment management of Alternative Investment Funds is required to be licensed as an investment manager ("Investment Manager") and a person engaging in the business of non-discretionary investment advisory to Alternative Investment Funds is required to be licensed as an investment adviser ("Investment Adviser") in accordance with the FIEA by the FSA, unless some relevant exemption applies.

If interests in Alternative Investment Funds are publicly offered in Japan, certain disclosure requirements including the filing of a securities registration statement, annual securities report and other relevant documents will be triggered under the FIEA.

Please note that if an Alternative Investment Fund is categorised as a CIS which directly (i.e. not indirectly through SPVs or REITs) invests in real estate, the Act on Specified Joint Real Estate Ventures (Act No. 77 of 1994; the "SJREVA") will be applicable instead of the FIEA. We have, however, omitted explanation of Alternative Investment Funds which fall under this category in the interest of brevity.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

As noted in question 1.1 above, a person engaging in the business of discretionary investment management, or non-discretionary investment advisory for Alternative Investment Funds is, in principle, under the FIEA, required to be licensed as an Investment Manager or an Investment Adviser respectively by the FSA. However, if both the Alternative Investment Funds and its managers or advisers are domiciled outside Japan, then such managers or advisers will be exempted from such licensing requirements.

It should be noted that if the Alternative Investment Funds are structured as a CIS which invests more than 50% of its assets in securities or derivative transactions, and if any Japanese investor invests in such a CIS, the sponsor (e.g. general partner) of the CIS is, in principle, required to be licensed as an Investment Manager by the FSA unless it delegates all of its investment authority to a locally licensed Investment Manager and meets certain requirements under the FIEA. There are, however, several exemptions to this general principle, which we set out below.

- The general partner will be exempted from the licensing requirement as an Investment Manager if:
  - (i) Japanese investors in the CIS consist of (a) one or more qualified institutional investors as defined under the FIEA ("QIIs"), and (b) not more than, if any, 49 eligible investors other than QIIs as set forth in the FIEA;
  - (ii) none of such QIIs and eligible investors other than QIIs are certain unqualified investors as set forth in the FIEA; and
  - (iii) the general partner has submitted a Form 20 under Article 63 of the FIEA to the relevant Local Finance Bureau prior to the commencement of the management of the assets of the CIS.
- The general partner will be exempted from the licensing requirement as an Investment Manager if:
  - (i) all of the direct investors (i.e., Japanese investors who directly hold interests in the CIS) are either (a) QIIs, or (b) those who satisfy the requirements under Article 63 exemption as summarised above;
  - (ii) if there are indirect investors (i.e., Japanese investors which indirectly invest in the CIS through a Japanese CIS which directly invest in the said CIS) in the CIS, such indirect investors must be QIIs;
  - (iii) the number of Japanese investors in the CIS (including indirect investors) is not more than nine; and
  - (iv) the aggregate amount of investment in the CIS by direct investors is not more than ⅓ of the aggregate amount of all investors' investment in the CIS.

QIIs include: banks; insurance companies; financial instruments business operators registered as Type I financial instruments businesses or discretionary investment management businesses; investment corporations and foreign investment corporations stipulated under the ITICA; the Government Pension Investment Fund; and investment limited partnerships stipulated under the Limited Partnership Act for Investment (Act No. 90 of 1998; the "Limited Partnership Act"). Whether a prospective investor is a QII can be ascertained by looking up the names of the QIIs that are enlisted on the FSA's website.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Alternative Investment Funds themselves are not required to be licensed or authorised by a regulatory body. However, in the case of public offering, filing of a securities registration statement is required. Further, if the Alternative Investment Fund is an investment trust or an investment corporation, a notification of an investment trust or investment corporation will be required. For details, please refer to question 3.4.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The regulatory regime does not distinguish between open-ended and closed-ended Alternative Investment Funds; provided that in the case of public offering, different rules established by the Japan Securities Dealers Association ("JSDA") (which is one of the self-regulatory bodies in Japan) will apply.

Also, the regulatory regime does not distinguish strategies of Alternative Investment Funds except for CIS's direct real estate investment as noted in question 1.1 above.

The regulatory regime differs depending on the legal structure of the Alternative Investment Funds (i.e. Investment Trusts, Investment Corporations or CIS).

1.5 What does the authorisation process involve and how long does the process typically take?

Before submitting a formal application for the grant of a licence of an Investment Manager and/or an Investment Adviser, an applicant would be expected to first conduct informal discussions with the relevant Local Finance Bureau concerning the draft application. The duration of this discussion stage will depend on the scope and organisational structure of the applicant's business and the extent to which the relevant application documents have been prepared (including the extent to which the relevant information has been gathered). Once the relevant Local Finance Bureau and the FSA are satisfied with the draft application, a formal application can be submitted. Thereafter, the FSA may seek clarifications or supplements to the formal application. Only after there are no more questions or requests from the regulator will the application be accepted.

The time required for procuring a licence of an Investment Manager and/or an Investment Adviser under the FIEA varies on a case-by-case basis. In general, the process time required for procuring a licence of an Investment Adviser is less than that for the licence of an Investment Manager. In principle, the licence of an Investment Advisor or an Investment Manager, as the case may be, will be issued within two months from the date of filing the formal application.

1.6 Are there local residence or other local qualification or substance requirements?

The table below summarises the requirements for a licence of an Investment Manager and an Investment Adviser under the FIEA.

Requirements	Investment Manager	Investment Adviser
Local presence in Japan	Required	Not required
Local representative in Japan	Required (if it is a foreign company)	Not required
Minimum stated capital and net assets requirements	Minimum stated capital: JPY 50 million Minimum net assets: JPY 50 million	None
Organisational requirements	The applicant must be a stock company (*Kabushiki Kaisha*) with a board of directors and a corporate auditor or such committees as prescribed in the Companies Act of Japan (Act No. 86 of 2005; "Companies Act"), or an equivalent foreign company	None
Staff requirements	Key requirements are as follows: ■ Those managing assets of investors must have sufficient knowledge and experience with respect to assets under management ■ There must be separate personnel employed with sufficient knowledge and experience to be in charge of compliance and regulatory matters which is independent of the investment management division	Key requirements are as follows: ■ Those providing investment advice based on an analysis of the value, etc. of securities and other financial instruments must have sufficient knowledge and experience to provide such advice ■ There must be separate personnel employed with sufficient knowledge and experience to be in charge of compliance and regulatory matters

1.7 What service providers are required?

If the Alternative Investment Funds are structured as investment trusts under the ITICA ("Japanese Investment Trusts") or investment corporations under the ITICA ("Japanese Investment

Corporations"), then the authority to manage investments must be delegated to a locally licensed Investment Manager pursuant to the ITICA. Further, if the Alternative Investment Funds are structured as Japanese Investment Corporations, they are also required to appoint a custodian and an administrator. There are no such requirements for foreign investment trusts, foreign investment corporations or CIS under Japanese laws.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

If foreign managers or advisers are licensed as Investment Managers or Investment Advisers under the FIEA, they must comply with certain codes of conduct for protection of investors under the FIEA. If foreign managers or advisers are not licensed as Investment Managers or Investment Advisers under the FIEA, no such regulations apply. For details, please refer to question 4.1.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The Asia Region Fund Passport ("ARFP") formally launched on 1 February 2019 is an international initiative enabling cross-border offerings of eligible investment funds to retail investors, with investor protection in economies participating in the ARFP. Initial participating economies are Australia, Japan, the Republic of Korea, New Zealand, and Thailand.

Under the ARFP, a fund may be "exported" to another participating economy if that fund complies with the regulations of the home economy in which the fund is registered, applicable regulations relating to the offer in the host economy and the ARFP passport rules.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

The principal legal structure used for Alternative Investment Funds is Japanese Investment Trusts formed under the ITICA. Japanese Investment Trusts are formed by entering into a trust agreement between an Investment Manager and a trustee whereby investors will acquire divided beneficiary interests from such trusts.

Whereas, Japanese real estate trusts ("J-REITs") are structured as Japanese Investment Corporations under the ITICA.

Alternative Investment Funds structured as foreign investment trusts or foreign investment corporations are also offered to Japanese investors.

CIS – more specifically, Japanese and foreign limited partnerships – are commonly used for private equity funds. Typically, a Japanese limited partnership (*toshi jigyo yugen sekinin kumiai*) is formed pursuant to the Limited Partnership Act ("Japanese Limited Partnership"). A Japanese Limited Partnership must consist of at least two partners: a general partner as a sponsor of the partnership; and a limited partner as an investor in the partnership.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

The liability of investors who hold interests in Japanese Investment Trusts, Japanese Investment Corporations and Japanese Limited Partnerships is limited to the amount of money invested by such investors.

It is possible for a Japanese Limited Partnership to operate on a capital call model where a limited partner owes obligations to make capital contributions up to the amount of its capital commitment in the limited partnership agreement.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

As noted in question 1.6 above, it is a legal requirement for an Investment Manager to be a stock company (*Kabushiki Kaisha*) with a board of directors and a corporate auditor or such committees as prescribed in the Companies Act or an equivalent foreign company with a branch office in Japan.

There is no legal organisational requirement for an Investment Adviser; however, it is common for an Investment Adviser to be structured as a stock company (*Kabushiki Kaisha*) or a foreign company with a branch office in Japan.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

There are no legal limitations on the manger's ability to restrict redemptions unless the constitutional documents of the Alternative Investment Funds restrict redemptions; provided that a limited partner of a Japanese Limited Partnership may withdraw if there are unavoidable grounds regardless of the restrictions under the limited partnership agreement.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no legislative restrictions on transfer of investors' interests in Alternative Investment Funds unless the constitutional documents of the Alternative Investment Funds restrict such transfers.

As noted in question 3.3 below, if Alternative Investment Funds are marketed to Japanese investors by way of a private placement, certain transfer restrictions must be imposed. Further, as noted in question 1.1 above, if the sponsor (e.g. general partner) of the CIS relies on certain exemptions from the licensing requirement, the transfers that result in not meeting the exemption requirements cannot be carried out.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

Please refer to section 4 below.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

In Japan, the FIEA and the regulations promulgated thereunder primarily govern the production and offering of marketing materials of Alternative Investment Funds.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

If interests in an Alternative Investment Fund are to be publicly offered, an offering memorandum (which should include but not be limited to, the investment objectives, the investment policy, the investment restrictions, the investment risks, all of the costs borne by investors and an outline of the investment management company) is, in principle, required to be delivered to investors.

In the case of private placement, an offering memorandum or any other marketing material is not legally required to be delivered to investors. However, it is common practice in Japan to provide investors with a private placement memorandum including description on transfer restrictions applicable to interests in an Alternative Investment Fund voluntarily. A private placement refers to an offering: (i) with respect to interests of investment trusts or investment corporations only to (a) an unlimited number of QIIs', and (b) less than 50 persons (excluding QIIs) subject (in both instances) to certain conditions including restrictions on transferability of interests of the fund; and (ii) with respect to interests of a CIS, resulting in less than 500 persons (including QIIs) subscribing to such interests.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

If interests in an Alternative Investment Fund are publicly offered, a securities registration statement including more detailed information in relation to the Alternative Investment Fund than those required to be described in an offering memorandum needs to be filed with the FSA prior to commencement of marketing of interests in the Alternative Investment Fund pursuant to the FIEA.

If marketing of interests in an Alternative Investment Fund is made by way of a private placement, no registration with the FSA is required under the FIEA (please note, however, that in the case of investment trust or investment corporation, filing of a notification under the ITICA is required as mentioned below).

In addition, if the Alternative Investment Fund is categorised as an investment trust, regardless of the type of marketing (i.e., even in the case of private placement), a notification of investment trust needs to be filed with the regulator prior to its establishment (in the case of those established under Japanese law) or commencement of solicitations of its units (in the case of those established under foreign law) pursuant to the ITICA. If the Alternative Investment Fund is categorised as an investment corporation, regardless of type of solicitation (i.e., even in the case of private placement), a notification of investment corporation needs to be filed with the regulator prior to its establishment (in the case of those established under Japanese law) or commencement of solicitations of its shares (in the case of those established under foreign law) pursuant to the ITICA.

3.4 What restrictions are there on marketing Alternative Investment Funds?

An Investment Manager and a business operator who filed a Form 20 with the regulator pursuant to Article 63 of the FIEA ("Article 63 business operator") (i.e., a general partner of a CIS) are, when marketing Alternative Investment Funds, subject to certain codes of conduct for protection of investors, such as refraining from the delivery of false information to investors and refraining from compensating investors for their losses. If interests in Alternative Investment Funds are marketed to investors who are not categorised as Professional Investors (*tokutei toushika*) as defined in the FIEA, more stringent codes of conduct for protection of investors, such as delivery of statutory documents and advertisement regulations, apply to such marketing activities. Professional Investors include QIIs, listed companies, stock companies whose stated capital is expected to amount to 500 million yen or more, financial instruments business operators (other than those who are categorised as QIIs) and foreign entities.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

Under Japanese law, there is no concept of pre-marketing or equivalent conduct in the context of marketing of interests in Alternative Investment Funds. Pre-marketing activities are not regulated unless such activities amount to solicitation of interests in Alternative Investment Funds.

Please note that the FIEA has no clear definition of "solicitation", and it is a matter of factual observation made by considering all circumstances to determine whether an activity falls within the purview of the term "solicitation". However, generally speaking, providing information about a specific fund would amount to an act of "solicitation". According to the policies of the FSA, the concept of "solicitation" is construed very broadly.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Alternative Investment Funds can be marketed to retail investors. However, if such marketing is implemented by way of a private placement, the number of investors (excluding QIIs) solicited to invest in Alternative Investment Funds must be less than 50 (in the case of interests of investment trusts or investment corporations) or the number of investors (including QIIs) investing in Alternative Investment Funds must be less than 500 (in the case of interests in CISs), as mentioned in question 3.3 above.

It should be noted, however, that if the sponsor (e.g. general partner) of a CIS relies on certain exemptions from the licensing requirement, the type and number of investors may be restricted to meet the requirements of such exemptions as noted in question 1.1 above.

3.7 What qualification requirements must be met in relation to prospective investors?

Where interests in Alternative Investment Funds are marketed by way of a private placement only to QIIs, it must be ensured that the prospective investor is categorised as a QII.

It should be noted, however, that if the sponsor (e.g. general partner) of a CIS relies on certain exemptions from the licensing requirement, the type and number of investors may be restricted to meet the requirements of such exemptions as noted in question 1.1 above.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no additional restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

There are no restrictions on participation in Alternative Investment Funds.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

There are no restrictions on the use of intermediaries. However, in principle, intermediaries may not engage in solicitation of investments in interests in Alternative Investment Funds without registering themselves as a Type I or Type II FIBO depending on the type of interests. Specifically, intermediaries that engage in solicitation of investments in interests of investment trusts or investment corporations are, in principle, required to be registered as a Type I FIBO. On the other hand, intermediaries that engage in solicitation of investments in interests of CISs are, in principle, required to be registered as a Type II FIBO.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

An Investment Manager and an Article 63 business operator (i.e., a general partner of a CIS) are subject to certain codes of conduct for protection of interests of investors when carrying on its discretionary investment management business for Alternative Investment Funds. In this regard, they are generally prohibited from managing assets of an Alternative Investment Fund for the purpose of conducting a transaction involving such assets and themselves, or their officers, or other assets managed by them for avoidance of conflict of interest.

In addition, the ITA provides for the rules that are applicable to Japanese Investment Trusts and Japanese Investment Corporations whose interests are publicly offered. These rules restrict certain activities such as short selling of bonds whose aggregate market value exceeds the amount of net asset value of the Japanese Investment Trust or the Japanese Investment Corporation.

The ITA's rules above do not apply to investment trusts and investment corporations established in foreign jurisdictions. However, JSDA provides for rules that would apply to investment trusts and investment corporations established in foreign jurisdictions whose interests are publicly offered in Japan. These rules would restrict certain activities such as short selling of securities whose aggregate market value exceeds the amount of net asset value of the investment trust or the investment corporation.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Japanese Investment Trusts and Japanese Investment Corporations are obliged to invest more than 50% of their assets in "specified assets". Such "specified assets" include, but are not limited to, securities, rights pertaining to derivative transactions, real properties, rights of lease of real properties, superficies rights, promissory notes, monetary claims, and commodities.

Japanese Investment Trusts and Japanese Investment Corporations are prohibited by the ITICA from acquiring a certain percentage of shares of an entity. Investment trusts and investment corporations established in foreign jurisdictions whose interests are publicly offered in Japan are also subject to a similar limitation imposed by JSDA.

In addition, ITA's rules provide certain limitations on investment objectives that Japanese Investment Trusts and Japanese Investment Corporations may acquire. These rules do not apply to investment trusts and investment corporations established in foreign jurisdictions.

CISs are not subject to any limitations on the types of investments; provided that where an Alternative Investment Fund is structured as a Japanese Limited Partnership, 50% or more of its contributed money may not be invested in foreign shares, etc.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

If Alternative Investment Funds directly invest in real estate or commodities (not through any fund), the following regulatory requirements apply depending on the legal structure of the Alternative Investment Fund (i.e., whether it is an investment trust, an investment corporation or CIS):

A locally licensed Investment Manager who intends to invest assets of a Japanese Investment Trust or a Japanese Investment Corporation in real estate must obtain an approval from the FSA pursuant to the FIEA. The Investment Manager also needs to be licensed as a real estate brokerage business as well as obtain an approval from the Ministry of Land, Infrastructure, Transport and Tourism pursuant to the Real Estate Brokerage Act (Act No. 176 of 1952) to conduct transactions in real estate on behalf of the Japanese Investment Trust or the Japanese Investment Corporation.

A general partner who intends to invest assets of a CIS in real estate is, in principle, required to be licensed as a specified joint real estate venture (*hudousan tokutei kyoudou jigyou*) pursuant to the SJREVA. A general partner locally licensed as an Investment Manager also needs to file a certain notification with the relevant Local Finance Bureau pursuant to the FIEA.

A locally licensed Investment Manager who intends to invest assets of a Japanese Investment Trust or a Japanese Investment Corporation in commodities or commodities derivatives must obtain an approval from the FSA pursuant to the FIEA.

A general partner who intends to invest assets of a CIS in commodities or commodities derivatives must delegate its authority to make investment decisions to a locally licensed commodities investment manager pursuant to the Act on Regulation of Business Pertaining to Commodity Investment (Act No. 66 of 1991). A general partner locally licensed as an Investment Manager also needs to file a certain notification with the relevant Local Finance Bureau pursuant to the FIEA.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Pursuant to ITA's rules, Japanese Investment Trusts and Japanese Investment Corporations may, in principle, borrow money only for the purposes of (i) payment of cancellation money, (ii) distributions for certain investment trusts, or (iii) financing for handling of any accident (excluding borrowings where the investment trust or the investment corporation bear interest on such borrowings).

In addition, JSDA provides for rules applicable to investment trusts established in foreign jurisdictions which are publicly offered in Japan (excluding, investment trusts investing in real estate trust beneficiary rights), under which the amount of its borrowing cannot exceed 10% of the net assets value of the investment trust; provided, however, that this restriction does not apply if such amount temporarily exceeds 10% for a reason such as a merger.

CISs are not subject to any restrictions on borrowing unless the constitutional documents of the CIS restrict borrowing.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

If interests in an Alternative Investment Fund are publicly offered, a securities registration statement which contains, (including but not limited to), the investment objectives, the investment policy, the investment restrictions, the investment risks, all of the costs borne by investors and an outline of the investment management company, needs to be filed with the FSA before commencement of such public offering, which is also publicly disclosed through the "Electronic Disclosure for Investors' NETwork" (so-called, "EDINET"). The Alternative Investment Funds which have filed the securities registration statement must file an annual securities report and semi-annual securities report periodically, which are also publicly disclosed on the EDINET.

In addition, an Investment Manager and an Article 63 business operator (i.e., a sponsor (e.g. general partner) of a CIS) needs to annually prepare an explanatory document describing certain information about its businesses and publicly disclose it at their business offices or through their website.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

An Article 63 business operator (i.e., a sponsor (e.g. general partner) of a CIS) needs to specify the names of prospective QIIs (to whom the Article 63 business operator will market interests in the CIS) in a notification of Article 63 business (Form 20) which is required to be filed with the relevant Local Finance Bureau prior to commencement of the Article 63 business. An Article 63 business operator also needs to provide the names of QIIs (who have actually invested in the CIS) and the amount of contributions by such QIIs in an annual business report to be filed with the regulator.

An Investment Manager and an Article 63 business operator are required to describe the names of their shareholders in an annual business report to be filed with the regulator.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

An Investment Manager and an Article 63 business operator (i.e., a sponsor (e.g. general partner) of a CIS) are, in principle, required to provide investors with a management report describing certain matters such as status of assets of the Alternative Investment Fund periodically pursuant to the FIEA or the ITICA depending on the types of Alternative Investment Funds.

Also they need to file an annual business report in relation to their business with the regulator after the end of each fiscal year.

5.4 Is the use of side letters restricted?

The use of side letters is not restricted. However, as a financial instruments business operator registered as an Investment Manager and an Article 63 business operator (i.e., a sponsor (e.g. general partner) of a CIS) are in principle prohibited from compensating customers for their losses or making a promise to do so, they would not be permitted to execute a side letter for the purposes of providing such compensation. In addition, an Investment Manager and an Article 63 business operator are subject to a duty of loyalty to its investors, and all the investors of the same Alternative Investment Fund are required to be treated fairly and equally.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

An investment corporation is subject to corporate tax. While calculating corporate tax on an investment corporation, dividends to investors can be treated as deductible expenses, if the conduit requirements are satisfied (so-called "pay-through taxation"). Conduit requirements are, among other things, that the amount of payment such as the amount of dividends for the fiscal year exceeds the amount equivalent to 90/100 of the amount of distributable profits.

With regard to investment trusts, there are two types of taxations. First, with respect to collective investment trusts, i.e., securities investment trusts, domestic public offering investment trusts and foreign investment trusts, the trust will not be required to pay Japanese corporate tax but the beneficiaries are taxed when they actually receive the income from such trusts. On the other hand, for investment trusts other than collective investment trusts, the income arising from the property of the trust is subject to corporate tax and the trustee of the trust is the taxpayer.

Vehicles to be used for collective investment schemes (other than investment corporations and investment trusts) include partnerships formed under the Civil Code of Japan (Act No. 89 of 1896) ("NKs"), limited liability partnerships formed under the Limited Liability Partnership Act (Act No. 40 of 2005) ("LLPs"), Japanese Investment Limited Partnerships ("LPSs"), those similar to these in foreign countries (together with NKs, LLPs and LPSs, referred to as "NKs etc.") and silent partnerships ("TKs"). With regard to NKs etc., these entities are fiscally transparent and therefore their assets/debts and profits/losses

are treated as being attributed to the members. The subject of direct tax liability is not NKs etc. themselves, but the members of them (so-called pass-through taxation). On the other hand, in the case of TKs, the contribution belongs to their business operator, and not the silent partners. Hence, the TKs themselves are not subject to be taxed, but the business operators are. When calculating the taxable income of the business operator, the amount of losses or profits distributed to its silent partners are treated as gross revenue or deductible expenses, respectively.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

Investment managers/advisers are usually formed as a stock company or a branch of foreign company. Their fees derived from managing/advising are subject to corporate tax. In the case of an investment trust which is subject to corporate tax, the trustee is obliged to pay corporate tax levied on the trust property. As for TK, the business operator is also subject to corporate tax on income derived from the TK's business.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

In general, there is no establishment tax or transfer tax levied in connection with an investor's participation.

On the other hand, in the case of transfer of interest in investment corporations and investment trusts, capital gains derived from such transfers are generally subject to corporate or income tax.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

(1) Investment corporations

(a) Resident investors

- Closed-ended investment corporations
  Dividends of closed-ended investment corporations, i.e. not assuming a refund, are subject to withholding tax at the rate of 20.42% and to comprehensive taxation for resident individuals in general.
  If the equity of an investment corporation is listed, dividends are subject to 15.315% withholding tax (plus 5% of local tax levied in the case of resident individual investors) and it is not necessary to file a tax return.
- Open-ended investment corporations
  Dividends of open-ended investment corporations, i.e. assuming a refund, are taxed generally same as dividends of unlisted equity of close-ended investment corporations.
  As for dividends from specified investment corporations, i.e. a domestic public offering investment corporation that assumes a refund in terms of conditions that meets certain requirements, are generally subject to withholding tax at the rate of 15.315% (plus 5% of local tax levied in the case of resident individual investors) when such dividends are paid to resident investors. If the tax is withheld at source, resident investors may select not to file a tax return or file a tax return under comprehensive taxation or separate self-assessment taxation.

(b) Non-resident investors
Concerning non-resident individuals or foreign corporations, who do not have a PE in Japan, dividends are subject to 20.42% withholding tax and it is not necessary to file a tax return.
Dividends of specified investment corporations are subject to 15.315% (plus 5% of local tax levied in the case of non-resident individual investors) withholding tax and it is not necessary to file a tax return.

(c) Pension fund investors and other common types of investors
Dividends received by a pension fund investor are not subject to tax, as long as the pension fund investor constitutes a public corporation or a public interest corporation as defined in the Corporation Tax Act (Act No. 34 of 1965; "Corporation Tax Act"). The majority of financial institutions and stock companies do not fall within the category of these corporations and are taxed according to (a) or (b) above depending on their residence.

(2) Investment trusts

(a) Resident investors
Income withholding tax at the rate of 15.315% and local withholding tax at the rate of 5% will be imposed on profit distributions (to be treated as interest income) from investment funds that only invest in public and corporate bonds (Bond-Related investment funds).
Income withholding tax at the rate of 15.315% and local withholding tax at the rate of 5% will be imposed on profit distributions (to be treated as dividend income) from investment funds that are Securities-Related investment funds other than Bond-Related investment funds (Equity-Related investment funds), where such investment funds publicly offer their shares or units in Japan.
Profit distributions from other investment funds, with some exceptions, will be subject to income withholding tax at the rate of 20.42% (but no local withholding tax).

(b) Non-resident investors
Income tax will only be imposed on non-resident investors with regard to income classified as domestic source income.

(c) Pension fund investors and other common types of investors
Profit distributions are not subject to tax, as long as the pension fund investor constitutes a public corporation or a public interest corporation as defined in the Corporation Tax Act. The majority of financial institutions and stock companies do not fall within the category of these corporations and are taxed according to (a) or (b) above depending on their residence.

(3) NKs etc.

(a) Resident investors
For resident members of NKs etc., as stated in question 6.1, these entities are fiscally transparent and therefore its members are subject to the direct tax liability (so-called pass-through taxation).
Distribution of profit from TKs is subject to 20.42% withholding tax. In addition, as to individual investors, the distribution will be subject to income tax under comprehensive taxation. As to corporate investors, the distribution will be subject to corporate tax. The withholding tax amount paid can be deducted in calculating the tax amount of both.

(b) Non-resident investors
Distributions of profits from the businesses through PE based on contracts of NKs etc. are generally subject to withholding tax at the rate of 20.42%.

In the case of TKs, those who do not have a PE are subject to withholding tax at the rate of 20.42%, and it is not necessary to file a tax return.

(c) Pension fund investors and other common types of investors
Profit distributions are not subject to tax, as long as the pension fund investor constitutes a public corporation or a public interest corporation as defined in the Corporation Tax Act. The majority of financial institutions and stock companies do not fall within the category of these corporations and are taxed according to (a) or (b) above depending on their residence.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

It is possible to apply for a tax ruling in Japan, but the Japanese tax authorities are not obliged to issue a tax ruling.

In the case of partnerships, it may be worthwhile to consult in advance if it is identified as a TK or an NK to make sure whether pass-through taxation is available.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

With respect to FATCA, a statement has been issued in 2013 that the government of Japan and the United States will cooperate with each other to implement FATCA in Japan. Based on this, the Japanese authorities have asked domestic financial institutions to register with the IRS and provide information on the targeted accounts to the IRS.

With respect to CRS, based on the Act on Special Provisions of Income Tax Act, Corporation Tax Act, and Local Tax Act Incidental to Enforcement of Tax Treaties (Act No. 46 of 1969), the system for financial institutions based in Japan to report the information of non-resident's accounts to the head of the corresponding tax office has been introduced.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

In cases where a Japanese corporation holding 25% or more of the issued shares in a foreign company receives dividends from the company, 95% of the dividends are excluded from treatment as the corporation's gross revenue. However, the relevant rules concerning this treatment were revised, based on recommendations from Action 2, in the 2015 tax reform. Commencing from the fiscal year beginning 1 April 2016, dividends from a foreign company which are included as deductible expenses in that country (in whole or in part) are now, in principle, treated as the corporation's gross revenue under the Corporation Tax Act.

In relation to Action 6, Japan has been introducing Principal Purpose Test (PPT), Limitation on Benefit clauses and Anti-conduit rules in tax treaties. By these, unfairly obtained treaty benefits are avoided. Also, on the protocol attached to the tax treaty executed with the United States, it has been stated that income arising from TKs can be taxed in accordance with domestic law in both countries in order to prevent tax avoidance.

In accordance with Action 7, the scope of PE under Japanese tax law has been revised in order to prevent artificial avoidance of PE status.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

There are no special tax-advantaged asset classes or structures available in Japan.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

There are no other material tax issues.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No, we do not anticipate any meaningful tax changes in the coming 12 months.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

No immediate reforms are in the pipeline.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The principal pieces of legislation governing funds in Jersey are the Collective Investment Funds (Jersey) Law 1988 (**CIF Law**) for public funds and the Control of Borrowing (Jersey) Order 1958 (**COBO**) for private funds. Jersey also has various fund products with their own sub-set of rules. For example, the Jersey Financial Services Commission (the **JFSC**) has published guides for each of Jersey Private Funds (**JPFs**), Expert Funds and Listed Funds, each of which contain the rules which govern the respective fund types. Similarly, Recognised Funds, which are the most highly regulated funds available in Jersey, are governed by the Collective Investment Funds (Recognised Funds) Rules 2003 (**Recognised Funds Rules**) in addition to being subject to the CIF Law, and open ended Unclassified Funds, which are also a highly regulated fund product that is suitable for marketing to retail clients, are governed by the Guide to Jersey Open-Ended Unclassified Collective Investment Funds Offered to the General Public (**OCIF Guide**).

If the fund will be an AIF that is marketing into Europe, it will be subject to the Alternative Investment Funds (Jersey) Regulations (**AIF Regulations**) and will need to adhere to the Jersey AIF Codes, which broadly mirror the requirements of AIFMD.

More broadly, depending on the structure of the fund, the Jersey entities making up the structure will be subject to the legislation governing the type of entity used; for example, a company will be subject to the Companies (Jersey) Law 1991, and a limited partnership will be subject to the Limited Partnerships (Jersey) Law 1994.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Managers or advisers that are based in Jersey are likely to be subject to the Financial Services (Jersey) Law 1998 (the **FSJL**), which is the primary piece of legislation governing financial services in Jersey. In particular, a person acting as a manager or adviser of an alternative investment fund is likely to be carrying on fund services business or investment business for the purposes of the FSJL, and so would be required to apply for a licence and be regulated by the JFSC. There are various exemptions which would allow a Jersey entity to provide services to a private fund without having to become regulated.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Every alternative investment fund launched in Jersey will need to apply to the JFSC for a consent under COBO, if a private fund, or a certificate under the CIF Law if there will be more than 50 investors or more than 50 offers to prospective investors. Private funds that are marketed into Europe under the AIFMD will also need to apply for an AIF certificate under the AIF Regulations.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

With the exception of Listed Funds (which must be closed-ended) there is no clear distinction based on strategy, and both open- and closed-ended funds are required to procure a COBO consent or a CIF Certificate (as applicable) in the same manner. However, certain funds do have restrictions which may limit a sponsor's ability to implement certain strategies. For example, a JPF may only admit, or make offers to admit, up to 50 investors, all of whom must be "professional investors" as defined in the Jersey Private Fund Guide (**JPF Guide**).

1.5 What does the authorisation process involve and how long does the process typically take?

The process varies depending on whether the fund is private or public. For Jersey Private Funds an online application form is submitted by the Jersey designated services provider, and the COBO Consent is usually issued within 48 hours. For public funds, the application forms, a structure chart, and offering document is submitted to the JFSC by Jersey counsel and the certificate is typically issued within three working days (for expert funds).

1.6 Are there local residence or other local qualification or substance requirements?

Public funds such as Jersey Expert Funds are required to have at least two Jersey resident directors with appropriate experience appointed to the fund's board if the fund is a corporate fund. If the fund is formed as a limited partnership or a unit

trust, Jersey resident directors with appropriate experience must be appointed to the board of the general partner or trustee (as applicable).

The majority of the board of a Jersey Listed Funds must be made up of independent directors, including at least two Jersey resident directors.

Funds formed as Jersey Private Funds or Unregulated Eligible Investor Funds are not strictly required to appoint Jersey resident directors, but the JFSC guidance suggests that they would generally expect Jersey resident directors to be appointed to the board of the fund or general partner (as applicable) of a Jersey Private Fund.

Unclassified Collective Investment Funds are required to appoint a Jersey-based trustee or custodian and must either: (i) have a manager that is a Jersey company; or (ii) appoint a Jersey-based administrator.

The Taxation (Companies – Economic Substance) (Jersey) Law 2019 (the **Economic Substance Law**) requires all Jersey tax resident companies to meet certain standards for economic substance. The Economic Substance Law sets out various requirements for Jersey companies undertaking certain activities, including engaging in fund management and holding company business, including, amongst other things, the requirement for the company to be directed and managed from Jersey and to have adequate physical assets and employees on the Island. This requirement is generally met by the company appointing a Jersey corporate services provider to act as the company's administrator.

1.7 What service providers are required?

Jersey Private Funds are required to appoint a Jersey fund administrator with the appropriate regulatory licences as its designated service provider (**DSP**). The DSP will take responsibility for ensuring the fund's compliance with the Jersey Private Fund Guide.

Jersey Expert Funds are required to have arrangements in place to deal with the safe custody of assets and a separate custodian with a physical presence in Jersey is required for open-ended (but not closed-ended) funds. This requirement is waived where a prime broker with a minimum credit rating of A1/P1 is appointed.

