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Investment Funds 2024

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Global Practice Guides

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Contributed by: Sam Kay, **Dechert LLP**

Dechert LLP is a global law firm with 21 locations across the US, Europe, the Middle East and Asia. It has one of the largest investment fund practices in the world, with a record of innovation stretching back 40 years. It advises across the full range of mainstream and alternative asset classes and strategies, representing some of the world's largest fund complexes. The asset management practice has dedicated lawyers across 17 offices and operates as a single practice group across the globe with no internal barriers to collaboration. Clients look to the team for support across the entire fund lifecycle, from development and formation to marketing, operations and transactions. It provides advice related to fund management and governance, and assists with the full range of regulatory and compliance issues, as well as investigations and litigation involving regulatory entities around the world.

Contributing Editor

Sam Kay is a partner in Dechert's financial services group. He advises on a wide range of investment funds matters, with a particular focus on fund formation, representing private funds and asset managers throughout the private equity, private debt/credit, infrastructure and real estate industries. Sam advises GPs on complex transactions such as continuation funds, tender offers and strip sales, and has extensive experience in advising clients on matters of strategic significance, such as GP-stake sales, internal restructurings for succession planning, management spin-outs and complex carried interest arrangements. He also advises institutional investors, funds-of-funds and asset allocators on their participation in funds, as well as LP-led secondary activity from single assets to large portfolio sales.

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INTRODUCTION

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Investment Funds 2024 – Global Overview

This cross-border legal guide provides a global comparison of fundamental legal, tax and regulatory considerations relating to the establishment and operation of investment funds in a range of jurisdictions where the industry is active. Each chapter is written by leading legal advisers from the relevant jurisdiction. The chapters focus on particular jurisdictions, in a question-and-answer format, providing information on the structures typically used, the regulatory framework for those funds, any significant operational requirements, how the funds may be marketed, a summary of the tax treatment for both the fund itself and investors, and customary or common terms. In addition, this guide contains a number of chapters highlighting certain trends and developments in the investment funds market.

This guide seeks to provide guidance on the key questions arising when industry participants are seeking to establish, operate, market and/or invest in an investment fund. Investment funds often operate across multiple jurisdictions, so those who understand the global landscape will be at a distinct commercial advantage, as well as minimising their risk of falling foul of local laws.

The key objectives when setting up an investment fund that are discussed in this guide include the following.

Choice of domicile

There are a multitude of different legal structures available, and each jurisdiction applies its own legal and regulatory framework. Certain jurisdictions are traditionally utilised for certain strategies. However, ongoing legal developments in those jurisdictions, coupled with attractive investment funds regimes being introduced and/or modernised in the less obvious choices of jurisdictions seeking to compete with more established jurisdictions, mean that the domicile used by a manager for its last fund may not be the best option for its next fund. We hope that this guide will help to provide the most up-to-date information on the typical forms of investment fund vehicles available in each jurisdiction, to assist in making decisions relating to domicile.

Asset class

There is also a wide variety of asset classes that are captured within the market, from traditional long-only equity funds through to leveraged buyout funds and hedge funds. Funds for different asset classes will have their own bespoke features and requirements. The industry develops in response to demand and now offers many ways for investors to customise their exposure to certain asset classes. Current trends – such as secondaries transactions, general partner-led fund restructurings, hybrid or “evergreen” funds and the drive towards the “democratisation” of the private funds market – demonstrate that the investment funds industry is flexible and accommodating to investors.

Regulatory and tax considerations

The global investment funds industry continues to grow and innovate at pace against the backdrop of an increasingly complex regulatory, tax and legal landscape, and we expect to see this carry on during 2024 and beyond. Without doubt, the number of legal, tax and regulatory issues that have to be considered when establishing an investment fund has increased significantly, and regulators and tax authorities across the world are introducing more complex reforms (the new Private Fund Rules introduced by the SEC in the United States being a current example). A fund manager's failure to comply with these requirements can lead to significant fines or, in extreme cases, custodial sentences. Therefore, it is important to understand the

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applicable requirements in jurisdictions where the fund or manager is doing business.

Investor base

Another key objective when structuring an investment fund is ensuring that the fund is suitable for its proposed investors, whether that will be institutional investors or retail investors, or a combination of both. The investment funds industry is a global market, so funds will often be marketed to investors in multiple jurisdictions. Therefore, a fund needs to be flexible enough to be adapted to different groups of investors; it needs to be capable of being marketed in different jurisdictions; and it needs to be sufficiently familiar to investors. The manager and sponsor will, therefore, need to consider and take advice on the securities and marketing laws and regulations in the fund's target jurisdictions. In many jurisdictions, the marketing or distribution of an investment fund is restricted to certain categories of investor – eg, "professional" or "sophisticated" investors (ie, not to the public at large). Funds that are targeted at retail investors are, on the whole, subject to a higher level of regulatory scrutiny and operating restrictions.

In recent years, lawmakers and regulators have continued to focus on investor protection whilst increasingly looking to ensure that the industry complies with wider ESG-related responsibilities, leading to many new (and often onerous) legal, tax and regulatory requirements. A further challenge is the need to navigate between the approaches taken in different regions or jurisdictions – eg, operating in line with EU ESG regulation – whilst also taking account of the differing views and approaches to ESG in the United States.

About This Guide

To provide a framework for each jurisdiction-specific chapter, the guide focuses on two categorisations of "investment funds": "alternative investment funds" and "retail funds". There will obviously be overlaps between these two categories, and some strategies or structures will not be adequately catered for (an obvious example being listed funds aimed at institutional investors). However, the suggested split is intended to be as follows.

- Alternative investment funds cover the non-traditional private fund strategies such as private equity, venture capital, infrastructure, alternative credit, hedge funds and real estate.
- Retail funds cover the traditional mutual, authorised, regulated or registered funds that are commonly available to the public and, therefore, are not usually offered on a private placement basis. For this reason, retail funds have historically been more heavily regulated than other types of funds.

This guide not only sets out the information needed, but also provides a network of leading experts from independent law firms around the world who can be called upon to provide advice. The chapters in this guide have been written by some of the leading legal investment funds practitioners around the world: we thank each of them for contributing their invaluable and highly relevant industry comments.

AUSTRALIA

Law and Practice

Contributed by:
Michael Lawson, Nicole Brown, Yoni Garson and Jessica Lucich
MinterEllison

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MinterEllison operates in every capital city in mainland Australia, as well as in New Zealand, Hong Kong, China, Mongolia and the UK, through a network of integrated and affiliated offices. The firm is recognised as having one of the largest and most specialised financial services practices in Australia. With over 40 qualified practitioners and a dedicated alternative funds group, the funds team has a deep understanding of the financial services regulatory environment and is an active participant in industry working groups. The team's expertise includes: advising on fund (including retail) formation, fundraising, distribution and investor disclosure; addressing regulatory requirements and liaising with regulators; third-party/service-provider engagement; advising on investments; participating in investor negotiations; and project management. The team has advised on leading alternative methods of raising funds in the industry, with clients including Next Capital, Quadrant Private Equity, Carthona Capital, Metrics Credit Partners and Tanarra Credit Partners. The team also works with BlackRock, Vanguard, Macquarie, BetaShares, Challenger and Qualitas in relation to their investment management businesses, including extensive work in exchange-traded funds and A-REITs.

Authors

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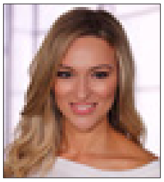

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1. Market Overview

1.1 State of the Market

The Australian investment funds market is highly developed, from both a regulatory and commercial perspective. Australia is a jurisdiction that is welcoming to retail and alternative fund strategies and managers.

There has continued to be a significant flow of transactional and regulatory matters following initially restrained activity during the COVID-19 pandemic, and this is anticipated to continue in the year ahead.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

The most commonly used structure is a unit trust, due to its flexibility.

For private equity and venture capital funds, a unit trust or a limited partnership, usually in the form of a venture capital limited partnership (VCLP) or early-stage venture capital limited partnership (ESVCLP) (in certain circumstances), can be used.

A unit trust is simpler to establish and offers greater flexibility with respect to the asset classes in which it can invest; however, certain limited partnerships can attract tax benefits for investors and fund managers, when certain requirements are met.

For hedge and credit strategies, a unit trust is the suitable local structure.

Following recent legislative changes, it is possible to establish corporate collective investment vehicles (CCIVs) which can be used as investment vehicles for a variety of asset classes.

2.1.2 Common Process for Setting Up Investment Funds

A regulated Australian unit trust will require registration with the Australian Securities & Investments Commission (ASIC). Such unit trusts are known as registered managed investment schemes. Once ASIC receives an application, it must make a decision on registration within 14 days. Key approval criteria are that:

- the trustee of the fund holds an Australian Financial Services Licence (AFSL) authorising it to be a "responsible entity" of a registered managed investment scheme;
- the responsible entity is an Australian public company; and
- the constitution of the fund meets the requirements of the Corporations Act 2001 (Cth) (the "Corporations Act") and relevant ASIC guidance.

The key required documentation is a constitution/trust deed. An investment management agreement is also typically required, by which the trustee outsources investment management to a manager entity.

The setting-up process is not lengthy, and costs are reasonable. Establishment of a registered managed investment scheme and registration with ASIC can take place within three to four weeks.

An unregistered unit trust can be established within one to two weeks.

The above timings assume a simple structure and that relevant licensing arrangements are previously in place.

VCLPs and ESVCLPs are incorporated limited partnerships established under state-based legislation. They are bodies corporate and need to be registered with relevant state regulatory bodies. In addition, these entities require registration with Innovation and Science Australia under the Venture Capital Act 2006 (Cth) (the "VC Act"). Due to legislative requirements, the general partner of the VCLPs and ESVCLPs must also be an incorporated limited partnership (VCMP). The general partner of that VCMP is generally a company.

The benefit of registering VCLPs and ESVCLPs is primarily the manner in which investment proceeds are taxed for both the general partner and the limited partners. Managers of each of these vehicles are required to:

- hold an AFSL;
- be an authorised representative of an AFSL holder; or
- have the benefit of a relevant exemption.

Key documents for partnerships are:

- a partnership agreement;
- a subscription agreement;
- a management agreement; and
- any side letters.

A partnership agreement for the VCMP is also required.

Incorporation of a limited partnership can occur in approximately two business days with modest registration fees. Registration of a VCLP or ESVCLP can be conditional or unconditional depending on whether all registration conditions have been met. Following receipt of a complete application, Innovation and Science Australia must typically make a decision in respect of registration under the VC Act within 60 days.

A significant workstream to be undertaken on fund inception is the relevant "carry" vehicles and rules applicable for the carry participants.

As discussed later (see **2.2.2 Legal Structures Used by Fund Managers**), if a CCIV is the preferred vehicle, these are formed on registration with ASIC.

2.1.3 Limited Liability

The trust deed for most unit trusts includes what is, in effect, a contractual limitation of liability of investors. The effectiveness of such limitations has broad commercial acceptance. Despite such acceptance, the question of the legal effectiveness of such limitations has not been settled across Australia's states and territories.

In relation to limited partnership structures, as a general rule, an investor's liability is limited to their capital committed to the investment vehicle. Typically, if there is a tax impost relating to an investor's commitment, the investor must fund that impost.

2.1.4 Disclosure Requirements

A fundamental disclosure requirement is that communications to investors cannot be misleading or deceptive, including by omission.

Where retail investors are issued with interests in a fund, the product disclosure statement (PDS) must comply with statutory disclosure rules, including detailed costs disclosure. The issuer of the product has continuous disclosure obligations.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Institutional investors from Australia and offshore frequently invest in alternative funds. Most major Australian institutional investors have an allocation for private equity and private debt funds. Venture capital investment in Australia is mostly high net worth and family office led, though some institutions have a venture capital allocation.

2.2.2 Legal Structures Used by Fund Managers

Unit Trusts

In Australia, unit trusts can be structured as open- or closed-end vehicles, where performance fees can take the form of a traditional performance fee on net asset value increase or a private equity-style "carry waterfall".

There are very few legal requirements that apply to Australian unit trusts, which are simple to establish and, provided they are only offered to wholesale investors, often have no regulatory or other registration or approval requirements (note that there would typically be regulatory requirements for the manager or trustee; see **2.3 Regulatory Environment**).

A unit trust is managed by its trustee, who may, in practice, appoint an investment manager to provide investment management services in respect of the trust. The use of corporate trustees is common by fund managers who do not wish to manage the day-to-day administration of their own trust or who may lack the necessary regulatory licence to act as a trustee.

Partnerships

The common partnership structures used by a private equity or venture capital fund to invest primarily in Australian businesses are known as VCLPs for private equity and venture capital funds, or as ESVCLPs for early-stage venture capital funds.

Overview of VCLPs and ESVCLPs

An incorporated limited partnership must meet specific requirements before it can be registered as a VCLP or an ESVCLP with Industry Innovation and Science Australia, an Australian government department. There are specific requirements for a VCLP and an ESVCLP set out in the VC Act, with many consistencies between the two, including that:

- the term of the partnership must be more than five years and less than 15 years;
- the minimum committed capital must be at least AUD10 million; and
- the partnership must only carry on activities that are related to making eligible venture capital investments (EVCIs), as defined by relevant Australian tax legislation.

An EVCI is an equity investment in an unlisted company or unlisted trust that:

- is located in Australia;
- does not exceed more than 30% of the partnership's committed capital; and
- has a predominant activity that is not an ineligible activity.

An ineligible activity includes:

- property development or land ownership;
- banking;
- providing capital to others;
- leasing;
- factoring;
- securitisation;
- insurance;

- construction or acquisition of infrastructure facilities and/or related facilities; and
- making investments that are directed at deriving income in the nature of interest, rent, dividends, royalties or lease payments.

For an investment to qualify as an EVCI, the investment must not exceed the value restriction imposed at the time of the investment (ie, AUD50 million for an investment by an ESVCLP and AUD250 million for an investment by a VCLP).

In addition to the requirements for registration, the VC Act applies various restrictions to these structures:

- no single investor in an ESVCLP, other than in certain circumstances, can contribute more than 30% of the total committed capital;
- the maximum committed capital for an ESVCLP is AUD200 million;
- VCLPs and ESVCLPs cannot invest in a single investment whose total assets exceed AUD200 million at the time of investment; and
- in general, they cannot make debt investments other than permitted loans as defined in the VC Act.

Given the strict requirements and restrictions imposed on VCLPs and ESVCLPs, many fund managers establish these vehicles together with parallel funds (usually soft stapled-unit trusts). This structure allows fund managers to obtain the tax benefits afforded to VCLPs and ESVCLPs in respect of investments that are EVCIs, while providing the fund manager the flexibility to invest in non-EVCIs via the parallel funds. This has been a common strategy for leading Australian private equity and venture capital funds.

CCIVs

Recent amendments to the Corporations Act have facilitated the emergence of a new fund vehicle – the CCIV. This vehicle is a company limited by shares, which must consist of one or more "sub-funds". While the CCIV itself is a legal entity, sub-funds are not separate legal entities. Each share in a CCIV must be referrable to a single sub-fund and the assets of the CCIV must be allocated to a particular sub-fund in an allocation register. The Corporations Act provides that the assets of one sub-fund are not available to satisfy the liabilities of another sub-fund.

CCIVs can be structured as open ended or closed ended and are suitable for retail or wholesale clients. A retail CCIV is subject to specific rules broadly similar to registered managed investment schemes. A CCIV must be designated as retail or wholesale, though under certain circumstances a CCIV will be required to register as a retail CCIV.

A CCIV is managed by a "corporate director" which must be a public company with an AFSL authorisation to "operate the business and conduct the affairs of a CCIV" for retail or wholesale CCIVs (as applicable) holding the relevant type of assets. A CCIV and each sub-fund is established on registration with ASIC and is governed by that CCIV's constitution.

2.2.3 Restrictions on Investors

Australia has a highly developed and continually evolving regulatory regime in relation to investments from offshore into Australia.

In summary, the Treasurer of Australia, acting through the Foreign Investments Review Board (FIRB), can block foreign direct investment that is "contrary to Australia's national interest" if clearance is required.

The foreign investment review framework is set by the Foreign Acquisitions and Takeovers Act 1975 (the "FATA Act") and the Foreign Acquisitions and Takeovers Fees Impositions Act 2015, along with their associated regulations.

The legislation generally regulates foreign investment proposals by a "foreign person". Foreign persons involved in applicable transactions are required to notify FIRB. "Foreign persons" essentially means individuals, offshore companies, or onshore companies in which offshore foreigners hold a substantial interest. It includes private foreign investors and foreign government investors.

Changes to the rules applied by FIRB from 1 January 2021 also give the Treasurer "call-in powers" and "last-resort powers", by which the Treasurer may "call in" investments not notified to FIRB for review and in exceptional circumstances may exercise "last-resort powers" to impose conditions, vary existing conditions or require divestment of approved investments where national security risks emerge. In addition, a new set of rules applies for screening national security businesses, which include:

- communications (including telecommunications, broadcasting and domain name systems);
- higher education and research;
- data storage and processing;
- the defence industry;
- energy (including electricity, gas, energy market operators and liquid fuels);
- food and grocery;
- financial services and markets (including banking, superannuation, insurance and financial market infrastructure);
- healthcare and medical (including hospitals);
- space technology;
- transport (including ports, freight infrastructure, freight services, public transport and aviation); and
- water and sewerage.

The critical infrastructure rules and FIRB's guidance also outline some specific entities (eg, Australia's big supermarkets, banks, insurers and superannuation funds) as critical infrastructure assets.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

Entities managing alternative funds should:

- hold an AFSL with appropriate authorisations;
- be appointed as the authorised representative of the holder of an AFSL; or
- fall within a relevant licensing exemption under the Corporations Act.

Where the fund is a unit trust, the trustee and the manager should have the appropriate authorisations in respect of managing, and issuing, interests in a managed investment scheme. Where a foreign manager wishes to offer interests in an Australian fund, it is common to appoint a corporate trustee as the trustee of the fund, who would appoint the manager as the investment manager of the fund (see **2.3.3 Local Regulatory Requirements for Non-local Managers** regarding regulation of the manager).

From a regulatory perspective, alternative funds open to only wholesale clients operate with relative freedom.

There are very few limitations applying to alternative funds. Significantly for private equity funds, there are adverse tax implications if a trust were to control a business such that it would be designated a "trading trust". In such a case, the trust would potentially not be eligible to qualify as a managed investment trust and could potentially be treated like a company (where the trust is widely held). The concept of "control" is widely interpreted for Australian income tax purposes.

In certain circumstances, including where 20% of the interests in an Australian fund are held by a foreign entity or 40% of the interests in aggregate in an Australian fund are held by foreign entities and their associates, approval may be required by FIRB in respect of the investments of such fund.

2.3.2 Requirements for Non-local Service Providers

Please see **2.3.3 Local Regulatory Requirements for Non-local Managers**.

2.3.3 Local Regulatory Requirements for Non-local Managers

Non-local providers of financial services, including investment managers, have two main options for providing financial services to Australian wholesale clients, in addition to the option of holding a full AFSL:

- they may apply for a foreign AFSL, which is a more limited type of AFSL;
- they may apply for individual relief from ASIC to be relieved of the obligation to hold an AFSL; or
- they may rely on some form of transitional relief.

Foreign AFSL

The foreign financial services providers (FFSPs) framework is under review. A new regime was initially proposed to take full effect on 1 April 2022, but has been delayed until 1 April 2025. The Australian federal government (the "Federal Government") consulted on a new direction for the regime in 2021 and introduced a bill in February 2022. However, when the Federal Government called an election in May 2022, the bill containing proposed new exemptions lapsed. A subsequent bill was introduced to Parliament in August 2023 with a proposed commencement date of 1 April 2024.

As a result, the current licensing arrangements for FFSPs remain in a transitional period. See **The Foreign Financial Service Providers (FFSP) Regime** in **4.1 Recent Developments and Proposals for Reform** for further information.

ASIC has announced that it will pause assessment of "foreign AFS licence" applications already lodged by FFSPs, unless specifically requested to proceed by the applicant. FFSPs that have been or are granted a foreign AFS licence will be able to continue to operate under the licence issued by ASIC, noting that the Federal Government's consultation is ongoing at the time of writing.

A foreign AFS licence allows FFSPs that are from jurisdictions that are regulated in a "sufficiently equivalent jurisdiction to Australia" to apply for a foreign AFS licence so they can provide a range of financial services to Australian wholesale clients, whether from inside or outside Australia.

This is similar to the former passport relief that was previously available to FFSPs regulated by the FCA (UK), SEC (US) (and certain other US regulators), MAS (Singapore), SFC (Hong Kong), BaFin (Germany) and CSSF (Luxembourg).

To be eligible to apply for a foreign AFS licence, FFSPs must satisfy a number of conditions. Most importantly, they must be regulated under an overseas regulatory regime that has been assessed by ASIC as "sufficiently equivalent" to

Australia's regime. This includes not only those listed above but also those regulated by the Danish FSA, the Swedish FI, the French AMF or ARPR, or the Ontario Securities Commission (subject to holding relevant authorisations).

Foreign AFS licensees do not need to comply with all the obligations of normal AFS licensees, but they do have a broader range of obligations than FFSPs relying on other forms of relief.

2.3.4 Regulatory Approval Process

A regulated fund (typically an Australian unit trust) is known as a registered managed investment scheme, meaning that it is registered with ASIC. The registration process is relatively straightforward and only requires that:

- the trustee of the fund holds an AFSL authorising it to be a "responsible entity" of a registered managed investment scheme;
- the responsible entity is an Australian public company; and
- the constitution of the fund meets the requirements of the Corporations Act.

Once an application for registration is received by ASIC, a decision on registration must be made within 14 days.

As previously noted, incorporation of a limited partnership can occur within approximately two business days. Registration of VCLPs and ESVCLPs can take as little as one month, assuming all required documents have been prepared. Registration fees are modest.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

In Australia, pre-marketing of alternative funds, like marketing of alternative funds, may involve the provision of financial services in Australia, for which an AFSL will be required, subject to applicable exemptions.

Please refer to **2.3.3 Local Regulatory Requirements for Non-local Managers**, **2.3.6 Rules Concerning Marketing of Alternative Funds** and **2.3.7 Marketing of Alternative Funds**.

2.3.6 Rules Concerning Marketing of Alternative Funds

Marketing an alternative fund may involve the provision of financial services in Australia, for which an AFSL will be required, subject to applicable exemptions.

Non-local providers of financial services should refer to **2.3.3 Local Regulatory Requirements for Non-local Managers**.

2.3.7 Marketing of Alternative Funds

Alternative funds can be marketed in Australia, as long as the person marketing the fund is authorised under an AFSL (or an exemption – see **2.3.3 Local Regulatory Requirements for Non-local Managers**) to provide financial product advice, or to deal in the relevant fund interests to the relevant client group. Typically, these funds would be marketed to wholesale clients only.

If the person is not authorised to provide these services to retail clients, marketing activities must be limited to wholesale clients. In addition, where the fund is marketed to retail clients, it would usually need to be registered with ASIC as a "registered managed investment scheme" (see **2.3.4 Regulatory Approval Process**) and comply with regulated disclosure requirements (see **3.3.1 Regulatory Regime**) and associated rules applying to regulated products.

2.3.8 Marketing Authorisation/Notification Process

In Australia, marketing of alternative funds may involve the provision of financial services in Australia, for which an AFSL will be required, subject to applicable exemptions. In these circumstances, depending on whether an AFSL will be required or whether an exemption is available, some form of prior authorisation or notification may be required to be made to ASIC.

For example, if it is determined that an AFSL is required, an application for an AFSL will need to be made to ASIC prior to any marketing activities taking place.

Alternatively, if it is determined that an exemption is available, then depending on the exemption, prior notification to ASIC may be required.

Please refer to **2.3.3 Local Regulatory Requirements for Non-local Managers**.

2.3.9 Post-marketing Ongoing Requirements

Once an alternative fund has been marketed to investors in Australia, there may be certain ongoing requirements that need to be considered.

Certain activities in relation to the alternative fund (for example, issuing interests in the alternative fund to investors in Australia and providing reporting and information to such investors) may involve the provision of a financial service in Australia. In these circumstances, the fund operator may require an AFSL or be able to rely on an exemption.

If an AFSL is obtained, the licensed entity will be subject to ongoing statutory duties and obligations including, for example, to:

- provide their services efficiently, honestly and fairly;
- manage conflicts of interest; and
- report "reportable situations" to ASIC.

Alternatively, if a relevant exemption was being relied upon, the conditions of that exemption would need to be complied with on an ongoing basis. For example, the sufficient equivalence relief includes certain reporting requirements to ASIC.

Please refer to **2.3.3 Local Regulatory Requirements for Non-local Managers**.

2.3.10 Investor Protection Rules

Investor protection rules in relation to financial services provided to wholesale clients are primarily focused on compliance with the conditions applicable in relation to the AFSL under which the relevant financial service is being provided. This includes compliance with relevant provisions of the Corporations Act, including restrictions on misleading and deceptive conduct.

Investor protection rules in relation to financial services provided to retail clients include compliance with the matters noted immediately above, and additional rules designed to protect retail clients, including membership of an alternative dispute resolution system, and more detailed and prescriptive product disclosure rules.

Since October 2021, persons issuing and distributing financial products to retail clients have been subject to provisions of the Corporations Act known as the financial product "design and distribution obligations" (DDO). This has been a significant focus of the industry in recent times.

Under the new obligations, to ensure that their products are designed and distributed appropriately, issuers are required to make a target market determination (TMD) for each product that identifies, among other things, the intended class of consumers. They are then required to take "reasonable steps" that will (or are reasonably likely to) result in the financial product being distributed in a manner that is consistent with the TMD. Issuers are obliged to conduct reviews of the TMD periodically and keep certain records; and where there are significant dealings in the financial product that are inconsistent with the TMD, issuers are required to notify ASIC.

Distributors are also subject to certain obligations under the DDO – specifically to:

- not engage in retail product distribution unless they reasonably believe a TMD has been made or is not required to be made;
- take "reasonable steps" that will (or are reasonably likely to) result in distribution being consistent with the TMD;
- notify the issuer of significant dealings that are inconsistent with the TMD; and
- keep certain records.

2.3.11 Approach of the Regulator

As the non-prudential regulator of the Australian financial services (AFS) industry, ASIC plays an active role. It conducts surveillance and enforcement of the industry and facilitates regulatory development and implementation.

ASIC's position on a range of regulatory matters is publicised via the ASIC website and through other communication channels. Documents issued by ASIC include regulatory guides, information sheets and media releases.

Meetings between industry participants and ASIC take place from time to time, in a variety of contexts.

2.4 Operational Requirements

The key restriction applicable in relation to the operation of an alternative investment fund is licensing. Each entity involved in the operation of the fund must hold or be authorised under a relevant AFSL, or must be subject to or validly rely on an applicable exemption.

As previously noted, there are very few limitations applying to alternative funds. Significantly for private equity funds, there are adverse tax implications if a trust were to control a business such that it would be designated a "trading trust". In such a case, the trust would potentially not be eligible to qualify as a managed investment trust and could be treated like a company (where the trust is widely held). The concept of "control" is currently widely interpreted for Australian income tax purposes.

Provided the trustee of the fund is appropriately authorised under its AFSL, there is no legal requirement for a depository or a custodian to be appointed to hold its fund assets.

Specific operational requirements for AFSL holders include:

- providing financial services efficiently, honestly and fairly;
- having in place adequate arrangements for the management of conflicts of interest;
- complying with the conditions on the entity's AFSL;
- complying with the financial services laws of Australia;

- taking reasonable steps to ensure that their representatives comply with the financial services laws of Australia;
- having available adequate resources (including financial, technological and human resources) to provide the financial services covered by an entity's AFSL;
- maintaining competence to provide the financial services; and
- ensuring that their representatives are adequately trained.

ASIC has issued guidance in relation to compliance with these obligations, and there are various practical ways in which AFSL holders may satisfy the obligations.

2.5 Fund Finance

The fund finance market in Australia is highly developed.

Restrictions on borrowings may arise due to the agreements that the fund equity holders have in place between themselves, or as a function of the constituent documents of the fund. In addition, financier-imposed borrowing restrictions and covenants will be relevant.

It is common for financiers to take security for finance provided, including mortgages, in relation to property and infrastructure funds.

Alternative fund managers often utilise capital call facilities, which are secured by the unpaid capital commitments of the investors to the investment vehicle, rather than the assets of the vehicle.

Certain large, institutional-grade investors do not support the use of capital call facilities.

There are limited examples of funds raising debt via bond markets, which typically takes place offshore.

2.6 Tax Regime

Taxation of a Trust

Typically, the income and gains of a trust are subject to flow-through tax treatment (ie, taxable income of a trust is taxed at the hands of the investors) and, therefore, investors are taxed directly on their pro rata share of the income of the trust and gains arising from the disposal of any investment of the trust.

In order to qualify as a "managed investment trust", broadly, the trust:

- must be managed by an AFSL holder;
- must be widely held;
- must not be closely held; and
- cannot control a trading business.

Where the trust qualifies and elects to be a "managed investment trust":

- fund payment distributions made by the managed investment trust to foreign investors may be subject to the concessional managed investment withholding tax of 15%; and
- investors' share of the gains arising from disposals of investments by the funds should be taxed under the capital gains tax provisions rather than be treated as a revenue gain (where certain election has been made by the trust) – as a result, a capital gains tax (CGT) discount may be available for eligible Australian resident investors.

Further detail is provided in **3.6 Tax Regime**.

Taxation of a VCLP or an ESVCLP

A VCLP or an ESVCLP provides fund managers and investors with support to help stimulate venture capital investments by way of tax benefits.

For a VCLP, the key Australian tax implications include:

- "flow-through" treatment – taxable income derived by the VCLP "flows through" the partnership to the investors and will be taxed in the hands of the investors; and
- CGT exemption – a full CGT exemption is available for eligible venture capital partners (ie, tax-exempt foreign residents or foreign venture capital funds) on gains derived from the disposal of EVCIs made by the VCLP (subject to satisfying certain requirements).

For an ESVCLP, the key Australian tax implications include:

- "flow-through" treatment – taxable income derived by the VCLP "flows through" the partnership to the investors and will be taxed in the hands of the investors;
- tax offset – a non-refundable carried-forward tax offset is available to investors for the lesser of 10% of their eligible contributions or share of investments in the ESVCLP (subject to satisfying certain requirements);
- revenue gain or profit exemption – any revenue gain or profit arising from the disposal of an EVCI by an ESVCLP will be excluded from the taxable income of an investor of the ESVCLP, which applies only if the revenue gain that arises would have been subject to the CGT exemption if the asset disposed of was a CGT asset (note that the exemption is capped where the relevant investment exceeds AUD250 million); and
- income exemption – an investor's share of income (eg, dividend) derived from EVCIs made by an ESVCLP will be excluded from the partner's taxable income calculation if the partner is a limited partner of an Australian-resident general partner.

Generally, a resident trust should be able to qualify for the benefits of a double tax treaty between Australia and a foreign jurisdiction. However, this should be considered on a jurisdiction-by-jurisdiction basis.

CCIVs

The new CCIV structure has been designed to provide tax treatment that aligns with the existing tax treatment of Attribution Managed Investment Trusts (AMITs). Investors in a CCIV sub-fund will receive the same tax treatment as those in an AMIT, including "flow-through" tax treatment.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

Unit Trust

The most commonly used structure for retail funds in Australia is a unit trust. Each unit entitles the unit holder (ie, the investor) to a beneficial interest in the trust property as a whole, but not in any particular asset comprising the trust property.

The trustee (which in the context of retail funds is referred to as a responsible entity) is responsible for the operation and management of the unit trust. As retail funds are regulated in Australia, the Corporations Act requires that the responsible entity be an Australian public company that holds an AFSL. For this reason, offshore managers looking to establish an Australian retail fund will often use the services of a local responsible entity for hire to act as responsible entity of the fund, as opposed to establishing their own responsible entity in Australia.