Listed funds and Eligible Investor Funds must make arrangements to deal with safe custody and must appoint a Jersey resident manager or administrator. Open-Ended Eligible Investor Funds must appoint a separate custodian.

Unclassified Collective Investment Funds must have a Jersey-based trustee or custodian with issued and paid-up capital and non-distributable capital reserves of at least £250,000, and must maintain aggregate net shareholders' funds of at least £250,000. The fund's manager must be a Jersey company. If a Jersey-based company with staff and a physical presence in the Island is appointed as administrator, the manager does not need to meet these requirements.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

The Expert Fund Guide requires that the fund's investment manager/adviser must meet certain criteria, for example that it is established in an OECD Member State or a state with which the JFSC has a memorandum of understanding, that it is regulated or has adequate experience and that there are no disciplinary actions being taken against it.

For unclassified funds, the manager must meet the criteria set out in the JFSC's Promoter Policy, which sets out certain guidelines on what the JFSC will expect to see based on factors such as the manager's experience and track record, reputation and financial resources.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

Jersey is a BEPS Associate, a member of the BEPS Inclusive Framework and a signatory to the multilateral instrument that forms part of the BEPS framework.

The Economic Substance Law makes provision for information on Jersey companies to be shares with the tax authorities in EU Member States.

Jersey signed an agreement with the United States in December 2013 in respect of FATCA reporting. The Jersey Comptroller of Taxes collates the data shared with the US Internal Revenue Service, and the relevant information must be submitted to the Comptroller by 30 June each year.

In January 2016, Jersey passed the Taxation (Implementation) (International Tax Compliance) (Common Reporting Standard) (Jersey) Regulations which implement the OECD's Common Reporting (**CRS**) Standard in Jersey. CRS forms are required to be submitted to the Jersey tax office and the relevant information is then shared with the participating jurisdictions. Separate agreements also exist for the automatic sharing of tax information with Guernsey and the Isle of Man.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

Alternative investment funds are generally formed as limited companies, limited partnerships, separate limited partnerships (**SLPs**), incorporated limited partnerships (**ILPs**) or unit trusts.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Investors in funds formed as Jersey limited companies are liable only up to the value of any unpaid shares that they hold in the company and will not be required to make any contribution to the assets of the company on winding-up beyond the value of any unpaid shares they hold.

Investors in limited partnerships, SLPs or ILPs are liable only up to the amount they have agreed to commit to the capital of the limited partnership, SLP or ILP, provided they do not participate in the management of the limited partnership, SLP or ILP. Various safe harbours setting out activities that investors can undertake without endangering their limited liability are set out in the relevant laws governing these entities.

An investor in a trust is liable only up to the value of the amount that it has contributed to the assets of the trust.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Managers and advisers are generally formed as limited companies, resident in Jersey, the UK or other jurisdictions. Manager and adviser entities are also often formed as LLPs.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Generally there are no restrictions under Jersey law. The exception is open-ended Unclassified Funds where redemptions may only be suspended in exceptional circumstances, having regard to the interest of investors and the manager must immediately notify the JFSC of any suspension and during the period of suspension a notice must be published at least monthly in a newspaper where details of the pricing of the units are normally published.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no restrictions on the ability to transfer interests set out in legislation, provided the transferee meets the relevant category of investor (expert funds can only have investors that fall within the definition of "expert investor", for example).

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

Recognised Funds and open-ended Unclassified Funds have prescriptive criteria for the types of assets that may be held by the fund and in what proportion different asset classes must be held, as set out in the Collective Investment Funds (Recognised Funds) (Rules) (Jersey) Order 2003 (**Recognised Funds Order**) and the OCIF Guide, respectively.

The Jersey AIF Codes broadly mirror the AIFMD, and therefore if the fund is an AIF that markets into the EU, the AIFMD's asset stripping rules (as replicated in the Jersey AIF Codes) are likely to apply.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Offering document content requirements for Jersey public funds are set out in the Collective Investment Funds (Certified Funds – Prospectuses) (Jersey) Order 2012 (**CFPO**).

Whether or not the requirement to produce a prospectus applies in respect of the various types of funds is set out in the relevant legislation and/or regulation governing the relevant fund product. Broadly Expert Funds, Unclassified Collective Investment Funds, Listed Funds and Eligible Investor Funds are required to produce CFPO compliant prospectuses. There is no requirement for JPFs to produce any form of marketing document, but if an offering document is produced it must not be misleading and must contain all of the information on the fund an investor would reasonably expect to see.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The CFPO sets out the content requirements for Jersey funds required to issue prospectuses (such as expert funds). Broadly these include details of matters such as the identity of the key stakeholders, valuation methodology, fund strategy, conflicts of interest, how fund assets will be held and various statutory statements. Where a prospectus is required additional content requirements may be set out in the regulation constituting the relevant fund product. Additional information may also need to be included to ensure compliance with the AIF Codes (where the fund will be an AIF marketing into Europe). Aside from prospectuses, financial services advertisements are governed by the Advertising Order which contains certain content and record-keeping requirements.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Any prospectus prepared in compliance with the CFPO must be submitted to the JFSC for approval.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Where the fund is to be marketed into Europe the fund will be subject to the Alternative Investment Funds (Jersey) Regulations and comply with Jersey's AIF Codes, which broadly mirror the requirements of AIFMD.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

The concept of "pre-marketing" is specifically addressed in the JPF Guide, which clarifies that only "offers capable of acceptance" count towards the 50 offers limit imposed by the JPF Guide, and so pre-marketing materials do not constitute an offer. Similarly, the CFPO provides that there is marketing if units are being "offered for sale". For non-Jersey funds marketing into Jersey, COBO applies to "offers" being circulated in Jersey, and so if there is no offer being made that is capable of acceptance there would not be "marketing" under the JPF Guide, CFPO or COBO. The practice of using draft offer documents to gauge interest in Jersey funds before they have received the necessary regulatory consents is common, but the documents must clearly be marked as "draft" until the consents are received and the subscription and other documents can be finalised.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Recognised Funds, Unclassified Collective Investment Funds and Listed Funds can be marketed to retail investors. Regulated managers can invest on behalf of retail investors in Expert Funds and JPFs if they are satisfied that the investment is suitable for the underlying investor and that the underlying investor is able to bear the economic consequences of investment in the fund, including the possibility of the loss of their entire investment.

3.7 What qualification requirements must be met in relation to prospective investors?

Investors in JPFs must be "professional investors" as defined in the JPF Guide, or must invest at least £250,000 (or currency equivalent).

Investors in a Jersey Expert Fund must be "expert investors" as defined in the Expert Fund Guide.

Investors in Eligible Investor Funds must be "eligible investors" as defined in the Eligible Investor Fund Guide.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no additional restrictions from a Jersey law perspective.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

There are no additional Jersey law requirements other than that the details of advisers will need to be disclosed in the prospectus (if a CFPO prospectus is required).

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

There are no Jersey law restrictions but providing services to Jersey investment funds may be a regulated activity under the FSJL if conducted in or from within Jersey.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Generally there are no specific restrictions of the activities that can be carried out by Jersey funds, but as noted above there are prescriptive criteria that govern Recognised Funds and Unclassified Collective Investment Funds. The JFSC has published a Sound Business Practice Policy (**SBPP**) where certain activities will be scrutinised more closely with a view to protecting the reputation of the Island. It covers investment in industries such as mining or drilling for natural resources, medicinal cannabis and cryptocurrency.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

As noted above, Recognised Funds and Unclassified Collective Investment Funds are subject to prescriptive criteria on the type of assets they can hold and in what proportion.

Other types of Jersey funds do not have the same limitations on the types of investments they can make, except under the SBPP.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

As noted above, there are prescriptive criteria that govern the asset classes in which Recognised Funds and Unclassified Collective Investment Funds may invest. A notification may also need to be made to the JFSC under the SBPP if the fund is investing in an asset class which is deemed to pose a risk to the reputation of the Island.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Recognised Funds and Unclassified Collective Investment Funds are subject to the rules on borrowing which are set out in the Recognised Funds Order and the OCIF Guide respectively. There are no statutory restrictions on the ability of an Expert Fund to borrow, but the funds approach to borrowing and gearing must be set out in the offer document, and if the fund can borrow more than 200% of the net asset value of the fund, then full details of how the risk posed by such borrowing is to be managed is to be disclosed to the JFSC in the application and the JFSC can undertake additional scrutiny.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

The amount of information made public on Jersey funds is limited. Companies incorporated in Jersey will appear on the Jersey Registry, which is searchable online. The company's constitutional documents are made available for public inspection, including the memorandum and articles. Special resolutions passed by the company must also be filed and will be made available for inspection as will the company's annual return, which shows a company's legal (but not beneficial) owners. As well as corporate funds, a general partner of a limited partnership and a trustee of a unit trust will also generally be formed as a limited company.

A search of the Jersey registry will also show any limited partnerships established in Jersey. There is no need for the Limited Partnership Agreement to be filed and no requirement to file a return detailing who the partners in the limited partnership are.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

Yes – the shareholders/controllers will be notified to the JFSC as part of the application to form the entity. A condition is typically added to the consent granted under COBO when the entity is formed requiring the entity to update the JFSC if any shareholder or beneficial owner increases or reduces their holding or beneficial ownership above or below certain thresholds, or if any controller becomes or ceases to be a controller. This information is not made public. The only ownership information that is publicly available is the name of the legal owner of shares in a Jersey company, which is available on the company's annual return.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Both Recognised Funds and Unclassified Collective Investment Funds have set reporting requirements which are set out in the Recognised Fund Order and the OCIF Guide respectively.

If the fund is to be marketed into Europe it will be subject to the AIF Codes. The AIF Codes contain reporting requirements that broadly mirror the requirements under AIFMD.

5.4 Is the use of side letters restricted?

There are no Jersey law restrictions on the entry of Jersey funds into side letters, except that regulated hedge funds must disclose the existence of side letters to the other investors and any material adverse effect on the other investors.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Jersey companies are tax opaque for the purposes of Jersey law and are generally taxed at a rate of 0%. Jersey companies are required to submit tax returns to the Jersey tax office.

Jersey limited partnerships, SLPs and ILPs are all tax transparent for Jersey law purposes.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

As noted above, Jersey companies are generally taxed at 0%.

Jersey LLPs are tax transparent entities for Jersey law purposes.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There are no transfer taxes payable in Jersey on the transfer of an investor's participation in a Jersey fund.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

Investors resident in Jersey will be subject to Jersey tax. Investors that are not resident in Jersey (including pension funds or fund of funds) will not be subject to Jersey tax.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

No, tax rulings are not generally sought ahead of the formation of a Jersey fund.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

The States of Jersey and the US Government have entered into an agreement whereby the Jersey tax office will provide the Internal Revenue Service with any information required to ensure compliance with FATCA. As part of the agreement, the 30% withholding tax and account closure requirements of FATCA will not apply in Jersey.

As noted above, CRS forms are required to be submitted to the Jersey tax office and the relevant information is then shared with the participating jurisdictions. Separate agreements also exist for the automatic sharing of tax information with Guernsey and the Isle of Man.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Jersey is a BEPS Associate, a member of the BEPS Inclusive Framework and a signatory to the multilateral instrument that forms part of the BEPS framework.

As noted above, Jersey has also recently introduced the Economic Substance Law in order to comply with the standard set by the EU CCG. Whilst the Economic Substance Law has been introduced specifically to comply with the requirements set by the EU CCG, it is also relevant to Action 7 of BEPS.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

As noted above, entities used as fund vehicles for Jersey funds are tax neutral, for Jersey law purposes.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Jersey fund vehicles are tax neutral, so tax matters tend to be driven by considerations relating to the jurisdictions in which the manager and/or investors are based rather than local tax issues.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

We are not aware of any significant changes that are expected to be made to Jersey's tax laws in the next 12 months.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

At the time of writing, Jersey is updating its limited partnership law so that non-Jersey funds and other vehicles structured as limited partnerships may migrate to Jersey.

Jersey is also in the process of introducing a new limited liability company (**LLC**) entity. LLCs, which are most commonly associated with the United States, share a number of characteristics with limited partnerships and are often described as a "hybrid" between a company and partnership. The Jersey LLC is expected to closely mirror LLCs as they exist in the US and offer its members limited liability combined with the flexibility of being able to draft an LLC agreement to set the terms of their relationship. Like LLCs in the US, it is expected that it will be possible to create series within the Jersey LLC, each with its own separate legal personality.

Given the popularity of the LLC in fund structures in the US, the LLC is expected to play a significant role in the Jersey funds industry once it is launched.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

In Luxembourg, an Alternative Investment Fund ("**AIF**") within the meaning of the law of 12 July 2013 relating to managers of alternative investment funds (the "**AIFM Law**" and an "**AIFM**"), will usually take the form of: (i) a fund authorised under Part II of the Luxembourg law of 17 December 2010 on undertakings for collective investment, as amended ("**Part II Fund**" and "**2010 Law**", respectively); (ii) a specialised investment fund ("**SIF**") under the law of 13 February 2007 relating to specialised investment funds, as amended (the "**SIF Law**"); (iii) a "**SICAR**" (*société d'investissement à capital risque*), being an investment company in risk capital, subject to the Luxembourg law of 15 June 2004 on companies investing in risk capital, as amended (the "**SICAR Law**"); or (iv) a reserved alternative investment fund ("**RAIF**") under the law of 23 July 2016 on reserved alternative investment funds (the "**RAIF Law**" and together with the SIF Law, the 2010 Law and the SICAR Law the "**Product Laws**" and each a "**Product Law**"; Part II Funds, SIF and SICAR together "**Regulated Funds**"). An AIF may also be set up as a non-Product Law structure (typically referred to as SOPARFI (*société de participations financières*)), subject to the law of 10 August 1915 on commercial companies as amended (a "**Corporate AIF**" and the "**1915 Law**", respectively) and may opt between the range of available corporate structures (the RAIF and the non-Product law structures, together "**Unregulated Funds**").

Part II Funds, SIF and SICAR are regulated by the Luxembourg financial supervisory authority (*Commission de Surveillance du Secteur Financier* – "**CSSF**").

The implementation of European Directive 2011/61/EU of the European Parliament in relation to the supervision of managers of alternative investment funds ("**AIFMD**") has changed the regulatory environment for managers of AIFs and for AIFs. Luxembourg was one of the first EU Member States to successfully transpose the AIFMD into national law.

All AIFs established in Luxembourg must be managed by an AIFM, responsible for ensuring compliance with the AIFM Law. The AIFM will be subject to either the simplified registration regime or the full-scope authorisation regime, depending on (i) the assets under management, and (ii) whether the AIFM will market the shares on a cross-border basis to investors located outside Luxembourg. Moreover, the AIFM can be (a) an externally appointed entity, or (b) where the legal form of the AIF permits internal management, the AIF itself.

Securitisation vehicles, which are governed by the Luxembourg law of 22 March 2004 on securitisation vehicles, as amended, should normally be out of the scope of the AIFM Law unless given its features it would fall within its scope.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

All Luxembourg entities that manage AIFs (based in Luxembourg, in another EU country or outside the European Union) are subject to the AIFM Law and, must be (i) regulated and supervised by, or (ii) at least registered with, the CSSF. Investment managers managing the portfolio of an AIF may be located abroad.

For Regulated Funds, the appointment of a manager is subject to CSSF approval. If unknown to the CSSF but supervised by a recognised financial supervisory authority, the CSSF will proceed to a due diligence on available information. If the manager is unregulated, the CSSF will carry out a due diligence on its expertise, track record, financial standing and reputation.

Luxembourg based advisers to AIFs (or their AIFM) are (i) either regulated by the CSSF and must be licensed pursuant to the law of 5 April 1993 on the financial sector, as amended (the "**1993 Law**"), subject to exemptions, or (ii) may be subject to the law of 2 September 2011 regulating the access to the professions of craftsman, merchant, industrial as well as certain liberal professions, as amended (the "**2011 Law**") and submit an application for a business licence as economic advisor (*conseiller* économique) to the Minister of Economy, subject to exemptions. (Please also refer to question 1.8 regarding foreign advisors.)

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Only Regulated Funds are subject to prior CSSF authorisation and ongoing supervision.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Luxembourg AIFs subject to a Product Law can be open or closed-ended and such information must be disclosed in the offering document.

Only SICARs are subject to strategy limitation (exclusive investment in risk capital within the meaning of Circular CSSF 06/241 of 5 April 2006 relating to the concept of risk capital under the SICAR Law ("**Circular 06/241**")).

The 2010 Law, the SIF Law and the RAIF Law provide for two different fund types: (i) contractual vehicles without legal personality (*fonds commun de placement* – "**FCP**"); or (ii) investment company, (a) with variable capital (*société d'investissement à capital variable* – "**SICAV**"), or (b) with fixed capital (*société d'investissement à capital fixe* – "**SICAF**").

There is also a distinction between funds subject to a Product Law or to the 1915 Law only, and between regulated and non-regulated funds.

1.5 What does the authorisation process involve and how long does the process typically take?

For Regulated Funds notably, the following draft documents and information must be submitted to the CSSF: articles of incorporation/LPA; offering document; service provider agreements; information on initiator; advisor; CSSF questionnaires; and director documents. On average the procedure takes three to four months.

For an authorised AIFM, the application must contain *i.a.*: CSSF questionnaire (CSSF website); draft articles of incorporation; information concerning shareholders (qualifying holdings); governing bodies; senior managers; drafts of policies and procedures; service provider agreements; and draft constitutional documents of the AIF to be managed.

The CSSF has three months from the date of acknowledging receipt of the file to complete its examination process, during which the clock may be stopped where additional information is requested. Once approved, the AIFM is entered on the CSSF's Official List of AIFMs, tantamount to formal authorisation.

1.6 Are there local residence or other local qualification or substance requirements?

Registered office and central administration of the AIF/AIFM must be located in Luxembourg to qualify as a Luxembourg-based AIF/AIFM. The depositary must be located in Luxembourg, the AIFM must have at least two Luxembourg resident conducting officers. A number of local resident directors is advisable.

1.7 What service providers are required?

If not internally managed, a Luxembourg AIF's appointed external AIFM is entrusted with portfolio and risk management, and potentially administration and marketing. An AIF established in the form of an FCP must appoint an external AIFM, in the absence of own legal personality.

For AIFs set up under a Product Law, the following service providers are required:

- Depositary: Luxembourg credit institution or PSF licensed under the 1993 Law, responsible for the safekeeping and supervision of the assets of the AIF.
- Paying Agent: a Paying Agent will be required in Luxembourg and in each country where the AIF is distributed (typically via the depositary (and its network)).
- Administration/Domiciliation/Registrar and Transfer Agent: either performed by the authorised AIFM (or regulated management company), potential sub-delegation to third party (credit institution or professional of the financial sector ("**PSF**")) or direct appointment by AIF.
- Auditor: audit of financial statements by Luxembourg independent approved statutory auditor with appropriate professional experience.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

For foreign advisors, there is no regulation requirement, provided that the CSSF views it favourably when an advisor opts into regulation where possible.

For foreign managers, evidence of supervision is required, or failing due diligence by CSSF (see question 1.2).

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The CSSF has signed:

- the Memorandum of Understanding ("**MoU**") on Cooperation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the EU on Cross-Border Financial Stability, dated 1 June 2008. The text of the MoU, including the list of signatories, is available on the CSSF website, (http://www.cssf.lu/fileadmin/files/Documents_internationaux/MoU_2008_Final_1_June_2008.pdf).
- MoUs with a number of supervisory authorities of the financial sector, laying down the principles and terms relating to cooperation between authorities on issues relating to prudential supervision. The list of signatories is available on the CSSF website (http://www.cssf.lu/en/eu-international/subnav/col3/memoranda-of-understanding/).
- Pursuant to the AIFM Law and further to ESMA's approval of cooperation arrangements between EU securities regulators and their global counterparts, as of February 2015, the cooperation agreements with 44 non-EU authorities. ESMA has published a list of the AIFMD MoUs signed between EU regulators (including the CSSF) (http://www.cssf.lu/fileadmin/files/AIFM/ESMA_34_32_418_AIFMD_MoU.pdf).

In addition, the CSSF is a member of the European System of Financial Supervision ("**ESFS**"), created with effect from 1 January 2011, and participates in each of the following entities comprising the ESFS:

- the European Banking Authority ("**EBA**");
- the European Securities and Markets Authority ("**ESMA**"); and
- the European Insurance and Occupational Pensions Authority ("**EIOPA**").

Their purpose is to contribute to establishing common regulatory and supervisory standards and practices and ensuring that the Member States' supervisory authorities apply a single set of harmonised rules and consistent supervisory practices.

In addition to the above, Luxembourg currently has around 77 double taxation treaties ("**DTT**") in force. The 46 DTTs entered into between Luxembourg and a third country include the provisions of Article 26 §5 on exchange of information of the Organisation for Economic Co-operation and Development ("**OECD**") Model Tax Convention on Income and on Capital, so that an effective exchange of information in tax matters is ensured.

Luxembourg signed the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters (the "**Convention**") on 29 May 2013, ratified in Luxembourg by the Law dated 26 May 2014 and entered into force on 1 November 2014.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

Stand-alone structures and umbrella funds with one or several compartments are feasible under the Product Laws as well as several forms of investment vehicles (notably FCP, SICAV, SICAF) (see question 1.4 above).

Investment companies may be set up as: public limited liability company (*société anonyme* – "**SA**"); private limited company (*société à responsabilité limitée* – "**SARL**"); partnership limited by shares (*société en commandite par actions* – "**SCA**"); corporate limited partnership (*société en commandite simple* – "**SCS**"); or special limited partnership (*société en commandite speciale* – "**SCSp**"). The SCSp has no legal personality and mirrors the Anglo-Saxon limited partnership. It is a very flexible corporate structure and a success story with over 2,000 SCPs launched since 2013. The limited partnership structures are the most used structures.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Liability of the limited partner/ordinary investor is generally limited to the amount committed/paid in to the fund. General partners' liability is unlimited but manageable if set up as a corporate entity.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

The principal legal structures used for investment managers and advisers in Luxembourg are the SA and the SARL, subject to the 1915 Law, the AIFM Law and/or the 2011 Law.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

No legal provisions limit a manager's ability to restrict redemptions.

It is, however, market practice to provide for rules for occasional suspension of the net asset value ("**NAV**") calculation and hence of the subscription, conversion and redemption, in certain prescribed and disclosed circumstances (e.g. a breakdown of communication devices/political instability/emergency). Suspensions must be communicated to investors by the AIFM in an appropriate manner. There is no distinction between open- and closed-ended AIFs in this regard.

Transfer of shares/units by investors to another investor are usually not restricted, except in commitment-based AIFs or in case of investor eligibility requirements (e.g. well-informed investors).

In corporate AIFs (other than SCS and SCSp), redemption at the request of investors is not possible.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no legislative restrictions on transfers other than those resulting from the well-informed investor requirement (see question 3.6) in the SIF, SICAR and RAIF environment. (Also refer to question 2.4.)

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

AIFs subject to the 2010, SIF and RAIF Law are subject to risk diversification provisions. SICARs are limited as regards their investments (see questions 2.4 and 4.1). All AIFs managed by authorised AIFMs are subject to asset stripping rules.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Post-authorisation marketing of AIFs is governed by the Product Laws, the AIFM Law, CSSF circulars and/or CSSF regulations.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The offering document of any AIF must include the information necessary for investors to be able to make an informed judgment of the proposed investment, in particular, of the risks attached thereto. Further content includes: NAV computation; costs; expenses; subscription; redemption; conversation mechanisms; and AIFM Law requirements.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Core fund documents of regulated AIFs must be CSSF approved (offering document, articles of incorporation, etc.). Presentations, flyers and similar short-form marketing documentation need not be approved.

3.4 What restrictions are there on marketing Alternative Investment Funds?

SIFs, SICARs and RAIFs are reserved for well-informed investors only (see question 3.6). No restrictions apply to Part II Funds and Corporate AIFs, which may be offered to retail investors, unless there is specific legal prohibition.

AIFs subject to the 2010 Law, SIF, SICAR or RAIF Law are automatically authorised for marketing in Luxembourg. The marketing of Luxembourg non-regulated AIFs is limited to professional investors.

The AIFM Law contains detailed provisions applicable to marketing/distributing of units/shares of Luxembourg AIFs or non-Luxembourg AIFs by Luxembourg AIFMs and non-Luxembourg AIFMs in Luxembourg and abroad, respectively. Only authorised AIFMs benefit from the marketing passport; in order to market EU AIFs in Luxembourg, the AIFMs established in another Member State must be authorised under the AIFMD.

"Marketing", under Luxembourg regulatory rules, means a direct or indirect offering or placement, at the initiative of the AIFM or on behalf of the AIFM of units/shares of an AIF it manages, to or with investors domiciled or with a registered office in the EU. Hence, any active marketing activities are covered by the term. Reverse solicitation, i.e. placement of AIF units/shares at the initiative of an investor, is not "marketing" and does not trigger AIFMD requirements.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

Directive 2019/1160/EU of 20 June 2019, amending Directives 2009/61/EU and 2011/61/EU with regard to cross-border distribution of collective investment undertakings ("**Cross-Border Distribution Directive**"), shall be transposed into Luxembourg law by 2 August 2021.

Its purpose, among others, is to provide a harmonised definition of pre-marketing and the conditions under which EU AIFMs can engage in pre-marketing activities. Under the Cross-Border Distribution Directive, pre-marketing means the provision of information or communication, direct or indirect, on investment strategies or investment ideas by an EU AIFM or on its behalf, to potential professional investors domiciled or with a registered office in the Union in order to test their interest in an AIF which is not yet established, or which is established but not yet notified for marketing and which does not amount to an offer or placement to the potential investor to invest in the units or shares of that AIF.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Only Part II Funds can be marketed to retail investors in Luxembourg (see above). Marketing of non-regulated EU AIFs is limited to professional investors.

EU AIFMs authorised in another EU Member State can market units/shares of EU AIFs they manage to retail investors in Luxembourg, provided (i) the EU AIF is subject to permanent supervision, and (ii) the EU AIF is furthermore subject in its home Member State to regulations offering a level of protection for investors, as well as to a prudential supervision considered by the CSSF as equivalent to that provided for in Luxembourg legislation.

The 2010 Law imposes additional conditions on the marketing of non-Luxembourg AIFs, including the appointment of a Luxembourg paying agent and prior authorisation by the CSSF.

3.7 What qualification requirements must be met in relation to prospective investors?

Investment in a SIF, SICAR or RAIF is reserved to "well-informed investors", i.e: (i) institutional; (ii) professional; or (iii) other investors who confirm in writing that they adhere to the status of "well-informed" investors and who either: (a) invest a minimum of EUR 125,000; or (b) have been assessed by a credit institution, an investment firm or a management company which certifies the investors' ability to understand the risks associated with investing in the product.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

Luxembourg law does not provide any specific restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

Luxembourg law does not provide for any specific restrictions.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Luxembourg or foreign intermediaries may act as distributors, provided the latter are authorised by competent authorities to act as distributors of a Luxembourg AIF.

The use of nominees who act as intermediaries between investors and the AIF is possible.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

SICARs are restricted to direct and/or indirect investment in securities that represent risk capital, i.e. mainly high-risk investments made in view of their launch, development or listing on the stock exchange in various forms.

For Part II Funds, SIFs, RAIFs (except risk capital RAIFs) and corporate AIFs, the eligible assets are unrestricted.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Luxembourg AIFs are not restricted in terms of types of investments (except the SICARs – see above).

Diversification requirements apply to:

- SIFs and RAIFs (maximum 30% of their net assets or commitments in the same type of security issued by the same issuer); and
- Part II Funds (maximum exposure 20% of net assets).

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

See question 4.1.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Luxembourg law does not provide for any restrictions. However, AIFs must mention the level of borrowing and leverage in the offering document.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

AIFs subject to Product Laws are required to produce and make available to investors an annual report. Part II Funds must publish an unaudited semi-annual report.

If mentioned in the documentation, the AIFM must publish the net asset value (or make it available to investors). Any other publication must be made in compliance with the offering document.

Luxembourg AIFMs are subject to transparency requirements towards investors and the CSSF, pursuant to the AIFM Law (e.g. information on conflicts of interest, liquidity risk, leverage, and remuneration policy).

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

The Luxembourg law of 13 January 2019 on the register of beneficial owners (the "**RBE Law**"), which entered into force on 1 March 2019, is also applicable to Alternative Investment Funds and managers. Alternative Investment Funds and managers have the obligation to identify, gather and file certain information regarding their beneficial owners with the RBE.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

AIFs must communicate their annual reports to the CSSF and are subject to reporting requirements. AIFMs are subject to requirements towards the CSSF, notably on principal instruments, markets, exposures and concentrations in which they trade on behalf of the AIFs managed, details on the assets of the AIFs, including risk profiles, liquidity arrangements, overall level of leverage per AIF and acquisition by AIF of important holdings in non-listed companies.

The CSSF may require further information on an *ad hoc* basis if it is considered necessary to ensure the effective monitoring of systemic risk.

5.4 Is the use of side letters restricted?

The use is not restricted but subject to disclosure to investors via the AIF's rules or incorporation documents to ensure fair treatment.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

1. Part II Funds

a) Subscription tax

- annual subscription tax of 0.05%, calculated and payable quarterly on aggregate net assets valued on the last day of each quarter. The value of units representing assets held by an undertaking in other Part II Funds, having already paid the subscription tax, is exempt therefrom; and
- reduced rate of 0.01% applies to undertakings the exclusive object of which is (i) the collective investment in money-market instruments, and (ii) the placing of deposits with credit institutions.

b) Registration tax

- upon their incorporation and upon any further corporate events (amendment of articles of incorporation or transfer of seat): fixed registration duty of EUR 75 (regardless of the number of compartments); and
- none for Part II Funds organised as FCPs (since FCPs are contractual agreements without legal personality).

c) Direct taxes

Part II Funds are exempt from any Luxembourg income, withholding, capital gains or net wealth taxes.

d) Value-added tax ("VAT")

Pursuant to Circular nº 723 of 29 December 2006, the Luxembourg tax authorities have expressly recognised that all investment funds are VAT-able persons (in the case of an FCP the management company is the VAT-able person). Consequently, Luxembourg VAT will be applicable under the reverse charge mechanism whereby a Luxembourg-based fund (or, in case of an FCP, the management company) receives services from suppliers located in other EU Member States.

A VAT exemption (article 44 (1) (d) of the Luxembourg VAT law) is available to portfolio management services, investment advisory services and certain administrative services, while mere technical services, supervision and control services supplied by a depositary are not exempt services. The VAT exemption on administrative and management services is also available to outsourced services, provided that these services, strictly recharged, form a distinct whole and are essential functions to the exempt management services, thus leaving isolated technical supplies outside of the VAT exemption scope.

Given the breadth of exemptions available, investment funds and their management companies will, in most cases, derive an almost 100% exempt turnover. For that reason, Circular nº 723 denies them the possibility to deduct the input VAT they might have borne on non-exempt services.

2. SIFs and RAIFs

a) Subscription tax

SIFs and RAIFs (other than RAIFs investing exclusively in risk capital – see below): annual subscription tax of 0.01%, calculated and payable quarterly on their aggregate net asset value at the end of the relevant quarter. Exemptions available to certain institutional cash funds, pension pooling funds and microfinance funds as well as funds investing in other funds already subject to the subscription tax.

b) Registration tax

Incorporated SIFs and RAIFs are subject to a non-recurring registration duty of EUR 75 at the time of their incorporation and at the time of any other corporate event (*e.g.* amendments of articles).

c) Direct taxes

Luxembourg SIFs and RAIFs (other than risk capital RAIFs – see below) are exempt from Luxembourg direct taxes.

Risk capital RAIFs may opt for a special tax regime similar to the SICARs. Hence RAIFs investing exclusively in risk capital, opting for this special tax regime, are fully subject to corporate income tax and municipal business tax but benefit from an exemption on any income from transferable securities, their transfer, contribution or liquidation, and are exempt from net wealth tax (except for the minimum net wealth tax of in principle EUR 4,815).

d) VAT

Regarding VAT, please refer to developments for Part II Funds.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

Investment management companies established in Luxembourg are subject to Luxembourg corporate income tax, municipal business tax and net wealth tax at standard rates. Their taxable base may, however, be reduced by various deductions. Fund

management services supplied in Luxembourg are in principle exempt from VAT (see VAT rules in the context of Part II Funds).

Private portfolio managers and investment advisers are professionals and fall under the rules of individual taxation for independent activities.

A withholding tax of 20% is levied on the gross amount of the director fees, creditable against the director's Luxembourg tax. Such withholding tax should be final for a non-resident director provided that the director fees do not exceed EUR 100,000 per year and constitute the only Luxembourg professional source income. It should be noted that with application from 1 January 2017, individuals who supply directorship services for consideration have the status of taxable persons for VAT purposes. However, such services might fall under the VAT exemption subject to certain conditions. Hence, a Luxembourg-resident independent director might be obliged to register for Luxembourg VAT and to file VAT returns reporting their supplies of directorship services.

The AIFM Law allows, under certain conditions (like the tax residency of the employee or the full return of committed capital to investors prior to payment to employees), the taxation of carried interest realised by certain employees of the AIF or the AIFM as "speculative income", with an applicable tax rate of 25% of the average tax rate applicable to the adjusted income, i.e. a marginal income tax rate of 11.44% (including the employment fund contribution) as from 2017. The AIFM Law defines "carried interest" as a share in the profits of the AIF accrued to the AIFM as compensation for the management of the AIF and excluding any share in the profits of the AIF accrued to the AIFM as a return on any investment by the AIFM into the AIF.

The minimum corporate tax introduced for certain holding companies as of 1 January 2011 (further amended as of 1 January 2013) has been replaced by a minimum net wealth tax as of 1 January 2016, which may apply to management and advisory companies in certain circumstances. Depending on the assets of the management and advisory company, the minimum net wealth tax is either a fixed rate of in principle EUR 4,815 or a progressive rate ranging from EUR 535 to 32,100.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There are none.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

No withholding tax is levied on distributions made by a regulated Luxembourg AIF to resident, non-resident or pension fund investors. Distributions made by an unregulated Luxembourg AIF to resident, non-resident or pension fund investors should be subject to a 15% withholding tax on the gross amount of dividends (unless availability of reduced rate or exemption under a DDT or the participation exemption regime).

Income distributed by the Luxembourg AIF should be taxed in the country of residence of the non-resident or pension fund investor. Capital gains realised by non-residents may only be taxed in Luxembourg (i) in case of unregulated AIFs, (ii) where no DDT is available, and (iii) under certain specific circumstances.

Luxembourg-resident individual or corporate investors have to declare their income in their annual tax return.

Dividends distributed by and capital gains realised on a regulated AIF should be subject to corporate taxation at the level of the Luxembourg corporate investor, whereas such dividends and capital gains from an unregulated AIF may benefit from the participation exemption regime at the level of the Luxembourg corporate investor, under certain conditions.

Dividends distributed by an AIF to a resident individual investor are subject to the progressive tax rates depending on the investor's annual income and matrimonial situation, the marginal income tax rate being 45.78% (including the employment fund contribution).

Capital gains arising from the sale of AIF shares or units, other than speculative gains (realised within six months after acquisition), are exempt from taxation in the hands of a Luxembourg-resident individual investor, except if the investor holds more than 10% of the capital of the SICAV or SICAF, the 10% threshold being determined on the umbrella fund.

AIFs set up as FCPs are tax-transparent for direct tax purposes and investors are treated as directly holding the underlying investments and directly receiving the corresponding income and capital gains.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

There is no requirement to obtain a tax ruling in Luxembourg prior to establishing an AIF. However, depending on complexity of the structure (*e.g.* the use of specific financial instruments or nonstandard structuring), it might be advisable to secure the structure with the Luxembourg tax authorities through a tax ruling before implementation. The tax ruling procedure is subject to an administrative fee ranging from EUR 3,000 to 10,000 depending on the complexity of the case.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Luxembourg and the USA signed the Intergovernmental Agreement Model 1 on 28 March 2014, amended by an exchange of notes signed on 31 March 2015 and 1 April 2015, ratified by the law of 24 July 2015. The first reporting obligations concerned the 2014 calendar year, which the Foreign Financial Institutions had to meet by 31 August 2015. The reporting for the 2015 calendar year and all following calendar years needs to be realised before 30 June of each following year.

As per the Common Reporting Standards ("**CRS**"), Luxembourg signed the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which provides a legal basis for the automatic exchange of tax information and which was approved by the law of 26 May 2014. Luxembourg is part of the 53 "early adopters" of the OECD's Common Reporting Standards. The reporting for the 2017 calendar year and all following calendar years needs to be realised before 30 June of each following year.

The CRS have been implemented at EU level by Directive 2014/107/EU, transposed by the law of 18 December 2015. The reporting starting from the 2016 calendar year needs to be realised before 30 June of each following year.

On 20 February 2020, a draft law was presented to Parliament which introduces some amendments to the Luxembourg legislation governing CRS and FATCA as from 1 January 2021. The draft law aims to rectify some elements in respect of which the "Global Forum on Transparency and Exchange of Information for Tax Purposes. Reporting financial institutions will be subject to additional obligations.

On 21 March 2020, the Luxembourg draft law transposing EU Directive 2018/822, commonly referred to as DAC 6 (or the "tax intermediaries directive"), was voted into domestic law. DAC 6 broadly reflects the elements of BEPS Action 12 on mandatory disclosure rules and is the fifth amendment to the 2011/16/EU Directive on administrative cooperation in the field of taxation (DAC). DAC 6 introduces an obligation for certain intermediaries and relevant taxpayers to disclose to the tax authorities information on cross-border arrangements that meet certain criteria. It also governs the regular exchange of information by and among the tax administrations of EU Member States. DAC 6 entered into force in the EU on 25 June 2018 and will become effective as from 1 July 2020.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Luxembourg is actively implementing all of the OECD's BEPS Action Plans through various domestic measures.

BEPS Action Plan 1 regarding VAT on business-to-consumer digital services was implemented in domestic law on 1 January 2015.

Luxembourg implemented BEPS Action Plan 2 on hybrid mismatches by transposing Directive 2014/86/EU on the prevention of double non-taxation deriving from hybrid loan arrangements. In addition, to extend the anti-hybrid provisions of ATAD 1 (2016/1164 EU Anti-Tax Avoidance Directive), the Luxembourg law implementing the hybrid mismatch measures in ATAD 2 (2017/952 EU Anti-Tax Avoidance Directive) into domestic law was approved by the parliament and published on 23 December 2019, also focussing on BEPS Action Plans 3 and 4 on CFCs and interest deductions.

BEPS Action Plan 5 on harmful tax practices led to the repeal of the previous IP Box regime in Luxembourg on 1 July 2016. A bill of law introducing a new IP Box regime was submitted to the Parliament on 4 August 2017 and approved on 17 April 2018.

With regard to (i) BEPS Action Plan 6 on treaty abuse, Luxembourg introduced a general anti-abuse rule when it transposed Directive 2015/121 amending the EU Parent-Subsidiary Directive, and (ii) BEPS Action Plan 7 on the prevention of artificial avoidance of permanent establishment status and BEPS Action Plan 14 on dispute resolution, Luxembourg implemented the new standards (Directive 2017/1852) by signing the OECD's multilateral instrument ("**MLI**"), which should enter into force three months after five countries have ratified, accepted and approved it. In December 2019, 90 jurisdictions had signed and almost 40 jurisdictions had ratified the MLI. The MLI entered into force in Luxembourg on August 1, 2019. It applied as from January 1, 2020 for withholding tax purposes. For all other taxes, the MLI generally will apply as from fiscal years beginning on or after February 1, 2020. As such, for calendar-year taxpayers, the MLI will apply as from fiscal year 2021.

BEPS Action Plans 8 to 10 on transfer pricing and Action Plan 13 on transfer pricing documentation and country-by-country reporting have been implemented through the amendment of Luxembourg transfer pricing regulation (in particular, by determining clearly the arm's length remuneration between related parties) as from 1 January 2017 and through the non-public country-by-country reporting obligations applicable as from the financial year 2016.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Tax advantages related to any asset class or structure depend on a wide variety of factors, such as the underlying investments, holding period as well as investor's status and residency.

It is therefore essential to seek counsel for using the optimal asset class and structure for each individual case.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Under Council Directive 2003/48/EC on the taxation of savings income (the "**Savings Directive**"), Luxembourg had elected for the withholding tax system instead of the exchange of information system. However, by virtue of the law of 25 November 2014, entered into force on 1 January 2015, Luxembourg abolished this withholding tax system and introduced an automatic exchange of information. The Savings Directive was repealed by Directive 2015/2060/EU on 10 November 2015 and will no longer be applicable once all reporting obligations have been complied with.

A tax issue which may arise is whether Luxembourg AIFs managed by a non-Luxembourg AIFM lose their Luxembourg tax residency due to the AIFM being established abroad and are thus taxed according to the laws of the seat of the AIFM. This, however, depends on the content of the laws of the jurisdiction of the AIFM. In the opposite sense, i.e. having a non-Luxembourg AIF and a Luxembourg-based AIFM, the Luxembourg AIFM Law makes clear that the non-Luxembourg AIF will not be subject to Luxembourg taxation.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No major tax changes are currently proposed that will directly impact AIFMs in 2020.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

No major reforms are currently proposed to impact directly AIFMs in 2020.

Acknowledgment

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The twofold division of AIFs into private funds and listed funds relates to the unregulated character of the former and with the position of the latter as regards the regulatory net; that is not to say that the actual investments performed through listed funds are in themselves regulated activities the performance of which is subject to authorisation, as discussed later. Rather, it has to do with the fact that the *fiduciarios* or "trustees" (it is of fundamental importance to note that the trust is distinct from the *fideicomiso*, while being mistaken for such, the reason for which being it is often translated as such) of the latter are required, under the *Ley del Mercado de Valores* or "*Securities Market Law*" – which is the chief body of law that governs listed funds – to secure an authorisation for the issuances of securities with the *Comisión Nacional Bancaria y de Valores* or "National Banking and Securities Commission" (hereinafter, the "**Commission**"), as well as with one of two stock exchanges in Mexico, and to have these registered with the *Registro Nacional de Valores* or "National Securities Registry", and to fulfil other regulatory requirements such as continuous reporting. It also does not mean that other legislation is not applicable to AIFs in other respects, particularly federal law, insofar as their activities are of a commercial nature, as commercial law is closely defined as pertaining to this sphere of competence.

Our participation in answering the questions of this comparative legal guide refer, naturally, to onshore structures, in the understanding that AIFs may be partially located offshore and, therefore, be subject to the law of other jurisdictions, which we are not familiar with or knowledgeable in.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

No, in principle; however, when the assets that the AIF invests in are listed securities, the managers of such funds' action shall be framed as that of *asesores en inversiones* or "investment advisers", who are required, pursuant to the aforementioned *Securities Market Law*, to register as such with the Commission.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

No. As explained above in the answers to questions 1.1 and 1.2, instances in which authorisations are required refer to either the issuance of securities or investment in securities, in which latter case only manager registration, not authorisation, is required.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

No, the regulatory regime does not differentiate between both kinds of AIFs, while the former is clearly preferred over the latter in this respect.

1.5 What does the authorisation process involve and how long does the process typically take?

Authorisation to have securities listed may take from six to 12 months, depending on the Commission's workload; of course, the COVID-19 pandemic has delayed the completion of some procedures, but the Commission should return and continue with its regular agency operations.

1.6 Are there local residence or other local qualification or substance requirements?

No formal requirements are foreseen in this respect in Mexican law.

1.7 What service providers are required?

The use of third-party AIFs to perform certain services is not only embraced, but required, because, as discussed extensively in our answer to question 2.1 below, they are typically structured as trusts, thus initially requiring the appointment of a trustee. Moreover, aside from the issuing trustee, listed funds retain: a common representative (the main duty of whom is to act on behalf of the respective securities holders' interests and to safeguard their rights); a structuring agent; a stockbroker-dealer, as the placement agent (or agents); independent legal advisers and tax advisers; an independent appraiser; and a custodian. Other AIF-engaged service providers are, of course: accountants; auditors; and a manager or general partner.

Should a service provider be hired, it is important to bear in mind that some of these require a specific regulatory authorisation, registration or concession; e.g., stockbrokers and trustees require an authorisation (the latter as a specific financial

intermediary, as the case may be), investment advisers require a registration and stock exchanges require a concession. Managers or general partners do not (see question 1.2 above).

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

There are no specific rules aimed at foreign managers or advisers.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

There are currently no particular agreements that permit sharing of information in the context of AIFs in place, excluding, of course, all tax information exchange agreements, which are all the more important as the tax transparency treatment (concerning capital gains, dividends, interest and income from the rental of real estate or immovable property) awarded to some AIFs for some foreign vehicles is dependent upon their creation in a jurisdiction with which Mexico has a tax information exchange agreement in place and, as of 2021, subject to some additional requirements.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

While there is a plethora of alternatives available to local managers to structure AIFs, they typically resort to the Mexican trust (*fideicomiso*). They are, indeed, free to do as they see fit, and this agreement is really flexible. Furthermore, it may be used to set up a passive income private equity investment trust (*fideicomiso de inversión de capital privado* – "**FICAPs**"), which affords tax benefits. It is also true that other foreign vehicles are used in this respect, such as Ontarian or Quebecer limited partnerships or American limited liability companies. A considerable portion of the reasons behind the use of the passive income *fideicomiso* or the myriad of foreign alternatives relate to taxation (both domestic and international). Suffice it to say that the most important feature in this particular respect relates to the possibility for them to qualify for transparent or "pass-through" treatment (from a Mexican perspective).

As for listed funds, they may be used to issue: (1) structured equity (or capital development) trust certificates (*certificados bursátiles fiduciarios de desarrollo* – "**CKDs**"), in which case the use of proceeds from the offering should be to create sources of capital for Mexican commercial entities and infrastructure or other projects which, importantly, need to be located in Mexico; (2) real estate trust certificates (*certificados bursátiles fiduciarios inmobiliarios* – "**FIBRAs**") which, akin to U.S. real estate investment trusts, should be used for investing in real estate portfolios; (3) investment projects trust certificates (*certificados bursátiles fiduciarios de proyectos de inversión* – "**CERPIs**"), which are securities aimed at raising money that may be invested in projects located either in Mexico (at least 10% of the offering proceeds should be invested in Mexico, pursuant to the investment regime of Mexican pension funds) or abroad, and which provide for broader and more discretionary powers than the CKD, and which, unlike the latter, may only be issued in a restricted offering (for institutional investors); or, finally, (4) energy and infrastructure investment trust certificates (*certificados bursátiles fiduciarios de energía e infraestructura* – "**FIBRA-E**"), the funds of which, as the name suggests, must be invested in long-term Mexican qualifying electricity, oil & gas, energy or infrastructure projects.

Trusts that issue and list CKDs or CERPIS, subject to the fulfilment of certain requirements under the tax regulations, may take advantage of the FICAP regime.

Underparticipation by investors in the marketplace, as well as the stagnation of the '90s Mexican pension system, led to a reform aimed at sourcing capital from pension fund managers or retirement funds administrators (*Administradoras de Fondos para el Retiro* – "**AFOREs**") and, more specifically, to allow them to invest through *sociedades de inversión especializadas de fondos para el retiro* or "pension fund specialised investment entities" in transactions to acquire CERPIS, CKDs, FIBRAs and/or special purpose acquisition companies' units.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

While the *fideicomiso* does not specifically provide for the limited liability of investors, it does result in them being actually shielded from personal liability, as the law, on the one hand, protects trustees when they contract with third parties in connection with the *fideicomiso*, in the understanding that its liability shall be, in principle, limited to the value of the trust estate. On the other hand, investors are endowed with certain contractual rights (through an indemnification clause or otherwise) – among the main documents that lay down these rights, are typically, aside from the trust agreement, the actual certificate and the management agreement – that protect them against negligence and fraud stemming from the manager's or the trustee's conduct.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Sociedades anónimas ("limited liability stock corporations") or *sociedades de responsabilidad limitada* ("limited liability partnerships").

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

No limitations are imposed in this respect; however, within the applicable boundaries of contractual freedom, any such restrictions may be set, including, by way of example, to achieve or meet with the FICAPs' tax requirements.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

No restrictions of this kind exist, other than those acknowledged under the answer to question 2.4 above, in the understanding, however, that contractual limitations may be foreseen at the respective agreements.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

No; however, as mentioned in question 2.1 above, in order for Mexican pension funds to be able to invest in the securities of

the listed funds available to them, at least 10% of the offering's profits should be invested in Mexico, in accordance with the investment regime for Mexican pension funds. In any event, please refer to questions 4.1 to 4.5 for further detail.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The aforementioned *Securities Market Law*, as regards listed funds and, while Mexico is lacking a specific advertising statute, other laws such as the *Ley Federal de Protección al Consumidor* or "Federal Consumer Protection Law", may be applicable in connection herewith.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

Content requirements of offering documents of listed funds, such as the prospectus (private placement offerings need not publish this prospectus), are dealt with in the regulations for issuers of the Commission and in the relevant stock exchange regulations; as such, these may result in the liability of the placement agent or the independent advisers involved in their elaboration. Among the chief requirements in this respect are, to name a few: general information regarding the securities (such as the trust certificates); an executive summary; risk factors; use of the offering proceeds; issuing trust structure; distribution plan; and dilution risks, etc.

Furthermore, while not marketing in itself, continuous reporting requirements (as stated in question 1.1 above) apply to listed funds.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Yes, please refer to question 3.4 below for further detail. As a general recommendation, to be sure as to whether the Commission will consider a particular offering public or private, it is important to keep it within the *Securities Market Law* safe harbour rule, and, therefore, to avoid public solicitation as appropriate.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Broker-dealers may not offer or market securities (such as CKDs, FIBRAs, etc.) insofar as the preliminary offering documents have been filed with the Commission and the relevant stock exchange (as explained in question 1.1); thereafter, they may begin, as soon as practicable, approaching prospective customers and clients amongst whom they may allocate the securities. Importantly, false information may not be disclosed, and its dissemination may result in the commission of a criminal offence. Of course, no trading may occur up until the moment at which authorisation and securities' registration is secured and when the Spanish offering documents are approved by the Commission.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

Vid. question 3.4 *supra*.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes, AIFs may be marketed to retail investors.

3.7 What qualification requirements must be met in relation to prospective investors?

See the answer to question 3.9 below.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

No, there are not, although, as mentioned above, pension fund-specialised investment entities and therefore, ultimately, Mexican pension funds or AFOREs, which are the most important institutional investors, cannot invest in all AIFs, but only in some of the securities they issue.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

Yes; it is common practice that the offerings of listed funds are restricted to qualified and institutional investors (such as the aforementioned pension fund-specialised investment entities); on a different note, private offerings of unregistered securities in national territory may only target qualified or institutional investors.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

No, there are not; however, to give further context to this statement we should begin by expressing that under Article 9 of the *Securities Market Law*, intermediation on the National Securities Registry is restricted to the securities market intermediaries listed in Article 113; this very same provision (Article 9) clearly states that the purchase or sale of securities may be effected by any person, unless otherwise provided.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

No. There are, of course, some other non-AIF-specific restrictions, such as those concerning foreign investment law, the examination of which does not pertain to this chapter. Otherwise, manager or sponsor co-investment commitments or undertakings are commonly agreed upon, but this an item of market practice and contractual negotiation.

The foregoing statement should be taken with a pinch of salt, because, as mentioned earlier (see question 2.1), trust certificates' proceeds should be devoted to specific kinds of investments.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

No; the Commission, however, frowns upon the acquisition of CKDs by CERPIs and *vice versa*.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Yes, aside from the requirements under questions 2.1 and 2.6 above, the investment in these particular investments is typically conditioned upon the authorisation of certain corporate governance bodies such as the Technical Committee of the respective trust (even holders of securities meetings), which may be more lenient or stringent (contractually) depending on the particular securities being offered, in accordance with regulations.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

There are no restrictions on borrowing for private AIFs; however, as regards listed funds, yes, there are leverage ratios (total debt to total assets) which vary depending on the kind of fund.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

Only listed funds have to fulfil the disclosure requirements referred to in the answer to question 2.2 above.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

Yes; while not particularly addressed in our answer to question 3.2 above, listed funds should include in their prospectus detailed information such as the *fideicomitente*'s or "settlor's" corporate structure, its shareholders or partners and the composition of its board of directors or management, the appointment of the manager, the description of its corporate structure, business and fees.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Listed funds face continuous (quarterly and annual) reporting obligations, e.g., regarding audited financial statements, and disclosure requirements.

5.4 Is the use of side letters restricted?

No, the use of side letters is not restricted.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

From a tax perspective, FICAPs are treated as transparent vehicles (see question 2.1 above), thus all items of income and loss are allocated directly to investors (inasmuch as they are the trust beneficiaries) who, therefore, are taxed accordingly depending on their tax status (resident entities, resident individuals, non-residents, tax-exempt organisations, etc.).

Taxation shall occur, however, at the trust level and income tax payments should be made in the name of the trust beneficiaries, albeit the trust not being a taxpayer in itself, insofar as the respective trust conducts business activities through a "business trust", in which case the trust beneficiaries shall be taxed for the distributions made pursuant to their applicable tax regime (resident entities, resident individuals, non-residents, tax-exempt organisations, etc.), in the understanding the investors are entitled to receive credit for taxes paid at the fund level.

It is common for, as referred to in question 2.1 above, CKDs or CERPIs to be structured as FICAPs, as the latter, as mentioned, are treated as transparent and typically do not qualify as "business trusts", insofar as certain requirements are met. The FICAPs regulation provides for a cash-flow income recognition system for the trust beneficiaries (who are the holders of the CKDs or CERPIs) and, importantly, requires FICAPs to invest only in Mexican tax resident entities (through debt or equity) to qualify for taxation as such, a feature which should be taken into account as it effectively narrows investment possibilities.

On the other end, the resulting FIBRAs' taxable income, which is the difference between all income (primarily of that stemming from leases and sales) and the applicable deductions. Then, a 30% withholding tax is levied on the allocations made to the holders of the FIBRA certificates. FIBRAs are also required to distribute at least 95% of their taxable income on a yearly basis.

Finally, the tax provisions applicable to a FIBRA-E lay down certain requirements: the FIBRA-E should, accordingly, generate at least 90% of the taxable income of the "promoted entities" from qualifying activities (*cf.* question 2.1 above); and, as with FIBRAs, the FIBRA-E must derive at least 95% of its taxable income to their respective certificate holders. Unlike the FIBRAs, the FIBRA-E is required to invest in the stock issued by the promoted companies, the reason for which being the sponsors monetise through the sale of these shares and should, for these purposes, resort to a special procedure to assess the capital gain or loss arising from any such transfer. "Promoted entities" are considered as "business trusts" for tax purposes. On another note, distributions made to the holders by the trustee are subject to withholding at a 30% rate.

Canadian limited partnerships are generally regarded as tax transparent vehicles, the partners of whom are taxed depending on their tax status (resident entities, resident individuals, non-residents, tax-exempt organisations, etc.) This condition may, nevertheless, change due to recently passed legislation and regulation (please refer to question 7.1 for further detail).

Furthermore, U.S. limited liability companies' income may be taxable in Mexico if: (i) they have an onshore permanent establishment; or (ii) such income is Mexican-sourced, in which case they would be subject to a withholding tax (depending on the type of income). The U.S.-Mexico tax treaty may provide tax benefits to the extent the LLC satisfies certain requirements.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

Sociedades anónimas or "limited liability stock corporations" and *sociedades de responsabilidad limitada* or "limited liability partnerships" are taxed as corporations and are, therefore, subject to a 30% corporate tax rate on their worldwide taxable income (i.e., as reduced by the applicable deductions).

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

No, there are not.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

Resident entities that receive AIF income are subject to a 30% income tax; as regards resident individuals, this shall be subject to variable tax rates in accordance with their annual income. The highest bracket is 35% and the individuals are taxed depending on the type of income (dividends, interest, etc.). If there is any tax paid at the AIF level (withholding taxes, estimated monthly income tax payments), such taxes are generally creditable against the income tax liability of the resident entities and individuals.

Non-residents are subject to withholding tax depending on the type of income. For interest, the withholding tax ranges from 4.9% to 35% depending on the type of interest, type of recipient and type of borrower. For dividends, the withholding tax rate is 10%. For capital gains, the rate is 25% on the gross amount, or 35% on the net gain, or 10%, or even an exemption for listed shares. Tax treaties may provide for a lower withholding tax rate or an exemption.

Non-Mexican pension funds are generally exempt for interest income, certain capital gains and certain dividends. For other income, tax treaties may provide for a lower withholding tax rate or an exemption. Pension fund-specialised investment entities are tax-exempt organisations.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

No; under certain (rare) circumstances, however, it may be advisable to do so.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Mexico's legislation implemented FATCA and the OECD's Common Reporting Standard ("**CRS**") by amending its domestic legislation and establishing certain obligations for financial institutions.

With respect to AIFs, we note that a Mexican trust is considered an entity for FATCA and CRS purposes; therefore, it has the same obligations as any other legal entity, which means that it has the obligation to determine its classification for these regulations.

It is important to mention that for these AIFs, there is a presumption that they are considered "Financial Institutions" based on the definition of "Investment Entity", especially for collective investment vehicles (such as funds known as *fondos de capital privado*, *fondos de capital de riesgo* or *capital emprendedor* – "exchange traded funds", "hedge funds" or "leverage buyout funds" respectively).

Insofar as AIFs do not qualify as Financial Institutions, they are typically deemed as Passive Non-Financial Entities, because in most cases more than 50% of their income is represented by passive income (interest, dividends, capital gains, etc.).

When a trust is considered a Passive Non-Financial Entity, it has to identify the controlling person, meaning the *fideicomitente* ("settlor"), the trustee, the *fideicomisarios* ("beneficiaries"), and any other natural person exercising ultimate effective control over the trust.

If the trust does not comply with FATCA and CRS, it can be subject to fines and, specifically for FATCA, a trust could be classified as a Nonparticipating Foreign Financial Institution, subject, thus, to the 30% withholding tax from U.S.-sourced income.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Mexico generally follows the OECD guidelines. With respect to hybrids, Mexico incorporated in 2020 a provision based on Action 2, but with a broader scope. This provision disallows the deduction of payments made to a *regímenes fiscales preferentes* or "preferential tax regimes" entity (a non-Mexican entity whose income is subject to a corporate tax rate lower than 22.5%) who is a related party, or for payments made through a structured agreement. There are certain exceptions (for instance, if the payment arises from a business activity and the recipient has enough assets and personnel, the payment should be deductible). Also, in 2020, the concept of private equity was broadened in light of Action 7. Mexico executed the MLI on June 7, 2017; however, it has not yet entered in force.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Yes. FIBRAs, for instance, do not make any estimated income tax payments. Settlors who contribute real estate to a FIBRA are entitled to defer the income tax payment on the capital gain. Mexican tax resident individuals and non-residents are tax-exempt regarding the sale of FIBRA certificates made through a Mexican stock exchange.

As noted above, the FICAPs regulation provides for a cash-flow income recognition system for the trust beneficiaries.

For FIBRA-E sponsors, there is no withholding tax on dividends for shareholders. Mexican tax-resident individuals and non-Mexican tax residents are exempt for the sale of FIBRA-E certificates on the Mexican stock market.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

AIFs' structures may have to assess certain VAT effects. For these purposes, the VAT is an indirect tax levied on entities or individuals who transfer gods, render services, lease assets or import goods or services. The current VAT tax rate is 16%. Furthermore, input VAT is creditable against output VAT.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No, there are not.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

Among the tax reforms enacted in 2020, one will enter into force and effect in 2021, under which alien tax transparent vehicles (without a corporate form, e.g., the Canadian limited partnership) would, presumably, lose their current treatment, something that would hamper or hinder the framing of current AIF structures. In this respect, another provision was introduced to preserve the transparency of these vehicles, to the extent certain requirements are fulfilled, and therefore we would encourage reviewing any structure in this light.

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VdA

1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Activity involving the management, investment and marketing of Alternative Investment Funds (AIFs) is mainly regulated by: the Undertakings for Collective Investment Law, enacted by Decree no. 54/99 of 8 September 1999 and amended by Decree no. 36/2005 of 29 August 2005 (the UCI Law), which sets out most of the rules relating to AIFs; Law no. 15/99 of 1 November 1999, amended from time to time, which implemented the Credit and Financial Institutions Regime (Banking Law); Decree no. 56/2004 of 10 December 2004, as amended by Decree no. 31/2006 of 30 August 2006 and by Decree no. 30/2014 of 5 June 2014, which implemented the Regulation on Credit and Financial Institutions (Banking Law); and Decree-Law no. 4/2009 of 24 July 2009 (Mozambique Securities Market Code); and Ministerial Ordinance no. 10/99 of 24 February 1999 (Financial Intermediation Activities Regulation).

The Bank of Mozambique (BoM) is the relevant supervisory authority.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Yes. Fund managers, as financial institutions, are subject to the BoM's supervision; accordingly, the relevant authorisation procedure shall be filed with the BoM.

The UCI Law does not foresee any *de minimis* exception or fast-track authorisation procedure; therefore, all fund managers, regardless of the type of assets under management, will need to comply, in general terms, with the same requirements.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Yes. The setting up of AIFs is subject to authorisation from the BoM, which is the competent regulator to conduct the supervision of AIF management activity and ancillary service providers as well as distribution and compliance with the general rules applying to AIFs, notably in connection with the protection of investors' interests.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes. In general terms, the UCI Law distinguishes between AIFs investing in (i) securities or financial assets, and (ii) real estate (real estate investment funds). Both AIF types may be open- or closed-ended.

In general terms, open-ended AIFs target the retail market and closed-ended AIFs target high-net-worth or professional investors; thus, in open-ended AIFs, scrutiny by the BoM tends to be tighter.

1.5 What does the authorisation process involve and how long does the process typically take?

In a nutshell, the authorisation request for setting up AIFs is filed with the BoM, and the relevant AIF manager must provide the BoM with the relevant AIF documentation, notably the regulation and a copy of the agreement to be executed between the fund manager and the depositary.

Furthermore, the BoM may request further information from the fund manager.

If applicable, authorisation should be given within 45 days of receipt of either the relevant documentation or any supplementary information or amendments to the documents required by the BoM. If at the end of such period the applicants have not been notified of the authorisation, this means it has been tacitly refused.

However, considering that the BoM has discretion to request further information, which will halt the term for granting authorisation, and that few AIFs are being constituted in Mozambique, the term for completing the process may vary significantly from case to case.

The marketing of the AIF's units shall begin within 90 days of the granting of the relevant authorisation.

1.6 Are there local residence or other local qualification or substance requirements?

No, there are not.

1.7 What service providers are required?

In Mozambique, an AIF is legally required to have a fund manager, a depositary, an auditor and, in the case of real estate AIFs, real estate appraisers.

It should be noted that the UCI Law does not expressly foresee the existence of an auditor and, in the case of real estate AIFs, real estate appraisers; however, the existence of two such entities in the case of real estate assets is fundamental in light of the fact that the AIF itself will need to be assessed and is subject to accounting control.

Furthermore, the AIF may also have, but is not legally compelled to have, distributors or entities that will market its units, although such entities are more common in open-ended AIFs.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

In accordance with the Banking Law, the same rules established for national managers will apply to foreign managers.

However, the foreign managers will need to be properly authorised to conduct their activities in Mozambique and will need to have a local establishment.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

We are not aware of any specific protocol or sharing agreement having been signed by the BoM with other governments or regulators in respect of the Alternative Investment Fund Managers Directive (AIFMD) or AIFs. However, Mozambique signed a cooperation protocol with the Portuguese Securities Market Commission (CMVM).

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

Under the UCI Law and subject to the licensing procedures described in question 1.5 above, an AIF may only adopt the contractual structure with no legal personality. This is the classic structure and requires that the AIF be managed by a separate fund manager. The investors' or unitholders' interests in such funds are called units (*unidades de participação*).

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

The assets of an AIF are only liable for its debts. Accordingly, the AIF will not bear liability for the debts of investors, fund managers, depositaries, distributors or other AIFs. Likewise, the investors are not personally liable for the debts of the AIF.

The statement of the preceding paragraph does not expressly stem from the UCI Law, but rather from general legal principles applicable to investment in AIFs.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

An AIF must be managed, depending on its scope, by a:

- fund manager (financial institution), which may only manage AIFs investing in securities and other financial assets;
- real estate fund manager (financial institution), which may only manage AIFs investing in real estate funds; or
- commercial or investment bank, but only in the case of closed-ended AIFs.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

The UCI Law is silent in respect of the fund manager's ability to limit redemptions in open-ended funds, but considering that such type of AIFs is, in general, targeted towards retail investors, the BoM will most certainly scrutinise this matter. In fact, such possibility would need to be clearly set out in the AIF's regulation, which is analysed throughout the authorisation procedure.

Moreover, the draft AIF regulation, approved by the UCI Law, includes a field where conditions set out for redemptions must be described, but only refers to applicable fees, settlement dates and the criteria for the determination of which units will be redeemed.

The fund manager may suspend the units' redemption, in the case of an abnormal situation that may impact the usual running of the market or jeopardise the interests of the unitholders, provided the BoM is immediately informed of said suspension.

As far as restriction of transfers in open-ended funds is concerned, the same rationale as described above in respect of redemptions is applicable.

Conversely, in the case of closed-ended AIFs – mainly those targeting professional investors – it should be considered that it is possible to establish, in the AIF's regulation, restrictions on the transfer of the units from investors to third parties.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

No. However, it is important to bear in mind the limitations established on foreign investment, which place constraints on transfers abroad of profits or dividends obtained in Mozambique. Therefore, prior to an investment in a Mozambique AIF being performed, the thresholds and requirements to be met by such an investment shall be assessed, on a case-by-case basis, as well as the provisions applicable to the transfer abroad of the profits or dividends obtained pursuant to the redemption of the units/shares or liquidation of the AIF.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The ability of the manager to manage its funds will be mainly limited by the investment policy established in the AIF's prospectus or regulation, as applicable, by the general investment limits by type of AIF, if any, established in the UCI Law and by the obligation to conduct its activity in the best interest of the investors.

The UCI Law has a list of acts that a manager cannot carry out, such as granting loans, executing certain transactions on its own account, executing transactions relating to the assets held by the AIF with related parties, e.g. entities of its group, the depositary, etc.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Please refer to question 1.1 above, as well as to the Consumer Law, approved by Law no. 22/2009 of 28 September 2009, and the Advertising Code, approved by Decree no. 38/2016 of 31 August 2016.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

There are no drafts available, nor does the UCI Law set out express provisions addressing marketing materials. However, providing information on the investment policy, markets targeted, main features (identification of the relevant entities, terms and conditions of the investment, links to the legal documents) and historic returns of the AIF is perceived as common practice for fund managers and other distribution entities.

However, the law states that marketing material must observe the need to be offered investors' explanations for a careful decision of investment. If marketing material contains projections of future outcomes of the investment, it shall state what was the base of that projection and if the outcome is certain or uncertain, among other legal requirements.

Lastly, on a general note, the information contained in the marketing materials must comply with the following principles: legality; identifiability; truthfulness; objectivity; adequacy; opportunity; and clarity.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Yes. AIFs' prospectuses, as well as their amendments, are subject to prior BoM authorisation.

Furthermore, all marketing actions in respect of an AIF shall inform the addressee of the existence of the prospectus and the place where it may be consulted.

3.4 What restrictions are there on marketing Alternative Investment Funds?

The concept of marketing or distribution of AIFs is not defined in the UCI Law. Nevertheless, it should be construed as comprising all activity directed towards investors with a view to promoting or proposing the subscription of the relevant AIF's units, regardless of the means of communication used.

Nonetheless, the general principles laid down in question 3.2 above in respect of marketing will be equally applicable to all marketing activities and materials.