The responsible entity may then appoint an investment manager to manage the assets of the fund. The investment manager can be an offshore entity or could be a locally established (usually an Australian proprietary company limited by shares) subsidiary of an offshore manager. The investment manager, regardless of whether it is locally established or offshore, would generally need to obtain an AFSL or a foreign AFSL (if available), or be able to rely on a relevant exemption. Please see **3.3.3 Local Regulatory Requirements for Non-local Managers** for further discussion regarding the local regulatory requirements for offshore managers.

Key Advantages and Disadvantages of Unit Trusts

The key advantages of unit trusts include the following.

- Tax "flow through" – unit trusts that have passive investments (and do not have active businesses) are typically managed as a flow-through vehicle for tax purposes, which means that, unlike a company, a unit trust does not itself pay tax. Rather, the unit holders of the unit trust will pay tax on their proportional share of the distributions to them.
- Asset protection – unit trusts offer additional asset protection from internal and external parties as the assets of the unit trust are held by the trustee on trust for the unit holders. The trustee is also subject to fiduciary and (as a responsible entity) statutory duties, including to act in the best interests of unit holders.

The perceived disadvantages of unit trusts include the following.

- Unit trusts are not common offshore – unit trusts tend to be creatures of common law jurisdictions and hence they are often only used or well understood in some offshore jurisdictions.
- No separate legal identity – unlike a company, a unit trust is not itself a separate legal entity and therefore any contracts relating to the fund will be entered into by the responsible entity. This can give rise to some additional complexities when applying the insolvency rules.

CCIVs

Recent amendments to the Corporations Act have facilitated the emergence of an alternative fund vehicle to the unit trust, namely the CCIV. Please refer to **2.2.2 Legal Structures Used by Fund Managers** for further information.

3.1.2 Common Process for Setting Up Investment Funds

Registration Requirement

A retail fund in Australia will generally be required to be registered with ASIC as a managed investment scheme in accordance with Chapter 5C of the Corporations Act, unless all investors are wholesale clients. Wholesale clients include:

- professional investors (for example, AFSL holders, trustees of superannuation funds with net assets of at least AUD10 million, or entities regulated by the Australian Prudential Regulation Authority);
- sophisticated investors (ie, persons regarded as having sufficient experience to assess the relevant investment);
- investors investing at least AUD500,000; and

- investors meeting the requisite wealth test of net assets of AUD2.5 million or gross income of AUD250,000 in each of the previous two years.

Investors that do not satisfy one of the wholesale client tests are considered retail clients.

CCIVs and their sub-funds are also subject to a registration requirement under the Corporations Act, although the registration requirement applies to both retail and wholesale CCIVs.

Process and Documentation Required

To register a fund with ASIC, the responsible entity must lodge the following documentation with ASIC:

- a prescribed form including details of the responsible entity, fund, the auditor and compliance plan auditor;
- the constitution (ie, the trust deed) for the fund, which complies with the prescribed requirements in the Corporations Act and relevant ASIC guidance; and
- the compliance plan for the fund, which complies with the prescribed requirements in the Corporations Act and relevant ASIC guidance.

Once an application for registration has been lodged with ASIC, ASIC has a statutory 14-day period to consider the application and register the fund or reject the application. During the 14-day registration period, ASIC will generally respond with queries and comments in relation to the constitution and compliance plan.

Despite the prescribed requirements for constitutions and compliance plans, the cost of preparing and lodging these documents with ASIC for registration is reasonable.

The registration process and documentation for a CCIV and its sub-funds is similar, and includes lodgement of the CCIV's constitution and, in the case of a CCIV offered to retail clients, the compliance plan.

3.1.3 Limited Liability

The trust deed for most unit trusts includes what is, in effect, a contractual limitation of liability of investors. The effectiveness of such limitations has broad commercial acceptance. Despite such acceptance, the question of the legal effectiveness of such limitations has not been settled across Australia's states and territories.

CCIVs take the form of a company limited by shares, which means that the liability of each investor is limited to the value of their shares.

3.1.4 Disclosure Requirements

Product Disclosure Statement

The offer of interests in an Australian retail fund to retail investors will generally require a PDS (ie, a regulated offer document), except in certain limited circumstances. The PDS will need to comply with the prescribed content requirements in the Corporations Act and relevant ASIC guidance and include disclosure regarding the benefits, risks and fees associated with the fund.

Confirmations

As the issuer of the Australian retail fund, the responsible entity (or corporate director in the case of a CCIV) will have an obligation to provide retail clients with certain confirmation statements. Broadly, these are provided in relation to transactions where a retail client acquires interests in the fund or redeems some or all of their interests in the fund.

Ongoing and Continuous Disclosure Requirements

The issuer of an Australian retail fund will also have continuous disclosure requirements with which they must comply under the Corporations Act. Broadly, these obligations require the issuer to disclose material changes, significant events and information that is not generally available and that a reasonable person would expect to have a material effect on the price or value of the interests in the fund (that is, influence persons who commonly invest in units in deciding whether to acquire or dispose of the interests).

Periodic Reporting

The issuer will have certain periodic disclosure requirements where the Australian retail fund is issued to retail clients. This generally involves providing retail clients with an annual periodic report detailing certain matters concerning their investment (for example, opening and closing balances, details of transactions during the reporting period and the return on investment).

Breach Reporting

In addition to the above disclosure and reporting requirements, the responsible entity or corporate director, as the holder of an AFSL, will also have an obligation to notify ASIC of certain breaches or likely breaches of its obligations under the Corporations Act and relevant financial services laws.

Certain changes to the breach reporting requirements commenced in October 2021. Please see **4.1 Recent Developments and Proposals for Reform** for further discussion in relation to this.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

Investor demand in the Australian retail funds market continues to grow, with approximately AUD480.1 billion total funds under management as of the end of September 2023 (Australian Bureau of Statistics, Managed Funds, Australian, September 2023).

The size and steady growth of the market is largely underpinned by the compulsory superannuation contribution system in Australia that was introduced in the early 1990s.

3.2.2 Legal Structures Used by Fund Managers

Retail fund managers established in Australia are themselves typically structured as Australian proprietary companies limited by shares. However, fund managers' internal structures often provide that the Australian management entity may contract with other internal entities for the provision of investment management services to mitigate tax and legal exposure.

3.2.3 Restrictions on Investors

There are no restrictions on the types of investors that may, or are eligible to, invest in an Australian retail fund that is a registered managed investment scheme. Therefore, retail clients and wholesale clients could invest in an Australian retail fund. Please see **3.1.2 Common Process for Setting Up Investment Funds** for further discussion on the definitions of "retail client" and "wholesale client".

3.3 Regulatory Environment

3.3.1 Regulatory Regime

The regulatory regime governing Australian retail funds includes three key areas, namely: registration, disclosure and licensing requirements.

Registration

A retail fund in Australia will generally be required to be registered with ASIC as a managed investment scheme in accordance with Chapter 5C of the Corporations Act. A CCIV is also subject to registration requirements. Please see **3.1.2 Common Process for Setting Up Investment Funds** for further discussion regarding the process and documentation involved in applying for registration with ASIC.

As a registered managed investment scheme, the fund will be governed by the provisions in Chapter 5C of the Corporations Act together with the fund constitution. Under Chapter 5C of the Corporations Act, the responsible entity and its officers will have certain statutory duties, including duties to:

- act honestly;
- exercise care and diligence; and
- act in the best interests of members.

Chapter 5C of the Corporations Act also governs the process by which a responsible entity may retire and be appointed as responsible entity of the fund.

CCIVs are subject to similar requirements under Chapter 8B of the Corporations Act.

Notably, an Australian retail fund is not subject to any investment limitations or restrictions under the Corporations Act (although the introduction of the DDO in October 2021 means that some Australian retail funds will need to restrict the scope of their investments – please see **4.1 Recent Developments and Proposals for Reform**). Rather, the scope of investments and permitted assets is governed by, and documented in, the constitution and associated disclosure documentation.

Disclosure

The offer of units in an Australian retail fund to retail investors will generally require a PDS (ie, a regulated offer document), except in certain limited circumstances. The PDS will need to comply with the prescribed content requirements in the Corporations Act and relevant ASIC guidance, and include disclosure regarding the benefits, risks and fees associated with the fund. Please see **3.1.4 Disclosure Requirements** for further discussion regarding PDSs.

Licensing

The Corporations Act requires a person, regardless of whether they are local or from offshore, who “carries on a financial services business in Australia” to hold an AFSL covering the provision of such services, unless an exemption applies. A person provides a financial service if, among other things, the person:

- provides financial product advice;
- deals in a financial product; or
- operates a registered managed investment scheme.

For these purposes, a unit in an Australian retail fund that is a registered managed investment scheme will be a financial product.

The responsible entity or corporate director of an Australian retail fund is required to hold an AFSL. The investment manager would also generally hold an AFSL or rely on an available exemption in order to provide these financial services.

3.3.2 Requirements for Non-local Service Providers

As discussed in **3.3.1 Regulatory Regime**, the Corporations Act requires a person, regardless of whether they are local or from offshore, who “carries on a financial services business in Australia” to hold an AFSL covering the provision of such services, unless an exemption applies. Depending on the scope and structure of the provision of the relevant services, a non-local service provider may need an AFSL or to be able to rely on an exemption in order to provide their services to an Australian retail fund.

Australian Licensing Options

If a non-local service provider is deemed to be carrying on a financial services business in Australia, it will need to:

- obtain an AFSL;
- apply for a foreign AFSL (if available); or
- consider whether there are any available exemptions.

Please see **2.3.3 Local Regulatory Requirements for Non-local Managers** and **4. Legal, Regulatory or Tax Changes** for further discussion.

Authorised Representative Exemption

An alternative exemption available is for a person to be appointed as an authorised representative of a holder of an AFSL. This effectively enables the non-local service provider to provide the same financial services as the AFSL holder, and the AFSL holder will be responsible for the provision of the relevant financial services by the non-local service provider.

AFSL

If a non-local service provider is not able to rely upon a suitable exemption or does not qualify for the foreign AFSL regime, the non-local service provider will likely need to apply for an AFSL.

Registration as a Foreign Company

Additionally, to the extent that a foreign company, itself or through its agents, is carrying on business in Australia, Australian law will require that company to be registered with ASIC as a foreign company in Australia.

3.3.3 Local Regulatory Requirements for Non-local Managers

Similar to as discussed in **3.3.2 Requirements for Non-local Service Providers**, any non-local manager that provides financial services in Australia would need to hold an AFSL or a foreign AFSL (if available) or seek to rely on an alternative exemption, depending on the scope of the services and the category of clients to whom those services are provided.

Where a non-local manager manages an Australian retail fund, particular consideration will need to be given as to whom the services are provided.

If the non-local manager provides financial services directly to retail clients in Australia, it would likely be required to obtain an AFSL or be appointed as an authorised representative to cover the provisions of these services to retail clients.

For more information on the key licensing options/exemptions that may be available, please see **3.3.2 Requirements for Non-local Service Providers**.

3.3.4 Regulatory Approval Process

Applying for Registration

As discussed in **3.3.1 Regulatory Regime**, the regulatory approval process for an Australian retail fund is relatively straightforward. Once the requisite documentation has been prepared (ie, the fund constitution and compliance plan), these are lodged with ASIC for its consideration. In the case of a registered managed investment scheme, ASIC then has a statutory 14-day period to consider the application and register the fund or reject the application. During the 14-day registration period, ASIC will generally respond with queries and comments in relation to the constitution and compliance plan.

Applying for an AFSL or Foreign AFSL

As discussed in **3.3.2 Requirements for Non-local Service Providers**, separate to registering the fund with ASIC, and depending on the structure and scope of services to be provided in relation to the fund, an AFSL or foreign AFSL (if available) may be required for the investment manager and will be required for the responsible entity or corporate director. The process of applying for an AFSL or foreign AFSL can be relatively lengthy and involves preparing a number of documents to be submitted to ASIC. The time to prepare an application, lodge it with ASIC and obtain the AFSL or foreign AFSL can take six to eight months or more.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

In Australia, pre-marketing of retail funds, as with marketing of retail funds, will likely involve the provision of financial services in Australia, for which an AFSL will be required, subject to applicable exemptions.

Please refer to **3.3.2 Requirements for Non-local Service Providers**, **3.3.3 Local Regulatory Requirements for Non-local Managers**, **3.3.6 Rules Concerning Marketing of Retail Funds** and **3.3.7 Marketing of Retail Funds**.

3.3.6 Rules Concerning Marketing of Retail Funds

Similar to as discussed in **3.3.2 Requirements for Non-local Service Providers** and **3.3.3 Local Regulatory Requirements for Non-local Managers**, an entity (whether local or offshore) that is involved in or engages in the marketing of an Australian retail fund to Australian clients (whether retail clients or wholesale clients) will need to consider its Australian licensing options. This is because the activity of marketing the fund will likely involve the provision of financial services (in particular, financial product advice, as well as potentially dealing or arranging for dealing in financial products).

3.3.7 Marketing of Retail Funds

The Corporations Act does not impose any restrictions on the types of investors that an Australian retail fund may be marketed to. Therefore, an Australian retail fund that is registered as a managed investment scheme may be marketed to any person in Australia, provided the entity marketing the fund holds an appropriate AFSL or a foreign AFSL (if available) or is able to rely on an available exemption that authorises it to provide the relevant financial services in relation to retail clients and wholesale clients.

The recent introduction of the DDO in October 2021 means that some Australian retail funds must ensure their marketing activities comply with the new obligations. Please see **4.1 Recent Developments and Proposals for Reform** for further discussion.

3.3.8 Marketing Authorisation/Notification Process

In Australia, marketing of retail funds may involve the provision of financial services in Australia, for which an AFSL will be required, subject to applicable exemptions. In these circumstances, depending on whether an AFSL will be required or whether an exemption is available, some form of prior authorisation or notification may be required to be made to ASIC.

For example, if it is determined that an AFSL is required, an application for an AFSL will need to be made to ASIC prior to any marketing activities taking place.

Alternatively, if it is determined that an exemption is available, depending on the exemption, prior notification to ASIC may be required.

Please refer to **3.3.3 Local Regulatory Requirements for Non-local Managers**.

3.3.9 Post-marketing Ongoing Requirements

Once a retail fund has been marketed to investors in Australia, there may be certain ongoing requirements that need to be considered.

Certain activities in relation to the retail fund (for example, issuing interests in the retail fund to investors in Australia and providing reporting and information to such investors) may involve the provision of a financial service in Australia. In these circumstances, the fund operator may require an AFSL or be able to rely on an exemption.

If an AFSL is obtained, the licensed entity will be subject to ongoing statutory duties and obligations including, for example, to:

- provide their services efficiently, honestly and fairly;
- manage conflicts of interest; and
- report “reportable situations” to ASIC.

Alternatively, if a relevant exemption was being relied upon, the conditions of that exemption would need to be complied with on an ongoing basis. For example, the sufficient equivalence relief includes certain reporting requirements to ASIC.

Please refer to **3.3.3 Local Regulatory Requirements for Non-local Managers**.

3.3.10 Investor Protection Rules

Investor protection rules in relation to financial services provided to a retail client in an Australian retail fund are primarily focused on compliance with the conditions applicable to the AFSL under which the relevant financial service is being provided. This includes compliance with the Corporations Act, which comprises prohibitions on unconscionable conduct and engaging in misleading, deceptive or dishonest conduct.

The investor protection rules also include provisions designed to protect retail clients. In addition to the prescribed product disclosure requirements discussed in **3.1.4 Disclosure Requirements**, these include obligations regarding dispute resolution systems, compensation and breaches of PDS obligations.

In addition to the above, the new DDO regime applies to product issuers and distributors. Please see **4.1 Recent Developments and Proposals for Reform**.

3.3.11 Approach of the Regulator

The provision of financial services in Australia is regulated and licensed by ASIC, which is an independent Australian government body established and administered under the Australian Securities and Investments Commissions Act 2001 (Cth) (the “ASIC Act”).

ASIC’s relationship with entities that are licensed or providing financial services in Australia is generally of an ad hoc nature, as opposed to an ongoing one, and usually arises in the context of specific circumstances or matters (for example, in response to lodgement of a breach report). While entities will generally not be assigned a designated officer for their relationship with the regulator, depending on the circumstances, it is often possible to reach out to ASIC to discuss or obtain feedback on certain matters.

3.4 Operational Requirements

There are a number of operational requirements that should be considered in the context of an Australian retail fund.

Obligations as a Responsible Entity of an Australian Retail Fund

An Australian retail fund that is structured as a registered managed investment scheme must be operated by its responsible entity in accordance with its constitution, compliance plan and the provisions of the Corporations Act. While the Corporations Act does not prescribe the types of assets that may be held by, or the types of investors that may invest in, an Australian retail fund, as discussed in **3.1.2 Common Process for Setting Up Investment Funds**, the Corporations Act does prescribe certain matters to be addressed in the content of the constitution and compliance plan. ASIC provides additional guidance in relation to these matters.

From an operational perspective, some of the key considerations will include:

- the issue and redemption pricing for units in the fund;
- the valuation of fund assets; and
- the holding of fund assets by the responsible entity itself or by a custodian.

Similar to a registered managed investment scheme, a retail CCIV must be operated by its corporate director in accordance with its constitution, compliance plan and the provisions of the Corporations Act.

Obligations as an AFSL Holder

As an AFSL holder, the responsible entity or corporate director of the Australian retail fund will be required to comply with obligations regarding:

- management of conflicts;
- availability of adequate resources;
- training of representatives;
- risk management; and
- dispute resolution.

ASIC provides guidance in relation to compliance with each of these requirements, which should be considered when developing relevant policies and procedures to address these matters.

Other Operational Considerations

Other operational obligations and requirements that will need to be considered include:

- anti-money laundering and counter-terrorism financing;
- insider dealing and market abuse;
- short selling; and
- derivatives transaction reporting.

3.5 Fund Finance

There continues to be strong growth and competition in the Australian fund financing market, providing greater accessibility to retail funds looking to borrow or leverage their portfolio. The Australian domestic banks tend to be the key players; however, offshore commercial banks and investment banks are becoming increasingly active in the fund financing market.

The facilities are usually provided on a bilateral basis, as opposed to a syndicated basis, and the lender will take some form of security (for example, over the assets of the fund or in the form of a guarantee). The fund financing documentation will also often impose certain limitations and restrictions on the use of the borrowings.

In terms of the fund documentation itself, a key consideration will be to ensure that the constitution of the fund permits the responsible entity to borrow and grant security over the assets of the fund.

3.6 Tax Regime

Overview of Tax Regime

The tax regime applying to Australian retail funds structured as a unit trust is comprehensive and complex, and should be carefully considered when establishing a fund in Australia. The Australian Taxation Office (ATO) is responsible for administering the federal tax laws in Australia.

Typically, the income and gains of a trust are subject to flow-through tax treatment, which means that the taxable income of a trust is taxed in the hands of the investors, and not the trust itself. Therefore, investors are taxed directly on their pro rata share of both the income of the trust and gains arising from the disposal of any investment of the trust, as well as on any disposal of their interests in the trust.

For Australian income tax purposes, different kinds of investors are subject to different taxation principles and taxation rates – for example:

- corporates are taxed at the corporate tax rate (generally 30% unless a complying small business):
- individuals are taxed at the relevant marginal tax rate (the highest being 45%); and
- complying superannuation funds are taxed at a rate of 15%.

Tax concessions may be available for foreign pension funds and sovereign wealth funds.

Where a capital gain has been derived by an Australian resident investor from its investment in a trust (ie, as a result of a disposal of either a capital asset by the trust or a disposal of an interest in the trust), the capital gain could be subject to a discount where the relevant asset has been held for at least 12 months and the investor is a qualifying taxpayer (ie, not a company).

Where a capital gain has been derived by a non-resident investor from its investment in a trust (ie, as a result of either a disposal of a capital asset by the trust or a disposal of an interest in the trust), the capital gain could be exempt if the relevant asset is not taxable Australian property (TAP). TAP is generally limited to interests in land and certain interests in land-rich entities. No capital gains discount is available for non-resident taxpayers.

Where a non-resident investor disposes of an asset that qualifies as TAP (eg, interest in a land-rich Australian fund), the purchaser will be required to withhold 12.5% of the purchase price and remit this amount to the ATO. The non-resident investor may be able to claim a tax credit for the amount withheld (which could be refundable if the tax liability of the non-resident investor is lower than the withheld amount).

Managed Investment Trust

Where the trust qualifies and elects to be a "managed investment trust" (MIT), certain MIT tax concessions are available, including those stipulated in **2.6 Tax Regime**.

Broadly, to qualify as an MIT, the trust must satisfy the requirements specified in **2.6 Tax Regime**.

AMIT
The attribution management investment trust (AMIT) regime provides for taxation on an attribution basis as opposed to distributing funds on a distribution basis, and is designed to provide greater flexibility for trusts and fairness for their investors. Under the AMIT regime, investors are taxed on income that is attributed to them on a "fair and reasonable basis" for each financial year, and the trust would not be liable to tax, provided all its taxable income is attributed to investors.

CCIVs
Detail of the new CCIV structure is provided in **2.6 Tax Regime**.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform
There have been numerous recent legal and regulatory developments and proposals for reform in the financial services industry in Australia, including some arising from the recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the "Royal Commission").

Some of the key areas of development and proposals for reform that are impacting on the Australian funds market are as follows.

The Design and Distribution Obligations Regime
The DDO regime commenced on 5 October 2021. This new regime applies broadly to the distribution of retail products and is not applicable to non-retail client products, such as wholesale investment funds. Please see **2.3.10 Investor Protection Rules** and **3.3.10 Investor Protection Rules** for further information.

The introduction of the DDO regime represented a fundamental shift in retail consumer protection in financial services and has allowed ASIC to move quickly to respond to potential retail consumer harm. Since July 2022, ASIC's approach to DDO has moved from facilitation to enforcement, and as of mid-June 2023, ASIC had issued approximately 71 interim stop orders after finding deficiencies in the TMDs of product issuers, including issuers of investment funds. Generally, interim stop orders prevent a product provider from issuing interests in a fund, giving a PDS for a fund or providing general advice to retail clients about an investment in a fund. The product issuers are expected to address ASIC's concerns promptly; otherwise, ASIC will consider making a final order.

ASIC published Report 762 *Design and distribution obligations: investment products* in May 2023, which sets out some of ASIC's key observations arising from its surveillance and enforcement activities. The observations primarily relate to an issuers' obligation to prepare a TMD, and include observations about:

- target markets being defined too broadly;
- inappropriate risk profiles being used in the target market;
- appropriate levels of portfolio allocation;
- inappropriate use of template TMDs; and
- inappropriate or no distribution conditions.

The Report also shares some observations in relation to an issuer's reasonable-steps obligation and in relation to the level of surveillance and due diligence that issuers should undertake in relation to their distributors.

Greenwashing – ASIC INFO Sheet 271

ASIC is seeking to support effective climate and sustainability governance and disclosure, and its regulatory focus is responding to the growth in sustainability-related investments. This growth has been stimulated by the global trend of capital markets aligning with sustainability goals, but ASIC is concerned that poor governance and disclosure will result in an increased risk of greenwashing.

Further to issuing Information Sheet 271 *How to avoid greenwashing when offering or promoting sustainability-related products* ("INFO 271") in June 2022, in 2023 ASIC began engaging in the enforcement of the principles derived therefrom. These principles are underpinned by misleading and deceptive conduct law derived from the Corporations Act and the ASIC Act. INFO 271 defines greenwashing as the practice of misrepresenting the extent to which a financial product or investment strategy is environmentally friendly, sustainable or ethical. INFO 271 provides nine principles ("Principles") that ASIC considers should be taken into account when preparing communications regarding sustainability-related products, as follows.

Is the product true to label?

Sustainability-related labels must reflect the substance of the product and the underlying investment strategy, stewardship approach and asset holdings.

Has vague terminology been used?

ASIC cautions against broad, sustainability-related statements or "jargon", including "socially responsible" and "ethical investing".

Are headline claims potentially misleading?

Sustainability-related "headline claims" should not be misleading or inconsistent with other disclosure document information.

How are sustainability-related factors incorporated into investment decisions and stewardship activities?

Issuers are to specify the sustainability-related considerations taken into account, and how they are incorporated into investment decisions and activities.

Has a clear explanation of investment screening been provided?

Disclosures must contain sufficient detail to enable investors to understand the product's sustainability-related screening criteria and how this is applied, including whether the particular investment screen applies only to a certain product or to the issuer as a whole.

Is there a clear explanation of the issuer's level of influence over the relevant benchmark?

Where issuers are able to influence the composition of an index against which portfolio composition is determined or performance is measured, they should disclose their level of influence.

Is a clear explanation of sustainability metrics provided?

Issuers relying on sustainability-related metrics in assessing whether an investment aligns with their product's stated objective/strategy should disclose the extent of metrics involvement, sources of metrics and a description of underlying data and risks/limitations.

Are there reasonable grounds for sustainability targets?

Products with sustainability targets attached should explain:

- what the target is;
- how and when it is expected to be reached;
- measurement metrics; and
- any assumptions relied on when setting targets/measuring progress.

Is information readily accessible?

Investors should have ready access to "adequate information, concise and clear enough to understand the sustainability-related considerations incorporated into the product". This information should be "consistent across all mediums".

ASIC has now provided additional guidance as to the interpretation of the Principles, through enforcement action. Key takeaways from this enforcement action include the following.

- When applying an investment screen, specificity as to the extent of the applicable exclusion is essential. See ASIC Infringement Notices – Vanguard Investments Australia Ltd issued 11 November 2023; Australian Securities & Investments Commission V LGSS Pty Limited ACN 078 003 497 as trustee for Local Government Super ABN 28 901 371 321 [2023] FCA NSD847/2023.
- Whether investment screening is a key facet of a bespoke investment strategy or is part of a broader investment policy, the same level of screening specificity is required (ASIC Infringement Notices – Vanguard Investments Australia Ltd issued 11 November 2022).
- Where third-party data providers are relied upon for investment screening purposes, issuers must be aware of the scope and accuracy of that data as is captured by the INFO 271 Principles (Australian Securities & Investments Commission v Vanguard Investments Australia Ltd ACN 072 881 086 [2023] FCA VID563/2023).
- ESG disclosure must be consistent across all platforms, including disclosure documents, websites and social media (Australian Securities & Investments Commission v Mercer Superannuation (Australia) Limited ACN 004 717 533 [2023] FCA VID117/2023).
- Disclosures made prior to INFO 271 being issued in June 2022 are subject to the Principles, as the law underpinning the Principles has not changed (ASIC Infringement Notice – Future Super Investment Services Pty Ltd issued 21 April 2023).

ASIC has also released a report outlining its recent greenwashing interventions. This report summarises a range of ASIC enforcement and action taken as a result of ASIC's review of the PDSs of 122 funds, the investment processes of 17 funds, and responses to reported misconduct.

ASIC is expected to continue its focus on greenwashing in 2024.

Report on the Updated Breach-Reporting Rules

The new breach-reporting rules for AFS licensees came into effect on 1 October 2021, arising from amendments to the Corporations Act, as inserted by the Financial Sector Reform (Hayne Royal Commission Response) Act 2020 (Cth). The reforms sought to address recommendations made by the Royal Commission that called for the strengthening and clarification of the breach-reporting regime for financial services licensees.

Under the new breach-reporting rules, ASIC is required to publish an annual report setting out its observations arising from the breach reports received.

ASIC published its second insights report in October 2023 in relation to the reports lodged with ASIC by licensees under the regime between 1 July 2022 and 30 June 2023. The report focuses on insights in relation to the following:

- the volume of reports and nature of lodgers;
- the subject of the reports and root causes of the breaches;
- the identification and investigation of breaches; and
- customer impact, remediation and rectification of breaches.

Some of the key insights shared by ASIC in Report 775 included that:

- the proportion of the licensee population engaging in reporting remains low;
- there was a significant increase in the proportion of larger licensees reporting;
- false and misleading statements remains the most common category of issues to which reports relate;
- the most common root cause of breaches continues to be staff negligence and/or error;
- a significant proportion of breaches involved customer financial loss;
- timeliness of identifying and investigating breaches remains a concern; and
- while there was a notable decrease from the previous reporting period in the time taken to complete rectification, significant variability was observed and a considerable number of remediations are still taking too long to complete.

Undoubtedly, breach reporting will remain an area of focus for ASIC, with it having recently announced compliance with the regime as one of its 2024 enforcement priorities.

The Foreign Financial Service Providers (FFSP) Regime

The FFSP Regime has been in a state of regulatory uncertainty following a prolonged period of ongoing transitional arrangements. However, there now appears to be some certainty with the introduction of the Treasury Laws Amendment (Measures for Future Bills) Bill 2023 to Parliament.

By way of background, in Australia FFSPs to wholesale clients have historically been able to benefit from class order relief, exempting them from the need to hold an AFSL, including by virtue of the “sufficient equivalence” relief (also known as “passport relief”) and “limited connection” relief, subject to transitional arrangements.

ASIC released a new regulatory framework for the foreign AFSL regime on 1 April 2020, repealing the passport relief and limited connection relief for FFSPs, and introducing a new funds management relief in their place. The transitional period for the class order relief was extended, and the new foreign AFSL regime was confirmed.

In the 2021–22 Federal Budget, the government announced that it would “consult on options to restore previously well-established regulatory relief” from holding an AFSL for FFSPs licensed and regulated in jurisdictions with comparable financial services rules and obligations to, or limited connection with, Australia. In addition, the government indicated that it would consult on options to create a “fast track” licensing process for FFSPs that wish to establish more permanent operations in Australia.

This announcement created uncertainty for the new FFSP regulatory framework that had been introduced by ASIC, and which was set to commence on 1 April 2022. The reforms were subject to criticism and further consultation was undertaken by the government towards the end of 2021 and into early 2022.

In February 2022, the Treasury Laws Amendment (Streamlining and Improving Economic Outcomes for Australians) Bill 2022 (the "2022 Bill") was introduced into the Australian Parliament. The 2022 Bill provided for two exemptions for FFSPs from the requirement to hold an AFSL, as follows.

- A new comparable regulator exemption – this exemption sought to replace the passport relief but with some changes, including that it would apply to all types of regulated financial services and products provided to wholesale clients. It would also apply to a broader range of regulators approved (by the government and not ASIC) as sufficiently equivalent.
- A new professional investor exemption – this exemption was designed to replace the limited connection relief, but would require FFSPs to notify ASIC before relying on the exemption.

However, when the government called an election in May 2022, the 2022 Bill, containing the above proposed new exemptions, lapsed.

On 7 August 2023, the Treasury announced new proposals to provide FFSPs with exemptions from the requirement to obtain an AFS licence by virtue of the Treasury Laws Amendment (Measures for Future Bills) Bill 2023 (the "2023 Bill"), for which consultation closed in September. The proposed legislation is akin to that previously tabled in Parliament, but with a few notable changes:

- the 2023 Bill proposes to give the government the power to stop FFSPs relying on the professional investor exemption in relation to dealings in financial products traded on prescribed markets – there is no indication when or whether this power will be used;
- a new exemption is proposed for making of a market for derivatives that are able to be traded on a prescribed market – again, there is no detail about when this exemption will be available;
- an additional condition applies to all the exemptions to require that financial services are provided efficiently, honestly and fairly (with certain carveouts); and
- ASIC is conferred an additional power to cancel an exemption on the grounds that the person is not providing financial services efficiently, honestly and fairly.

On 4 August 2023, ASIC released ASIC Corporations (Amendment) Instrument 2023/588 to extend the existing relief for FFSPs until 31 March 2025. Accordingly, FFSPs may continue to rely on the passport relief and limited connection exemptions for a further year. Notably, the passport relief is only available to an entity if that entity was relying on the exemption before 31 March 2020. Because of this, ASIC has indicated that it will consider new temporary licensing relief applications for FFSPs that were not relying on the passport relief as of 31 March 2020, or foreign AFSL applications for entities that cannot rely on the transitional relief.