Furthermore, attention is drawn to the fact that the reverse solicitation is not officially recognised or defined under Mozambican law and it is thus not an official exemption expressly foreseen in the applicable legal framework, but rather a tolerated practice. Such practice consists of an investor, on its own initiative and without having been engaged for such purpose by the distributor, requesting information on a specific AIF. However, a case-by-case assessment must be conducted, considering that the use of the reverse solicitation exemption may come under the BoM's scrutiny.

Lastly, the requirements and principles laid down in the Consumer Law and Advertising Code in respect of investors, who are deemed consumers, shall also be observed.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

Similar to that of marketing, the concept of pre-marketing is not expressly recognised in the UCI Law (please refer to question 3.4 above).

Nevertheless, if the pre-marketing has only a general nature, i.e. it seeks to present to the investor the existence and activity carried out by the fund manager or an overall look at the market, without recommending or referring to any investment opportunity in particular, there are grounds to sustain that it will not be facing marketing activity subject to the UCI Law requirements.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes, they can.

3.7 What qualification requirements must be met in relation to prospective investors?

There is no particular requirement to be fulfilled in relation to investors in AIFs. However, every marketing material must make reference to the existence of the AIF's prospectus and the place where it may be consulted by the investor.

Nonetheless, the fund manager shall ensure that the "know your customer" and investment adequacy analyses are properly carried out in relation to the investor, and that the procedures against money laundering and the financing of terrorism are closely respected.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

No, there are no additional restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

No. However, the holding of AIFs' units may have an impact on credit institutions' and financial institutions' own funds, which must be assessed on a case-by-case basis.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

No. However, the relationship established between the intermediaries and the AIF shall be laid down in a written agreement and disclosed in the AIF's legal documents.

Furthermore, the intermediary, when carrying out the fundraising process, must act within the scope of activities that it is authorised to conduct, i.e. if the fundraising process corresponds to AIF marketing, the intermediary will need to be an authorised institution under the applicable legal terms in order to carry out the distribution of securities.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Yes. AIFs may only focus on investment activities and their investments must comply with the general rules applicable to financial instruments markets.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Yes. The assets eligible for the portfolio of an AIF will depend on its specific type.

In general terms, an AIF cannot hold in its portfolio: (i) units from a UCI managed by the same fund manager; (ii) assets encumbered with *in rem* security, liens or precautionary proceedings; (iii) securities issued or held by its fund manager; (iv) securities issued or held by entities that hold more than 10% of the fund manager share capital; (v) securities issued or held by entities 20% or more of whose share capital is held by the fund manager; (vi) securities issued or held by entities that are members of the management body of the fund manager; (vii) securities issued or held by entities 20% or more of whose share capital is held by members of the management body of the fund manager; (viii) securities issued or held by entities whose management bodies are comprised of one or more directors of the fund manager; (ix) securities issued or held by entities, pursuant to a placement agreement, by the fund manager, depositary or entities which hold 10% or more of the share capital of the fund manager, save for public subscription offers targeting securities envisaged to be admitted to trading in a stock exchange; and (x) real estate assets in co-ownership.

The prohibitions laid down in points (iv) to (viii) do not apply if the securities at stake are admitted to trading in the Mozambique Stock Exchange.

Moreover, in general terms, an AIF investing in securities or financial assets may have on its portfolio securities as defined in the Mozambique Securities Code, which comprise shares, bonds, participation titles in public funds, units and any other similar instruments, as well as instruments stemming from rights detached from the previous securities, provided that they are exchangeable in a secondary market.

An AIF investing in real estate may hold in its portfolio real estate assets registered in the Land Registry Office as pertaining to an investment fund, and holdings of 50% or more in companies listed in a stock exchange and whose scope consists of acquiring, selling, renting and exploring real estate assets.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

As a matter of principle, the investment in derivatives by AIFs is generally limited to risk management purposes.

Loans originated by AIFs are not permitted under Mozambique law.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Fund managers may obtain loans on behalf of AIFs under their management, but the loan period cannot exceed 120 days, consecutive or not, within a period of one year and up to a maximum of 10% of the AIF's global value.

Moreover, the assets of the AIF can only be encumbered, in any way whatsoever, in order to obtain loans within the conditions referred to in question 4.2 above.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

AIFs' legal documents and their updates shall be made available to investors, in the premises of the fund manager, the depositary and, if applicable, the distributor.

Considering that legal documents must describe the identity of the fund manager, depositary, auditor, distributors and other AIF services providers, the majority of data in connection with the AIF will be made available to the public.

However, the identity of the investors in the AIF is not mandatorily subject to public disclosure.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

The fund manager shall implement anti-money laundering/counter terrorist financing (AML/CTF) proceedings in respect of the investors and their beneficial owners, and the relevant authorities may request information on the fund manager's compliance of its obligations in this regard. However, there is no public record-keeping or register of beneficial owners.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Fund managers must prepare annual accounts of the AIFs under management by 31 December of each year. In the following four months, the fund manager shall publish the balance sheets and profit and loss accounts.

The fund manager shall also prepare biannual accounts after the end of the relevant semester.

The annual and biannual accounts shall be made available to investors, as they become ready, in the premises of the fund manager, the depositary and, if applicable, the distributor.

Additionally, with regard to such data, the fund manager shall publish a report containing the activities carried out during the last term, which shall comprise information on the units, transactions, portfolio evaluation and evolution, etc.

In cases where the marketing entity of the AIF is also a bank of which the investor is a client, it can provide the above information together with the investor's bank statement.

The fund manager shall publish in the Mozambique Stock Exchange's official journal, on a monthly basis with reference to the last day of the immediately preceding month, an inventory of the AIF's asset portfolio, its global net value and the number of units currently in circulation. The fund manager shall remit this information to the BoM within three days after its publication.

Lastly, the fund manager shall submit to the BoM its monthly trail balances, by the 15th day of the following month.

5.4 Is the use of side letters restricted?

The use of side letters that set out particular terms and conditions in respect of governance, investment, etc. of an AIF is not specifically addressed by the UCI Law.

However, in the case of open-ended AIFs, considering that they usually target retail investors and/or a broader unrestricted scope of investors, the use of side letters which alter any relevant provision of the legal documents shall be deemed illegal, considering that fund managers need to abide by the AIF's legal documents as a general principle during the provision of its activity.

In closed-ended AIFs, notably in AIFs targeting only professional investors, we trust that there is a wider margin to set out specific provisions, namely through a side letter, in respect of certain matters. However, in general terms, as the provisions of the UCI Law are imperative, any side letter providing for actions in breach of such legal provisions will be deemed illegal and may subject the fund manager to administrative offence proceedings.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Considering there is no special tax regime applicable to Collective Investment Vehicles, the general tax regime applies, under which Mozambican-resident entities are subject to corporate income tax (CIT) at the rate of 32% (*Imposto sobre o Rendimento das Pessoas Coletivas* – IRPC) to be levied on taxable profits obtained on a worldwide basis (including income obtained abroad).

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

There is no special tax treatment or rules applicable in Mozambique for investment managers or advisers. Therefore, as Mozambican-resident entities, they will also be subject to the general taxation regime referred to in question 6.1 above (32% IRPC rate to be levied on taxable profits obtained on a worldwide basis).

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

No establishment or transfer taxes are applicable.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

For tax purposes, income deriving from a fund's units is qualified as investment income, while income deriving from the sale of said units is qualified as capital gains.

Resident investors

Personal Income Tax (*Imposto sobre o Rendimento das Pessoas Singulares* – IRPS): investment income earned by resident beneficiaries is subject to final withholding tax at a 20% rate.

The positive difference between capital gains and capital losses assessed by resident beneficiaries on the sale of fund units is included in the taxable income of the beneficiary and subject to taxation at progressive income rates (currently between 10% and 32%). Such balance may be partially exempt according to the fund units' holding period.

IRPC: investment income payments to a resident entity are subject to withholding tax at a rate of 20% (to be paid on account of the final CIT bill). Such income will subsequently be included in the entity's final IRPC tax result.

Capital gains earned on the sale of fund units are also included in the final IRPC tax result of the resident entity and are subject to IRPC at a 32% rate.

Non-resident investors

IRPS: investment income earned by non-resident beneficiaries is subject to a final withholding tax at the rate of 20%.

As a rule, capital gains taxation on the sale of fund units is similar to that which is set out above for resident individuals. Nevertheless, capital gains obtained by non-resident investors do not benefit from partial exemption according to the fund units' holding period and are fully taxed.

IRPC: investment income paid to a non-resident entity is subject to a 20% final withholding tax rate.

As a rule, capital gains taxation on the sale of fund units is similar to that which is set out above for resident corporate beneficiaries, with the exception that capital gains obtained by non-resident investors do not benefit from partial exemption according to the fund units' holding period and are fully taxed.

Pension funds

Pension funds established and operating according to Mozambique law are subject to a similar tax treatment to that mentioned above for resident investors subject to IRPC.

Pension funds established and operating according to the laws of a foreign jurisdiction are subject to a similar tax treatment to that mentioned above for non-resident investors subject to IRPC.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

Mozambique legislation provides for a tax ruling system in which tax authorities may provide a binding ruling by request. In this respect, since there is no specific tax regime for investment funds, we would recommend the request for a tax ruling in order to obtain more certainty on the taxation that will be applicable. This results from the fact that, after the ruling is issued, the decision obtained by the taxpayer (which it may request previously to a potential transaction or the setting up of a fund) is binding on the tax authorities and may only be amended or changed by a court decision.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Mozambique has not entered into any treaty or adhered in any way to any mechanism in order to implement either FATCA or

the Common Reporting Standard and, to the best of our knowledge, no initiative has been undertaken by the Mozambique authorities regarding this matter.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Mozambique is not an OECD Member State and we are not aware of any initiative by the Mozambican tax authorities regarding this subject.

However, the OECD's Commissioners General and Heads of Delegations of the Revenue Authorities of Botswana, Lesotho, Mozambique, Namibia, South Africa, Swaziland and Zambia gathered in Pretoria, South Africa on 16 July 2015 in order to discuss BEPS, among other matters. No further relevant developments have occurred so far on these topics.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

No, there are not.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

No, there are not.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No, there are not.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

The Mozambique capital markets framework has been subject to several updates in recent years. However, at the present date, the UCI Law remains in urgent need of a complete revamp in order to address its shortfalls and increasing market needs, particularly as far as real estate AIFs are concerned.

Nonetheless, we are not aware of any legislative initiatives aimed at amending or updating the UCI Law currently in effect.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Activity involving the management, investment and marketing of Alternative Investment Funds (AIFs) is mainly regulated by the Undertakings for Collective Investment Law (*Regime Geral dos Organismos de Investimento Coletivo*), enacted by Law no. 16/2015 of 24 February 2015 (UCI Law), which implemented, in Portugal, Directive 2009/65/EC on undertakings for collective investment in transferable securities (UCITS) (UCITS Directive), as amended from time to time, as well as Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD), which sets out most of the rules relating to AIFs, the CMVM Regulation no. 2/2015 on Undertakings for Collective Investment (Regulation no. 2/2015), which sets forth more specific rules regarding certain aspects of the UCI Law and the Portuguese Securities Code (*Código dos Valores Mobiliários* or PSC), enacted by Decree-Law no. 486/99 of 13 November 1999, as amended from time to time, which entered into force on 1 March 2000.

The Portuguese Securities and Exchange Commission (*Comissão do Mercado de Valores Mobiliários* or CMVM) is the competent regulatory body in relation to the aforementioned matters.

In addition, it should be noted that, in Portugal, the AIFMD has been partially implemented by Law No. 18/2015 of 4 March 2015, relating to venture capital, social entrepreneurship and specialised investment (the Venture Capital Law).

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Yes. Fund managers are also subject to the CMVM's authorisation and supervision in what concerns the rules governing their management of AIFs' activity.

Therefore, the fund managers' authorisation procedure will be conducted before the CMVM.

The UCI Law did not implement, in Portugal, the *de minimis* exemption foreseen in the AIFMD. As a result, all fund managers, regardless of the asset under management, will need to comply, in general terms, with the same requirements.

Nonetheless, considering the type of AIFs the fund manager intends to manage, i.e. AIFs investing in securities or financial assets, non-financial assets or real estate, there will be some specific requirements to be met, notably as regards investment policies and contracts with service providers.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Yes. The setting up of AIFs is subject to authorisation by the CMVM, which is the competent regulator to undertake the supervision of AIF managers, ancillary service providers, AIFs' distributors and compliance with the general rules applying to AIFs, notably those relating to the protection of investors' interests.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes. In general terms, the UCI Law distinguishes between AIFs investing (i) in securities or financial assets, such as undertakings for collective investment in transferable securities that do not comply with the UCITS Directive limits and are thus classified as AIFs which invest in securities, (ii) in real estate (real estate investment funds), and (iii) in long-term non-financial assets with a determinable value.

Furthermore, Regulation no. 2/2015 allows AIFs investing in securities to adopt the branding of AIF investing in bonds, shares, index tracker, money-market fund, etc., provided that its investment policy complies with certain criteria.

The AIFs described in points (i) and (ii) above may be open- or closed-ended, but the type referred to in point (iii) shall be closed-ended.

The UCI Law does not contain any specific provisions regarding private equity or hedge funds; thus in principle they will be encompassed by the regime of the AIFs investing in securities. Nevertheless, the Venture Capital Law contains a specific regime applicable to funds investing in equity instruments for a limited period of time, as well as in other structures, which, despite having similar features to the undertakings for the collective investment (UCI) framework, are perceived under Portuguese law as being an autonomous subject. That being said, the Venture Capital Law falls outside the relevant scope of this chapter.

In general terms, the open-ended AIFs are addressed to the retail market and the closed-ended AIFs target affluent or professional investors. As a result, the CMVM's scrutiny over open-ended AIFs tends to be tighter.

Furthermore, depending on the type of AIF at stake and whether it is open or closed-ended, different investing limits will apply, notably in respect of leverage and asset allocation.

1.5 What does the authorisation process involve and how long does the process typically take?

In a nutshell, the authorisation for the setting up of an AIF must be filed with the CMVM. In requesting such authorisation, the relevant AIF's manager must provide the CMVM with the AIF's documentation, notably the Key Investor Information Document (KIID) and the full prospectus of the AIF (if applicable), which must also include the AIF's regulation.

In addition, the CMVM must also be given copies of the agreements to be executed between the management company and (i) the depository, (ii) the distributors or entities that will market the AIF, and (iii) any other entities that will render services to the AIF or the AIF manager.

Documents evidencing the acceptance of the rendering of the relevant services by all entities involved in the AIF's activities must also be provided to the CMVM.

An authorisation is given within 20 days (or three months, extendable for another three by decision of the CMVM, in the case of self-managed collective investment companies) of the receipt of either the fully documented application or of any supplementary information or amendments to the documents required by the CMVM. If at the end of such period the applicants have not yet been notified of the deferral of their application, the authorisation is considered to have been tacitly granted.

The CMVM may refuse the authorisation if the applicant does not submit the required documentation or if the AIF manager at stake engages in irregular management of other investment funds.

After the authorisation has been granted, an AIF will be fully set up from the moment the first subscription is settled or the from the moment the articles of association are registered with the Commercial Registry Office, depending on the AIF being set up, respectively, under the contractual form or as a company.

1.6 Are there local residence or other local qualification or substance requirements?

Considering that the vast majority of AIFs in Portugal have been set up under the contractual form with no legal personality, they ought to be managed by a separate fund manager.

The fund manager may be a Portuguese incorporated entity or an entity providing services on a cross-border basis under the AIFMD passport legal framework, either through the free provision of services or the freedom of establishment.

As regards Portuguese incorporated fund managers, they shall have a board of directors comprising at least two members.

Moreover, pursuant to Law no. 148/2015 of 9 September (Auditing Supervision Framework), the fund manager shall also have an audit board comprising at least three members (the majority of which need to be considered independent) plus a sole auditor.

The members of the board of directors and audit board of the fund manager need to be previously authorised by the CMVM, being subject to a thorough suitability assessment during such a procedure.

Furthermore, the fund manager shall have in place several internal policies aiming to address the risk of its activity, remuneration issues, outsourcing, internal control, evaluation of the assets pertaining to the AIFs under management, anti-money laundering, selection of the members of the boards of directors and audit board, all subject to the control of the CMVM and to a certain extent of the depository, and entailing permanent record-keeping by the fund manager.

1.7 What service providers are required?

An AIF is legally required in Portugal to have a fund manager (if it is not endowed with legal personality), a depository, an auditor and, in the case of real estate AIFs, real estate appraisal experts.

Furthermore, the AIF may also have, but is not legally compelled to have, distributors or entities that will market the AIF, which is standard practice in the case of open-ended AIFs.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

The same rules established for national managers will apply, in addition to the harmonised rules for requesting a passport to carry out management of AIFs' activity in Portugal.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

In accordance with the information currently available on the CMVM's website, the CMVM has signed memorandums of understanding with the competent regulators of other non-EU Member States, namely Abu Dhabi, Cabo Verde, Angola, Algeria, USA (SEC), Israel, China, Malaysia, Mozambique, etc.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

An AIF may take one of two forms or structures, both subject to the licensing procedures described in question 1.5 above:

- Contractual structure with no legal personality. This is the classic structure and requires that the AIF be managed by a separate fund manager. The investors' or participants' interests in these funds are called units (*unidades de participação*).
- Collective investment company endowed with legal personality (*sociedade de Investimento coletivo*). They may be self-managed or have appointed a third party as their manager, which must be a duly authorised investment fund manager. Participants in these collective investment companies will hold shares (*ações*).

In Portugal, besides one collective investment company endowed with legal personality that has been set up to date, all AIFs are usually set up under the contractual structure with no legal personality.

In an overall assessment of pros and cons of both structures, it should be taken into account that the contractual structure has a long track record in Portugal, being the preferred choice for setting up AIFs, as it offers an affordable, simple and well-known model for AIFs.

Conversely, the collective investment company endowed with legal personality and self-managed is clearly a more complex model that allows, however, greater control for the investors over the management of the AIF. Nonetheless, the lack of a decisive incentive to change the current *status quo* in respect of the way AIFs are usually set up in Portugal may be deemed as holding back a better use of the opportunities offered by this structure.

Recently, we have also been assisting in a market trend based on the transformation of non-AIF companies into collective investment companies endowed with legal personality, but

externally managed by a fund manager. This model does not differ significantly from a contractual structure, given that it needs to have a fund manager in place complying with the aforementioned requirements.

Lastly, real estate investment trusts (SIGIs) are not subject to the UCI Law nor do they need to be managed by a fund manager. Even though SIGIs are qualified as real estate collective investment companies endowed with legal personality, they are only subject to the SIGIs Framework, the Portuguese companies code and certain provisions of the PSC regarding publicly traded companies.

SIGIs' main activity is the acquisition of rights in real estate, leases or other forms of economic exploitation of real estate, the acquisition of holdings in companies with similar purposes and under equivalent requirements and the acquisition of units or shares in real estate AIFs, whose profit distribution policy is equal to the one provided for in the SIGIs Framework. The shares of SIGIs are traded on a regulated market or multilateral trading facility. In addition, SIGIs are subject to specific requirements regarding the dissemination of their share capital, asset allocation and profit distribution to investors.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Legally, the asset of an AIF is only liable for its debts, thus it will not be liable for investors, the fund manager, depository, distributors or other AIFs' debts. Likewise, investors are not personally liable for the AIF's debts and will under no circumstances be burdened by any debt of the AIF.

Notwithstanding, in the case of closed-ended real estate AIFs, the UCI Law allows for the AIF's regulation to establish that, following a resolution of the investors' assembly, the investors in a privately subscribed real estate AIF will take over the debts of the AIF, provided that the creditors agree so and that it is ensured that the debts arising after the extinction of the AIF will be taken over by the fund manager.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

The AIF, which is not self-managed, will need to be managed by a fund manager authorised to manage UCITS or AIFs, as applicable (*sociedade gestora de organismos de investimento coletivo*).

Considering that it is unusual for an AIF to be self-managed in Portugal, almost every AIF is managed by fund managers as described in the paragraph above.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

The UCI Law is silent in respect of the ability of the fund manager to restrict redemptions in open-ended funds, but considering that such types of AIFs in general target retail investors, the CMVM will most certainly closely scrutinise this matter. In fact, such possibility would need to be clearly set out in the AIF's regulation, which is analysed during the authorisation procedure.

Moreover, the layout of the AIF regulation, approved by Regulation no. 2/2015, contains a field where the conditions set out for redemptions must be described, but only as regards the applicable fees, settlement dates and the criteria for the determination of which units/shares will be redeemed. Likewise, Regulation no. 2/2015 only seems to foresee conditions under which redemptions may be suspended, but not restricted.

As regards the restriction of transfers in open-ended funds, the same rationale described above in respect of the redemption applies.

Conversely, regarding closed-ended AIFs, mainly those targeting professional investors, we trust that it is possible to establish in the AIF's regulation restrictions on the transfer of units from investors to third parties.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no legislative restrictions.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The ability of the manager to manage its funds will be mainly limited by the investment policy established in the AIF's prospectus or regulation, as applicable, by the general investment limits by type of AIF, if any, established in the UCI Law and by the obligation to conduct its activity in the best interest of the investors.

The UCI Law has a list of acts that a manager cannot carry out, such as granting loans, executing certain transactions on its own account, executing transactions relating to the assets held by the AIF with related parties, e.g., entities of its group, the depository, etc.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Please refer to question 1.1 above. In addition, marketing materials are also subject to the general provisions regarding marketing of products to the public, such as the Marketing Code, etc.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

Regulation no. 2/2015 provides minutes for the AIF's legal documents (KIID, prospectus and regulation).

On the contrary, there are no minutes available in respect of marketing materials. Nonetheless, it is common practice for the fund manager and other distribution entities to provide information on the investment policy, markets targeted, main features (identification of the relevant entities, ISIN Code, terms and conditions of the investment, links to the legal documents) and historic returns of the AIF.

Pursuant to Regulation no. 2/2015, if the marketing materials disclose return figures, they shall also contain, at least:

- The identification of the AIF and fund manager.
- The reference "the disclosed returns represent past data and do not guarantee future returns".
- The identification of the reference period for return figures indicated.
- Confirmation on whether or not the return figures disclosed already include the applicable taxation.

- Information on where and how the KIID and other legal documents may be obtained.
- In cases where the AIF's units/shares are admitted to trading on a regulated market, identification of the market at stake and if the values disclosed are calculated on the basis of the asset value or on the market value of the units/shares.
- The warning that investment in the AIF may lead to the loss of principal invested, in cases where the AIF does not guarantee payment of the principal invested.
- If the figures disclosed are annualised, but have a reference period greater than one year, the information disclosed shall also contain the reference according to which the reference return could only be obtained if the investment was performed during the entire period of reference.
- The risk level, with identical emphasis of the return figure, for an identical period of reference.

Lastly, as a general note, in accordance with the PSC, the information contained in the marketing materials shall be prepared in Portuguese or followed with a duly legalised translation, and must be complete, true, updated, clear, objective and licit.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Marketing materials in respect of AIFs do not need to be registered or authorised by the CMVM.

However, an AIF's legal documents, namely the KIID, the full prospectus of the AIF and/or the AIF's regulation, as well as any further amendment to them, need to be registered with the CMVM and publicly disclosed through the CMVM's website.

3.4 What restrictions are there on marketing Alternative Investment Funds?

The marketing or distribution (*comercialização*) of AIFs is very broad, being defined as the activity directed towards investors with a view to promoting or proposing the subscription of units/shares, regardless of the means of communication used.

The entities which are legally permitted to market AIFs are (i) AIF managers, (ii) depositaries, (iii) financial intermediaries registered or authorised by the CMVM to perform the relevant activities, namely those of placement or reception and transmission of orders on behalf of third parties, and (iv) other entities as foreseen in Regulation no. 2/2015 and subject to its authorisation.

Furthermore, the concept of reverse solicitation is not an official exemption from the UCI Law requirements, but rather a tolerated practice, which consists of an investor, on its own initiative and without any previous engagement on the part of the distributor, requesting information on the AIF at stake. However, a case-by-case assessment needs to be conducted, considering that the new AIFMD framework has induced a greater use of the reverse solicitation expedient, which may come under the CMVM's scrutiny.

Virtually every type of marketing falls into the category of distribution (*comercialização*), thus if such is not carried out by a duly licensed entity or under the reverse solicitation exemption, it will be in breach of the UCI Law.

A clear distinction must be drawn regarding pre-marketing. If such marketing is conducted in relation to a specific AIF with the intention of triggering a future solicitation by the addressee to receive more information and subscribe the AIF, it is rather likely that the CMVM will consider it to fall within the concept of actual marketing. Conversely, if the pre-marketing has only a general nature, there are grounds to sustain that it does not constitute a marketing activity subject to the UCI Law requirements.

An AIF may only be marketed in Portugal after its constitution has been authorised by CMVM and, in any case, the marketing material may contradict or diminish the importance of the AIF's prospectus or regulation and KIID.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

The concept of pre-marketing is not expressly recognised in the UCI Law and is generally viewed by CMVM as being encompassed in the concept of marketing itself (please refer to question 3.4 above).

Nevertheless, if the pre-marketing has only a general nature, i.e. it seeks to present to the investor the existence and activity carried out by the fund manager or an overall look at the market, without recommending or referring to any investment opportunity in particular, there are grounds to sustain that it does not constitute a marketing activity subject to the UCI Law requirements.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes. However, AIFs passported under the AIFMD can only be marketed in Portugal to professional investors.

In order for the AIF to be marketed to retail investors in Portugal, the fund manager will need to obtain an authorisation of the CMVM, to be granted after the conclusion of a full registration procedure in Portugal of the AIF.

3.7 What qualification requirements must be met in relation to prospective investors?

There is no particular requirement to be fulfilled in relation to investors in AIFs.

Nonetheless, the fund manager shall ensure that the "know your customer and investment suitability analysis" is properly carried out in relation to the potential investor, as well as ensure that the anti-money laundering and terrorism financing procedures are respected.

We stress that in the case of AIFs exclusively targeting professional investors, the fund manager shall guarantee that the investors that do not meet such eligibility criteria cannot invest in the AIF.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no additional restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

No. However, the holding of units/shares in AIFs may have an impact, that needs to be assessed on a case-by-case basis, on the own funds and reserves of the credit and financial institutions.

Regarding the Portuguese insurance and pension funds sectors, there are limits relating to the representation of technical provisions with interests in AIFs, as well as to the asset allocation of pension funds, which restricts the exposure to a single AIF or the investment in AIFs in excess of a certain percentage of the portfolio, which will vary in accordance with the entity at stake.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

No. However, the relationship established between the intermediaries and the AIF shall be put in a written agreement and disclosed in the AIF's legal documents.

Furthermore, the intermediary, when carrying out the fundraising process, needs to act within the scope of activities that it is authorised to conduct, *i.e.* if the fundraising process corresponds to marketing of the AIF under the UCI Law, the analysis carried out in respect of question 3.4 above will be entirely applicable herein.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Yes. AIFs can only focus on investment activities and their management and investment shall comply with the general rules applicable to the financial instruments markets, notably those resulting from the implementation carried out in Portugal of the MiFID II by the PSC, with the due adaptations in accordance with their specific nature.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Yes. The assets eligible for the portfolio of the AIF will depend on its specific type.

Therefore, AIFs investing in securities or financial assets, such as undertakings for collective investment in transferable securities that do not comply with the UCITS Directive limits, may also invest up to 10% of their net asset value (NAV) in units/shares of real estate AIFs. Moreover, the AIF's regulation shall set out the other relevant limits, otherwise the limits established in the UCITS Directive, as implemented by the UCI Law, shall apply.

Real estate investment funds shall invest the majority of their assets in real estate, but may also invest in shares of real estate investment companies (*sociedades imobiliárias*), derivatives, mainly for hedging purposes, units/shares of other real estate investment funds and liquidity instruments. The extent to which the investment in the referred assets is limited will depend on the fact of the AIF being closed-ended or open-ended, and privately or publicly subscribed. Either way, the real estate investment fund cannot invest in assets encumbered, with liens or charges that may render its future disposal more difficult, such as *in rem* security.

AIFs which invest in long-term non-financial assets with a determinable value need to hold at least 30% of their NAV in long-term non-financial assets with a determinable value and may invest up to 25% of their NAV in real estate, units/shares in real estate investment funds and shares in real estate investment companies.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

As a matter of principle, the investment in derivatives by AIF is generally limited to risk management purposes, save for specific cases where they may be used of leveraging purposes and if that is specified in the AIF's constitutional documents.

Loans originating from AIFs are not allowed in general terms under Portuguese law. Nevertheless, a recent amendment to the Venture Capital Law created a new type of AIF, the loan originating fund, which may extend loans, subject to the limitations established in CMVM Regulation No. 3/2015, as amended; namely, it cannot extend credit to natural persons or credit institutions and the maturity of the loans shall not exceed the maturity of the AIF.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Yes. In respect of real estate AIFs, the borrowing limits are 25% of the asset for open-ended AIFs and 33% of the asset for closed-ended publicly and privately (by more than five investors, which are not exclusively qualified as professional investors) subscribed AIFs. Closed-ended AIFs which are privately subscribed by five or fewer retail investors or whose investors are exclusively qualified as professional investors are not subject to any borrowing limit.

As regards AIFs investing in securities or financial assets and AIFs investing in long-term non-financial assets with a determinable value, their regulations shall set out the limits for borrowing.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

Besides the reporting obligations referred to in question 5.3 below, the elements which are made available to the public on the CMVM's website and the identity of the persons/companies holding qualifying shareholdings (10% or more) in the fund manager shall also be publicly disclosed.

Furthermore, the legal documents of the AIFs and their updates shall also be made available on the CMVM's website. Considering that the legal documents shall describe the identity of the fund manager, depository, auditor, distributors and other services providers to the AIF, the majority of the data in connection with the AIF will be made available to the public.

However, the identity of the investors in the AIF is not mandatorily subject to public disclosure.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

The implementation in Portugal of the Fourth Anti-Money Laundering Directive set out a broad range of administrative measures to prevent and tackle breaches of the applicable AML/CFT framework. Within this context, the Ultimate Owner Central Registry (*Registo Central do Beneficiário Efetivo*) was created, in order to collect and centralise the data provided by entities subject to this framework.

AIFs and fund managers or any other entity established in Portugal or possessing a Portuguese tax payer number will need to provide information to the Registry, and keep it permanently updated, on their ultimate beneficial owners, which, depending on the specific case, may include details on the investors and their shareholders or controllers.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

The fund manager must prepare and publish annual and biennial accounts. These must be made available free of charge at the investors' request.

The marketing entity must send or make available to the investors a statement informing them of:

- the number of units such investor holds; and
- their value and the aggregate value of the investment.

In addition to this information, the marketing entity may provide any additional information regarding the investor's financial situation. For example, if the marketing entity is a bank of which the investor is a client, it could provide the above information together with the investor's bank statement.

Any information published pursuant to the requirements set out below is available to investors, usually through the CMVM's information diffusion system (website).

Moreover, the fund manager must publish and send to the CMVM:

- The annual accounts within four months after the end of the financial year.
- The biennial accounts within two months after the end of the relevant semester.
- An inventory of the fund's asset portfolio, its global net value, any responsibilities not found in the balance sheet and the number of units currently in circulation, on a monthly basis.

The fund manager as a regulated entity shall also, in respect of its activities, prepare and submit its accounts and financial statements and internal control report to CMVM.

Lastly, the fund manager needs to provide CMVM with continuous regulatory reports on its activities and the funds under management, in accordance with CMVM's instructions.

5.4 Is the use of side letters restricted?

The use of side letters that set out particular terms and conditions in respect of governance, investment, etc. of the AIF is not specifically addressed by the UCI Law.

However, in the case of open-ended AIFs, considering that they tend to target retail investors and/or a broader unrestricted scope of investors, the use of side letters which alter any relevant provision of the legal documents, shall be deemed illegal, considering that, as a general principle, the fund manager needs to abide by the AIF's legal documents during the provision of its activity and treat equally all investors.

In closed-ended AIFs, notably those which are privately subscribed or targeting only professional investors, we trust that there is a wider margin to set out, namely through a side letter, giving specific provisions in respect of certain matters. However, in general terms, the provisions of the UCI Law are imperative, therefore any side letter providing for actions in breach of such legal provisions will be deemed illegal and may subject the fund manager to administrative offence proceedings.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

AIFs are subject to corporate income tax (CIT) at the general rate (currently set at 21%), but are exempt from municipal and state surcharges. Taxable income corresponds to the net profit assessed in accordance with an AIF's accounting standards.

However, passive income, such as investment income, rental income and capital gains (except when sourced in a tax haven) are disregarded for taxable profit assessment purposes. Costs incurred in connection with such income (including funding costs) are also disregarded for profit assessment purposes. The following are also disregarded for taxable profit assessment purposes: (i) non-deductible expenses under the CIT Code; and (ii) income and expenses relative to management fees and other commissions earned by AIFs.

An AIF's income is not subject to withholding tax. However, autonomous tax rates established in the CIT Code will apply.

AIFs that are exclusively investing in money market instruments and bank deposits will also be subject to stamp duty calculated on their global net asset value at a rate of 0.0025% (per quarter). Other AIFs will be subject to stamp duty to be levied on their global net asset value at a rate of 0.0125% (per quarter).

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

In the case of AIFs endowed with legal personality that are self-managed, the tax regime referred to in question 6.1 above applies.

On the contrary, in the case of AIFs managed by a third party, income obtained by such an AIF manager (including capital gains earned on the transfer of fund units) is subject to CIT at a rate of 21% to which a municipal surcharge of up to 1.5% may be applicable on taxable profits, depending on the municipality of where the AIF manager is established (the municipalities have the right to decide if the municipal surcharge is levied and at which rate).