FFSPs already validly relying on passport relief (relief for FFSPs already covered by regulations sufficiently equivalent to those in Australia) can continue to do so until 31 March 2025. New applications for this relief can only be made under an application for individual relief in the same form as the passport relief (ie, providing an avenue for new FFSPs to have access to relief in the form of the passport relief).

FFSPs that have been granted a foreign AFSL or are granted one during this period can continue operating their financial services business in Australia.

FFSPs may also still rely on the limited connection relief to allow them to provide financial services to wholesale clients in Australia, until 31 March 2025. This relief allows FFSPs operating outside Australia to provide financial services to wholesale clients in Australia.

The 2023 Bill currently has a proposed commencement date of 1 April 2024. This signals the government's intention that FFSPs would have 12 months to switch from relying on one of the existing exemptions to the new exemptions proposed in the Bill.

Please see **2.3.3 Local Regulatory Requirements for Non-local Managers** for further discussion regarding the FFSP regime.

Unfair Contracts Regime

Following a 12-month transition period, on 9 November 2023 the updated unfair contract terms (UCTs) regime commenced. Reforms to the Competition and Consumer Act 2010 (Cth) and the ASIC Act 2001 (Cth) now mean there are significant consequences for using or relying on unfair terms in a standard-form consumer or small business contract. Businesses now face substantial penalties for contravening the updated laws, and with each unfair term forming a separate contravention there could be multiple contraventions in a single contract. Penalties up to AUD50 million or more, depending on the benefit obtained from the conduct, could be imposed for each contravention.

ASIC updated its guidance material on UCTs in INFO 210 (for consumers) and INFO 211 (for small businesses) following the commencement of significant changes to the UCT regime.

In summary, a standard-form contract is a contract that has been prepared by one party to the contract (the business offering the product or service) without negotiation between the parties. It could apply even when the other party has the opportunity to only negotiate minor changes, or where changes are permitted but only from a range of pre-prepared options. A term of a standard-form contract could be "unfair" if it:

- would cause a significant imbalance in the parties' rights and obligations arising under the contract;
- is not reasonably necessary to protect the legitimate interests of the party that would benefit from the term; or
- would cause detriment (financial or otherwise) to a small business if it were to be applied or relied on.

There is an exception that applies to the funds management industry. The UCT regime does not apply to a contract that is the constitution of a managed investment scheme. However, if the contractual arrangements fall outside the constitution of the scheme, the product issuer might still be caught.

One feature of the reforms was that they expanded the class of small business that can rely on UCT protections. A business will be a small business if it either:

- employs fewer than 100 people; or
- has a turnover of less than AUD10 million for the previous income year.

If a contract relates to financial products and services, there is a monetary cap on the upfront price of AUD5 million. For other types of contracts, there is no cap. The “small business” definition has resulted in some unintended consequences, including some large sophisticated financial services entities being caught by the reforms. The authors believe that both ASIC and the industry is turning its attention towards such issues, particularly where dealings are between two institutional parties.

Compliance with the UCT regime is among ASIC’s 2023 enforcement priorities.

Trends and Developments

Contributed by:
Michael Lawson, Nicole Brown, Yoni Garson and Jessica Lucich
MinterEllison

MinterEllison operates in every capital city in mainland Australia, as well as in New Zealand, Hong Kong, China, Mongolia and the UK, through a network of integrated and affiliated offices. The firm is recognised as having one of the largest and most specialised financial services practices in Australia. With over 40 qualified practitioners and a dedicated alternative funds group, the funds team has a deep understanding of the financial services regulatory environment and is an active participant in industry working groups. The team's expertise includes: advising on fund (including retail) formation, fundraising, distribution and investor disclosure; addressing regulatory requirements and liaising with regulators; third-party/service-provider engagement; advising on investments; participating in investor negotiations; and project management. The team has advised on leading alternative methods of raising funds in the industry, with clients including Next Capital, Quadrant Private Equity, Carthona Capital, Metrics Credit Partners and Tanarra Credit Partners. The team also works with BlackRock, Vanguard, Macquarie, BetaShares, Challenger and Qualitas in relation to their investment management businesses, including extensive work in exchange-traded funds and A-REITs.

Authors

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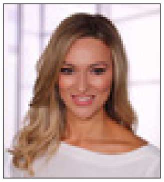

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The Australian investment funds landscape has seen a number of trends and developments over the past 12 months, from both a commercial and regulatory perspective.

Commercial Trends and Developments

Direct to retail

The Australian market continues to move away from intermediated retail with fund managers pursuing avenues that provide a more direct path to retail inventors. There is strong growth in the ETF market with traditional fund managers exploring exchange-traded structures, particularly for active or bespoke strategies. Retail investors are seeking access to a more diverse range of investment offerings at competitive price points.

Dual access

There has been increasing interest in the dual access structure for ETFs, with fund managers wanting to take advantage of the benefits and flexibility provided by the structure. This structure allows a financial product issuer to offer the product as an ETF (by quoting units in the fund on an exchange such as the ASX) while also allowing applications and redemptions off-market. Dual access mechanics and infrastructure are increasingly being considered and built into new products, even where the structure is not immediately utilised, to allow fund managers the flexibility to offer this access when demand arises.

Regulatory Trends and Developments

ASIC focus on enforcement

On 3 November 2023, in his opening statement at the Parliamentary Joint Committee on Corporations and Financial Services, Oversight of ASIC, the Takeovers Panel and the Corporations Legislation, ASIC Chair Joe Longo emphasised ASIC's strong enforcement outcomes by reference to an increase from 107 to 134 in new investigations commenced from 2022 to 2023, a 24% increase in surveillances and a 16% increase in internal summary prosecutions.

High-level observations by ASIC Deputy Chair Sarah Court in her opening speech at the ASIC Annual Forum included that ASIC is one of the most active enforcement agencies in Australia, the regulator having appeared before courts almost every business day during 2023. Ms Court stated: "ASIC's enforcement approach of today is fundamentally different to that which pre-dated the Royal Commission. In those days, ASIC negotiated outcomes, accepted undertakings from large financial institutions and – in those matters that did go to court – penalties were relatively low. Our enforcement approach of today, by contrast, is proactive, strategic and bold."

Other remarks included that ASIC operates with finite resources and therefore prioritises investigations that promise the most extensive deterrent impact. This strategic approach often leads to pursuing civil actions against major corporations, their misconduct typically inflicting the greatest harm on consumers and investors. ASIC stands firm in this approach, taking on challenging cases where outcomes may be uncertain. The agency has been proactive in ensuring that the laws enacted by Parliament have "broad protective application". ASIC is "comfortable in testing the limits of the law" where it considers there to be "consumer or investor detriment, or damage to market integrity", even where the law is complex or has not previously been litigated. Recently, this has been particularly evident in the enforcement of design and distribution legislation, which will be expanded on shortly.

The authors expect to see this bold action approach continue into 2024 as ASIC continues to focus on its immediate enforcement priorities, which include acting on:

- misleading misconduct relating to greenwashing;
- technology and operational resilience for market operators and market participants; and
- DDO compliance.

It is with this outlook that existing participants and new entrants of the Australian funds market need to always ensure they:

- have a customer-centric mindset;
- implement adequate legal compliance processes to monitor their financial services activities; and
- maintain the appropriate governance, oversight and systems over those compliance processes.

Design and distribution obligations

ASIC has demonstrated that it is actively monitoring DDO compliance and stands ready to act where necessary to prevent consumer harm. Since the obligations commenced, ASIC has instigated civil penalty proceedings against three providers. Between July and mid-December 2022, ASIC issued 21 interim stop orders. At least 50 interim stop orders were issued between January and June 2023, including 38 against 67 pet insurance products for deficient target market determinations. ASIC has announced that enforcement action targeting poor distribution of financial products will remain an enforcement priority in 2024.

In simple terms, DDO requires issuers of financial products to "retail" clients to design their products to meet consumer needs, and for distributors of those products to distribute them in a more targeted manner. ASIC intervention can be very disruptive from an operational and product-continuity perspective. A product issuer's reputation is also at risk given that ASIC's approach is to publicly announce its regulatory findings (including the issuing of stop orders), which are typically picked up quickly by the financial press.

It is thus important for product issuers to ensure they have appropriate product governance arrangements in place through each stage of the product life cycle, including during product design, product distribution, monitoring and review. ASIC expects that product governance arrangements would, among other things, include:

- an assessment of products against the likely objectives, financial situation and needs of the class of consumers for whom the product is intended;
- analysis of distribution methods;
- product testing;
- consideration of how consumer outcomes will be measured and monitored when the product is being distributed;
- a risk-product-distribution risk assessment; and
- regular monitoring and reviewing of product performance and distribution.

ASIC have shown through their actions that where they identify financial product issuers and distributors which in their view are not adopting a consumer-centric approach, they "will take quick action under DDO to disrupt poor conduct and prevent potential consumer harm".

ESG and greenwashing

Further to ASIC publishing INFO 271 in 2022, in 2023 ASIC has continued its focus on ESG and greenwashing. INFO 271 continues to provide a stringent framework of disclosure principles and standards to prevent greenwashing of financial services and products, with this framework now resulting in enforcement action by ASIC, including its having commenced a number of civil penalty proceedings in the Federal Court against issuers deemed to have engaged in potentially misleading disclosure.

INFO 271 complements ASIC's true-to-label and marketing review initiatives, requiring a high standard of clarifying disclosure for sustainability-related financial products. ASIC has been focusing on the use of claims and jargon terminology related to ESG, "green" or "sustainable" products, and has made it clear that product issuers making these claims or using ESG labels and terms need to disclose and explain these thoroughly. INFO 271 sets out nine sustainability-related disclosure principles ("Principles"). These include regarding:

- use of jargon terminology;
- misleading headline claims;
- disclosing sustainability-related measures, benchmarks and screens; and
- inadequate explanation of sustainability and stewardship claims.

Through enforcement of the Principles, ASIC has now provided additional guidance as to their scope and application. One such example is Australian Securities & Investments Commission v Mercer Superannuation (Australia) Limited ACN 004 717 533 [2023] FCA VID117/2023, which in particular provides that ESG disclosure must be consistent across all platforms. ASIC's scrutiny is not limited to disclosure documents, but also includes websites and social media.

These enforcement actions taken by ASIC send a clear message to those providing financial services in Australia that the bar has been raised, and that more detail and disclosure is required to avoid greenwashing and, in turn, ASIC enforcement action.

Foreign financial services providers

A key area of interest for foreign investment managers is the state of play of the regime for regulating foreign financial services providers (FFSPs) in Australia. ASIC has extended the transitional relief for FFSPs from the need to hold an Australian financial services (AFS) licence, and has delayed the start of the new proposed "funds management financial services relief" until 31 March 2025. In welcome news for FFSPs given what has been a prolonged period of uncertainty, the government has also released exposure draft legislation to provide FFSPs with exemptions from the requirement to obtain an AFS licence, for which consultation is now closed. The Bill is largely akin to that of 2022 which lapsed due to the calling of the last federal election. The proposed legislation seeks to introduce the following.

- A comparable regulator exemption – similar to ASIC's current "sufficient equivalence" relief, this will be available to FFSPs that provide financial services from within Australia or their home jurisdiction to wholesale clients, and that are regulated by regulators approved by the government (and not ASIC, as is currently the case).
- A professional investor exemption (which will replace ASIC's current "limited connection" relief), available where:
  (a) an FFSP provides a financial service to a "professional investor";
  (b) the service is provided from outside Australia or during a permitted "marketing visit";
  (c) the service does not involve dealing in certain financial products tradeable on certain licensed markets; and
  (d) the FFSP reasonably believes that providing the same or similar service would not contravene any laws in the location where it is provided from or where the FFSP's head office and principal place of business are located.
- A market maker exemption – available where an FFSP is making a market for derivatives that are able to be traded on a licensed market prescribed by the regulations from outside Australia (exchange-traded futures only), and the FFSP reasonably believes that making a market in derivatives would not contravene any laws in the location where it is provided from or where the FFSP's head office and principal place of business are located.
- An exemption from the fit and proper person assessment – available to FFSPs authorised to provide substantially the same financial services in a comparable regulatory regime to wholesale clients, to fast-track the licensing process.

If passed, the exemptions will take effect on 1 April 2024.

While ASIC has not amended the transitional arrangements to allow new FFSPs to rely on the "sufficient equivalence" relief (that is, relief for FFSPs from the need to hold an AFS licence where they are regulated by a foreign regulator sufficiently equivalent to the applicable regulations in Australia), ASIC has indicated that it will consider new temporary individual licensing relief applications for FFSPs seeking relief in the same form as the "sufficient equivalence" relief. This means that during the remaining transitional period FFSPs that were not relying on such relief before 1 April 2020 need to:

- rely on the "limited connection" relief;
- apply for individual relief in the same form as the "sufficient equivalence" relief; or
- apply for an AFS licence if they wish to commence providing financial services in Australia.

Cyber-risk

Most fund managers generally have mature risk management systems and processes. This is because it is a requirement of the Australian financial services licensing regime. However, with the frequency and sophistication of cyber-attacks on the rise, ASIC is calling on licensees to prioritise their cybersecurity risks; in fact, ASIC wants this to be a top priority. This call comes after a recent ASIC report into the cyber capability of corporate Australia identified that "organisations are reactive rather than proactive when it comes to managing their cybersecurity".

ASIC are encouraging the industry to start focusing on cyber "resilience" rather than cyber "security"; that is, it should have adequate arrangements in place to prepare for, detect, respond to and recover from a cyber-attack, rather than just focusing on trying to prevent a cyber-attack. ASIC has indicated that this should include oversight of cybersecurity risk throughout the fund manager's supply chain (eg, administrators, custodians, distributors or other third-party service providers). This is because ASIC recently found that "third-party relationships provide threat actors with easy access to an organisation's systems and networks".

Good practice on cyber-resilience would include practices such as:

- ensuring boards are engaged with the cyber strategy and are increasingly educated about cyber-resilience;
- tailoring governance processes to ensure "responsive governance";
- having proactive arrangements to prepare for, detect, respond to and recover from a cyber-attack;
- regularly reviewing crisis management arrangements, including incident response plans and recovery processes;
- regularly testing plans and assumptions to test for vulnerabilities;
- undertaking cyber-risk management, including through collaboration, information-sharing and third-party risk management;
- having centralised asset-management systems;
- conducting audits to identify confidential and business-critical systems and data; and
- providing internal cyber-awareness and training.

Cyber and operational resilience is a current strategic priority for ASIC. Its Chair, Joe Longo, has indicated it will be more active in this space by "looking for the right case where company directors and boards failed to take reasonable steps, or make reasonable investments proportionate to the risks that their business poses".

Unfair contract terms

With the updated unfair contract terms (UCT) regime now in place, fund managers need to consider whether any of their contracts need to be reviewed for potentially unfair terms, particularly given that penalties of up to AUD50 million or more could be imposed for each contravention within a contract. While it should be noted that the constitution of a managed investment scheme is carved out of the regime, there may be terms that fall outside the constitution and that could be caught. For example, fund managers may need to consider whether an application form or the terms and conditions of their website or investor portals contain any potentially unfair terms. In addition, potentially unfair terms could arise in service provider or other scheme-related agreements. Compliance with the UCT regime is among ASIC's 2023 enforcement priorities.

AML

In April 2023, two rounds of public consultation on proposed reforms of Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime were announced. The reforms are aimed at aligning Australia's AML/CTF regime with current international standards, including expanding the regime to capture a range of industries which do not currently have

AML/CTF obligations – ie, lawyers, accountants, conveyancers, real estate agents, trust/company service providers and, potentially, property/leasing managers.

Among other things, it is proposed that the regime be streamlined and that a less prescriptive approach be implemented via overarching obligations. This is intended to provide flexibility for reporting entities to implement risk-based systems and controls that suit their particular business. It also demonstrates the government's intention to discourage tick-a-box compliance behaviour. Instead, reporting entities will be required to invest time and resources to properly consider their risks and implement appropriate controls and procedures. The proposal includes proposed changes to:

- the structure of the AML/CTF programme;
- customer due diligence obligations;
- amendments to existing safe-harbour provisions; and
- the standards reporting entities should adhere to.

The first round of public consultation has closed.