Taxable profits are also subject to a progressive state surcharge which has the following applicable rates: (i) 3% on the part of the taxable profits exceeding €1.5 million up to €7.5 million; (ii) 5% on the part of the taxable profits exceeding €7.5 million up to €35 million; and (iii) 9% on the part of the taxable profits exceeding €35 million.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

Establishment taxes are not applicable in Portugal to the mere holding of a participation in an AIF. Please note in this regard that the acquisition of an AIF's units of a privately subscribed closed-ended real estate AIF, as well as operations of redemption, capital increase or reduction, which results in a single investor or two spouses holding more than 75% of the units representing the assets of such AIF, property transfer tax should apply proportionally at the applicable rate (up to 6.5%) to the taxable value or the total value of the assets, as the case may be, but in each case with preference to the evaluation report of the investment fund manager, if higher.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

(a) Resident investors

The taxation of resident investors is as follows:

Personal income tax (PIT): Income distributed or derived from redemptions to Portuguese individuals (outside their commercial activity) is subject to a 28% final withholding tax. If the investor opts to aggregate the income received, it will be subject to progressive income tax rates of up to 48%. In the latter circumstance, an additional income tax will be due on the part of the taxable income exceeding €80,000 as follows: (i) 2.5% on the part of the taxable income exceeding €80,000 up to €250,000; and (ii) 5% on any taxable income exceeding €250,000.

Income payments to omnibus accounts are subject to a final withholding tax rate of 35%, unless the relevant beneficial owner of the income is identified, in which case the tax rates applicable to the beneficial owner apply. Capital gains arising from the transfer of units are taxed at a special tax rate of 28% on the positive difference between capital gains and losses or the above progressive income tax rates and additional income tax rates, if the investor opts to aggregate the income received.

Corporate income tax (CIT): Income payments to a resident entity are subject to withholding tax at a rate of 25% (to be paid on account of the final CIT due) and are qualified as income or gains for CIT purposes. Income payments to omnibus accounts are subject to a final withholding tax rate of 35%, unless the relevant beneficial owner of the income is identified, in which case the standard tax rates applicable to the beneficial owner apply.

A resident entity is subject to CIT at a rate of 21% (if the taxpayer is a small or medium-sized enterprise as established in Decree-Law no. 372/2007 of 6 November 2007, the rate is 17% for taxable profits up to €25,000 and 21% for taxable profits in excess thereof). A resident entity may also be subject to a municipal surcharge (*derrama municipal*) of up to 1.5% on taxable profits, depending on the municipality where it is established (the municipalities have the right to decide if the municipal surcharge is levied and at what rate). Taxable profits are also subject to a progressive state surcharge (*derrama estadual*) which has the following applicable rates: (i) 3% on the part of the taxable profits exceeding €1.5 million up to €7.5 million; (ii) 5% on the part of the taxable profits exceeding €7.5 million up to €35 million; and (iii) 9% on the part of the taxable profits exceeding €35 million.

Capital gains earned on the transfer of fund units are fully included in the taxable income of the resident entity and are subject to the same rates and surcharges as above.

(b) Non-resident investors

Non-resident investors are taxed as follows:

PIT: Income payments and capital gains derived from units in a securities AIF are exempt from PIT provided that the evidence of non-resident status required by the tax law is timely delivered by the beneficiary of the income to the AIF. A refund procedure is available within a two-year period in cases where a 28% withholding tax was applied for failure to timely deliver the documentation. The refund procedure requires the certification of a special form by the competent authorities of the state of residence. Non-resident investors domiciled in a blacklisted jurisdiction listed in Ministerial Order 150/2004 of 13 February, as amended from time to time, are not able to benefit from income tax exemptions and, in addition, will be subject to an aggravated 35% withholding tax. Income payments to accounts opened in the name of one or more account holders acting on behalf of one or more unidentified third parties are subject to a final withholding tax rate of 35%, unless the relevant beneficial owner of the income is identified, in which case the tax rates applicable to the beneficial owner apply.

Non-resident individuals who obtain income distributed by a real estate AIF or through the redemption of such AIF units shall become subject to withholding tax at the final rate of 10% provided the non-residence evidence in Portugal has been obtained in due time. Capital gains deriving from the sale of said units are taxed autonomously at a 10% rate.

If the exemptions or reduced withholding tax rates do not apply, the general rules and tax rates (28% or 35%, as the case may be) will apply.

CIT: A CIT exemption applies where income arising from the units of a securities AIF is distributed or made available to a non-resident entity without a permanent establishment in Portugal. Capital gains arising from the transfer of the said units are also exempt from CIT.

In order to benefit from such exemptions, adequate evidence of non-resident status must be timely provided.

Non-resident corporate investors who obtain income distributed by a real estate AIF or through the redemption of units on such AIF are subject to withholding tax at the final rate of 10%. Capital gains deriving from the sale of units in a real estate AIF are taxed autonomously at a rate of 10%.

However, non-resident investors cannot benefit from the exemptions or the reduced withholding tax rates, as the case may be, pursuant to the characteristics of the AIF, if: (i) the non-resident entity is domiciled in a blacklisted jurisdiction listed in Ministerial Order 150/2004 of 13 February, as amended from time to time; (ii) more than 25% of the capital of the non-resident entity is held, directly or indirectly, by resident legal entities except when such entities are resident (a) in a Member State of the EU other than Portugal or in a Member State of the European Economic Area provided, in this case, that such a State is bound to cooperate with Portugal under an administrative cooperation arrangement in tax matters similar to the exchange of tax information existing within the EU Member States, or (b) in a State with which Portugal has a double tax treaty in force or a tax information exchange agreement in force; or (iii) non-resident investors have not timely provided non-residence evidence in Portugal.

If the exemptions or reduced withholding tax rates do not apply, the general rules and tax rates (25% or 35%, as the case may be) will apply.

(c) Pension fund investors

Pension fund investors are taxed as follows:

1. Pension funds which are established and operate in accordance with Portuguese law are taxed as follows:
   i. In the event of income deriving from AIFs distributions, pension funds are exempt from CIT and are exempt from withholding tax.
   ii. In the event of income deriving from the redemption of the units or liquidation of the AIF, pension funds are subject to withholding CIT at a 25% rate, which will be refunded upon submission of the annual income tax return, since pension funds are exempt from CIT.
2. Pension funds which are established and operate in accordance with the law of a Member State of the EU other than Portugal or in a Member State of the European Economic Area are taxed as follows:
   i. In the event of income distributed by real estate AIFs or through the redemption of the units or liquidation of such a real estate AIF, the pension funds are subject to withholding tax at a final rate of 10%.

ii. In the event of income deriving from securities AIFs, including income deriving from distributions and from the redemption of the units or liquidation of the AIF, pension funds should be exempt from CIT. In order to benefit from such exemptions, adequate evidence of non-resident status must be timely provided.

iii. However, non-resident pension funds cannot benefit from the exemptions or the reduced withholding tax rates, as the case may be, pursuant to the characteristics of the AIF if: (i) the non-resident pension fund is domiciled in a blacklisted jurisdiction listed in Ministerial Order 150/2004 of 13 February, as amended from time to time; (ii) more than 25% of the capital of the non-resident pension fund is held, directly or indirectly, by resident legal entities except when such entities are resident in a Member State of the EU other than Portugal or in a Member State of the European Economic Area provided, in this case, that such a State is bound to cooperate with Portugal under an administrative cooperation arrangement in tax matters similar to the exchange of tax information existing within the EU Member States or in a State with which Portugal has a double tax treaty in force or a tax information exchange agreement in force; or (iii) non-resident pension funds have not timely provided non-residence evidence in Portugal.

iv. If the exemptions or reduced withholding tax rates do not apply, the general rules and tax rates (25% or 35%, as the case may be) will apply.

3. In addition, pension funds which are established and operate in accordance with the law of a Member State of the EU other than Portugal or in a Member State of the European Economic Area are exempt from CIT, provided, in this case, that such Member State is bound to cooperate with Portugal under an administrative cooperation arrangement in tax matters similar to the exchange of tax information existing within EU Member States which are also exempt from CIT, provided the following cumulative requirements are met:

   i. the pension fund covers exclusively the payment of retirement benefits for old age or disability, for survival, for early retirement, post-employment healthcare benefits and, where they are supplementary to those benefits and are provided on an ancillary basis to the previously mentioned benefits, the attribution and death grants;

   ii. the pension fund is managed by institutions for occupational retirement, as provided by Directive no. 2003/41/EC, of the European Parliament and of the Council, of 3 June;

   iii. the pension fund is the ultimate beneficial owner of the income; and

   iv. with respect to income distributions made by AIFs, the corresponding participation in the share capital is held, continuously, for at least one year.

In this case, however, it is not clear if the applicable exemption for CIT purposes at the level of the pension funds enables either (i) the operation of a withholding tax exemption upon payment of income from the AIF to the pension fund or, alternatively, (ii) the attribution to the pension funds the right to claim a refund of the CIT withheld. To the best of our knowledge, the tax authorities have not provided any public guidance in this respect up to this moment.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

Portuguese taxpayers may request advance rulings regarding specific tax situations. When advance rulings are issued, the tax authorities may not derogate from such rulings in relation to the taxpayers that requested it, except pursuant to court decisions.

Subject to the payment of a fee (it may range from €2,550 up to €25,500), an advance ruling may be provided urgently, provided that such request by the applicant is accompanied by a tax framework proposal, reasons raised for urgency and the amount to be determined by the tax authorities according to the complexity of the topic is paid.

If the tax authorities accept the urgency of the matter, the binding ruling will be issued within 75 days from the date of presentation of the request, and in the event that the tax authorities do not issue the ruling in such a time frame, it is considered that the tax treatment presented by the taxpayer is agreed to by the tax authorities. Non-urgent rulings are delivered within 150 days, although this deadline is merely indicative.

Unless the new law does not provide a clear answer on any particular topic that might be raised by an investor, it is not necessary to obtain a tax ruling from the tax or regulatory authorities prior to establishing an AIF.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Portugal has implemented, through Law no.82-B/2014 of 31 December, the legal framework based on reciprocal exchange of information on financial accounts subject to disclosure in order to comply with FATCA. Portugal signed an Intergovernmental Agreement with the US on 6 August 2015, which has been in force since 10 August 2016 and, as such, Portuguese financial institutions (funds and fund managers) have implemented procedures to fully comply with the legal reporting and compliance rules.

In addition, the Common Reporting Standard (CRS) has also been enacted, through Decree-Law no. 64/2016, of 11 October 2016, as amended, which implemented the legal framework based on reciprocal exchange of information on financial accounts subject to disclosure in order to comply with CRS and, as such, Portuguese financial institutions (funds and fund managers) have implemented procedures to fully comply with the legal reporting and compliance rules.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

There have been several amendments to the Portuguese legislation in connection with the recommendations of the Base Erosion and Profit-Shifting (BEPS) action plan, issued by the OECD.

Directive (EU) 2016/1164 of 12 July 2016 (ATAD 1), amended by Directive (EU) 2017/952 of 29 May 2017 (ATAD II) was transposed into the domestic legislation through Law 32/2019,

of 3 May. This Law has established a broader scope of financial costs and a different concept of EBITDA (taxable income or loss not exempt, adjusted by the net financial expenses and by the depreciation and amortisation tax deductible). Law 32/2019, of 3 May, also introduced significant changes to the general anti-abuse clause and to its application procedure in order to facilitate the application of the general anti-abuse clause, ensuring a higher level of protection against abusive planning and fiscal avoidance schemes.

The rules regarding hybrid mismatches have not yet been transposed into the domestic legislation but it is expected to happen shortly.

Portugal is also a signatory of the Multilateral Convention for the implementation of measures related to tax treaties which was ratified by the Portuguese President and deposited with the Secretary General of the OECD on 28 February 2020. This Convention will enter into force in Portugal on 1 June 2020.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

There are some types of investment funds that benefit from a tax-advantaged treatment, namely: (a) Real Estate Investment Funds on Forest Resources; (b) Residential Letting Real Estate Investment Funds; (c) Real Estate Investment Funds on Urban Rehabilitation; and (d) Venture Capital Funds.

(a) Real Estate Investment Funds in Forest Resources

Real Estate Investment Funds in Forest Resources (REIFFR) incorporated under the Portuguese law are exempt from CIT when at least 75% of its assets are allocated to exploitation of forest resources according to approved forest management plans, provided they are carried out accordingly to the applicable regulations and are subject to the legal forest certification proceedings.

Investors who obtain income distributed by a REIFFR are subject to withholding tax at the rate of 10% unless: (i) the investors are entities exempt from CIT on capital income; or (ii) the investors are non-resident entities with no permanent establishment in Portugal to which the income can be attributed and that do not reside in a blacklisted jurisdiction or that are not held in more than 25% by resident entities.

Individual investors subject to PIT who opt to aggregate the income received may deduct 50% of the distributed income which concerns to dividends, as a means of eliminating the economic double taxation.

Capital gains deriving from the transfer of units are taxed at a 10% rate if the investors do not benefit from the specific exemption applicable to capital gains obtained by non-residents (foreseen in Article 27 of the Portuguese Tax Benefits Code) or if they are individual investors who do not obtain this income under their professional activity and that do not opt to aggregate the income received.

Whenever the conditions above described regarding the composition of the fund's assets cease to be met, the investment fund and its investors shall be taxed according to the regime described in questions 6.1 and 6.4.

For contributions in kind made for the subscription of units made by resident or non-resident individuals, no income is assessed from the transfer of rural properties intended for forest exploitation, and the acquisition value of such properties is considered as the acquisition value of those contributions for tax purposes.

Also, the acquisitions by REIFFR of rural properties intended for forest exploitation or parcels of the ownership right relating to these rural properties are exempt from stamp duty.

(b) Residential Letting Real Estate Investment Funds

Residential Letting Real Estate Investment Funds (RLREIFs) incorporated between 1 January 2008 and 31 December 2015 are exempt from CIT, Property Transfer Tax and Stamp Duty levied on the transfer of the immovable property to the RLREIF when the previous owners become the tenants or when they opt to purchase the immovable property, in accordance with the lease contract.

Investors who obtain income deriving from these funds are exempt from CIT and PIT, except with regards to capital gains earned on the transfer of fund units.

These benefits shall apply if certain conditions are met, such as the RLREIF's portfolio being composed of a minimum of 75% of real estate located in Portugal and used for residential letting purposes.

Whenever the legally required conditions cease to be met, the investment fund and its investors shall be taxed according to the regime described in questions 6.1 and 6.4.

(c) Real Estate Investment Funds for Urban Rehabilitation

Real Estate Investment Funds for Urban Rehabilitation (REIFURs) incorporated between 1 January 2008 and 31 December 2013, of which 75% of their assets are immovable property subject to urban renewal and located in urban renewal areas, are exempt from CIT on income of any type. This exemption is only applicable if urban renewal interventions were initiated after 1 January 2008 and concluded up to 31 December 2020.

Income distributed by the REIFUR is subject to withholding tax at the rate of 10% unless: (i) the investors are entities exempt from CIT on capital income; or (ii) the investors are non-resident entities with no permanent establishment in Portugal to which the income can be attributed and that do not reside in a blacklisted jurisdiction or that are not held in more than 25% by resident entities. This withholding tax becomes final when the investors are non-resident and have no permanent establishment in Portugal or when they are individual investors who earn this capital gains irrespective of their professional activity and that do not opt to aggregate the income received.

Individual investors subject to PIT who opt to aggregate income received may deduct 50% of the distributed income corresponding to dividends, as a means of eliminating the economic double taxation.

Capital gains deriving from the transfer of units are taxed at a 10% tax rate if the investors do not benefit from the specific exemption applicable to capital gains realised by non-residents (foreseen in Article 27 of the Portuguese Tax Benefits Code) or if they are individual investors who do not obtain this income under their professional activity and that do not opt to aggregate the income received.

Whenever the conditions above described regarding the composition of the fund's assets cease to be met, the investment fund and its investors shall be taxed according to the regime described in questions 6.1 and 6.4.

(d) Venture Capital Funds

Venture Capital Funds constituted under the Portuguese law are exempt from CIT on any type of income.

Investors who obtain income deriving from the distribution of income by a venture capital investment fund or from the redemption of units on such funds are subject to withholding tax at the rate of 10% unless: (i) the investors are entities exempt from CIT on capital income; or (ii) the investors are non-resident entities with no permanent establishment in Portugal to which the income can be attributed. This exception does not comprise investors that reside in a blacklisted jurisdiction or that

are held in more than 25% by resident entities. This withholding tax becomes final when the investors are non-resident and have no permanent establishment in Portugal or when they are individual investors who earn this capital gains irrespective of their professional activity and that do not opt to aggregate the income received.

Capital gains deriving from the transfer of units are taxed at a 10% rate if the investors do not benefit from the specific exemption applicable to capital gains obtained by non-residents (foreseen in Article 27 of the Portuguese Tax Benefits Code) or if they are individual investors who do not obtain this income under their professional activity and that do not opt to aggregate the income received.

(e) Real Estate Investment Trust

Real Estate Investment Trusts are subject to the same tax regime as Real Estate Investment Funds and Real Estate Investment Trust investors are subject to the same tax regime as Real Estate Investment Fund investors.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

If an exemption is not applicable, the acquisition of real estate by an AIF is subject to Property Transfer Tax (up to 6.5%) and stamp tax (0.8%) and each applicable tax rate will be levied either on the purchase price or the tax value of the property if higher.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

To the best of our knowledge, we are not aware at this stage of any proceedings or actions taken or proposed to be taken by the Portuguese Authorities that consist of meaningful tax changes in the coming 12 months.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

It is expected that the UCI Law will be subject to further amendments, particularly regarding the enforcement and sanctioning powers of CMVM.

Moreover, more regulations should be issued by CMVM in order to update the current rules in force for AIFs and fund managers on matters, such as reporting obligations, continuing the trend of the beginning of 2020.

The COVID-19 pandemic has also impacted the local market with unforeseeable consequences as of this moment. Nevertheless, local operators are capable of applying contingency plans to face the crisis and CMVM is in permanent contact with them, paying attention to risk management and information reporting during this period.

In case of a no-deal Brexit, in 2019 Portugal published a Decree-Law establishing contingency measures for investment funds and fund managers. Nevertheless, since the Decree-Law will cease to produce effects on 31 December 2020 and that in the meantime it is applying the transition period provided under the Withdrawal Agreement, this matter will need legislative intervention in case no definitive agreement is reached between the EU and the UK before the referred date.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The primary legislation that governs the establishment and operation of Alternative Investment Funds (AIFs) in Scotland is:

- the Financial Services and Markets Act 2000 (FSMA) and related orders;
- the Limited Partnerships Act 1907 (LPA 1907); and
- the Companies Act 2006.

In general, the relevant provisions of the above legislation apply on a UK-wide basis; however, many AIFs are structured as Scottish Limited Partnerships (SLPs), which benefit from particular provisions of the LPA 1907 that do not apply to limited partnerships governed by English law. This is discussed further in section 2 below.

The rules which implement the EU Alternative Investment Fund Managers Directive (AIFMD) apply in Scotland. These rules affect the AIFs managed by managers within the scope of the Directive.

SLPs are the main focus of this chapter. However, some consideration is also given to other AIF structures which have been used in Scotland.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

The management and operation of an AIF in Scotland will normally involve regulated activities that are required to be carried out by persons authorised by the UK Financial Conduct Authority (FCA). The exact scope of regulated activities will depend on factors such as (i) the assets under management, and (ii) the structure of the fund; however, regulated activities that are typically considered during the fund structuring process are:

- establishing and operating a collective investment scheme (CIS);
- managing investments;
- managing an AIF;
- arranging transactions in investments; and
- advising on investments.

In cases where the manager and operator do not have the required FCA authorisations, it is usually possible to structure the AIF so as to outsource these activities to authorised service providers.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

AIFs that are structured as SLPs under the LPA 1907 are generally classed as unregulated collective investment schemes (UCIS) and are not themselves required to be authorised or regulated by the FCA or any other regulatory body. Registration with the Registrar of Limited Partnerships in Edinburgh is required.

The vast majority of AIFs registered in Scotland utilise the SLP structure. However, in terms of market practice, other AIF structures have been used in Scotland and two examples are considered below.

AIFs can be structured in Scotland (as they can in England) using certain forms of authorised fund structures, for example, qualified investor schemes (QISs) which take the form of an open-ended authorised unit trust (AUT) or open-ended investment company (OEIC). In general, the same regulatory regime applies to these funds irrespective of whether they are domiciled in England or Scotland. QIS structures are required to be authorised by the FCA, but can only be marketed to certain categories of eligible investor. AIFs that are structured as QISs benefit from investment and borrowing powers that are very flexible, for example, compared with UCITS and other authorised funds designed for retail investors. QISs are required to achieve a basic spread of risk consistent with the investment objective and policy. QIS structures can also be used for non-retail fund of funds structures, facilitating indirect investment exposure to, for example, private equity, hedge funds, and real estate funds. These are referred to as "Funds of Alternative Investment Funds" (FAIFs) and are subject to specific rules in relation to matters such as concentration, liquidity and due diligence, valuation and audit of the underlying funds. FAIFs may also be structured as "non-UCITS retail schemes" (NURS) to facilitate marketing to a wider range of investors.

In addition, there has been a trend for certain retail funds using authorised UCITS structures to adopt investment strategies similar to those used by some hedge funds. As with QIS structures, the same regulatory regime applies to these funds irrespective of whether they are domiciled in England or Scotland.

Listed AIFs have also been created using Scottish companies with securities admitted to trading on a securities market such as the Main Market or the Alternative Investment Market (AIM) or the Specialist Fund Market (SFM) of the London Stock Exchange. Historically there have been many examples of Scottish investment companies of this type, designed to facilitate indirect investment into alternative asset classes such as real estate and commercial forestry assets. In these cases, the

company becomes subject to regulation by the FCA and the London Stock Exchange, in respect of compliance with applicable provisions of FSMA, the Disclosure and Transparency Rules, the Admission & Disclosure Standards of the London Stock Exchange and, as applicable, the Prospectus Regulation Rules and/or AIM Rules for Companies.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The table below sets out the key features of the three main examples of AIF described above:

Key Features	**Scottish Limited Partnership**	**Authorised Unit Trust or OEIC (for example: Qualified Investor Schemes)**	**Investment Company Admitted to Trading on a Securities Market**
Legal structure	Partnership	Trust or Company	Company
Separate legal personality	Yes	Yes	Yes
Open-/closed-ended	Either	Open-ended	Closed-ended
Is the Fund/Manager/Trustee/Depositary regulated?	Manager and/or operator (FCA)	Manager or Authorised Corporate Director, Trustee/Depositary and Fund (FCA)	Manager and Custodian (FCA), Fund (Companies Act, FCA listing rules or AIM rules)
Admitted to trading on a securities market?	No	Not in practice, with the exception of those Exchange Traded Funds (ETFs) that use these fund structures	Admitted to trading on a securities market, for example the Alternative Investment Market, Main Market or Specialist Funds Market of the London Stock Exchange
Collective Investment Scheme?	Yes	Yes	No
Pricing	Bespoke valuation provisions in fund documentation	NAV of fund	Determined by market

1.5 What does the authorisation process involve and how long does the process typically take?

AIFs structured as SLPs

No authorisation is required at fund level. As indicated in question 1.3 above, the manager and/or operator will typically be required to be authorised by the FCA. Where not already authorised prior to the launch of the fund, the manager or operator will be required to apply to the FCA for authorisation to conduct the expected range of regulated activities. This will require the production of a detailed business plan, including proposed internal controls and outsourcing, a staff organisational chart including all those individuals who are seeking approved person status and relevant reporting lines, a compliance monitoring programme, details of IT systems as well as numerous other pieces of information. A typical, straightforward application would normally be processed within three months. More complex applications can take longer. As indicated in question 1.2 above, where the manager and operator do not have the required FCA authorisations, it is usually possible to structure the AIF so as to outsource these activities to authorised service providers.

AIFs structured as QISs or NURSs

An application for authorisation of a QIS or NURS must be submitted to the FCA. This involves submission of a structured application form, constitutional documents and prospectuses which comply with the detailed requirements of the FCA Collective Investment Schemes sourcebook (COLL), and a solicitor's certificate. A typical application would normally be processed within two months.

AIFs structured as public companies admitted to trading on AIM or SFM

The company must be registered as a public limited company and obtain a trading certificate. A prior requirement is that the nominal value of the company's share capital is not less than £50,000. At least one quarter of the nominal capital and the whole of any premium must be paid-up.

The process of applying for admission to AIM includes (i) the production of a detailed AIM admission document (which complies with the AIM Rules for Companies and the AIM Rules for Investing Companies), and (ii) the appointment of a nominated adviser (nomad) and broker. A nomad is usually a corporate finance firm, investment bank or a broker that has been approved by the London Stock Exchange. The nomad is responsible to the London Stock Exchange for assessing the appropriateness of a company for an application to AIM and for advising the company on the admission process and its continuing obligations under the AIM Rules for Companies.

The process of applying for admission to the Specialist Fund Market is a two-stage process. The requirements include (i) the approval of a prospectus by the UK Listing Authority, and (ii) following approval of the prospectus, application to the London Stock Exchange for admission to trading on the SFM. Applicants will require specialist advice.

1.6 Are there local residence or other local qualification or substance requirements?

Basic formation requirements for Scottish Limited Partnerships

Some market practice for the formation of SLPs is outlined below. Where the separate legal personality of the SLP is required for the operation of the fund (which is often the case with AIFs, particularly in the case of fund of funds, feeder funds and other vehicles), some of these steps are of particular importance:

- It is fundamental that the partnership agreement be written so as to be governed by Scots Law, specifically stating that the partners intend the partnership to be a Scottish partnership.

- The SLP is generally required to have a principal place of business in Scotland. This is often an address provided by the lawyers advising on the SLP formation.
- It is recommended that the general partner is a Scottish entity. This is most usually a Scottish special purpose private limited company. The general partner will be responsible for any day-to-day management of the SLP; however, this is normally delegated to an authorised manager. The registered office of the general partner is normally the principal place of business of the SLP.
- The partnership agreement is usually signed in Scotland. This is often undertaken by an attorney for the partners, who do not have to be physically present in Scotland to sign documents.

In addition, an occasional meeting, for example, an annual review meeting, is sometimes held at the SLP's principal place of business address in Scotland.

1.7 What service providers are required?

In the case of SLPs, the service providers required will vary depending on the activities of the fund. As indicated above, the management and operation of a typical AIF SLP will be undertaken by manager and operator, which may be the same entity, authorised by the FCA to carry out the regulated activities involved. However, operator services are often provided by specialist fund administration businesses, which will often also provide ancillary services such as fund accounting.

The rules implementing the EU Alternative Investment Fund Managers Directive (AIFMD) in the UK apply in Scotland. These rules introduced requirements for specific service providers, such as depositaries, for AIFs managed by managers within the scope of the AIFMD.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

As indicated in question 1.2, the management and operation of an AIF in Scotland will normally involve regulated activities that are required to be carried out by persons authorised by the UK Financial Conduct Authority (FCA). The exact scope of regulated activities will depend on factors such as (i) the assets under management, and (ii) the structure of the fund.

In cases where the manager and operator do not have the required FCA authorisations, it is usually possible to structure the AIF so as to outsource these activities to authorised service providers.

These rules apply to foreign managers or advisers. Specific advice should be taken on whether the relevant regulated activities are within the UK regulatory perimeter or not.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

Co-operation or information sharing agreements are entered into at the UK level and there are currently no separate agreements applicable to Scotland. Please see the England & Wales chapter of this publication for an overview of those agreements entered into at the UK level.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

As indicated in question 1.3 above, the vast majority of AIFs registered in Scotland utilise the SLP structure. However, in terms of market practice, some other structures have been used, for example, QIS structures and listed investment companies (described in questions 1.3 and 1.4 above).

As indicated in question 1.4 above, the focus of this chapter is on SLPs.

SLP key features include (i) flexible terms of management and operation, (ii) tax transparency, (iii) separate legal personality, (iv) limited liability for investors, and (v) the possibility of multiple passive investors (limited partners). For these reasons SLPs are frequently used as AIF vehicles, particularly as private equity funds, real estate funds (including their feeder funds and carried interest vehicles), and fund of funds structures.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Investors participate in SLPs as limited partners. Provided it does not involve itself in the management of the SLP, a limited partner's liability for the debts and obligations of the SLP is limited to the amount of its capital contribution. It is normal for AIF SLPs to be structured so as to ensure that this capital contribution is a nominal amount. For example, "capital contribution" is often defined in the partnership agreement as a fraction (e.g. 0.01 per cent) of a limited partner's commitment to the SLP. The rest of the limited partner's commitment to the SLP will comprise a loan.

If the partnership is wound up, for example, on an insolvent basis, the limited partner will normally rank as an ordinary creditor for sums advanced above the nominal capital commitment.

With effect from 6 April 2017, most AIF SLPs can apply to be treated as Private Fund Limited Partnerships (PFLPs). Limited partners in PFLPs are not required to contribute capital and any capital contributed can be repaid at any time without affecting the limited liability status.

The general partner of the SLP, which (subject to any delegation arrangements) is responsible for the management and operation of the SLP, has unlimited liability.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

The principal legal structures used for managers and advisers of AIFs in Scotland are limited companies and limited liability partnerships (LLPs).

LLPs are tax-transparent, which may assist efficient structuring of the management vehicle.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

AIF SLPs can be either open- or closed-ended.

Subject to the point below about the restriction on distributions of capital by SLPs, a manager may restrict redemptions or transfers, generally in accordance with the terms of the fund documentation.

The LPA 1907 restricts distributions of capital by SLPs during the life of the partnership. This makes the redemption of an investor's capital commitment difficult. However, as described in question 2.2 above, this capital commitment is usually a nominal amount, with the rest of an investor's commitment comprising a loan. This means that in practice there is no legal impediment to structuring an SLP as an open-ended vehicle. In addition, with effect from 6 April 2017, most AIF SLPs can apply to be treated as PFLPs. Limited partners in PFLPs are not required to contribute capital and any capital contributed can be repaid at any time without affecting the limited liability status.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

In the case of SLPs, transfers of partnership interests are required to be advertised in the Edinburgh Gazette and, for the purposes of the LPA 1907, do not take full effect until publication of the advert. Publication of the advert is a simple administrative procedure.

With effect from 6 April 2017, the requirement to advertise in the Edinburgh Gazette has been removed for PFLPs.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The AIFMD rules regulating the acquisition of substantial stakes in EU companies apply in Scotland as in the rest of the UK. These rules impose disclosure obligations on the acquisition of major holdings (starting at 10% of voting rights) in non-listed EU companies as well as restrictions on "asset stripping". These rules impose certain limitations on distributions, share redemptions or buybacks and capital reorganisations during a period of 24 months following the acquisition of control.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

As indicated in question 1.3 above, for regulatory purposes, AIF SLPs are generally classified as unregulated collective investment schemes (UCIS).

The marketing and promotion of UCIS is regulated by the FSMA and related orders and the AIFMD-driven rules, where the manager is within the scope of the Directive.

In very general terms, these regulations mean that, as is the case with AIFs in many other jurisdictions, AIF SLPs cannot be freely marketed to the public, but only to certain categories of eligible investor (such as "investment professionals" and "sophisticated investors").

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

Key content requirements for AIF SLP marketing materials are similar to those used in many other jurisdictions and, typically, details include:

- investment objectives and strategy;
- investment process;
- management personnel;
- summary of key fund terms;
- risk disclosures;
- disclosure of UK tax treatment of the fund and investors and, if the fund is being distributed on a cross-border basis, disclosure of the tax treatment of the fund and investors in other key jurisdictions; and
- regulatory statements and disclosures required by the FSMA and other securities laws in the UK and, if the fund is being distributed on a cross-border basis, regulatory statements and disclosures required by securities laws in other key jurisdictions.

This content is required by a combination of market practice and certain provisions of the FSMA and related orders, the common law of Scotland and the securities laws of other jurisdictions in which the fund may be being promoted. The AIFMD-driven rules apply where the manager is within the scope of the Directive.

In addition, the Packaged Retail and Insurance-based Investment Products Regulation (PRIIPS Regulation) requires product manufacturers to prepare Key Investor Documents (KIDs) for all Packaged Retail and Insurance-Based Investment Products (PRIIPS) that are offered to sale to retail investors in the EEA. This includes alternative investment funds (AIFs) sold to retail investors.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

SLPs are required to be registered with the Registrar of Limited Partnerships in Edinburgh. This requires the filing of a form at registration, containing basic details of the partnership, the partners and capital contributions. There are limited continuing obligations to notify the registrar of various changes relating to the partnership, its business and capital. There is no registration requirement in respect of an SLP's marketing document.

3.4 What restrictions are there on marketing Alternative Investment Funds?

As indicated in question 3.1 above, most AIF SLPs are classified as unregulated collective investment schemes (UCIS). The marketing and promotion of UCIS is regulated by the FSMA and related orders.

In very general terms, these regulations mean that, as is the case with AIFs in many other jurisdictions, AIF SLPs cannot be freely marketed to the public, but only to certain categories of eligible investor (such as "investment professionals", "high-net-worth individuals" and "sophisticated investors").

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

There is currently no formal concept of pre-marketing in the AIFMD rules as implemented in the UK including Scotland. Pre-marketing is, however, possible under the existing regulatory framework and the FCA has indicated in its Perimeter Guidance manual that, in its view, draft documentation does not fall within the meaning of an offer or placement for the purposes of the AIFMD, because an AIFM cannot apply for permission to market an AIF at that point. On that basis, it is possible under existing rules to conduct pre-marketing activities using an advanced draft of an information memorandum or prospectus.

If the EU Regulation and Directive on the cross-border distribution of collective investment funds are implemented in UK legislation, then it is expected they would apply in Scotland. Article 2(1) of this directive defines pre-marketing as:

> "provision of information or communication, direct or indirect, on investment strategies or investment ideas by an EU AIFM or on its behalf, to potential professional investors… in order to test their interest in an AIF or a compartment which is not yet established, or which is established, but not yet notified for marketing… and which in each case does not amount to an offer or placement to the potential investor to invest in the units or shares of that AIF or compartment."

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes, AIFs can be marketed to some investors classed as retail investors subject to the restrictions described under question 3.4 above and compliance with suitability assessment rules.

3.7 What qualification requirements must be met in relation to prospective investors?

A range of qualification requirements for eligible investors are set out primarily in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (FPO), the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (CIS Promotion Order) and specific FCA conduct of business rules. The specific rules that apply will depend on factors such as whether the promoter of the AIF is authorised by the FCA or not. Some commonly used categories of eligible investors are noted below:

- investment professionals;
- certified high-net-worth individuals; and
- certified sophisticated investors.

These categories are specifically defined in the applicable legislation.

AIFMD also introduced a passport which facilitates marketing to professional investors on a pan-European basis.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

No; public bodies will often fall within one of the categories of eligible investor, such as "investment professional", but this should be specifically checked.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

Generally, and subject to the points made above (see questions 1.2, 3.4 and 3.7 in particular) on authorisation and marketing, there are no restrictions on the participation in Alternative Investment Funds by particular types of investors.

Some qualifications apply to this. For example, Scottish local government pension schemes (LGPS) are subject to the restrictions set out in the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, which contains concentration limits for various classes of investments. LGPS, together with other types of pension funds, will also be subject to the terms of their internal investment policies.

Certain types of retail investment funds (for example, UCITS funds) also have to comply with investment restrictions which may limit their exposure to Alternative Investment Funds.

In addition, investments by financial institutions in AIFs may impact their regulatory capital requirements.

The rules which implement the AIFMD in the UK apply in Scotland. These significantly restrict the range of activities which managers within the scope of the Directive can undertake.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

The restrictions on marketing that apply to the manager or promoter will also apply to intermediaries.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

In general, no. However (as described in question 1.2 above), the management and operation of an AIF in Scotland will normally involve regulated activities that are required to be carried out by persons authorised by the FCA. Such persons will be authorised to conduct a specific scope of activities.

The rules that implement the AIFMD in the UK also restrict certain activities, for example, where an AIF acquires control of a non-listed company. These restrictions relate to matters such as distributions, capital reductions and share buybacks.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

No such limitations apply to AIF SLPs, although it is common for fund documentation to limit the types of investments held.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

No such restrictions apply to AIF SLPs, although it is common for fund documentation to limit exposure to specific instruments, such as derivatives, by the fund.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

No such restrictions apply to AIF SLPs, although it is common for fund documentation to limit borrowing by the fund.

The rules implementing the AIFMD in the UK require managers within the scope of the Directive to specify leverage limits.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

The registration and disclosure requirements, contained in the LPA 1907, that apply to AIF SLPs are set out in question 3.3 above.

In addition, the Partnerships (Accounts) Regulations 2008 (as amended) require the annual accounts of certain SLPs to be filed.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

With effect from 26 June 2017, SLPs were brought within the scope of the UK rules that require UK companies and all UK limited liability partnerships (LLPs) to keep a register of "persons with significant control" (PSC) and file their PSC information with Companies House.

The purpose of the PSC regime is to improve transparency and identify those individuals who ultimately own and control UK companies, LLPs and SLPs.

A person will be a PSC if they meet one or more of the following conditions:

- holding, directly or indirectly, the right to more than 25% of any surplus assets in the partnership on a winding up;
- holding, directly or indirectly, more than 25% of the voting rights in the partnership;
- holding the right, directly or indirectly, to appoint or remove the majority of the persons who are entitled to take part in the management of the partnership;
- having the right to exercise, or actually exercising, significant influence or control over the SLP; and
- having the right to exercise, or actually exercising, significant influence or control over the activities of a trust or firm (that is not a legal person) where the trustees or members of that firm meet any of the above conditions in relation to the partnership.

There are complex rules for applying these conditions, for example, if rights or interests are held or exercised indirectly or jointly with others.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

The rules which implement the AIFMD in the UK introduce various reporting requirements. These involve periodic reports to the FCA using an online reporting system.

5.4 Is the use of side letters restricted?

A requirement to disclose arrangements, such as side letters, was introduced by the AIFMD. Other than this, the use of side letters is not restricted by current legislation. As is common in other jurisdictions, investors will often seek to negotiate "most favoured nation" provisions.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Although SLPs have separate legal personality (which is why they are often used in fund of funds structures, feeder funds, and similar vehicles), they are tax-transparent for most UK taxes. This means that no income, corporation or capital gains tax is payable by the SLP itself. Instead, the UK tax authorities look through the partnership structure and partners are taxed on their share of partnership income arrived at in accordance with their profit-sharing ratios (which can be different from the ratios in which capital has been contributed). For capital gains tax purposes, partners are treated as owning fractional shares in the underlying assets.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

The tax treatment of the principal forms of investment manager/adviser will vary according to the structure used, for example, a company or limited liability partnership (LLP). LLPs are often used as management vehicles, as they are tax-transparent corporate vehicles, offering limited liability, with no restrictions on members participating in management. VAT on management fees is often a key tax consideration, as is the use of the Investment Manager Exemption, which allows a non-UK resident fund that is trading for tax purposes, such as a hedge fund, to appoint a UK-based investment manager without creating a permanent establishment in the UK.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There are no establishment taxes levied in connection with an investor's participation in an AIF. Stamp duty may be payable on the transfer of an investor's interest in an SLP if the SLP's property includes stock or marketable securities. In practice, transfers of interests are often structured so as to mitigate stamp taxes. Stamp duty land tax or land and buildings transaction tax may apply where the SLP's property includes land.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

As indicated above, although SLPs have separate legal personality, they are generally tax-transparent and the UK tax authorities look through the partnership structure. Partners are taxed on their share of partnership income in accordance with their profit-sharing ratios (which can be different from the ratios in which capital has been contributed). For capital gains tax purposes, partners are treated as owning fractional shares in the underlying assets. The tax profile of individual investors determines their tax liability.

AIF SLPs are generally operated so that they are not treated for UK tax purposes as carrying on a trade, the result of which is that non-resident investors should not be subject to UK tax on gains from the SLP. Non-resident investors may, however, be

subject to UK tax on investment income, although this is likely to be restricted to UK tax that is withheld at source (for example, by a portfolio company in a private equity fund). Withholding tax on UK investment income would be subject to the relevant double taxation treaty between the UK and the investor's jurisdiction of residence. It should be noted that some SLP or LLP based funds may be treated as trading if they invest directly in relevant activities such renewable energy operations.

Non-resident investors who hold their interest in the AIF SLP as part of their trade (for example, financial traders such as banks) are likely to be treated as carrying on part of that trade in the UK through a permanent establishment, branch or agency which is a UK representative (for example, the general partner or manager of the fund). The UK-resident general partner would then be treated as the investor's UK tax representative, and would share responsibility with the investor for submitting UK tax returns and paying any UK tax due on the investor's partnership income. In these circumstances, the manager will often be authorised to retain an amount equal to such investor's liability to UK corporation or income tax and pay such amounts to the UK tax authorities. These tax liabilities can usually be mitigated by the use of special purpose vehicles established for the purpose of participating in the AIF SLP.

In addition, non-UK jurisdictions may apply or withhold tax on income or gains receivable by the AIF SLP from investments in those jurisdictions. In these circumstances, investors will normally seek relief under applicable double tax treaties, and the availability of relief may depend on whether the SLP is treated as fiscally transparent in the overseas jurisdiction.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

This is not generally necessary.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

FATCA and other Automatic Exchange of Information (AEOI) compliance is currently coordinated at the UK level. The use of AIFs domiciled in Scotland should not ordinarily introduce any additional material factors relevant to FATCA or compliance with similar information reporting regimes.

It is to be noted that SLPs often elect to be treated as corporations for US tax purposes. Where that is the case, it may be relevant for FATCA compliance purposes (for example, when considering which entity may become liable for FATCA withholding tax).

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Implementation of the OECD's Action Plan on Base Erosion and Profit-Shifting is being dealt with at UK level.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Other than SLPs, which are described above and are generally tax-transparent, the tax and regulatory regime applicable to tax advantaged fund structures and asset classes generally applies on a UK-wide basis.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Individual investors, managers and advisors who are classed as Scottish tax payers for income tax purposes will be liable to pay the Scottish rates of income tax on any non-savings non-dividend income. For example, management fees or trading income treated as arising from an SLP could be subject to the Scottish rates.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

The UK tax authorities (HM Treasury) have released a consultation document relating to the tax treatment of UK asset holding companies in the context of alternative fund structures. This will include a review of the value-added tax (VAT) charges on investment management fees and also consideration of a new UK intermediate asset holding company vehicle through which alternative funds could hold assets, to facilitate the flow of capital, income and gains between fund investors and their underlying investments through such asset holding vehicles.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

If the EU Regulation and Directive on the cross-border distribution of collective investment funds are implemented in UK legislation then it is expected they would apply in Scotland. The Regulation seeks to ensure that regulatory fees levied by regulators for authorisation, registration and supervision are proportionate and publicly disclosed. The Regulation will also require regulators to maintain databases outlining applicable marketing rules for AIFs and UCITS funds.

The Directive aims to further "facilitate" cross-border marketing. The Directive clarifies the definition of "pre-marketing" compared to "marketing". The proposed Directive defines "pre-marketing" as "provision of information or communication, direct or indirect, on investment strategies or investment ideas by an EU AIFM or on its behalf, to potential professional investors… in order to test their interest in an AIF or a compartment which is not yet established, or which is established, but not yet notified for marketing… and which in each case does not amount to an offer or placement to the potential investor to invest in the units or shares of that AIF or compartment".

The proposals are intended to provide clarity and align marketing rules across the EU Member States.

At the time of writing, the impact of Brexit on the UK investment management industry, including Scotland, is uncertain. Topics such as the continued availability of management and marketing passports under AIFMD are areas of focus. Investment management firms and funds continue to benefit from passporting between the UK and EEA during the Brexit transition period until 31 December 2020. Obligations under EU law continue to apply during the transition period, and firms must continue with their implementation plans for EU legislation that is due to come into effect before the end of 2020.

The FCA has stated that this transition period is intended to allow for further cooperation between UK and EU regulators, to provide solutions for investment managers firms following Brexit.

The position after 31 December 2020 is uncertain as the trade negotiations that will shape the relationship between the UK and the EU following the transition period continue. It is not certain that a trade deal will be agreed and, if one is agreed, how it will operate. If no trade deal is agreed, then this would disrupt the activities of investment managers currently operating on a cross-border basis between the UK and the EU under AIFMD management or marketing passports (or other financial services passports).

For this reason, many investment management firms currently operating on a cross-border basis between the UK and the EU under financial services passports are developing appropriate contingency plans to address the possibility of a "no deal" scenario and the loss of such passports.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

For the purpose of this chapter, an Alternative Investment Fund (hereinafter, "AIF") means a collective investment scheme undertaking, including investment compartments thereof, which: i) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and ii) does not require authorisation pursuant to article 5 of Directive 2009/65/EC.

Spanish legislation distinguishes between closed-ended and opened-ended AIFs.

Spanish closed-ended AIFs are governed by *Law 22/2014, of 12 November 2014, regulating private equity entities, venture capital entities and other closed-ended collective investment entities and the management companies of closed-ended collective investment entities, and amending the Collective Investment Schemes Act* ("Law 22/2014"), which involves the transposition into Spanish law of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers ("AIFMD") applicable to companies managing AIFs. The main purpose of Law 22/2014 is the establishment of the applicable rules for the authorisation and supervision process and governance of management companies managing AIFs, rather than the particular requirements of closed-ended AIFs for which Law 22/2014 is very flexible.

Spanish open-ended AIFs are governed by *Law 35/2003, of 4 November, on Collective Investment Schemes* ("Law 35/2003"), which has been modified by the aforementioned Directive relating to fund management companies of alternative funds, and *Royal Decree 83/2015, of 13 February, amending Royal Decree 1082/2012, of 13 July, approving the Regulation for the Development of Collective Investment Schemes Law* ("RD 83/2015"). The current Spanish legal framework transposes Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("UCITS").

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Yes, management companies of open-ended AIFs (under the regulation of UCITS regime) ("*Sociedad Gestora de Instituciones de Inversión Colectiva*" or "*SGIICs*", in Spanish official terminology) are governed by Law 35/2003. For additional information, please review the Spanish chapter of *ICLG – Public Investment Funds 2020.*

Management companies of closed AIFs ("*Sociedad Gestora de Entidades de Inversión Colectiva de Tipo Cerrado*" or "*SGEICs*" in Spanish official terminology) are governed by Law 22/2014. SGEICs are regulated by the Spanish National Securities Market Commission ("CNMV") and require its prior authorisation; although it has to be noted that non-Spanish Alternative Investment Fund Managers ("AIFMs") already authorised in other EU Member States can be passported with no need of obtaining further authorisation or any other additional requirements.

Management companies from non-EU countries providing marketing services in Spain are not required to obtain prior authorisation by the CNMV, although a prior authorisation of the AIF is required prior to its marketing in Spain. This process is governed by the reciprocity principle, and the following conditions shall be evidenced to the CNMV prior to its marketing among Spanish investors:

- The existence of cooperation agreements between the CNMV and the home country regulator of the management company, with the purpose of ensuring proper exchange of information.
- The home country of the management company shall not be listed as a Non-Cooperative Country and Territory ("NCCT") by the Financial Action Task Force on anti-money laundering and terrorist financing.

Please note that SGIICs, management companies for UCITS funds, can also carry out activities for closed-ended AIFs. When managing AIFs, SGIICs must comply with the provisions of Law 22/2014.

The CNMV, as the supervisory authority, has created a special register where AIFMs must register prior to the start of their activities. However, depending on the type of AIF, the requirements and timeline will vary and Spanish AIFMs must be registered in the Commercial Registry ("*Registro Mercantil*") and must have obtained prior authorisation from the CNMV after the approval of their application (demonstrating that they meet the regulatory criteria, including: equity requirements; suitable risk management and investment selection procedures; suitability requirements of the shareholders, managers, directors and other key persons; and, if any, applicable exemptions). Consequently, any AIFM which does not appear to be registered in the special CNMV registry is not able to perform management activities.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Yes, AIFs themselves must obtain authorisation from the CNMV, since it is the authorising, supervisory and control

authority. For EU management companies, the cross-border marketing of an AIF duly authorised in an EU country is free once the regulator's home country notifies the management company that it has sent the notification letter to the CNMV including information required pursuant to the EU Passport Regime. In case an EU management company intends to market an AIF not registered in an EU country, it will be necessary to demonstrate to the CNMV that the following conditions are met:

- A cooperation agreement exists between the CNMV and the home country regulator of the management company, with the purpose of ensuring proper exchange of information.
- The AIF's home country shall not be listed as a Non-Cooperative Country and Territory ("NCCT") by the Financial Action Task Force on anti-money laundering and terrorist financing.
- The AIF's home country has signed a tax agreement with Spain according to the principles stated in article 26 of the Organisation for Economic Co-operation and Development ("OECD") regulation for the exchange of tax information.

Non-EU management companies intending to market AIFs are also required to comply with the aforementioned conditions.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes. As set out in question 1.1 above, the Spanish legal system distinguishes between open-ended and closed-ended AIFs, regulated, respectively, by Law 35/2003 and Law 22/2014. Each law establishes different types of structures and, among others, the requirements, aspects and procedures of each of these entities. Neither the Spanish regulator (the CNMV) nor Law 22/2014 (AIFs) nor Law 35/2003 (UCITS) have included a specific definition of an Alternative Investment Fund, which is provided for by the AIFMD. In our understanding, all collective investment schemes which are not UCITS should be classified as AIFs.

Open-ended AIFs are those whose object is the collective investment of the funds raised from the public and whose operation is subject to the principle of risk sharing, and whose units, at the request of the holder, are repurchased or reimbursed, directly or indirectly, out of the assets of these undertakings. Open-ended AIFs may adopt the form of either an investment fund or an investment company, and can be financial or non-financial, depending on their purpose and on whether or not they invest in financial instruments or assets.

Closed-ended AIFs are those collective investment entities that, lacking a commercial or industrial goal, raise capital from investors, through an advertising activity, to invest in all types of financial and non-financial assets, according to a defined investment policy.

Law 22/2014 designates closed-ended AIFs as "*Entidades de Inversión de Capital Cerrado* or "*EICC*", establishing the following types: (i) closed-ended investment funds ("*Fondos de Inversión de Capital Cerrado*" or "*FICC*"); and (ii) closed-ended investment companies ("*Sociedades de Inversión de Capital Cerrado*" or "*SICC*"). In addition, Law 22/2014 establishes two types of closed-ended entities focused on private equity activity: ("*Entidades de Capital Riesgo*" or "*ECR*"); and companies ("*Sociedades de Capital Riesgo*" or "*SCR*").

1.5 What does the authorisation process involve and how long does the process typically take?

Given the difference of treatment between open-ended and closed-ended AIFs, the authorisation process will depend on the type of fund and, in addition, on whether it is already authorised outside or within the EU.

Those AIFs authorised within the EU will not require specific authorisation by the CNMV and are enabled to operate in the country through the EU passport. However, non-EU AIFs shall be required to obtain prior authorisation by the CNMV in order to carry out any activity in Spain.

An AIF seeking to set up in Spain shall submit its application and draft constitution documents for approval by the CNMV. The authorisation request must, in all cases, include the following documents: (i) a report; (ii) accreditation of the good reputation and professionalism, in the terms stated in the regulations, of those who hold a position of fund administrator; (iii) in general terms, any data, reports or records deemed appropriate to verify compliance with the conditions and requirements legally established; (iv) the prospectus and the key investor information document; and (v) the rules of management.

In the case of both AIFs and investment companies which designate an AIFM already authorised by the CNMV as their management company, they are obliged to notify such appointment to the CNMV.

AIFs cannot start their activity until they are registered in the special CNMV register.

The resolution of the CNMV shall be notified within two months of submitting the authorisation request or having presented all the required documentation. If no management company has been appointed, the resolution will be notified within three months of submitting the authorisation request or having presented all the necessary documentation. The resolution shall be considered denied if it has not been resolved five months after having submitted the application or all the needed documents.

Regarding the formal authorisation of a "*Sociedad Gestora de Entidades de Inversión Colectiva de Tipo Cerrado*" or "*SGEIC*", the final resolution of the CNMV must be made and shall be notified within the three months following the initial submission by the management company of its application.

In February 2017, the CNMV published a welcome programme for investment and management firms; although this dossier is for informational purposes only and does not entail any legal or administrative responsibility for the CNMV, it highlights that the CNMV will try to complete its authorisation process within two months, provided that the applicant meets the mandatory requirements and the required documentation has been substantially presented. This initiative was mainly due to the still ongoing Brexit process.

1.6 Are there local residence or other local qualification or substance requirements?

Local residence and other local qualification requirements only apply for Spanish-based AIFs or AIFMs registered in Spain and for those foreign AIFs intended to be marketed in Spain.

Thus, those AIFs or AIFMs which carry out their activities in Spain will be subject to local residence or qualification requirements, except in those cases where the AIFM is authorised to carry out its activities in Spain on a cross-border basis through the EU passport, as noted in question 1.2 above.

Foreign AIFs marketed in Spain shall designate a legal person responsible for complying with the general provisions of disclosure of information and communication of any change affecting the essential elements in its offering to investors or data registration with CNMV. In addition, all foreign AIFs will be required to submit to the CNMV statistical data on a regular basis.

1.7 What service providers are required?

In addition to the management of an AIF, the "*Sociedad Gestora de Entidades de Inversión Colectiva de Tipo Cerrado*" or "*SGEICs*" can perform duties of an administrative, distribution or fiduciary nature. Furthermore, different types of ancillary services, such as: maintenance of a discretionary management portfolio; investment advice; and reception or transmission of client orders can also be handled by SGEICs.

The applicable law and regulations set out that there shall be a depositary institution in which: (i) securities, cash or any other products; and (ii) management companies (in case of investment funds) need to be deposited.

Although SGEICs are allowed to outsource certain functions, they must retain ultimate responsibility over their functions, establishing reasonable controls over any such outsourced functions. The information related to the outsourcing of functions shall be at the disposal of the CNMV.

In addition, please note that AIFs may be marketed by financial intermediaries, which mainly tend to be banks, securities firms or securities agencies.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Under Law 35/2003, foreign managers or advisers wishing to manage, advise or operate open-ended funds domiciled in Spain can do so if they have been authorised by Directive 2009/65/EC, 13 July 2009, in another Member State. If they have been authorised in another Member State, they can operate in Spain either through a subsidiary or under the free provision of services regime. As established in article 55.2 of Law 35/2003, under any circumstances the establishment of subsidiaries or the free provision of services can be conditioned to the acquisition of an additional authorisation or contribute to an endowment fund or any measure of equivalent effect.

Under Law 22/2014, foreign managers or advisers wishing to manage, advise or operate closed-ended funds domiciled in Spain can do so by filing a request for authorisation before the CNMV if they have been authorised in another Member State under Directive 2009/65/EC.

According to article 82 Law 22/2014, EU management companies are also allowed to manage closed-ended AIFs domiciled in Spain, as well as to provide services in Spain either through a subsidiary or under the free provision of services regime with similar procedures to those mentioned in Law 35/2003 for open-ended AIFs.

For foreign management companies to be registered in Spain, article 49 of Law 22/2014 establishes the obligation for the CNMV to, prior to authorisation of the manager, consult with the national authority of the Member State where the manager was authorised if:

- The manager wishing to operate in Spain is a subsidiary of another manager company authorised under Directive 2009/65/EC in another Member State.
- If the manager company is the subsidiary of the parent company of another managing company authorised under Directive 2009/65/EC, an investment services company, a credit entity, or an insurance or reinsurance company authorised in another Member State.
- If the managing company is under the control of the same natural or legal persons as another managing company authorised under Directive 2009/65/EC or Directive 2011/61/EU, an investment services company, a credit entity or an insurance or reinsurance company authorised in another Member State.

Please note that Directive (EU) 2019/1160, amending Directives 2009/65/EC and 2011/61/EU on cross-border distribution of collective investment undertakings, has included additional information obligations to be fulfilled by UCITS in each Member State where it intends to market its units.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The CNMV, within the EU supervisory framework, has entered into many information exchange agreements with other jurisdictions and supervisory bodies from within the EU and abroad; for example: Argentina; Australia; Belgium; Bolivia; Brazil; Canada; Chile; China; Colombia; Costa Rica; the Czech Republic; the Dominican Republic; Ecuador; El Salvador; France; Germany; Hong Kong; Italy; Mexico; Panama; Peru; Portugal; Romania; Taiwan; the United Arab Emirates; and the USA.

Specifically with regard to information-sharing agreements, these include, amongst others: (i) the European Union Agreement on Cooperation Between the Financial Supervisory Authorities, Central Banks and Finance Ministries – On Financial Stability in the European Union; (ii) the International Organization of Securities Commissions ("IOSCO") Multilateral Agreement; (iii) the European Securities and Markets Authority ("ESMA") Multilateral Agreement for the Exchange of Information and Supervision of Securities Activities; (iv) the Co-operation Framework Agreement for Mutual Assistance in the Supervision and Monitoring of an AIFM, its Delegates and Depositaries; (v) the Securities and Exchange Commissions ("SEC") and Committee of European Securities Regulators ("CESR") (currently ESMA) Work Plan; and (vi) the exchange of confidential information between the SEC and the CNMV, in accordance with International Financial Reporting Standards ("IFRS"), on companies issuing securities in both markets.

All information regarding sharing agreements is available on the CNMV's website.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

Essentially, AIFs can be constituted through either an investment fund or an investment company. However, investment funds can only be managed by a management company since they have no legal personality, whereas an investment company can be managed directly (by its own board of directors), or by delegating management to an authorised institution.

The main legal structures for open-ended AIFs are investment funds whose objective is to obtain the highest possible return using all the investment opportunities available to the manager ("hedge fund" or "*Instituciones de Inversión Colectiva de Tipo Libre*" or "*IICIL*") and funds of hedge funds ("*Fondos de Instituciones de Inversión Colectiva de Tipo Libre*" or "*IICIICIL*").

The main legal structures for closed-ended AIFs are: private equity entities (which can take the form of funds or companies); and other types of entities (i.e. closed-ended collective investment entities, which can be either funds or companies, as noted in question 1.4 above). To sum up, Law 22/2014 distinguishes between two types of open-ended investment schemes:

- "*Sociedades de Inversión de Capital Cerrado*" or "*SICC*" (Spanish terminology), a closed-ended collective investment scheme in company form.
- "*Fondos de Inversión de Capital Cerrado*" or "*FICC*" (Spanish terminology), a closed-ended collective investment scheme in funds form.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

The investors (i.e. participants of the AIF) will be responsible up to the limit of their contributions to the AIF.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

As mentioned, managing both investment funds, being either UCITS or AIFs, is a regulated activity, limited to licensed institutions. Any legal persons whose regular business is to manage one or more closed-ended AIFs must be registered at the CNMV under the official name of "*Sociedad Gestora de Entidades de Inversión Colectiva de Tipo Cerrado*" ("*SGEICs*"). Consequently, the name of SGEICs can only be used by any legal person with this sole purpose. All SGEICs must vest the form of public limited company whose corporate purpose is the managing of AIFs.

Please take into account that management companies managing UCTIS or open-ended AIFs ("*Sociedad Gestora de Instituciones de Inversión Colectiva*" or "*SGIICs*", in Spanish terminology) can also manage closed-ended AIFs complying with Law 22/2014. The legal status of SGIICs is similar to SGEICs.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

The management companies of open-ended AIFs issue and redeem shares at the same intervals as net asset value calculations upon the request of any participant, under the terms established in the relevant regulations. Notwithstanding the foregoing, AIFs do not have to grant the requested redemption on a net asset value calculation date set by the participant, and so it does not constitute any right by itself and shall be expressly stated in the prospectus. However, in the CNMV, on its own initiative or upon the request of the management company, this may temporarily suspend the subscription or redemption of units when it is not possible to determine its price or concur on other *force majeure* events. In principle, subscription or redemption of shares may only be restricted or suspended if there is just cause or in cases of *force majeure*.

Closed-ended AIFs can establish restrictions on redemptions and will be subject to their own ruling provisions.

Furthermore, please note that Law 22/2014 was amended by means of the Royal Decree-Law 22/2018, of 14 December, establishing macro-prudential tools ("*Real Decreto-ley 22/2018, de 14 de diciembre, por el que se establecen herramientas macroprudenciales*") ("RD-Law 22/2014"). Namely, based on the stability and integrity of the financial system, the CNMV is entitled to demand AIFM to reinforce the level of liquidity of their portfolios and, particularly, to increase the percentage invested in especially liquid assets, as defined by the CNMV itself. This order may be justified on necessity and proportionality ground and must be adopted for a specified timeframe.

In fact, due to the public health emergency caused by COVID-19, a series of economic measures have been approved in Spain, among which is the modification of Law 35/2003, which establishes that: (i) AIFMs will be required to reinforce the level of liquidity of the portfolios of the managed IIC and, in particular, to increase the percentage of investment in liquid assets, as defined by the CNMV; and (ii) AIFMs may establish notice periods for redemptions managed by them without applying the requirements of time, minimum amount and prior notice in the management regulations. Such notice periods may also be established by the CNMV.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

No, there are no specific legislative restrictions. However, general principles of public order and company law may apply.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

As mentioned, for closed-ended AIFs, Law 22/2014 focus mainly in the authorisation process of management companies ("*SGEICs*"), considering that this type of fund is more flexible than UCITS and there are no significant requirements for their investment and liquidity structure.

It is worth noting the liquidity enhancing requirements that may be ordered by the CNMV to the AIFM as provided by RD-Law 22/2014 (please see question 2.4).

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Legislation governing the production and the offering of marketing materials of investment funds will depend on whether it is a closed-ended or open-ended fund, based on the "advertising activity" concept.

Thus, Law 35/2003 and Regulation 1082/2012 on Collective Investment Entities apply to open-ended AIFs; and Law 22/2014 to closed-ended funds.

However, there is a common generic regulation for both types of AIF, which consists of: (i) the revised text of the Securities Market Law 4/2015, which states, in general terms, the basic conditions for marketing materials, as well as Act 34/1998, of 11 November 1998, on General Advertising; and (ii) Royal Decree 217/2008, of 15 February 2008, on investment firms.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

For retail investors, the new legislation of Packaged Retail Investment Products ("PRIIPS") came into force in January 2018. SGIICs currently providing Key Investment Information

Document ("KIID") are exempt from applying the new PRIIPS regime until 2022, following the vote to postpone the PRIIPS application to UCIT funds issued by the Committee on Economic and Monetary Affairs ("ECON") of the European Parliament (although an in-depth review of PRIIPS regime is expected by European industry funds in the short term). The fund shall not carry out their activities until the current KIID and information brochure is registered in the relevant CNMV's administrative register.

The KIID shall include information containing the essential characteristics of the fund. The works "key investor information" shall appear prominently at the top of the first page of the document in Spanish or another language that accepts the CNMV. Specifically, information shall include the following data: (i) identification of the AIF; (ii) a brief description of its investment objectives and investment policy; (iii) a presentation of the historical returns or, where appropriate, profitability scenarios; (iv) costs and associated expenses; and (v) risk/reward investment, with appropriate guidance and warnings in relation to the risks associated with investments in the Council of Institutional ("CII") considered warnings profile.

The KIID will be drafted in concise, non-technical language and presented in a common format, allowing for comparison, and must be easily analysable and comprehensible to the average investor in order that he/she is reasonably able to understand the essential characteristics, nature and risks of the investment product that is offered and make investment decisions without recourse to other documents. The document must be continuously updated and any amendments thereto should be sent to the CNMV.

Regarding closed-ended AIFs, upon the entry into force of PRIIPS a KIID is required to be delivered to any retail investor.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Yes, the CNMV establishes the standard model applicable to all the documentation to be submitted to investors. In this sense, it keeps a record of brochures, documents with key investor information, and annual and quarterly reports on the AIF, to which the public will have free access.

All documents published in the public domain will be forwarded simultaneously to the CNMV in order to keep the above-mentioned records updated.

In the case of the dissemination of the prospectus and the document containing key investor information, prior registration by the CNMV is required. Registration of the prospectus and the document containing key investor information will require prior verification by the CNMV.

3.4 What restrictions are there on marketing Alternative Investment Funds?

From a client perspective, there is a very relevant distinction between the marketing of UCITS and AIFs. UCITS can be marketed both to retail or professional investors. However, as a general rule, AIFs are to be marketed to professional clients, as defined in the Spanish Securities Market Act. The marketing to retail clients is an exception limited to those retail clients who commit to invest a minimum of EUR 100,000 and acknowledge in writing that they understand the risks of the fund being marketed.

AIFs and their management companies must respect, in any event, the regulations concerning marketing and advertising in Spain. The CNMV monitors compliance with these obligations.

It is especially relevant that authorisation is required for marketing in Spain. The CNMV monitors compliance with these obligations. Authorisation for marketing in Spain may be refused due to prudential reasons, specifically: (i) not being treated in an equivalent manner to investment funds in the respective country of origin; (ii) non-compliance with the rules of order and discipline in the Spanish securities markets; (iii) not sufficiently ensuring the adequate protection of investors resident in Spain; or (iv) the existence of disruption in the conditions of competition between AIFs authorised outside Spain and those authorised in Spain.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

There is no express legal definition of "pre-marketing" (or equivalent) recognised under the laws of Spain as of today. Please note that in this sense Directive (EU) 2019/1160 is complemented by Regulation (EU) 2019/1156 of the European Parliament and of the Council.

Both the Directive and the Regulation are aimed to establish uniform rules on the publication of national provisions concerning marketing requirements for UCITS and AIFMs in relation to their cross-border activities. In particular, the Regulation further strengthens the principles applicable to marketing communications governed by UCITS Directive and extends the application of those principles to AIFMs, thereby resulting in a high standard of investor protection, regardless of the type of investor. As a novelty, these pieces of regulation introduce a harmonised definition of "pre-marketing", whose rules on pre-marketing will only apply to authorised-EU AIFM.

Please note that the new regime on pre-marketing introduced by Directive (EU) 2019/1160 has not yet been transposed in Spain.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Please see the answer to question 3.4.

According to AIFMD and MiFID, AIFs managed by AIFMs regulated by AIFMD may be marketed and advertised to retail investors but subject to enhanced investment requirements set forth in the Spanish legislation in order to ensure protection for such retail investors.

Accordingly, open-ended funds can be marketed to retail investors provided the following conditions are fulfilled: (i) an investment of, at least, EUR 100,000; and (ii) a written declaration from the retail investor confirming that it is aware of the associated risks.

Despite the fact that the advertising of closed-ended AIFs is targeted to professional investors, this does not preclude the possibility for retail investors to invest in closed-ended funds, provided they fulfil the conditions mentioned above.

Additionally, and without prejudice of the obligations aforementioned, the Directive (EU) 2019/1160 introduces a new Article 43 a) to Directive 2011/61/UE setting out additional information obligations for AIFM to be made in each Member State where it intends to market units or shares of an AIF to retail investors.

3.7 What qualification requirements must be met in relation to prospective investors?

Prior to investment, investors shall declare, in writing, that they acknowledge the investment risks.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

The legislation does not provide any additional restrictions on marketing to public bodies.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

No, other than in relation to pension funds, there are no general restrictions in the applicable laws or regulations. However, we would recommend that an in-depth analysis be carried out, on a case-by-case basis, on the individual restrictions resulting from legal or statutory provisions of the relevant sponsor or investor.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Financial intermediaries, which can be banking or non-banking entities, shall perform activities related to the selling, buying, transferal or subscription of participations in AIFs.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Compared to UCITS, AIFs have lower investment rules and the possibility to have a higher leverage ratio. Their investment object can consist of either financial or non-financial activities. The distinction between open-ended and closed-ended has been already explained (please see question 1.4).

Closed-ended funds are subject to different restrictions regarding their object, as this cannot constitute a commercial or industrial purpose. The object of closed-ended funds must be related to a predefined investment policy.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Law 35/2003 states that requirements for financial UCITS are applicable to open-ended AIFs.

To comply with the principle of risk diversification, AIFs must comply with the limitations that are imposed regarding the minimum percentage of the assets which shall be invested (in some cases, investment in assets and financial instruments may not exceed certain thresholds).

In both open-ended and closed-ended AIFs, a minimum of 60% of their assets shall be invested. However, open-ended AIFs cannot invest more than 10% of their assets in another hedge fund. In the case of closed-ended funds, the aforementioned minimum of 60% of their assets must be invested in financial instruments as shares or profit-participating loans.