BRAZIL

Law and Practice

Contributed by:
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Machado Meyer Advogados

Contents

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Machado Meyer Advogados

Machado Meyer Advogados has an investment funds practice that is vastly experienced in handling matters relating to all kinds of funds, such as private equity funds (FIPs), asset-backed securities investment funds (FIDCs), infrastructure private equity funds (FIP-IEs) and real estate investment funds (FIIs). The firm handles the structuring and formation of funds, the offering of fund quotas (public offerings) and the setting-up of credit assignment frameworks under FIDC structures, as well as advises on funds governance and intricate regulatory matters. Machado Meyer's funds practice is enhanced by the expertise of the firm's partners and associates in other areas, and its impressive clientele includes banks, national and international funds, investment banks, hedge funds, fund managers and private equity funds.

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Luciana Costa Engelberg focuses on the investment funds practice at Machado Meyer Advogados, and also specialises in corporate law, M&A and private equity transactions. She provides legal assistance in the structuring and implementation of investment funds, the offering of securities of investment funds (public offerings), the review and negotiation of M&A and private equity transactions, corporate law and corporate restructuring, joint ventures, asset purchases and sales, and structured transactions. Luciana has previous experience with the food and beverage, education, information technology, timber, pharmaceuticals, paper and cellulose, services, agribusiness, printing, roadways and logistics industries.

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1. Market Overview

1.1 State of the Market

The investment funds market in Brazil is very active and has become more sophisticated in the last decade, especially with the enactment of CVM Resolution 175 of 23 December 2022, which completely changed the regulatory framework applicable to investment funds in Brazil.

The rise in the interest rate in the last couple of years, following a rise in inflation and other market speculations, has caused retail investors to avoid risks with variable income investments, which has led to further investment in fixed-income assets.

According to publicly available data published by the Brazilian Financial and Capital Markets Association (ANBIMA), the consolidated net equity of investment funds amounted to BRL8.2 trillion as of 30 November 2023, representing an increase of 10% in the last 12 months, despite the investment funds industry having reached a negative net funding (difference between investments and redemptions) of BRL177.4 billion, which possibly reflects the instability of the capital market in Brazil in 2023.

According to the latest ranking from the International Organization of Securities Commissions (IOSCO), Brazil is the fourth major capital market in the world in terms of investment funds industry.

Notwithstanding the negative result in net funding in 2023 for the total funds industry, alternative funds had positive results with investments in FIDCs totalling BRL22.8 billion and investments in FIPs totalling BRL44.1 billion (until November 2023). With the government's intention to reduce the interest rates for 2024, the perspective for 2024 is positive for alternative funds.

The changes promoted by CVM Resolution 175 and recent tax reforms, which also bring beneficial changes for foreign investors, are expected to have a positive impact for the investment funds industry in 2024.

CVM Resolution 175 represents an important milestone for the evolution of the funds industry in Brazil, with a view towards reducing bureaucracy and costs, and increasing security for investors, bringing the industry closer to practices adopted in other jurisdictions – including, for example:

- limitation of the liability of investors (up to the limit of the value of their quotas);
- the creation of different classes of quotas that may track specified assets of the portfolio; and
- the application of insolvency rules provided for legal entities in general (ie, investment funds are directly responsible for their legal and contractual obligations).

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

Investment funds in Brazil are regulated by the CVM under Federal Law No 6,385 of 7 December 1976 (the "Securities Law") and the Brazilian Civil Code. The CVM is a governmental agency of the Ministry of Economy and is responsible for, inter alia, monitoring the investment funds industry and issuing regulations.

Resolution CVM 175 comprises a general part applicable to all categories of investment funds in Brazil, and contains annexes with specific rules applicable to the different categories of investment funds, such as:

- financial investment funds (FIFs – ie, fixed-income funds, equity funds, multi-market funds and foreign-exchange funds);
- asset-backed securities funds (FIDCs);
- private equity funds (FIPs); and
- real estate funds (FIIs).

Brazilian investment funds are organised as a special condominium – ie, a pool of financial assets jointly owned by the holders of interests in the fund, called "quotas", under the structure of a co-ownership. The funds can be organised as an open-ended condominium (ie, redemption of quotas allowed during the fund's term of duration) or a closed-ended condominium (ie, no redemption of quotas is permitted until the end of the fund's term of duration or in the case of its early liquidation). Alternative funds are generally set up as closed-ended condominiums.

Pursuant to CVM Resolution 175, all funds will be entitled to create different classes of quotas with different economic and political rights, and with segregation of net worth. Subclasses of quotas will also be permitted only with respect to:

- target public;
- terms and conditions for investment, amortisation and redemption; and
- administration, management, maximum distribution, entry and exit fees.

Other economic rights and political rights pertaining to subclasses of restricted classes (ie, those exclusively targeted at qualified and professional investors) may be included in the fund's by-laws. The possibility of implementing different classes and subclasses of quotas as set forth in CVM Resolution 175 will enter into force on 3 April 2024.

Private Equity Funds (FIPs)

Currently regulated by CVM Resolution 175, FIPs are organised in the form of a closed-ended condominium restricted to qualified investors. FIPs are allowed to invest in shares, debentures, warrants and convertible debt securities issued by listed and unlisted companies. FIPs shall participate in the decision-making process of invested companies and have effective influence in the definition of their strategic polices and management (the "Influence Test"). FIPs are classified into the following categories.

- Seed Capital FIPs are allowed to invest in corporations or limited liability companies with gross revenue of up to BRL20 million in the fiscal year prior to the fund's investment.
- Emerging Companies FIPs are allowed to invest in corporations with gross revenue of up to BRL400 million in the fiscal year prior to the fund's investment.
- Infrastructure (FIP-IE) and Intensive Economic Production in Research, Development and Innovation (FIP-PD&I) FIPs are allowed to invest in corporations that develop new infrastructure or intensive economic production in research projects in the energy, transportation, water and sanitation, and irrigation sectors, and in other priority areas as determined by the federal government. Brazilian regulation defines "new projects" as those implemented after 22 January 2007 and expansions of existing or implemented projects, or projects in the process of implementation, provided that the investments and results of the expansion are segregated by means of the formation of a specific purpose company. Such funds shall have at least five quotahold-

ers, each of whom may not hold more than 40% of the quotas issued by the fund nor have the right to earn income exceeding 40% of the total income of the fund.
- Multi-Strategy FIPs are the most common form used in the Brazilian market and may invest in different types and sizes of companies. A Multi-Strategy FIP targeted at professional investors may invest up to 100% of its subscribed capital in foreign assets.

FIPs may have classes of quotas with different economic and/or political rights, subject to the applicable regulation. As of April 2024, different classes of quotas will be entitled to "track" specified assets of the portfolio of the FIP.

Asset-Backed Securities Funds (FIDCs)

FIDCs may be organised as open-ended or closed-ended condominiums. Annex II of CVM Resolution 175 consolidates the rules applicable to FIDCs and FIDC-NPs (non-standard asset-backed securities funds) into a single regulation. CVM Resolution 175 allows non-qualified investors (retail) to subscribe/acquire senior quotas of the standard FIDCs. The subscription of quotas of a FIDC that allows investment in non-standard receivables is restricted to professional investors.

FIDCs may invest in receivables such as credit rights and underlying instruments originating from transactions in the financial, commercial, industrial, real estate, mortgage, leasing and service segments. A FIDC that allows investment in non-standard receivables may also invest in receivables such as litigated claims, government bonds and overdue receivables. FIDCs may have different classes of quotas (senior and subordinated). Senior quotas have priority in the amortisation and redemption of quotas, while the other classes of quotas will be subordinated to the senior quotas for amortisation and redemption. As per Resolution CVM 175, other economic and political rights may be attributed to FIDCs' classes of quotas.

Real Estate Funds (FIIs)

FIIs are organised in the form of a closed-ended condominium and invest in real estate developments. FIIs may be targeted at general investors (retail) or at qualified investors.

Quotas of FIIs may be divided into series, with the specific purpose of establishing different dates for the payment of the quotas by the holders of each series of quotas. Quotas targeted at qualified investors may be divided into different classes with certain limitations. As of April 2024, quotas of FIIs will be allowed to be divided into different classes with different economic and political rights, and with segregation of net worth.

2.1.2 Common Process for Setting Up Investment Funds

All Brazilian investment funds must be registered with the CVM, regardless of whether their quotas are subject to a public or private offer, or whether they are open-ended or closed-ended condominiums.

In order to set up alternative investment funds in Brazil, there should be a constitutive act from the administrator and the manager approving the formation of the fund and its by-laws. A minimum set of documents should be filed with the CVM for the registration of the fund, as per the applicable regulation.

CVM Resolution 175 sets forth that the registration of the fund will be granted automatically by the CVM upon filing of the required documents with the CVM through its electronic system.

Currently, the enrolment of the fund on the Federal Revenue Office taxpayer's register is made concurrently with the registration of the fund with the CVM.

The public placement of quotas requires intermediation by a company pertaining to the so-called Brazilian Securities Distribution System. For closed-ended investment funds, such placement must also be registered with the CVM.

Such registration shall be effected pursuant to the Securities Law and CVM Resolution 160 (which replaced CVM Instruction No 400/2003 and CVM Instruction No 476/2009). Public offerings in Brazil follow the definition found in other jurisdictions – ie, a public offering takes place whenever it is directed to an undetermined group of people. The ordinary registration process with the CVM may take from four to six months on average. Public offerings are also subject to several other requirements, including:

- publication of a prospectus with respect to the offering of quotas to retail and qualified investors (not applicable to offerings to professional investors);
- publication of offering announcements;
- the payment of a supervisory fee to the CVM; and
- adherence to conduct rules under CVM Resolution 160 (such as silence period rules, and full and proper disclosure).

The placement of quotas of closed-ended investment funds targeted at qualified and professional investors is subject to an automatic offering registration process with the CVM, pursuant to CVM Resolution 160. In such cases, there are no limitations with respect to the maximum number of investors to be assessed. A lock-up period may apply if the quotas of the investment fund subject to an automatic offering registration process with the CVM are subsequently traded to a different category of investors (eg, in the case of a fund/class of quotas targeted only at professional investors, no lock-up period will apply if they are traded to other professional investors; but a 180-day lock-up period will apply if they are traded to qualified investors and a 12-month lock-up period will apply if they are traded to retail investors).

2.1.3 Limited Liability

Liability is limited to the value of the quotas held by each investor, provided that such limitation is expressly provided in the fund's by-laws. Otherwise, quotaholders will be liable for any negative equity of the fund, meaning they could be called to invest more in the fund than their original committed capital.

Considering that the quotaholders' liability shall be disciplined in the annexes of each class of quotas (as part of the fund's by-laws), it is possible for the same fund to create different classes of quotas with unlimited and limited liability.

CVM Resolution 175 has a chapter dedicated to the procedures to be observed by administrators and managers upon the verification that the net equity of a class of quotas with limited liability is negative.

2.1.4 Disclosure Requirements

Pursuant to CVM regulations, investment funds must disclose a variety of information to the CVM, the market or the quotaholders.

Any disclosure of information to quotaholders must be comprehensive, equitable and simultaneous, and the following materials must be made available on electronic channels and on the website of the administrator, the distributor (while the distribution is in progress) and, if applicable, the managing entity of the organised market where the quotas are admitted for trading:

- the updated fund's by-laws;
- an updated essential information sheet (*lâmina*), if any;
- the performance history;
- the voting policy; and
- a description of the applicable taxation.

Any marketing materials and other information provided to investors in public offerings must be:

- true, complete, consistent and not misleading;
- written in simple, clear, objective and concise language; and
- useful for investment evaluation.

The information cannot guarantee or suggest the existence of a guarantee of future results or risk exemption for the investor. Factual information must be accompanied by an indication of sources and differentiated from interpretations, opinions, projections and estimates.

The administrator of the fund is responsible for disclosing the following:

- the value per quota and the net worth of the open-ended funds (daily or at a frequency compatible with the liquidity of the fund);
- a statement containing information on the fund and the quotaholder (monthly or at other intervals as provided in the fund's by-laws) to each quotaholder, including the balance and value of the quotas at the beginning and the end of the period;
- general information about the fund, including regarding the portfolio; and
- the performance statement of the fund, pursuant to the requirement of CVM regulations.

The administrator should also submit other documents to the CVM and, where applicable, to quotaholders and to the organised market where the quotas are admitted for trading, such as:

- daily and monthly newsletters;
- quarterly and biannual statements regarding the portfolio composition and diversification;
- the annual accounting statements accompanied by the independent auditor's opinion; and
- a standard form with basic information about the fund, whenever there is an amendment to the by-laws.

Where the quotas are admitted for trading, the administrator should also immediately disclose to the quotaholders, the CVM and the organised market any relevant act or fact that occurred or is related to the functioning of the fund or the assets that are part of the portfolio, which might reasonably influence the value of the quotas or the decision of the investors to acquire, sell or keep such quotas.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

The following investors have been active in alternative investments:

- institutional investors, notably development banks, other financial institutions and pension funds;
- foreign investors, including sovereign funds and private equity funds of funds;
- family offices; and
- high net worth individuals (qualified or professional investors).

2.2.2 Legal Structures Used by Fund Managers

Please see **2.1.1 Fund Structures** for the legal structures typically used by alternative fund managers in Brazil.

According to Brazilian law, investment funds shall generally have a fiduciary administrator (principal fund "gatekeeper") and an asset manager (responsible for the investment and divestment decisions, subject to the limitations set out in the fund's by-laws), both of which are duly authorised by the CVM to provide securities portfolio-management services.

The fiduciary administrator shall be a legal entity, while asset managers may be either an individual or a legal entity (for FIPs, the manager shall be a legal entity in any event). In addition, entities may be registered as "full administrators", which means they can act as both fiduciary administrator and asset manager, provided they comply with the Chinese wall requirements.

CVM Resolution No 21 of 25 February 2021 sets forth the minimum criteria applicable to fiduciary administrators and asset managers, including that they must be domiciled or have their headquarters in Brazil.

FIIs may be administered by:

- commercial banks;
- multiple banks with investment portfolios or real estate loan portfolios;
- investment banks;
- brokerage companies or securities dealerships;
- real estate credit companies;
- savings banks; or
- mortgage companies.

2.2.3 Restrictions on Investors

Investors are divided into three categories in Brazil:

- professional investors;
- qualified investors; and
- non-qualified investors.

According to current CVM regulation, FIPs and FIDCs are restricted to qualified investors, while FIIs can also be marketed to non-qualified investors (ie, retail investors). As mentioned in **2.1.1 Fund Structures**, CVM Resolution 175 allows senior quotas of FIDCs to be targeted at non-qualified investors.

CVM Resolution No 30/2021 sets forth the criteria for qualified investors (including individuals or legal entities that hold financial investments in an aggregate amount exceeding BRL1 million) and professional investors (including individuals or legal entities that hold financial investments in an aggregate amount exceeding BRL10 million and non-resident investors).

Non-professional or non-qualified investors are considered retail investors.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

For more information on the regulatory regime applying to alternative funds in Brazil, please see **2.1.1 Fund Structures**.

ANBIMA (a private and voluntary self-regulatory association) establishes rules for the market regarding enforcement and control, as well as codes of best practice for its members (which include asset managers, banks, brokers, securities dealers and investment advisers). It monitors the application of such codes and issues penalties for non-compliance.

Brazilian regulations set forth rules regarding the composition of the portfolio of alternative funds and certain limitations, as summarised below.

FIPs

A FIP must maintain at least 90% of its net assets invested in securities (the "90% Rule"), which will not apply during the term set forth in the regulations for the FIP to consummate an investment after a capital call. For purposes of the 90% Rule, the regulations set forth that amounts may be added to the net assets invested in securities, such as amounts for the payment of the FIP's expenses (limited to 5% of the committed capital), funds deriving from a divestment (subject to certain conditions), etc.

If the issuer of the securities targeted by the FIP is a privately held company, certain governance requirements must be observed by such issuer.

There is no maximum or minimum number of companies in which a FIP may invest, nor is there a maximum or minimum percentage of shares (ie, equity interest) that a FIP must hold in an invested company, provided in any case that the Influence Test is met and subject to certain concentration limits.