Those AIFMs authorised within any Member State of the EU or in those countries not included in the Financial Action Task Force ("FATF") list of countries not co-operating in the exchange of information, are able to invest up to 100% of their assets in other ECRs.

As mentioned, Law 22/2014 mainly focuses on the requirements for management companies (SGEICs). Compared to UCITS, Law 22/2014 establishes only high-level principles regarding due diligence procedures that the SGEIC need to perform in managing close-ended AIFs, especially regarding conflicts of interest, valuation procedures and risk and liquidity levels. Indeed, there is no specific limit on leverage. In any case, SGEICs have to disclose sufficient information regarding the main characteristics of every single fund, level of risks and leverage limits to the potential investors.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

There are no additional requirements for AIFs in any particular investments beyond those stipulated in Law 35/2003; more specifically, AIFs will be authorised to invest in the assets listed in Article 30 of the same without any limitations other than those explained in previous questions, as well as the limitations established by the statutes of each of the entities involved.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

While the applicable law does not state a specific cap for closed-ended AIFs, in the case of open-ended AIFs, debt may not exceed five times the value of its assets and must be consistent with the implementation of its strategy and investment policy. In both open-ended and closed-ended funds, the cap on borrowing shall be specified in the prospectus.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

In general, AIFMs shall disclose any facts considered specifically relevant to the situation or development of the institution and must be communicated immediately to the CNMV. Once analysed, the CNMV must disseminate and include any relevant development in the quarterly and annual or semi-annual report immediately.

The legislation applicable to open-ended AIFs states that a series of documents must be provided on a mandatory basis, the most important of which are: (i) a prospectus, containing the investment fund rules; (ii) the document containing the main information for the investor; (iii) an annual report containing, among others, the annual accounts, the management report and the audit report; and (iv) two quarterly reports. These are provided in order to ensure that all relevant circumstances that may influence the determination of the value of the assets and prospectus of the institution are publicly known, on a continually updated basis, as well as the inherent risks involved, and compliance with the applicable laws.

In the case of closed-ended funds, AIFMs must notify the CNMV, within 10 days, of any acquisition or loss of a significant interest held by the AIF, provided that the voting rights of the AIF in such company increase or decrease from a certain triggering percentage (10% to 50% or 75%). However, in the case of open-ended funds, the obligation to inform the CNMV arises when the investor position reaches, goes above, or falls below the triggering percentage (20%, 40%, 60%, 80% or 100% of the company capital or fund assets).

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

There are no specific AIFMD-Spanish legislation requirements to provide details of participants in AIF. However, AIF managers must keep details of participants' data (with no reporting obligations).

On a side note, there is a register obligation which applies as per Act 10/2010, of 28 April, on the prevention of money laundering and terrorism financing "*Ley 10/2010, de 28 de abril, de prevención del blanqueo de capitales y de la financiación del terrorismo*" following provisions of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing ("IV AML Directive") and "*Orden Ministerial 319/2018*" regarding the register of beneficial owners, which follows that of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

An AIFM must provide the CNMV with any information it requires at any time, and shall provide, on a regular basis, information about: (i) the principal markets and instruments in which it trades on behalf of the fund, company or entity it manages; (ii) the main instruments in which the fund trades; and (iii) the principal exposures and concentration of each of the funds it manages. In particular, and as noted in question 5.1 above, AIFMs shall provide the CNMV with an annual report.

Open-ended AIFs must submit to the CNMV a monthly memorandum containing the operational statistics, and another investment portfolio. Also, they must provide every investor with a semi-annual and a quarterly report.

AIFs should inform the CNMV about, *inter alia*: (i) the percentage of the fund's assets that are subject to special arrangements arising from their illiquid nature; (ii) any new arrangements for managing the liquidity of the fund; (iii) the actual risk profile of the fund and risk management systems used by the management company for, among others, market risk, liquidity risk, counterparty risk and operational risk; (iv) the main categories of assets in which the Collective Investment Undertaking ("CIU") has invested; and (v) the results of the stress tests.

SGIICs, SGEICs or any other management companies providing services on a cross-border basis need to report statistical information on a regular basis to the CNMV. Circular 2/2017 of the CNMV defines the information requirements.

5.4 Is the use of side letters restricted?

Any preferential treatment granted to an investor(s) shall be disclosed in the prospectus. Moreover, AIFs shall comply with the relevant provisions in relation to conflicts of interest and the overall obligation to keep investors duly informed.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

The tax treatment of the main forms of Alternative Investment Funds depends on whether the fund is an open-ended or a closed-ended fund.

Open-ended funds are subject to a special tax regime foreseen in the Spanish Corporate Income Tax Law, which includes the application of a 1% tax rate if certain requirements are met.

Closed-ended funds (e.g. private equity entities) are subject to the general Spanish Corporate Income Tax rate of 25% on their worldwide income. However, these sorts of funds will benefit from: (i) a 99% tax exemption for capital gains derived from the sale of subsidiaries; and (ii) a full exemption for dividends obtained from their subsidiaries, both subject to certain requirements.

These tax measures are compatible with the existing participation exemption regime, which may also be applicable.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

The Spanish tax system does not foresee any special tax treatment for investment managers or advisers. Consequently, the provisions set out in the Spanish Corporate Income Tax Law will apply and the tax rate will be 25% on their worldwide income.

The management of the fund may be exempt from VAT if several requirements are met.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

No. However, further analysis would be required on the tax implications derived from the transfer of participations in a fund with more than 50% of its assets in real estate located in the Spanish territory. In particular, Spain has introduced an anti-abuse clause in order to avoid the transfer of real estate through the sale of real estate companies. However, this clause will not apply if the real estate owned by these companies is used for business activities.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

Both resident and non-resident investors, as well as pension fund investors, will be taxed on dividends and capital gains, if any, derived from the sale of shares. Capital gains will be assessed for the difference between the transfer value and the acquisition cost.

Residents

Individuals will be subject to a 19% to 23% tax rate, and companies will be subject to a fixed 25% tax rate.

It is important to point out that Spanish tax-resident individuals will not be taxed on the capital gains derived from the sale of participations in an investment fund, provided a subsequent investment in a qualifying investment fund is made.

Non-residents

Depending on the tax treaty enforced with Spain, capital gains may be taxed at the source or only in the country of residence of the seller. In addition, EU residents may apply for an exemption on the capital gains obtained in Spain. As a general rule, the applicable tax rate will be 19%. However, if the non-resident constitutes a permanent establishment ("PE") in Spain, the tax rate will be 25% and the Corporate Income Tax provisions will apply.

Capital gains arising from the transfer or reimbursement of participations in a closed-ended Alternative Fund obtained by a non-resident investor would not be considered to be obtained in Spain for tax purposes. However, this rule will not apply if the non-resident investor resides in a country qualified as a tax haven for tax purposes or if capital gains are obtained through a tax haven.

Pension fund investors

Tax treatment of pension fund investors will depend on their tax residence as indicated in previous paragraphs.

Income obtained by a Spanish-resident pension fund will be subject to Corporate Income Tax at 0% over its income if it is covered under the scope of Act 1/2002 of 29 November.

Dividends obtained by a pension fund resident in the EU or EEA will not be subject to withholding tax in Spain.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

It is not strictly necessary to obtain a tax ruling from the Administration as a step prior to establishing an AIF. However, it would be advisable to file a tax ruling in order to foresee the tax treatment given by the Administration to a particular AIF.

The ruling must be issued by the General Tax Directorate within six months following the request. Tax rulings duly requested are binding on the tax authorities, and their criteria must be compulsorily applied to taxpayers in similar cases, provided the regulations existing at the time of issuance and the applicable case law remains unchanged. However, in practice, the tax authorities may change their criteria on newly issued tax rulings from time to time, but such changes will not have retroactive effects for taxpayers (the new criteria will supersede the previous ones for future cases).

The filing of a tax ruling prevents penalties in case of a tax audit, provided the facts are the same.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

FATCA has been developed in Spain by "*Orden HAP/1136/2014*", which regulated Form 290, and which is used to provide information to the Spanish tax authorities in order to comply with the FATCA provisions. Spanish Royal Decree 1065/2007 Regarding the Obligation to Report Information on Financial Accounts, has also been adapted to incorporate the FATCA provisions.

Like many other jurisdictions, Spain will begin to report information after a maximum of nine months after 31 December 2017 with regards to complying with the CRS provisions.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Spain has passed measures to adopt the actions of the OECD's Action Plan with regard to Action 6 ("Prevent treaty abuse"). Spain has signed tax treaties with several countries (Belgium, Bolivia, Croatia, Cuba, Ireland, Israel, Nigeria, Portugal, Russia, Slovenia, etc.), with a specific Limitation on Benefits ("LoB") clause. The tax treaty between Spain and the United States contains a global LoB clause. Spain has also introduced excluding clauses for several entities or regimes (for example, in the tax treaties with Barbados, Jamaica, Luxembourg and Uruguay).

In addition, in 2017 Spain signed the multilateral Convention to Implement Tax Treaty Related Measures to prevent BEPS.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

There are not any tax-advantaged structures others than what is described in question 6.1.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

No, there are not.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No, there are not.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

Besides the evolution of the regulatory body established by Directive 2014/65/EC on markets in financial instruments and amending Directive 2002/92/EU (recast) ("MiFID II") and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 ("MiFIR") since its entry into force in January 2018, we shall see the adaptation of the Spanish legal order to further adjust and develop the UCITS and AIF regime mainly by action taken by ESMA.

Additionally, please note that the new regime on pre-marketing introduced by the Directive (EU) 2019/1160 has not yet been transposed in Spain. However, by 2 August 2021, Member States shall adopt and publish the correspondent national laws and regulations necessary to comply with such provisions.

Moreover, the Brexit impact scope still remains unclear due to the uncertainty surrounding the effective exit process.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The establishment and operation of Alternative Investment Funds ("**AIFs**") (and their managers) is governed by the Federal Act on Collective Investment Schemes of 23 June 2006 ("**CISA**", SR 951.31) and its implementing ordinances, the Ordinance on Collective Investment Schemes of 22 November 2006 ("**CISO**", SR 951.311), the Ordinance of the Swiss Financial Market Supervisory Authority on Collective Investment Schemes of 27 August 2014 ("**CISO-FINMA**", SR 951.312) and the Ordinance of the Swiss Financial Market Supervisory Authority on Collective Investment Schemes of 6 December 2012 ("**CISIO-FINMA**", SR 951.315.2). In addition, the Federal Act on Financial Institutions of 15 June 2018 ("**FinIA**", SR 954.1) and its implementing ordinance, the Ordinance on Financial Institutions of 6 November 2019 ("**FinIO**", SR 954.11) set out the legal framework for financial institutions acting as fund management companies and investment managers of AIFs and their assets. Finally, the Federal Act on Financial Services of 15 June 2018 ("**FinSA**", SR 950.1) governs among others the sale of financial instruments to clients in Switzerland.

In addition, the Swiss Financial Market Supervisory Authority ("**FINMA**") has published a number of circulars addressing specific areas of collective investment schemes law which are currently undergoing changes resulting from the entry into force of the FinSA and the FinIA. Finally, a number of guidelines of the Swiss Funds/Asset Management Association ("**SFAMA**") have been recognised as a minimum standard by FINMA and apply to all institutions regardless of SFAMA membership.

Investment companies that are incorporated as a Swiss corporation and that are either listed on a Swiss stock exchange or restricted to qualified investors (within the meaning of the CISA) do not fall within the scope of the CISA. Accordingly, the establishment and the operation of investment companies are governed by Swiss corporate law and, in the case of a listed company, the listing rules and any additional regulations of the stock exchange.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Subject to limited *de minimis* exemptions provided in the FinIA for asset managers of collective investment schemes, asset managers to AIFs have to obtain a licence as manager of collective assets from FINMA prior to engaging in asset management activities for AIFs. The licensing requirement applies to asset managers of Swiss and foreign collective investment schemes. The licence is subject to specific licence requirements that include, *inter alia*, minimum capital requirements and rules regarding the organisation and the operation of the asset manager. Asset managers who fall within the *de minimis* exemptions, however, require a licence as portfolio manager and are subject to the ongoing supervision of a FINMA approved supervisory organisation.

Investment advisors of AIFs which provide only advisory activities, without any authority to execute orders, do not need a licence from FINMA.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

As a matter of principle, four types of vehicles are available to set up an alternative investment fund in Switzerland: (i) a contractual collective investment scheme; (ii) a corporate collective investment scheme with a variable capital (SICAV – see question 1.4 below); (iii) a limited partnership for collective investments; and (iv) an investment company.

Further, all Swiss AIFs require a licence from FINMA irrespective of their organisational structure (whether established contractually or as a company) and the type of investors. CISA provides that investment companies organised as a company limited by shares are out of the scope of the act, provided that (a) all their shareholders are qualified investors, or (b) they are listed on a Swiss stock exchange.

AIFs organised under a foreign law are subject to a licensing requirement only if they are offered to non-qualified investors. By contrast, there are no licensing requirements for foreign AIFs that are exclusively offered to qualified investors. However, Swiss rules on offering and marketing of AIFs apply (see below section 3).

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The CISA provides four different investment vehicles for structuring Swiss collective investment schemes. The four structures are divided into open-ended and closed-ended collective investment schemes. Open-end collective investment schemes entitle investors to request the fund or a related party to redeem their units at their net asset value at regular intervals. Closed-end

investment schemes exclude this right. The CISA provides for two types of open-ended collective investment schemes: the contractual investment fund; and the investment company with variable capital (*Société d'investissement à capital variable*; "**SICAV**"). The contractual investment fund and the SICAV constitute two open-ended investment vehicles and are largely interchangeable. They allow for a broad category of structures, ranging from securities funds which are based on the EU-UCITS standard, to real estate funds, so-called other funds for traditional investments and so-called other funds for alternative investments.

Closed-end investment schemes include limited partnerships for collective investments ("**LPCIs**") and investment companies with fixed capital (*Société d'investissement à capital fixe*; "**SICAFs**"). The SICAF and the LPCI do not share many commonalties other than being closed-ended structures: the SICAF is an investment company organised as a company limited by shares which is open to retail investors, whereas the LPCI is a special form of limited partnership reserved to qualified investors.

The contractual investment fund, the SICAV and the SICAF can be used for any generally permissible investment strategy. Typically, open-ended AIFs will be set up as "other funds for alternative investments", which provide the broadest flexibility in terms of permitted investments. However, depending on the strategy, an investment fund or a SICAV can be set up as another fund for traditional investments or even a securities fund if it can meet the demanding restrictions applicable to UCITS.

By contrast, the LPCI is conceived primarily as a vehicle for investments in venture capital, private equity and construction, real estate and infrastructure as well as alternative investments.

1.5 What does the authorisation process involve and how long does the process typically take?

The authorisation process for Swiss AIFs, fund management companies or managers of collective assets usually starts with a preliminary discussion with FINMA. Based on the outcome of such discussion a licence application will be prepared and filed. The applicant has to demonstrate that it complies with the regulatory requirements and explain its business model and investment strategy.

When seeking the licence for a fund management company, the applicant will need to appoint a regulatory auditor to review its application and provide an assessment to FINMA. Later the applicant has to appoint another recognised audit firm as its regulatory auditor.

The duration of the authorisation process may vary and will depend on the complexity and the scope of the application, the applicable investment strategies and also on the organisation of the applicant. FINMA seeks to approve AIFs that are open to all investors within a deadline of eight weeks and AIFs that are only open to qualified investors within a deadline of four weeks. These deadlines start once FINMA receives a complete filing and are merely indicative. No deadlines exist to authorise fund management companies or managers of collective assets. However, FINMA will usually take three to six months to process an application.

Foreign AIFs are not subject to a licensing process. However, if they are offered to non-qualified investors, FINMA must authorise them: FINMA will grant the authorisation if the following conditions are satisfied: (i) the collective investment scheme, the fund management company or the fund company, the asset manager as well as the custodian, are subject to public supervision intended to protect investors; (ii) the regulatory framework regarding the organisation of the fund management company, the fund company and the custodian, the rights granted to investors and investment policy are equivalent to the framework set forth by the CISA; (iii) the designation of the collective investment scheme does not give reason for deception and confusion; (iv) the fund appointed a Swiss representative and Swiss paying agent; and (v) FINMA and the foreign supervisory authorities have entered into an agreement on the co-operation and exchange of information regarding the offering of the fund.

As a practical matter over the last decade, FINMA has only authorised UCITS for the offering in Switzerland. Existing foreign AIFs maintained their authorisation and can continue to be offered to the public. However, no new foreign AIF was authorised for offering to all investors.

By contrast, there are no licensing requirements for foreign AIFs that are exclusively offered to qualified investors. However, Swiss rules on offering and marketing apply (see section 3 below).

1.6 Are there local residence or other local qualification or substance requirements?

Swiss AIFs must be administered in Switzerland. Consequently, the ultimate supervision of the AIF must be carried out in Switzerland. However, the investment decisions may be delegated to third parties domiciled outside of Switzerland. Such persons need to be supervised by a recognised supervisory authority, which entered into a co-operation agreement with FINMA, whenever such jurisdictions condition the delegation to managers in third countries on the existence of co-operation agreements. This is typically the case for EU Member States under the Directive on Alternative Investment Fund Managers ("**AIFMD**").

The members of the executive board of Swiss fund management companies or Swiss managers of collective assets must reside in a place which allows them to ensure the proper management of the business operations. Practically speaking, this means that they must reside in Switzerland or in the neighbouring areas.

Furthermore, the members of the board of directors and senior management must meet the fit and proper requirements and possess adequate professional qualifications. These requirements are construed broadly and will generally be examined on a case-by-case basis.

1.7 What service providers are required?

Fund management companies, SICAVs, SICAFs and LPCIs must appoint a regulatory auditor, which acts as an extension of FINMA and carries out most on-site audits and reports to FINMA.

Open-ended Swiss AIFs are required to appoint a custodian. The custodian must be a Swiss bank. AIFs may, subject to the approval of FINMA, also appoint a prime broker. If the prime broker is a licensed Swiss securities firm or a Swiss bank, a separate custodian is not required.

Foreign AIFs that are offered or, more broadly, marketed in Switzerland are required to appoint a Swiss representative and a Swiss paying agent, unless the offering or marketing is strictly limited to qualified investors who are not high-net-worth individuals or private investment structures set up for them who opted to be treated as professional clients under the FinSA.

Marketing foreign AIFs to other professional investors (such as banks, securities firms, insurance companies or Swiss-licensed fund management companies or managers of collective assets, pension funds with a professional treasury, undertakings with a

professional treasury) as well as to retail clients who entered into a long-term investment advisory or an asset management agreement with regulated financial intermediary in Switzerland or a foreign financial intermediary subject to equivalent prudential supervision would not trigger the requirement to appoint a Swiss representative and a Swiss paying agent.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Foreign managers or advisers cannot act as fund managers of Swiss funds or Swiss AIFs. However, a Swiss fund management company, a SICAV, a Swiss manager of collective assets and a Swiss representative of foreign collective investment schemes may, however, delegate certain fund administration activities and the asset management to foreign asset managers who are supervised by a recognised supervisory authority.

The tasks delegated to third parties must be set out in written agreements, which will precisely describe the delegated tasks, powers and responsibilities, authority to further delegate any tasks, reporting duties and inspection rights. The delegation should not prevent the audit company from auditing or FINMA from supervising the activities of the AIF or the AIFM. In particular, where tasks are delegated to foreign managers, the licensee must be able to demonstrate that the regulatory audit company, FINMA and itself are able to exercise their inspection rights and enforce them under the law. The regulatory audit company must review the documentation before outsourcing takes place.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

In December 2012, FINMA entered into a co-operation arrangement with the EU securities regulators (represented by the European regulator ESMA) for the supervision of Alternative Investment Funds, including hedge funds, private equity and real estate funds. The co-operation arrangements include the exchange of information, cross-border on-site visits and mutual assistance in the enforcement of the respective supervisory laws. Such co-operation arrangement applies to Swiss AIFMs that manage or market Alternative Investment Funds in the EU and to EU AIFMs that manage or market AIFs in Switzerland. The agreement also covers co-operation in the cross-border supervision of depositaries and delegates of AIFMs.

In addition, with respect to the offering of foreign collective investment schemes to non-qualified investors, FINMA has entered into various agreements regarding co-operation and the exchange of information. As of 29 April 2020, FINMA had entered into such agreements with the supervisory authorities of Austria, Belgium, Denmark, Estonia, France, Germany, Guernsey, Hong Kong, Ireland, Jersey, Liechtenstein, Luxembourg, Malta, the Netherlands, Norway, Sweden and the United Kingdom.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

As mentioned above, Swiss AIFs can be set up as: open-ended funds, such as a contractual fund managed by a fund managed company or a SICAV; or closed-ended funds, such as a SICAF or an LPCI.

In terms of investment strategy, Swiss law does not distinguish between funds and SICAVs. Typically, open-ended AIFs will be set up as "other funds for alternative investments" which provide the broadest flexibility in terms of permitted investments. However, depending on the strategy, an investment fund or a SICAV can be set up as an "other fund for traditional investments" or even a securities funds if it can meet the demanding restrictions applicable to UCITS.

By contrast, the LPCI is conceived primarily as a vehicle for investments in venture capital, private equity and construction, real estate and infrastructure as well as alternative investments. LPCIs have been mainly used for private equity investments or investments in real estate projects.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Investors are only liable for their investment in a Swiss AIF. Funds and SICAVs can be set up as an umbrella fund and have various sub-funds. In such a case, investors are only entitled to the income and assets of the sub-fund in which they invested and each sub-fund is only liable for its own liabilities.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Under the CISA, a fund management company must be organised as a company limited by shares. By contrast, a manager for collective assets can be organised as a company limited by shares, a partnership limited by shares, a limited liability company, a general partnership or a limited partnership. In practice, however, they tend to be organised either as companies limited by shares or limited liability companies.

Foreign asset managers of collective investment schemes may, subject to certain additional requirements, open a branch in Switzerland.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Investors in open-ended funds are, in principle, entitled to request the redemption of their units and payment of the redemption amount in cash at any time. This right to redeem at any time may only be restricted in the case of collective investment schemes whose value is difficult to ascertain, or which have limited marketability (e.g. investments which are not listed or traded on another regulated market open to the public; mortgages; or private equity investment). In any event, the right to redeem at any time may only be suspended for a maximum period of five years and such restrictions must be stated explicitly in the fund's regulations and in the prospectus.

Closed-ended funds cannot, by definition, be redeemed. However, an LPCI may have a limited duration, after which the LPCI will be wound up.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

The transferability of investors' interests in an AIF depends on the fund's legal structure. Generally speaking, there are no statutory restrictions on transfers of investors' interests in

open-ended AIFs. However, the fund's regulations may provide for such restrictions. This is typically the case if the AIF is restricted to qualified investors.

Further, the Swiss LPCI is, by design, a legal structure that is only available to qualified investors. Consequently, interests in an LPCI may only be transferred to other qualified investors. Furthermore, the partnership may also subject the transfer of a partnership interest to the consent of the general partner.

Typically, open-ended Swiss collective investment schemes and LPCIs, including AIFs, provide for a compulsory redemption in their fund documentation in case an investor no longer meets the eligibility requirements to invest in the fund or if their investment in the fund could jeopardise the interests of all the other investors.

Finally, investment companies that do not fall within the scope of a CISA (see question 1.1) are required to provide for transfer restrictions in their articles of association to ensure that their shareholders are exclusively qualified investors.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

There are no other limitations on a manager's ability to manage its own funds provided it satisfies the capital maintenance requirements.

Subject to the terms of the partnership agreement, general partners of LPCIs are allowed, without the consent of the limited partners, to conduct other business transactions for their own account and on behalf of third parties and participate in other companies, provided this is disclosed and the interests of the limited partnership for collective investment are not impaired as a consequence.

Finally, restrictions generally apply to related party transactions in connection with real estate, construction and infrastructure projects.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The production and offering of marketing materials for Swiss and foreign AIFs offered in Switzerland are governed by the CISA and the FinSA and their implementing ordinances.

Investment companies that are not subject to the CISA are, consequently, not subject to these rules and must only comply with the general requirements of Swiss corporate law and, in the case of a listed investments company, the listing rules of the respective stock exchange.

Finally, the Swiss legislation against unfair competition provides for a number of prohibited marketing practices with respect to marketing activities in Switzerland.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The prospectus of a Swiss AIF must contain, *inter alia*, information on: (i) the AIF; (ii) the types of units it issued and the rights they carry, including the terms and conditions for the redemption of units; (iii) the investment policy and investment restrictions; (iv) the fees payable to the fund management company, the custodian and any other third party; (v) other fees and costs, such as performance fees, commissions, retrocessions and other financial benefits and rebates; (vi) the information on taxes (including any withholding taxes); (vii) the fund management company and the custodian; and (viii) third parties that carry out delegated tasks.

In addition, the fund's regulations, the prospectus, the key information document and any other marketing material made available to non-qualified investors in Switzerland must contain a notice regarding the special risks involved in alternative investments. The wording of such warning clause must be approved by FINMA and must be placed on the first page of the fund's regulations, the prospectus and the key information document. In addition, marketing materials for AIFs must be clearly labelled as such and must include a reference to the prospectus and the key information document and must include information on where they can be obtained.

Under the current transitional regime, AIFs are not required to prepare a simplified prospectus or a key investor information document. However, this is due to change when the FinSA is fully phased in.

The prospectus for foreign collective investment schemes that are offered to non-qualified investors or high-net-worth individuals or private investment structures set up for them who opted to be treated as professional clients under the FinSA in Switzerland must include a "Swiss wrapper", containing specific Swiss information, including the name of the Swiss representative and of the paying agent, the place where the prospectuses, the last annual and semi-annual reports as well as the articles of association can be obtained without costs. This information must also be included on all marketing material used in connection with the offering in Switzerland.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Swiss AIFs must file their prospectus and any amendment thereto with FINMA. Other marketing material does not need to be filed or approved by FINMA.

The prospectus of foreign AIFs that are offered to non-qualified investors in Switzerland must be approved by FINMA. By contrast, no such requirement applies if the offering is limited to qualified investors.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Marketing of AIFs does not require a licence from FINMA but may qualify as a financial service under the FinSA and, consequently, trigger the respective rules for the provision of financial services that include, *inter alia*, rules of conduct at the point of sale, organisational measures, a duty to register client advisors in a newly established register of advisers and a requirement for financial services provider to affiliate to an ombudsman's office. However, reference to the special risks involved in alternative investments must be made in the fund's name, prospectus and other marketing materials (see also question 3.3). Depending on the type of AIF, there may be restrictions on marketing an AIF to non-qualified investors (see also question 3.6).

AIFs organised under a foreign law are subject to a licensing requirement only if they are offered to non-qualified investors. By contrast, there are no licensing requirements for foreign AIFs that are exclusively offered to qualified investors. However, Swiss rules on offering and marketing of AIFs apply. Foreign AIFs that are offered to qualified investors in Switzerland who

are high-net-worth individuals or private investment structures set up for them who opted to be treated as professional clients under the FinSA are required to appoint a Swiss representative and a Swiss paying agent.

Marketing foreign AIFs to professional investors (such as banks, securities firms, insurance companies or Swiss-licensed fund management companies managers of collective assets, pension funds with a professional treasury, or undertakings with a professional treasury) as well as to retail clients who entered into an investment advisory or an asset management agreement with regulated financial intermediary in Switzerland or a foreign financial intermediary subject to equivalent prudential supervision would not trigger the requirement to appoint a Swiss representative and a Swiss paying agent.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

Switzerland does not have a legally defined concept of "pre-marketing", meaning general information that falls short of marketing a specific collective investment scheme, as in the European Union. However, any activity addressed directly at certain clients that is specifically aimed at the acquisition or disposal of units in a collective investment scheme qualifies as a financial service triggering the respective requirements under the FinSA (see question 3.4). If advertising does not have sufficient information on the terms of an offering and the financial instrument or does not intend to draw the attention to a certain financial instrument and to sell it, the advertisement it will fall short of an offer.

Similarly, for sales activity to be considered as providing a financial service pursuant to the FinSA, the collective investment scheme in question must exist or its key terms should be defined. This is the case if it is either already established or, at the latest, if the key characteristics (e.g. name of collective investment scheme, main parties, investment policy, fees, issuing and redemption terms) that will enable investors to make a decision to buy have already been definitely determined.

On this basis, exploratory discussions with investors on their general interest to invest in a new fund that is still in the early stage of its inception or abstract discussions with potential investors not relating to a specific product are not deemed to constitute a financial services or an offer. This is the case, for example, if information is provided on certain strategies or composites without reference being made to an actual specific product.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Open-ended Swiss AIFs can be marketed to all investors. However, they may, in particular if they seek exemptions from certain provisions of CISA, limit themselves to qualified investors. Similarly, limited partnerships for collective investments can only be subscribed by qualified investors.

Foreign collective investment schemes can be offered to retail investors, only if they were authorised for offering in Switzerland by FINMA. Foreign collective investment schemes that were not authorised for offering to non-qualified investors can only be offered to qualified investors including supervised financial investors and clients who entered into an investment advisory or an asset management agreement with regulated financial intermediary in Switzerland or a foreign financial intermediary subject to equivalent prudential supervision.

3.7 What qualification requirements must be met in relation to prospective investors?

If a foreign AIF has not been approved for offering to retail clients in Switzerland, the fund's manager and any third-party involved in the offering must ensure that the fund is only offered to qualified investors. According to the CISA, the following investors are considered as qualified investors: (i) supervised Swiss and foreign financial intermediaries (including banks, securities firms, insurance companies, fund management companies and managers of collective assets); (ii) central banks; (iii) public bodies and pension funds or institutions that have the purpose to provide occupational pension plans with professional treasury management; (iv) large corporations; (v) corporations and private investment structures set up for high-net-worth individuals with professional treasury management; (vi) national and supranational institutions with professional treasury management; (vii) investors who entered into an investment advisory or an asset management agreement with regulated financial intermediary in Switzerland or a foreign financial intermediary subject to equivalent prudential supervision would; and (viii) high-net-worth individuals or private investment structures set up for them, provided they have opted to be treated as professional clients under the FinSA.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no restrictions on marketing to public bodies and government pension funds specifically. Public bodies such as government pension funds are considered qualified investors provided that their assets are managed on a "professional basis". No special licence is required to market AIFs to Swiss government pension funds. However, the marketing activity may qualify as a financial service triggering the respective requirements under the FinSA (see question 3.4).

In addition, pension funds are subject to certain investment restrictions (see question 3.9).

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

There are no restrictions *per se*. However, certain financial institutions and other qualified investors, such as pension funds and insurance companies, are only allowed to invest a certain amount of their net assets in AIFs. In particular, pension funds are allowed to invest directly in AIFs only if this possibility is specifically covered by its investment regulations and it complies with the general principles for safe and diversified asset management.

Moreover, persons entrusted with the management of a general partner of an LPCI may only invest themselves in the LPCI if: (i) the partnership agreement provides for it; (ii) the participation is funded from private assets; and (iii) the subscription is made at the inception of the LPCI.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

The fundraising process may fall within the scope of the FinSA. Consequently, any Swiss and foreign persons assisting in the fundraising process, such as placement agents or other

intermediaries, have to, as a matter of principle, comply with the requirements of the FinSA if they target clients in Switzerland.

Foreign intermediaries qualifying as client advisors, however, are exempted from the duty to register themselves in the register of advisors if they work for an entity that is subject to prudential supervision in its home country and who provides financial services to professional or institutional clients only.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

As mentioned above, the investments depend on the specific type of collective investment scheme. Among open-ended collective investment schemes, open-ended collective investment schemes for alternative investments offer the broadest range of possible investments and strategies. They are specifically designed to carry out investments that (i) have only limited marketability, (ii) are subject to strong price fluctuations, (iii) exhibit limited risk diversification, or (iv) are difficult to value. They may engage in short-selling and borrow funds.

In particular, they may invest in: (i) securities; (ii) units in collective investment schemes; (iii) money market instruments; (iv) sight and time deposits with a maturity of up to 12 months; (v) precious metals; (vi) derivative financial instruments whose underlyings are securities, collective investment schemes, money market instruments, derivative financial instruments, indices, interest rates, exchange rates, loans, currencies, precious metals, commodities or similar instruments; and (vii) structured products. In addition, FINMA may authorise other investments such as commodities and commodity certificates. In the latter case, the investment regulations must explicitly mention this fact.

Open-ended collective investment schemes for alternative investments may (i) raise loans for an amount of up to 50 per cent of the fund's assets, (ii) may pledge or cede as collateral no more than 100 per cent of the fund's net assets, (iii) commit to an overall exposure of up to 600 per cent of the fund's net assets, and (iv) engage in short-selling. The fund's regulations must explicitly set out those investment restrictions.

Furthermore, FINMA may grant exemptions from these principles on a case-by-case basis, in particular when the AIF is limited to qualified investors.

LPCIs can invest in risk capital, including private equity, debt, and hybrid forms. They can also engage in construction, real estate and infrastructure projects, as well as alternative investments generally speaking. They can take control of companies and sit on the board of target companies in order to safeguard the interests of limited partners.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Open-ended collective investment schemes for alternative investments may (i) raise loans for an amount of up to 50 per cent of the fund's assets, (ii) may pledge or cede as collateral no more than 100 per cent of the fund's net assets, and (iii) commit to an overall exposure of up to 600 per cent of the fund's net assets.

LPCIs are not subject to particular restrictions on their investments.

Generally speaking, there are prohibitions on self-dealing and dealing with related parties in connection with construction, real estate and infrastructure projects.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Swiss AIFs have to comply with the general investment restrictions set out for the respective type of collective investment scheme. Entering into derivative transactions is generally permissible provided that the economic effects of using derivatives does not lead to a breach of the investment objectives stated in the fund regulations and the prospectus. Exotic derivatives such as, e.g., path-dependent options may, however, only be used if the minimum and maximum delta can be calculated over the entire price spectrum of the underlying assets and its effect and the factors determining its value are known. OTC derivatives must be entered into based on a standardised master agreement complying with international standards.