FIPs may invest up to:

- 33% of their subscribed capital in foreign assets (securities), unless the fund is targeted at professional investors, in which case the FIP may invest up to 100% of its subscribed capital in foreign assets; and
- 33% of their subscribed capital in non-convertible debentures or other non-convertible debt instruments, except for FIP-IEs, which may invest up to 100% in such debt instruments.

FIPs may invest in quotas of other FIPs or of equity funds. FIPs may not invest in credit rights – except those issued by invested companies of the fund.

FIDCs

FIDCs may acquire credit rights and other assets of the same debtor, or a co-obligation of the same debtor, within the limit of 20% of its net equity. This limit may not be applied if the fund is targeted at professional investors. The limit may also be increased if certain requirements are met (eg, the debtor is a publicly-held company or has financial statements audited by an independent auditor registered with the CVM). The fund may acquire credit rights originated or assigned by the administrator, manager, custodian or specialised consultant, or by parties related to them in certain situations, namely:

- when the manager, registering entity and custodian of the credit rights are not related parties between themselves, and, cumulatively, the registrar and the custodian are not parties related to the originator or assignor; and
- in the case of classes of quotas intended exclusively for professional investors.

Other rules regarding the composition of the portfolio and limitation on investment by issuer and by type of investment can also be included in the fund's by-laws.

FIIs

The properties, assets and use rights to be acquired by FIIs must be subject to prior evaluation by the administrator, the manager or an independent third party, subject to the requirements set out in the regulations. FIIs that invest predominantly in securities must respect the limits of application by issuer and by type of financial assets established in the general rules on investment funds. Such limits do not apply to investments by FIIs in quotas of FIPs, FIIs, certificates of real estate receivables and quotas of FIDCs.

FIIs can maintain a portion of their assets permanently invested in investment funds or fixed-income securities, public or private, to meet liquidity needs.

2.3.2 Requirements for Non-local Service Providers

The main service providers, such as the fiduciary administrators, asset managers, custodians and bookkeepers, have to be established in Brazil and be duly authorised by the CVM (with the exceptions applicable to FIIs) or by a recognised local authority.

Administrators and portfolio asset managers must comply with the requirements of CVM Resolution 21, as explained in **2.2.2 Legal Structures Used by Fund Managers**.

2.3.3 Local Regulatory Requirements for Non-local Managers

Please see **2.3.2 Requirements for Non-local Service Providers**.

2.3.4 Regulatory Approval Process

Please see **2.1.2 Common Process for Setting Up Investment Funds**.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

Conduct rules set forth in CVM Resolution 160 apply, specifically silence period rules, which set forth that the offer participants are expressly prohibited from publicising the public offering, including through statements regarding the fund, in the following periods:

- beginning at the moment in which the public offer was approved by means of a deliberative act, or on the 30th day prior to the filing of the request for registration of the offer with the CVM, whichever is earlier; and
- ending on the date of announcement of the closing of the public offering (quiet period).

2.3.6 Rules Concerning Marketing of Alternative Funds

The marketing and distribution of quotas of investment funds in Brazil are made by members of the Distribution System.

Under the applicable regulation, the asset manager may act as the distributor of quotas of the funds under its investment management or administration, subject to the adoption of certain procedures and policies applicable to distributors.

All marketing materials of investment funds must:

- be clear and concise;
- contain specific disclaimers and information regarding the fund's by-laws; and
- alert the investors of the investment risks.

Conduct rules set forth in CVM Resolution 160 also apply (such as silence period rules, full and proper disclosure, etc).

In the case of open-ended investment funds targeted at retail investors, the administrator must prepare an essential information sheet, including information such as:

- target investors;
- the fund's purpose;
- the investment policy;
- risks; and

- profitability.

2.3.7 Marketing of Alternative Funds

Please see **2.2.3 Restrictions on Investors** for more information on the investors to whom alternative funds can be marketed in Brazil.

2.3.8 Marketing Authorisation/Notification Process

Notification is required only after the use of marketing material as permitted under CVM Resolution 160, which shall be sent to the CVM within one business day after its use.

2.3.9 Post-marketing Ongoing Requirements

During the period between the beginning of the quiet period (as indicated in **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**) and the date of disclosure of the notice to the market, the offer participants must limit the disclosure and use of information regarding the public offer strictly to the purposes related to the preparation of the public offering, warning recipients about the reserved nature of the information transmitted.

After the beginning of the market-offering period, the offering participants may widely publicise the public offering, provided that the conditions set forth in CVM Resolution 160 are observed, including by means of disseminating:

- the prospectus and offer sheet;
- material of an explanatory and educational nature that contains useful and relevant aspects;
- marketing material;
- presentations to investors, including supporting documents for such presentations; and
- media interviews.

The permitted communications must:

- be consistent with the content of the prospectus and the issuer's periodic information required by the legislation in force;
- use calm and moderate language; and
- observe the principles of quality, transparency and equity of access to information.

The permitted communications must refrain from:

- using language that omits or does not adequately reflect the existence of risks;
- containing statements that remove the responsibility of the offeror and the institutions participating in the distribution consortium regarding the information provided;
- stating that it is not a public offer;
- stating that the information contained in the communication is confidential;
- containing language of a contractual nature that implies a perception of tacit consent to a reservation or placing an order; and
- using information that is false or inaccurate, or that misleads the investor.

2.3.10 Investor Protection Rules

Please see **2.2.3 Restrictions on Investors** for more information on the restrictions relating to certain categories of investors in certain types of alternative investment funds.

The administrator and the manager of an investment fund have fiduciary duties towards the fund and its quotaholders, and shall be liable for any damages caused to the quotaholders in the case of non-compliance with the fund's by-laws or the applicable laws and regulations.

The CVM may apply penalties to service providers for any violation of the fund's by-laws or the applicable laws and regulations – including fines, suspension of authorisation or registration for the exercise of the administration and/or management activities, or temporary disqualification to carry out such activities, up to a maximum of 20 years.

2.3.11 Approach of the Regulator

The CVM usually responds to day-to-day questions by email within a reasonable timeframe, and is also open to virtual or face-to-face meetings, which may be requested online through the CVM's website. Complex queries should be submitted to the CVM by means of a formal consultation, which may take longer for the CVM to respond to. Filings of registration processes are all done electronically through the CVM's website.

2.4 Operational Requirements

Each alternative fund is allowed to invest in certain types of assets, as provided by its specific regulation. For types of investments and the applicable regulation for each alternative fund, please see **2.1.1 Fund Structures** and **2.3.1 Regulatory Regime**.

Pursuant to Brazilian regulations, investment funds must engage a custodian duly authorised by the CVM, which will be responsible for managing the bookkeeping of the investment fund's assets. For FIIs, the custody service is not required for financial assets that represent up to 5% of the fund's net equity, provided that such assets are admitted for trading on a stock exchange or organised over-the-counter market, or are registered in a registration or financial settlement system authorised by the Central Bank of Brazil or the CVM.

The main regulations regarding risk, borrowing restrictions and the valuation and pricing of the assets held by investment funds are set up by CVM Resolution 175, as described in **3.4 Operational Requirements**.

In addition to the general rules, Normative Annex IV of CVM Resolution 175 provides that FIPs that obtain direct financial support from development agencies are authorised to contract loans directly from such development agencies, limited to an amount corresponding to 30% of the FIP's assets. In addition, the FIP's administrator and asset manager may contract a loan on behalf of the fund only in cases authorised by the CVM (in practice, a consultation should be submitted to the CVM requesting authorisation for such borrowing) or to cover the default of quotaholders who have not paid their subscribed quotas. The last case will also be applied to classes of quotas destined for qualified or professional investors of all other categories of funds as set forth in CVM Resolution 175.

As for FIDCs, the administrator may not currently borrow or grant loans on behalf of the fund, which only allows the granting of loans and the assumption of debts as a result of transactions carried out in the derivative market.

FIIs are not currently allowed to borrow or grant loans. They may borrow their equities and securities, provided that such loans are processed exclusively through services authorised by the Brazilian Central Bank or the CVM, or are to provide guarantees for their own operations.

Also, for each type of alternative fund, the CVM regulates the accounting standards for the recognition, classification and measurement of assets and liabilities, as well as those for:

- valuation;
- pricing and revenue recognition;
- the appropriation of expenses; and

- the disclosure of information in the financial statements for each investment fund.

These are expressly provided by the following:

- CVM Instruction No 579 of 30 August 2016 for FIPs;
- CVM Instruction No 489 of 14 January 2011 for FIDCs; and
- CVM Instruction No 516 of 29 December 2011 for FIIs.

According to Brazilian law, insider dealing and market abuse are illegal activities subject to administrative, civil and criminal sanctions. CVM penalties for such activities include warnings, fines and suspension, and even prohibition from trading in the capital markets.

2.5 Fund Finance

Please see **2.4 Operational Requirements**.

2.6 Tax Regime

Based on the fact that an investment fund does not present a formal corporate existence, being classified only as a flow-through entity in Brazil, it is not considered a legal entity for Brazilian tax purposes and is subject to special income tax treatment.

In this context, an investment fund can invest in different assets and sell the investments with gains. Such gains will not be subject to Brazilian taxes at the level of the investment fund, but they may be taxed upon their distribution to investors.

FIPs

Pursuant to Law No 11,312/2006, gains and earnings obtained by the investors of a FIP whose portfolio is compliant with CVM regulations are generally subject to withholding income tax (WHT) at a 15% rate. Law 11,312 also established a specific tax treatment applicable to foreign investors who invest in a FIP by means of the mechanisms provided for by Resolution 4,373 issued on 29 September 2014 by the National Monetary Council, provided that certain requirements are met. Under the specific tax treatment, gains and earnings recognised by foreign investors as a result of the amortisation, redemption or sale of the FIP quotas are subject to WHT at a 0% rate.

The legal requirements to avail of the specific tax treatment afforded to foreign investors have been significantly changed by Law 14,711/2023, which was enacted on 30 October 2023.

The legal requirements originally set forth by Law 11,312 and the ones set forth by Law 14,711/2023 for application of the specific tax regime are as follows.

Residence of investors

- Original legal requirements – Law 11,312: quotaholders domiciled or resident in a low tax jurisdiction, as defined by Brazilian legislation, do not benefit from the special regime.
- New requirements – Law 14,711: quotaholders that are domiciled or resident in a low tax jurisdiction still cannot benefit from the beneficial regime (an exception is made for sovereign funds).

FIP portfolio

- Original legal requirements – Law 11,312: at least 67% of a FIP's portfolio should be represented by shares of corporations (SA), convertible debentures or warrants, and the FIP cannot have, at any time, debt bonds equal to or higher than 5% of its net assets (not including public bonds or convertible securities).

- New requirements – Law 14,711: a FIP's portfolio should observe CVM regulations.

40% Test

- Original legal requirements – Law 11,312: the foreign investor should hold, directly or via related parties, less than 40% of the quotas of the FIP, or must be entitled to receive less than 40% of the FIP earnings. Such requirements were cumulative with the 90% Rule. If those requirements were not met, gains and earnings received by FIP foreign investors were subject to WHT at a 15% rate.
- New requirements – Law 14,711: the 40% Test was revoked. The FIP foreign investor can hold any percentage of the FIP quotas or be entitled to receive any percentage of the FIP earnings to benefit from the regime.

Investment entity

- Original legal requirements – Law 11,312: there was no requirement establishing that the FIP should qualify as an investment entity, for the FIP investors benefit from the special regime.
- New requirements – Law 14,711: the special regime only applies to FIPs that qualify as an investment entity, based on the rules defined by the National Monetary Council.

Finally, Law 14,754/2023 modified the tax regime applicable to funds in general, and introduced the come-quotas taxation for closed funds. There are, however, certain exceptions. FIPs that qualify as investment entities and comply with the portfolio composition requirements established by the CVM are not subject to such regime.

FIP-IEs

Law No 11,478/2007 provides that any income (including capital gains) received by Brazilian individuals from FIP-IEs benefits from 0% WHT, provided that the general legal requirements for 0% benefits are met (ie, the requirements applicable to FIP-IEs – see **2.1.1 Fund Structures**).

Legal entity quotaholders of a FIP-IE are subject to WHT at a rate of 15% on the income earned upon the redemption and amortisation of quotas, and in the case of liquidation of the fund or the sale of the quotas. For foreign investors, the same specific tax treatment afforded to FIPs applies to FIP-IEs. The original tax treatment applicable to foreign investors in FIP-IEs was also changed by Law 14,711.

FIDCs

Gains on distributions by a FIDC are subject to WHT. The general WHT applicable is regressive, depending on whether the fund is qualified as a long-term investment (if the FIDC portfolio has a term of more than 365 days) or a short-term investment (if the FIDC portfolio has a term of less than 365 days), as follows.

- Long-term investment:
  - (a) 22.5% rate – investments due up to 180 days;
  - (b) 20% rate – investments due from 181 days up to 360 days;
  - (c) 17.5% rate – investments due from 361 days up to 720 days; and
  - (d) 15% rate – investments due over 720 days.
- Short-term investment:
  - (a) 22.5% rate – investments due up to 180 days; and
  - (b) 20% rate – investments due over 180 days.
- Long-term investment: mandatory redemption come-quotas modality of taxation at a rate of 15% in May and November of each

year, or at the redemption of the quotas if that occurs first.
- Short-term investment: mandatory redemption come-quotas modality of taxation at a rate of 20% in May and November of each year, or at the redemption of the quotas if that occurs first.

According to Law 14,754/2023, an FIDC that qualifies as an investment entity and has a portfolio composed of at least 67% of credit rights is not subject to the come-quotas taxation.

There is a difference in taxation concerning Brazilian individuals, legal entities and non-resident investors. Legal entities should consider WHT as an anticipation to corporate income tax (IRPJ). For individuals and non-resident investors, on the other hand, WHT is definitive.

In addition to WHT for the investor, for open-ended funds there is also a tax on financial transactions (IOF, *Títulos*) if the redemption occurs before the 30th day of investment, on a regressive-rate basis.

WHT applies at the rates indicated above to investments in FIDCs held by foreign investors, although foreign investors in low-tax jurisdictions benefit from a flat 15% rate.

FIIs

Taxation of an FII's accrued gains only occurs at the level of the investors, and the respective treatment will depend on the location of the investor. There is one exception to this rule, as Law No 8,668/93 establishes that FIIs investing in any real estate enterprise that has a quotaholder holding (individually or jointly with an affiliate) of more than 25% of the quotas of the FII as developer, constructor or partner will be taxed as a legal entity. Under Law No 8,668/93, the FII will be obliged to distribute its results to the quotaholders twice a year.

The gains on distributions by the FII and the gains derived from the sale of the FII's quotas are generally subject to WHT at a rate of 20%. Gains on distributions made to and gains derived from the sale of the quotas by beneficiaries not located in low-tax jurisdictions that invest in Brazil via the mechanics of Resolution 4,373 are subject to WHT at a 15% rate.

However, if the FII is listed and the quotas are sold within the stock exchange, gains earned by foreign investors not located in low-tax jurisdictions would be subject to WHT at a rate of 0%. The application of the 0% WHT to a sale performed within an over-the-counter market is controversial. In addition, gains on distributions made to individuals are exempt when the quotaholder holds less than 10% of the fund's quotas or rights to receive income not exceeding 10% of the fund's total income, and when the FII has at least 100 quotaholders and quotas are traded exclusively on the stock exchange or organised over-the-counter market. Besides, according to Law 14,754, the tax exemption does not apply to a group of individuals that qualify as related parties if they jointly own 30% or more of the FII's quotas, or if they are entitled to receive earnings that represent more than 30% of the total gains of the FII.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

Brazilian retail funds are also organised as condominiums (pools of assets) and can be organised as closed-ended or open-ended funds, as mentioned in **2.1.1 Fund Structures**.

Retail funds are regulated mainly by CVM Resolution 175's Normative Annex I (called FIFs), and are classified as follows.