Further, restrictions apply to investments in certain assets and undertakings, e.g. residential real estate in Switzerland, banks, financial institutions and other industries. Such restrictions are driven by regulatory concerns related to the assets rather than to fund laws or regulations.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Open-ended collective investment schemes for alternative investments may raise loans for an amount of up to 50 per cent of the fund's assets and may pledge or cede as collateral no more than 100 per cent of the fund's net assets.

LPCIs are not subject to particular restrictions on borrowing.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

Open-ended AIFs or their manager must disclose information on the investment policy, the investment techniques (whether the fund uses leverage or engages in short-selling) and information on the maximum level of management fees in its prospectus. The prospectus will include the fund regulations. Furthermore, the AIF or its manager must publish annual and semi-annual financial reports.

On request, open-ended AIFs or their manager must provide information concerning information on the basis of the calculation of the net asset value per unit. Furthermore, investors may require further information on a specific transaction, including the exercise of voting rights, creditors' rights or risk management.

These obligations do not extend to LPCIs. Limited partners are, however, entitled to inspect the business accounts of the partnership and to obtain information about the performance of the LPCI at least once every quarter.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

As part of the authorisation process, FINMA ascertains that significant equity holders of AIFs, fund management companies,

asset managers, and LPCIs have a good reputation and do not exert their influence to the detriment of a prudent and sound business practice. A person is deemed to hold a significant stake in equity if they control directly or indirectly at least 10 per cent of the capital or votes or can materially influence the business activities in another way. Consequently, any change of participants needs to be approved by FINMA.

Furthermore, SICAVs are required to maintain a register of shares, and a register of the beneficial owners of the shares held by company shareholders who hold, directly or in concert with third parties, more than 25 per cent of the capital or shares of the SICAV. These registers are not public but may be made available to law enforcement agencies in accordance with applicable rules of procedure.

Investment companies that are not subject to the CISA are also required to maintain a register of shares and, if they are not listed on a stock exchange, a register of beneficial owners. Unlike the SICAV, these obligations apply to all shareholders and not only the company shareholders.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Open-ended collective investment schemes and LPCIs are required to maintain accounts and publish an annual report and semi-annual reports.

The annual report must be audited and published within four months of the end of the financial year. The annual report includes financial statements, information on the number of shares/units issued and redeemed during the financial year as well the total number of shares/units outstanding, the inventory of the fund's assets at market value, valuation principles, a break-down of buy and sell transactions, the performance of the open-ended collective investment scheme, possibly benchmarking it with comparable investments, and information on matters of particular economic or legal importance (amendments to the regulations, changes of manager, custodian bank, change of directors or officers, and legal disputes).

In addition, the semi-annual report has to be published within two months of the end of the first half of the financial year. It must include, *among others*, unaudited financial statements, information on shares issued and redeemed during that period and the number of shares outstanding, the inventory of the fund's asset at market value and a break-down of buy and sell transactions.

Further, fund management companies and SICAVs must publish the net asset value of their funds at regular intervals.

Investment companies that are not subject to the CISA are subject to the general rules on financial reporting, which vary depending on whether the company is listed or not.

5.4 Is the use of side letters restricted?

The use of side letters is not specifically restricted by Swiss law. However, they must comply with the general rules of conduct. In this backdrop, AIFs and their managers should ensure that they comply with their duty of loyalty and their duty to treat investors equally when they enter into side letters.

As a practical matter, side letters can therefore only be used if they serve an objective purpose, such as facilitating the commitment of anchor investors, and do not breach these principles. In this context, commitments to provide detailed information do not raise any particular issue as long as all investors benefit from the additional transparency. By contrast, it would typically not be permissible to reduce fees for the exclusive benefit of one investor or to promise preferred liquidity under a side letter.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Swiss collective investment schemes (i.e. contractual funds, SICAVs and LPCIs) are viewed in a transparent manner from a Swiss corporate income tax perspective. They are thus not subject to Swiss corporate income taxes on their income or gains (except if they directly hold real estate situated in Switzerland. A collective investment scheme directly holding real estate situated in Switzerland may nevertheless be tax-exempt for the purposes of corporate income tax if its investors consist exclusively of tax-exempt occupational pension institutions).

Distributions made by Swiss collective investment schemes are subject to withholding tax at a 35 per cent rate, unless they correspond to distributions of capital gains or income realised from real estate held directly by the fund. Swiss investors may claim the refund of withholding tax if they declare the income in their tax return or account for it in their financial statements. Foreign investors may qualify for an exemption from Swiss withholding tax under the so-called affidavit procedure (exemption provided for by Swiss internal law irrespective of the applicability of a tax treaty). This requires that more than 80 per cent of the Swiss collective investment scheme's assets are from a non-Swiss source and that the investors demonstrate (typically via their bank) that they are not Swiss residents. Foreign-resident investors may further qualify for a partial or total exemption from Swiss withholding tax under a double taxation treaty existing between their country of residence and Switzerland. The relief is typically granted by way of reimbursement rather than by way of exemption.

SICAFs, as well as investment companies that are incorporated as a Swiss corporation and are not regulated under the CISA (see question 1.1) are taxed as corporate entities and hence subject to corporate income tax and tax on net equity. In addition, their distributions are subject to withholding tax at a 35 per cent rate.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

Swiss investment managers/advisers organised in corporate form, as well as Swiss branches of foreign managers (whether organised in corporate form or as a partnership) are subject to corporate income tax at federal, cantonal and communal levels on their net profit as accounted for in the statutory financial statements and, as the case may be, adjusted for tax purposes. They may also be subject to tax on their net equity at cantonal and communal levels. There is no special tax status available for investment managers/advisers. Managers/advisers organised in the form of a Swiss partnership are not subject to corporate tax; instead, the partners are subject to individual income and wealth tax in respect of their share in the partnership's income and net assets.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

In general, the issuance and redemption of Swiss collective investment scheme shares/units does not trigger any Swiss issuance stamp duty or securities transfer tax. An exception applies

in respect of the issuance of shares in a SICAF or an investment company in the form of a Swiss corporation (see question 1.1), which are subject to Swiss issuance stamp duty. A legislative proposal of the Swiss parliament on the abolishment of issuance stamp duty has been suspended.

Further, the transfer of shares/units in a Swiss collective investment scheme (irrespective of its legal form) is subject to a 0.15 per cent transfer stamp duty if a Swiss securities dealer (e.g. Swiss bank, Swiss broker-dealer, Swiss investment manager, or Swiss holding company) is involved in the transaction as a party or an intermediary.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

Broadly speaking, resident investors are taxable on the income (whether accrued or distributed) from AIFs; individual investors holding the AIF as part of their private wealth are not taxed on income generated by the AIF from capital gains or direct real estate holdings. Non-resident investors are not subject to income tax in Switzerland for the sole reason of investing in a Swiss AIF; however, they financially suffer the withholding tax paid by the fund, whereby such withholding tax may be recovered in full or partially, based on domestic law or depending on the terms of the applicable double taxation treaty, if any (see question 6.1). Tax-exempt domestic pension fund investors are exempt from tax on their income from AIFs and are fully entitled to a refund of withholding tax deducted by the AIF. Furthermore, an AIF whose investors consist exclusively of tax-exempt domestic pension fund institutions may apply for the declaration procedure for the purposes of the withholding tax. In respect of foreign pension funds, a number of Swiss double taxation treaties do allow for a full withholding tax refund on distributions from AIFs. In addition, certain foreign occupational pension institutions are considered tax-exempt investors for securities transfer tax purposes.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

The laws and regulations applicable to Swiss collective investment schemes are clear. Thus, it is generally not necessary to obtain a tax ruling as regards the AIF itself. This being said, when an entire structure is set up, including an asset manager in Switzerland with an AIF located offshore, then it is market practice to require rulings from the competent local tax authorities in respect mainly, but not exclusively, to the allocation of profits between the different entities of the structure (i.e. asset manager in Switzerland, manager offshore, and investment funds). Furthermore, when dealing with private equity or hedge funds, tax rulings may be necessary to confirm the tax treatment of the carried interest or performance fees. In this respect, the practice of the tax authorities may vary widely from one Swiss canton to another. Finally, the contribution/transfer of assets into the AIF and the application of tax-exempt reorganisation provisions may require the filing of an upfront tax ruling request.

In light of developments regarding the spontaneous exchange of information in tax matters, such a ruling may be subject to a spontaneous exchange of information with the tax authorities of countries of residence of entities involved in the structure and the country of residence of the ultimate shareholder of the structure.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Switzerland has entered into a FATCA inter-governmental agreement ("**IGA**"). This Swiss IGA follows the Model 2 IGA. Accordingly, a Swiss Financial Institution (as such term is defined in the Swiss IGA) is required to register with the US Internal Revenue Service ("**IRS**") and enter into a Foreign Financial Institution ("**FFI**") agreement. Under the Swiss IGA, the Reporting Swiss Financial Institution will report its US-related accounts directly to the IRS. Further, it should be noted that the Swiss IGA provides for certain exemptions with respect to Swiss collective investment schemes. The Swiss IGA, as well as the Swiss Federal Act on the Implementation of the FATCA Agreement with the United States of America, entered into force on 30 June 2014 and non-compliance with the provision of the Act or the Swiss IGA may be sanctioned by a fine of up to CHF 250,000. Unlike most jurisdictions, which have entered into a Model 1 type IGA, Switzerland has not issued any official guidance notes regarding the implementation of the Swiss IGA. However, a committee known as the FATCA Qualification Committee, headed by the State Secretariat for International Financial Matters ("**SIF**") and consisting of representatives of the major financial industry associations including SFAMA, publishes a Q&A section in order to provide some assistance regarding questions arising from the implementation of the Swiss IGA.

Switzerland has also created the necessary legal basis for the implementation of CRS. The national legislation entered into force and data is being collected as of 1 January 2017.

Certain collective investment schemes may qualify as non-reporting financial institutions. Additionally, for an automatic exchange of information to actually take place, an international agreement between the respective countries is needed. Switzerland has entered into such agreements with various countries (i.e. the EU Member States, Japan, Canada and Australia).

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Switzerland, as a member of the OECD, has actively participated in the base erosion and profit-shifting ("**BEPS**") project. The Federal Council has instructed the Federal Department of Finance ("**FDF**") to offer analysis and proposals in order to implement the outcomes.

Switzerland has recently implemented a third series of corporate tax reforms. These reforms address certain BEPS outcomes. In particular, a patent (or royalty) box that complies with internationally accepted standards was introduced and internationally criticised tax regimes have been abolished. The changes brought by this tax reform do not affect the AIFs directly but rather the managers/advisors and their owners.

Switzerland has ratified the multilateral administrative assistance convention of the organisation for Economic Cooperation and Development ("**OECD**")/Council of Europe and put in place national legislation on this matter. Additionally, the total revision of the Tax Administrative Assistance Ordinance

("**TAAO**") entered into force on 1 January 2017. The ordinance defines the framework and the procedures required for the spontaneous exchange of information. Switzerland has also implemented country-by-country reports for multinational groups exceeding a certain size. To this effect, the federal act on the exchange of such country-by-country reports has been adopted. Treaty abuse is combatted through the respective anti-abuse clause in double taxation treaties, which Switzerland amends with the consent of its treaty counterparties based on the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**MLI**"), to which Switzerland is a signatory state.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

This is not applicable.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

This is not applicable.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

This is not applicable, besides the changes mentioned under question 6.7 above.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

On 15 June 2018, the Swiss Federal Assembly passed a Federal Act on Financial Services ("**FinSA**") and a Federal Act on Financial Institutions ("**FinIA**"). The FinSA and the FinIA which have entered into force on 1 January 2020 entail far reaching changes to offering of financial products, including AIFs, to clients in Switzerland. The FinSA harmonises the rules of conduct that apply in connection with the offering of financial products. More importantly, the regime regarding the marketing of foreign collective investment schemes has changed fundamentally (see question 3.3 for further details). However, client advisors who provide financial services including investment advice will need to be registered in a register of client advisors, unless they work for a supervised financial institution. This requirement will also apply to foreign client advisors who provide financial services to clients in Switzerland. An exemption applies for foreign client advisors who work for entities that are subject to prudential supervision in their home country and who provide financial services to professional or institutional clients only.

In June 2019, the Federal Department of Finance initiated a consultation process regarding a new type of funds or more specifically a new regime for funds that are limited to qualified investors: under this regime, fund management companies and SICAVs will have the possibility to create new funds that are limited to qualified investors without seeking the prior approval of FINMA. This should lower the costs to set-up such funds and shorten the time to market. It is expected that the Federal Council will publish the official dispatch to implement the so called Limited Qualified Investment Fund (L-QIF) in the coming months which will then be submitted to parliament.

Rashid Bahar's practice focuses on banking, finance and capital markets, as well as general corporate law. He heads the funds, financial products and asset management practice group.
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Rashid Bahar is also an associate professor at the University of Geneva, where he teaches corporate law and financial markets regulation. He is a member of the executive committee of the Center for Banking and Financial Law and the editorial committee of the *Swiss Business Law Review*. He was appointed as an expert member of the working group of the Federal Department of Finance responsible for drafting the Federal Act of Financial Services (FIDLEG) and its implementing ordinance.

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- 2018 IFLR M&A Deal of the Year
- 2018 Best in Trusts & Estates by Euromoney LMG
- 2018, 2017 Trophées du Droit Silver
- 2016, 2013 and 2012 Chambers Award
- 2016, 2015 and 2014 Legal 500 ("most recommended law firm in Switzerland")
- 2016 Trophées du Droit Gold
- 2015, 2014, 2013, 2011, 2010 The Lawyer European Award
- 2015 Citywealth Magic Circle Award ("Law firm of the Year – EMEA")
- 2014 Citywealth International Financial Centre Award

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The establishment and operation of investment funds is governed by state law. The two most popular forms of organisation are the Delaware limited partnership ("LP") and Delaware limited liability company ("LLC"), organised under the Delaware Revised Uniform Partnership Act and the Delaware Limited Liability Company Act, respectively. Other relevant U.S. legislation includes but is not limited to the U.S. Securities Act of 1933 (which regulates securities in the U.S.), the U.S. Securities Exchange Act of 1934 (which regulates the offer and sale of securities in the U.S.), the U.S. Investment Company Act of 1940 (which regulates investment funds in the U.S.), the U.S. Investment Advisers Act of 1940 (which regulates investment managers and advisers in the U.S. or offering services to U.S. clients), and the U.S. Commodity Exchange Act of 1936 (which regulates commodity interests in the U.S.) ("CEA").

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Yes, managers and advisers must be regulated by the Securities and Exchange Commission ("SEC") or a state securities commission, or able to rely on an exemption from regulation. Please note that SEC regulations apply to both investment managers and investment advisers. For simplicity, this response only uses the word "adviser".

The requirements can differ depending on whether the adviser is domiciled inside or outside the United States.

Advisers located outside the United States

Advisers located outside the United States may be (1) able to rely on the Foreign Private Adviser Exemption, (2) able to rely on the Private Fund Adviser Exemption, or (3) required to register as an investment adviser with the SEC.

The "Foreign Private Adviser Exemption" provides an exemption for any firm which:

- has no place of business in the United States;
- has, in total, fewer than 15 U.S. clients (i.e., separate accounts) and investors in the United States in private funds advised by the adviser;
- has aggregate assets under managements ("AUM") of less than $25 million attributable to (i) clients in the United States (including U.S. separate accounts and U.S.-domiciled private funds), and (ii) U.S. investors in private funds advised by the adviser; and
- neither (i) holds itself out generally to the public in the United States as an adviser, nor (ii) advises investment companies or business development companies registered under the Investment Company Act.

The "Private Fund Adviser Exemption" provides an exemption for advisers to private funds (such as hedge funds and private equity funds) with less than $150 million in AUM, but it requires such advisers to maintain certain records and provide certain reports to the SEC (such advisers: "Exempt Reporting Advisers"). The exemption treats U.S. advisers (i.e., those advisers with their principal office and place of business in the United States) and non-U.S. advisers differently. To rely on the exemption, a non-U.S. adviser only needs to include assets managed at a place of business in the United States in calculating whether it falls below the $150 million threshold. In addition, the firm's only U.S. clients must be private funds or U.S. persons investing in such funds. As a result, as long as a non-U.S. adviser does not manage any separate account mandates for U.S. investors and manages less than $150 million from a place of business in the U.S., the Private Fund Adviser Exemption allows the non-U.S. adviser to manage unlimited investments from U.S. investors. To claim this exemption, an adviser must file Part 1 of Form ADV within 60 days of beginning to rely on the Private Fund Adviser Exemption. Entities relying on this exemption must not have or take on any direct U.S. clients (i.e., SMAs) until they have fully registered with the SEC as an investment adviser.

Non-U.S. advisers that cannot comply with either of the above exemptions must register with the SEC as an investment adviser.

Advisers located within the United States

Advisers located within the United States may be (1) able to rely on the Private Fund Adviser Exemption, or (2) required to register as an investment adviser. Depending on the level of assets under management, the adviser may be regulated at the state level or the federal level (by the SEC).

As noted above, the "Private Fund Adviser Exemption" provides an exemption for advisers to private funds (such as hedge funds and private equity funds) with less than $150 million in AUM (such advisers: "Exempt Reporting Advisers"). The exemption treats U.S. advisers (i.e., those advisers with their principal office and place of business in the United States) and non-U.S. advisers differently. To rely on the exemption, a U.S. adviser needs to calculate assets under management by including all assets managed for all clients. In addition, the firm's only clients must be private funds. As a result, as long as a U.S. adviser does not manage any separate account mandates and manages less than $150 million of assets, the adviser can rely on the Private Fund Adviser Exemption. Once the U.S. adviser manages more than $150 million in AUM, the U.S. adviser cannot rely on the Private Fund Adviser Exemption and must register fully as an investment adviser.

Depending on the level of assets under management, a U.S. adviser may need to file at the state level, rather than with the SEC. Firms with less than $100 million in AUM must file with the states in which they have an office (either for full registration or to claim the Private Fund Adviser Exemption) with the exception of New York State (for which firms must file with the SEC when AUM exceeds $25 million). Firms with AUM exceeding $100 million file with the SEC rather than with any state (either for full SEC registration or to claim the Private Fund Adviser Exemption).

These requirements can be complicated and it is recommended that firms seek advice of counsel.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

No, Alternative Investment Funds do not need to be licensed, authorised or regulated by any securities regulator but must be able to rely on an exception from registration as an investment company under the Investment Company Act of 1940. Funds will seek to come under one of the "private" investment fund exceptions found in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act in order to avoid registration thereunder. Section 3(c)(1) limits the number of beneficial owners in a fund to no more than 100. Section 3(c)(7) does not impose any limits on the number of beneficial owners but limits investors to those meeting the definition of "qualified purchaser". Sections 3(c)(1) and 3(c)(7) also require that the fund must not conduct a public offering of its securities in the United States (essentially imposing the accredited investor requirements found in Regulation D under the Securities Act).

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

There is no such distinction.

1.5 What does the authorisation process involve and how long does the process typically take?

There is no authorisation process for Alternative Investment Funds in the United States, but the vehicle must be organised under state law and make the appropriate organisational filings.

1.6 Are there local residence or other local qualification or substance requirements?

No, but Delaware LPs and LLCs must make the necessary filings under state law in order to form the LP or LLC, must appoint an agent for service of process in Delaware, and must make the necessary local tax filings.

1.7 What service providers are required?

A general partner for an LP or a managing member for an LLC, a custodian, an administrator, and an auditor. Certain funds may wish to appoint one or more prime brokers.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Foreign managers and advisers must either be registered as an investment adviser with the SEC or fit within an exemption from the requirement to register as an investment adviser with the SEC (see question 1.2 above). Foreign managers must also comply with regulations of the Commodity Futures Trading Commission ("CFTC") if the fund utilises commodity interests to any extent. Finally, if the funds allow investment by "benefit plan investors" pursuant to the U.S. Employee Retirement Income Security Act of 1974 ("ERISA"), the managers and advisers need to be aware of potential ERISA requirements.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The SEC has entered into a number of bilateral Memoranda of Understanding ("MOUs") as well as signed the International Organization of Securities Commissions' Multilateral Memorandum of Understanding. These MOUs are designed to make cross-border regulatory cooperation and information-sharing a convenient and attractive option. See the International Organization of Securities Commissions, *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information*, (May 2012), text available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD386.pdf [link accessed 24 June 2020]. *See also Memorandum of Understanding between the SEC and the FSA Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight and the Supervision of Financial Services Firms* (14 March 2006) under which the UK Financial Conduct Authority (FCA) (previously named the UK Financial Services Authority or FSA) will provide assistance to the SEC in conducting compliance inspections or examinations and obtaining specified information and documents from persons, as well as in questioning or taking testimony, in the UK.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

The two most popular forms of organisation are the Delaware limited partnership (LP) and Delaware limited liability company (LLC), organised under the Delaware Revised Uniform Partnership Act and the Delaware Limited Liability Company Act, respectively; however, it is common for non-U.S. legal structures (such as Cayman corporate funds, Cayman limited partnerships, and other structures of Alternative Investment Funds) to be marketed in the United States.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Under Delaware law, an investor in a Delaware limited partnership (LP) is not liable to third parties for the obligations of the LP, as long as the investor does not participate in the management of the fund. Similarly, an investor in a Delaware limited liability company (LLC) is not liable to third parties for the debts, obligations or liabilities of the LLC unless the investor agrees to become personally obligated.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

For managers and advisers domiciled in the United States, the firm must be organised under state law. The choice of state and structure within the state will vary depending on the personal preferences and tax requirements of the individuals forming the firm. However, common choices are the Delaware limited liability company and the Delaware corporation. An investment manager or adviser is not required to be formed in the United States, and it is common for firms formed by individuals who are not U.S. citizens to organise the manager or adviser under local law in Europe or Asia.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

There are no limits under Delaware laws governing Delaware LPs or Delaware LLCs. However, an investment manager or adviser fully registered as an investment adviser with the SEC is deemed to be a fiduciary and is subject to the requirement to act in the best interests of its clients and provide detailed disclosure to investors in funds it sponsors.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no limits under Delaware laws governing Delaware LPs or Delaware LLCs. However, under the provisions of the U.S. Securities Act of 1933, an investor typically is required to qualify as an "accredited investor", and a U.S. accredited investor must transfer any interests to another person (U.S. or non-U.S.) who is an "accredited investor".

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

There are no limits under Delaware laws governing Delaware LPs or Delaware LLCs.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Firms registered as an investment adviser are subject to the advertising rules under the Investment Advisers Act. Registered broker-dealers are subject to certain advertising requirements by the Financial Industry Regulatory Authority ("FINRA") and commodity pool operators ("CPOs")/commodity trading advisers ("CTAs") are subject to advertising requirements by the CFTC.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The Investment Advisers Act provides that it is unlawful for an adviser to engage in any act which is fraudulent, deceptive or manipulative. The Act grants the SEC authority to issue rules and regulations to prevent such acts, and the SEC has issued various rules and no-action letters regarding which activities are deemed to be fraudulent. Some examples of activities that are seen as fraudulent are the use of testimonials, publication of past specific recommendations, and showing performance gross of fees. It is not possible to go into detail in this chapter. Please also note that it is expected that the SEC will issue an update to the advertising rules in 2020, so the requirements are subject to change. Finally, please note that although the SEC's substantive advertising rules apply only to fully registered advisers, the prohibition in the Investment Advisers Act not to engage in fraudulent, deceptive or manipulative acts applies to all firms regardless of SEC registration status.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

No, marketing materials and legal documents are not required to be registered with or approved by the local regulator.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Alternative Investment Funds must be sold in the U.S. on a private placement basis.

The SEC has adopted Rule 506 of Regulation D as a "safe harbour" for private placements. Rule 506(b) requires that: (i) sales are made only to "accredited investors" (defined in question 3.7 below); (ii) there is no general solicitation or advertising involved with the offering; and (iii) the accredited investors buy the securities for investment and not for resale. Regulation D also contains a relatively new provision, Rule 506(c), which eliminates the ban on general solicitation and general advertising, provided the issuer takes reasonable steps to verify that all purchasers are accredited investors. However, the private fund industry has been hesitant to rely on Rule 506(c) in part due to uncertainty about future regulatory requirements.

The restriction on general solicitation and general advertising applies to any person acting on behalf of a fund, including any marketing or placement agent. The term "general solicitation and general advertising" includes:

- any advertisements, articles, or communications published in any newspaper or similar media or broadcast;
- seminars or meetings whose attendees have been invited by general solicitation or general advertising and cold postal mailings;
- cold calling or email messages sent to previously unknown persons; and
- the offer of securities on publicly available websites.

In order to ensure that a private placement is valid, the persons responsible for marketing should be able to identify each person to whom interests were offered and have information to support the conclusion that the investor is eligible to invest in the Alternative Investment Fund.

In addition, Regulation D also technically requires a fund to file a short notice (a Form D) with the SEC within 15 days of the first sale of interests to U.S. investors.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

No, there is no concept of permitted "pre-marketing" in the United States.

3.6 Can Alternative Investment Funds be marketed to retail investors?

No, Alternative Investment Funds cannot be marketed to retail investors.

3.7 What qualification requirements must be met in relation to prospective investors?

All investors must meet the definition of "accredited investor" as defined in Rule 501(a) under the Securities Act. Very generally, an "accredited investor" is: (1) an individual whose net worth (or joint net worth with that person's spouse) exceeds $1 million (excluding the value of the individual's primary residence), or whose income was in excess of $200,000 in each of the preceding two years (or, together with that person's spouse, in excess of $300,000 in each of the preceding two years) and who reasonably expects to reach the same level of income in the current year; or (2) corporations, partnerships, trusts or foundations with total assets in excess of $5 million.

In addition, investors in funds relying on the Section 3(c)(7) exception from registration under the Investment Company Act must meet the definition of "qualified purchaser", which very generally consists of: (1) natural persons who own at least $5 million in "investments" (as such term is defined in the Investment Company Act); and (2) entities that, in the aggregate, own and invest on a discretionary basis at least $25 million in investments.

For U.S.-domiciled funds, all investors must meet the qualification requirements; for non-U.S.-domiciled funds, only U.S. investors must meet these qualification requirements.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

The SEC has adopted the "pay-to-play" rule (Rule 206(4)-5 under the Investment Advisers Act) which prohibits registered and unregistered investment advisers from providing advisory services for compensation to a government entity within two years following a contribution to an official of the government entity by the adviser or certain "covered associates". Providing advice for compensation to a hedge fund in which a government entity has invested is considered to be providing advisory services for compensation to a government entity. Registered and unregistered investment advisers and their covered associates are also prohibited from compensating third party solicitation agents unless they are investment advisers or registered broker-dealers who are themselves complying with the applicable pay-to-play rules.

In addition, many states have adopted state "procurement lobbying" laws or provisions, many of which are broad enough to apply to fund managers seeking investments from state or local government entities and pension plans. In some instances, the state has adopted specific laws. However, in most instances it is simply a matter of an advisory opinion by the state attorney general. Those that do apply specific laws include California, Ohio, Illinois, and New York City. The state laws, however, do not include local city or county laws that may apply to large local pension plans such as LACERS or LACERA.

Funds seeking these types of investors should take care that the requirements of any relevant state and local laws are being met before soliciting investments from these types of investors.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

No, there are no restrictions other than restrictions on retail investors investing in Alternative Investment Funds (discussed above).

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Yes, intermediaries involved in fundraising should be registered as a broker-dealer with the FINRA. Introductions made by certain fiduciaries (such as a regulated investment adviser) also may be permissible in certain circumstances. Use of unregistered "finders" is strongly discouraged.

Finally, "associated persons" ("APs") of a fund (including partners, directors and employees of the fund or its investment manager, managing member or general partner) who market the fund in the United States also may be subject to broker-dealer registration, but usually rely on a safe harbour from registration. Pursuant to the Rule 3a4-1 safe harbour, no registration is required of an AP if the person: (1) is not subject to a statutory disqualification; (2) is not being compensated by sales-based compensation in connection with the offering; and (3) is not an AP of a U.S.-registered broker-dealer. Several potential other conditions apply, but the further condition most frequently utilised requires compliance with the following additional criteria: the AP (1) performs substantial duties for the issuer that are not connected to the offering, (2) was not a broker-dealer or an AP of a FINRA-member broker-dealer within the preceding 12 months, and (3) does not participate in the selling of securities for any issuer more than once every 12 months.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

There are no limits under Delaware laws governing Delaware LPs or Delaware LLCs. Please note, however, that an Alternative Investment Fund may be subject to other restrictions under other U.S. legislation. For example, an Alternative Investment Fund with a commodity pool operator relying on an exemption from CFTC regulation will be subject to restrictions on the level of commodity interests in which the fund can invest. Funds that are deemed to be "plan assets" under ERISA are subject to certain restrictions on investments. Funds also may be subject to restrictions on certain activities under provisions of the U.S. Internal Revenue Code of 1986, as amended.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Please see the answer to question 4.1 above.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Derivatives

Under the U.S. Commodity Exchange Act of 1936, as amended (CEA), and implementing CFTC regulations, an investment fund is considered to be a "commodity pool" subject to CFTC regulation if the fund transacts in commodity interests (i.e., futures contracts or options on futures contracts or commodities and most types of OTC derivatives) to any extent. Thus, even a fund which is predominantly a vehicle for investment in securities and makes use of commodity interests only for hedging purposes is deemed to be a "commodity pool" under CFTC requirements.

Without registration in an appropriate capacity with the CFTC, a firm and its employees may not solicit U.S. investors for a commodity pool (i.e., under CFTC interpretations, a fund which engages in transactions in commodity interests to any extent). Unless an exemption is available (as discussed below), the operator or marketer of a commodity pool must register as a CPO, and one who manages a fund that trades in futures or who gives advice about futures trading must register as a CTA. Marketing personnel and their supervisors would be required to register as APs of the registered firm.

Loans

There are no local regulatory requirements with respect to investing in loans (although there may be tax issues arising from investment in loans).

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

There are no limits under Delaware laws governing Delaware LPs or Delaware LLCs. However, as noted above, Alternative Investment Funds may be subject to other restrictions under other U.S. legislation, including tax issues.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

Alternative Investment Funds domiciled or sold in the United States are expected to make detailed disclosure of all material terms of the offering, as well as potential risks and conflicts of interest, to prospective investors. There is no requirement to file the fund's offering materials with the SEC. Investment advisers that are fully registered with the SEC are required to make detailed information about the firm, its investment techniques, its fees, its risks and other information available publicly by filing Form ADV (Part 1 and Part 2) with the SEC and providing a copy of Part 2 to all clients and fund investors. Firms that have filed with the SEC as an "exempt reporting adviser" must make certain information publicly available as well.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

There is no requirement in the United States to provide details of fund investors to any local regulator or the public for purposes of a register of beneficial owners. However, investment advisers that are fully registered or registered as an "exempt reporting adviser" with the SEC are required to disclose to the public certain direct and indirect owners of the adviser.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Investment advisers that are fully registered or registered as an "exempt reporting adviser" with the SEC are required to report updated information on their Form ADV annually (or certain materials changes must be reported "promptly") to the SEC. Information on Form ADV is available to the public on the SEC's website. Investment managers or advisers to certain categories of funds (hedge funds, private equity funds, liquidity funds, etc.) that exceed certain asset level thresholds are required to report information on holdings periodically to U.S. regulators on "Form PF". This is similar to the "Annex IV" reporting required for European Alternative Investment Funds.

5.4 Is the use of side letters restricted?

No, the use of side letters is not restricted under Delaware law.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Delaware funds are typically tax transparent and generally not subject to income taxation. Non-U.S. funds may be tax transparent or opaque, but in either event generally operate in a manner that qualifies for safe harbour relief from net income taxation. Withholding taxes may apply to non-U.S. opaque funds.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

These entities can be either tax transparent, in which case they are generally not subject to income taxation, or opaque, in which case corporate income taxes apply.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

Cash contributions generally can be made on a tax-free basis. Transfers generally are taxable events.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

U.S. citizens and residents are subject to taxation on worldwide income. Non-residents are taxable directly on net income derived in connection with U.S. trade or business activity (including U.S. real estate-related disposition gains) and through withholding on the gross amount of dividends and other categories of U.S. source income not connected with a U.S. trade or business. U.S. tax-exempt investors are generally taxable only on income derived from (i) a business that is unrelated to their exempt purpose (with certain exclusions), or (ii) debt-financed property.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

Generally, no. Entity classification elections may be desirable.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

U.S. funds are withholding agents for FATCA purposes. Diligence is achieved through collection of IRS W-8/9 forms from investors. The U.S. is not a participant to the OECD's Common Reporting Standard.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

The U.S. is generally supportive of BEPS. Tax reform enacted in 2017 made significant changes designed to address profit-shifting, base erosion and taxation of U.S. multinationals in a manner that provides incentives to maintain operations in the U.S. The U.S. has not agreed with the OECD measures that would allow for taxation of digital services. In June 2020, the U.S. Treasury Secretary recommended a pause in OECD talks to allow governments to focus on their COVID-19 pandemic responses.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Non-corporate taxpayers pay reduced rates on long-term capital gains (generally, from dispositions of investment assets held for more than one year) and certain corporate dividends. Certain asset-specific structures that can avoid entity-level taxation if various conditions are satisfied include REITs, REMICs and RICs.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Generally, no.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

Depending on the outcome of the November 2020 elections, significant tax reform is possible.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

The SEC has proposed updating certain provisions of the advertising rules, which would impact the marketing of Alternative Investment Funds.

Karen L. Anderberg advises UK, U.S. and European asset managers and investment funds on all aspects of U.S. financial services regulatory issues, including Securities and Exchange Commission (SEC) investment adviser and investment fund registration and exemptions and Commodity Futures Trading Commission (CFTC) requirements. Ms. Anderberg's practice also consists of advising investment funds (including UCITS and AIFs) on global distribution issues, both via registration or passporting and on a private placement basis. Ms. Anderberg also counsels large financial services firms on global compliance and distribution matters. Ms. Anderberg co-edited *US Regulation for Asset Managers Outside the United States* published by Sweet and Maxwell in 2017. She has spoken extensively on financial services regulatory matters, and has co-hosted a regular seminar series on "US Regulation for UK Legal and Compliance Professionals" since 2008.

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