- Fixed-income fund: the main risk factor for the portfolio of such fund must be the variation of the interest rate or of the price index, or both. Such funds must have at least 80% of their portfolio in assets directly related, or synthesised via derivatives, to the risk factor that names this class of funds. In this category of funds, there is also the incentivised infrastructure fund aimed at investing in infrastructure assets with an incentivised tax treatment pursuant to Federal Law No 12,431/2011.
- Equity fund: the main risk factor for the portfolio of such fund must be the variation of the prices of shares admitted for trading in the organised market. At least 67% of the equity fund's net worth must be represented by:
  - (a) shares admitted for trading in the organised market;
  - (b) warrants or subscription receipts and depositary certificates of shares admitted for trading in the organised market;
  - (c) equity fund quotas and quotas of share-based index funds; and
  - (d) Brazilian Depositary Receipts (BDRs), classified as level II and III (BDR-Shares and BDR-ETF Shares).
- Foreign-exchange fund: the main portfolio risk factor for such fund must be the variation of foreign currency prices or the variation of the exchange rate coupon. Such funds must have at least 80% of their portfolio assets directly related, or synthesised via derivatives, to the risk factor that names this category of funds.
- Multi-market fund: such fund must have investment policies involving several risk factors, without the commitment to concentrate on any particular factor.

In addition, Normative Annex V of CVM Resolution 175 regulates exchange-traded funds (ETFs), which are retail funds formed as open-ended funds. ETFs' quotas are required to be admitted for trading in stock exchanges or organised markets. Brazilian-formed ETFs may be backed by variable-income and fixed indexes, and at least 95% of their net equity must be invested in:

- financial assets composing the index;
- liquidity positions in future contracts, which shall be traded on a commodities and futures exchange, and settled in clearing and settlement chambers and service providers that assume the position of central counterparty; and
- quotas of other index funds that aim to reflect the variations and profitability of the investor ETF's benchmark index.

3.1.2 Common Process for Setting Up Investment Funds

The process for setting up the common structures used for retail funds in Brazil is similar to the process for alternative investment funds; please see **2.1.2 Common Process for Setting Up Investment Funds**.

Retail funds are automatically registered with the CVM as of the filing of the requested set of documents.

3.1.3 Limited Liability

The rules regarding the limited liability of retail fund investors are the same as for alternative investment fund investors; please see **2.1.3 Limited Liability**.

3.1.4 Disclosure Requirements

The disclosure requirements for retail funds are the same as provided for alternative investment funds; please see **2.1.4 Disclosure Requirements**.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

Please see **1.1 State of the Market** and **2.2.1 Types of Investors in Alternative Funds**.

3.2.2 Legal Structures Used by Fund Managers

Please see **3.1.1 Fund Structures** for more information on the legal structures used by retail fund managers in Brazil.

3.2.3 Restrictions on Investors

There is no legal requirement regarding the type of investor to which retail funds can be marketed in Brazil.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

Please see **3.1.1 Fund Structures** for more information on the regulatory regime applicable to retail funds.

Limitations on the Composition of the Portfolio

A retail fund must invest its equity in financial assets that are registered in a registration system, or that are the object of custody or a central deposit, in all cases with institutions duly authorised to perform such activities by the Central Bank of Brazil or by the CVM. This is not applicable to quotas of open-ended investment funds duly registered with the CVM. A retail fund may not invest in quotas of funds that hold an interest in such retail fund.

Foreign Assets

FIFs are subject to the following concentration limits when investing in financial assets abroad.

- There are no limits for:
  - (a) funds (or classes of quota pursuant to CVM Resolution 175) classified as "Fixed Income – External Debt"; and
  - (b) funds (or classes of quota pursuant to CVM Resolution 175) exclusively targeted at professional investors.
- Up to 40% of net equity for funds exclusively targeted at qualified investors.
- Up to 20% of net equity for funds targeted at the general public.
- Investment is prohibited for fixed-income funds classified as "simple" (ie, those with 95% of the net equity invested in federal public debt securities, or fixed-income securities issued by financial institutions/operations backed by federal public debt securities or by securities issued by authorised institutions).

Under CVM Resolution 175, the limits applicable to classes of quotas targeted at qualified investors may be exceeded if certain requirement are met.

Limits per Issuer

The concentration limits per issuer for FIFs are as follows, according to the general rules:

- up to 20% of the fund's net equity when the issuer is a financial institution authorised to operate by the Central Bank of Brazil;
- up to 10% of the fund's net equity when the issuer is a publicly held company;
- up to 5% of the fund's net equity when the issuer is a natural person or a legal entity under private law that is not a publicly held company or financial institution authorised to operate by the Central Bank of Brazil; and
- no limits when the issuer is the Federal Union or an investment fund, or when the investment policy provides for the acquisition of assets of a single securities issuance.

CVM Resolution 175 also sets forth that there will be no limits per issuer when the issuer is an investment fund and the investment policy provides for the acquisition of fungible assets from a single issue of securities.

Limits by Type of Financial Asset

The concentration limits per type of financial asset for retail funds are as follows, according to the general rules.

- Up to 20% of the fund's net equity, for the following assets:
  - (a) FIFs' quotas targeted at qualified investors, of which 5% may be directed at FIFs' quotas targeted exclusively at professional investors;
  - (b) quotas of FIIs;
  - (c) quotas of FIDCs, of which 5% may be directed at FIDCs investing in non-standard credit rights;
  - (d) Certificates of Real Estate Receivables (CRIs); and
  - (e) securities issued by privately held companies.
- Up to 15% of the fund's net equity, for the following assets:
  - (a) FIP's quotas; and
  - (b) quotas of agro-industrial investment funds (FIAGROs).
- Up to 10% of the fund's net equity, for the following assets:
  - (a) collective investment bonds and contracts;
  - (b) crypto-assets, carbon credits and CBIO;
  - (c) securities issued through electronic participatory investment platforms, as long as they are subject to bookkeeping carried out by a bookkeeper authorised by the CVM; and
  - (d) other financial assets not provided for above.

There is no concentration limit per type of financial asset for investment in:

- federal public securities and repo operations backed by these securities;
- gold, provided it is negotiated in an organised market;
- the issuance or co-obligation securities of a financial institution authorised to operate by the Central Bank of Brazil;
- promissory notes, debentures and shares, provided they have been issued by publicly held companies and subject to a public offering;
- FIFs targeted at the public in general;
- ETFs, BDR-shares, BDR-corporate debt and BDR-ETF;
- derivative contracts, unless referenced to the assets listed above; and
- assets, perfectly fungible from a single issue of securities, provided that this specific application constitutes the investment policy of the class, and the assets have been issued by publicly held companies and are the subject of a public offering.

FIFs targeted at professional investors are exempted from the concentration limits. FIFs targeted at qualified investors may increase the percentage of the concentration limits.

For ETFs that seek to reflect the variations and profitability of fixed-income indexes (ie, fixed-income ETFs), financial assets that are not part of the benchmark index but are of the same nature as those with different issuances will be admitted, limited to 20% of the ETF's net equity.

3.3.2 Requirements for Non-local Service Providers

Please see **2.3.2 Requirements for Non-local Service Providers**.

3.3.3 Local Regulatory Requirements for Non-local Managers
Please see **2.3.2 Requirements for Non-local Service Providers**.

3.3.4 Regulatory Approval Process
Please see **3.1.2 Common Process for Setting Up Investment Funds**.

3.3.5 Rules Concerning Pre-marketing of Retail Funds
Please see **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**.

3.3.6 Rules Concerning Marketing of Retail Funds
Please see **2.3.6 Rules Concerning Marketing of Alternative Funds**.

3.3.7 Marketing of Retail Funds
Please see **3.2.3 Restrictions on Investors**.

3.3.8 Marketing Authorisation/Notification Process
Please see **2.3.8 Marketing Authorisation/Notification Process**.

3.3.9 Post-marketing Ongoing Requirements
Please see **2.3.9 Post-marketing Ongoing Requirements**.

3.3.10 Investor Protection Rules
Please see **3.2.3 Restrictions on Investors** and **2.3.10 Investor Protection Rules**.

3.3.11 Approach of the Regulator
Please see **2.3.11 Approach of the Regulator**.

3.4 Operational Requirements
As described in **3.1.1 Fund Structures**, each retail fund is allowed to invest in certain types of assets.

Like alternative funds, retail funds must also engage a custodian, which shall be an entity duly authorised by the CVM.

Upon becoming quotaholders, all investors must confirm, through the formalisation of an adhesion and risk-acknowledgment term, that they had access to the entire content of the by-laws and the essential information sheet, if applicable, and that they are aware of the risk factors related to the fund.

The administrator and the asset manager are not allowed to borrow or grant loans on behalf of the fund, except in cases authorised by the CVM or specific cases set forth in the regulations. Investment funds may use their assets to provide guarantees for their own operations, as well as lend and borrow financial assets, provided that such loan operations are processed exclusively through services authorised by the Brazilian Central Bank or the CVM.

The fiduciary administrator is required to have a manual regarding its valuation practices for both liquid and illiquid assets available on its website. Also, all investment funds must follow international accounting standards.

ETFs may carry out lending transactions with respect to the securities of the portfolio, in the manner regulated by the CVM and in accordance with the limits and conditions set forth in the ETF's by-laws.

Resolution CVM 175 sets forth the possibility of the manager/administrator borrowing to cover for negative equity of a class of quotas.

3.5 Fund Finance
Please see **3.4 Operational Requirements**.

3.6 Tax Regime

As investment funds do not have legal personality and generally are not subject to taxation on income and gains derived from their portfolio transactions, no tax arises at the fund level. Therefore, taxation may occur in relation to the investors specifically and not to the fund itself.

Earnings out of quota redemption/amortisation are generally subject to WHT, which is regressive, depending on whether the fund is qualified as a long-term investment (if the fund portfolio has a term of more than 365 days) or a short-term investment (if the fund portfolio has a term of less than 365 days), as follows.

- Long-term investment:
  - (a) 22.5% rate – investments due up to 180 days;
  - (b) 20% rate – from 181 days up to 360 days;
  - (c) 17.5% rate – from 361 days up to 720 days; and
  - (d) 15% rate – investments due over 720 days.
- Short-term investment:
  - (a) 22.5% rate – investments due up to 180 days; and
  - (b) 20% rate – investments due over 180 days.
- Long-term investment: mandatory redemption come-quotas modality of taxation at a rate of 15% in May and November of each year, or at the redemption of the quotas if that occurs first.
- Short-term investment: mandatory redemption come-quotas modality of taxation at a rate of 20% in May and November of each year, or at the redemption of the quotas if that occurs first.

Law No 14,754/2023 also introduced the come-quotas taxation to closed-ended funds, as of 1 January 2024. Previously, such regime was only applicable to open-ended funds.

There is a difference in taxation concerning Brazilian individuals, legal entities and non-resident investors. Legal entities should consider WHT as an anticipation of their corporate income tax (IRPJ); on the other hand, for individuals and non-resident investors, WHT is definitive.

Specific tax treatment applies to foreign investors, as described in previous sections.

In addition to income tax for the investor, for open-ended funds there is also a tax on financial transactions (IOF, *Títulos*) if the redemption occurs before the 30th day of investment, on a regressive rate basis.

ETFs

Brazilian law distinguishes variable-income ETFs from fixed-income ETFs, as follows:

- a fixed-income ETF is qualified as such for tax purposes if it invests at least 75% of its net worth in financial assets that are covered or referenced by the underlying fixed-income index; and
- a variable-income ETF is qualified as such for tax purposes if its portfolio comprises stocks also covered by the underlying index.

The distribution from a variable-income ETF is tax-exempt (exemption is not applicable for undistributed gain), and the distribution from a fixed-income ETF is taxed at the following rates:

- 25% rate – investments due up to 180 days;
- 20% rate – investments due from 181 days up to 720 days; and

• 15% rate – investments due over 720 days.

Certain ETFs are not subject to the come-quotas modality of taxation, so accumulation is possible, and taxation is deferred upon disposal as per capital gains tax rules. In this sense, ETFs that qualify as an investment entity, comply with the portfolio composition, classification and reclassification established by the CVM, and have quotas listed on a stock exchange or organised over-the-counter market (an exception is made for fixed-income ETFs) are not subject to the come-quotas taxation.

Gains on the disposal or redemption of quotas of a fixed-income ETF are calculated using the same rates as apply to distributions.

Gains on the disposal of quotas of a variable-income ETF in a Brazilian stock exchange are subject to the net gains regime at a rate of 15%, and gains arising from the redemption of quotas of a variable-income ETF are subject to a rate of 15%, as per capital gains tax rules.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

Regulatory

CVM Resolution 175 came into force on 2 October 2023 (except for some specific rules that come into effect later) and significantly changed the regulatory framework applicable to investment funds in Brazil.

Tax

On 28 August 2023, the Brazilian federal government issued Provisional Measure No 1,184/2023, through which it aimed at modifying several aspects of the Brazilian tax framework applicable to investors of funds incorporated in Brazil.

Among other provisions, the main change envisaged by the new rules was the extension to the closed-end funds of the fictional amortisation of quotas in May and November of each calendar-year (come-quotas).

Later on, the federal government presented Bill of Law No 4,173/2023, which encompassed the changes proposed by Provisional Measure No 1,184/2023. Bill of Law 4,173/2023 was converted into Law 14,754/2023 on 12 December 2023. As the changes proposed by Provisional Measure No 1,184/2023 are introduced into the Brazilian legal framework, Provisional Measure No 1,184/2023 will likely lose its effectiveness.

Some of the changes introduced by Law 14,754/2023 are described below.

- As of 1 January 2024, earnings derived by investment funds, including closed-end funds, are subject to the come-quotas taxation.
- Earnings and gains of certain funds such as FIPs, FIDCs, stock funds (FIA) and ETFs are not subject to such regime if they qualify as an investment entity (on the terms defined by the National Monetary Council) and comply with the following requirements:
  - (a) FIPs shall comply with the portfolio composition requirements established by the CVM;
  - (b) FIDCs shall have a portfolio composed of at least 67% of credit rights and shall comply with the portfolio composition requirement within 180 days from the first subscription of quotas;
  - (c) FIAs shall have a portfolio composed of at least 67% of variable-income financial

assets (eg, shares, subscription certificates, share deposit certificates, BDRs, etc), regardless of whether they are qualified as investment entities; and

(d) ETFs shall comply with the portfolio composition, classification and reclassification established by the CVM, and shall have quotas listed on a stock exchange or organised over-the-counter market (an exception is made for fixed-income ETFs).

If the funds do not comply with such requirements, they will be subject to the come-quotas taxation, and WHT will be due at a 15% rate.

Funds of funds

Funds that invest 95% of their net assets in FIPs, ETFs (variable income) and FIDCs (classified as investment entities), FIAs, FIIs, Fiagros, FIP-IE, FIP-PD&I and infrastructure investment funds are not subject to the come-quotas taxation.

Foreign quotaholders of Brazilian investment funds are not subject to the come-quotas taxation if they are not domiciled in a low-tax jurisdiction.

Foreign quotaholders investing under Resolution 4,373 will continue to be subject to the WHT upon distribution of earnings and gains and at the amortisation or redemption of quotas.

Different quota classes

In those cases where the investment fund has different quota classes, with different rights and obligations, and a segregated net equity of the fund for each class, each quota class will be considered a fund for tax purposes.

The transference of quotas among different subclasses of a class is not considered a taxation event for the purposes of the imposition of the WHT, if there is no change in quota ownership and no distribution to quotaholders.

Fund reorganisations

Law 14,754/2023 introduced the tax treatment that should be observed in mergers, spin-offs and transformations of investment funds.

BRITISH VIRGIN ISLANDS

Law and Practice

Contributed by:
Jeffrey Kirk
Appleby

Contents

Appleby is one of the world's leading international law firms. Its global teams of legal specialists advise public and private companies, financial institutions and private individuals. It is a full-service law firm providing comprehensive, expert advice and services across corporate, dispute resolution, property, regulatory, and private client and trusts practice areas. The firm has offices in ten highly regarded, well-regulated global locations, operating in nine and practising the laws of eight jurisdictions. Its office locations include the key international jurisdictions of Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey, Isle of Man, Jersey, Mauritius and the Seychelles, as well as the international financial centres of Hong Kong and Shanghai. Its global presence enables it to provide comprehensive, multi-jurisdictional legal advice at the most beneficial times to clients. The firm is regularly recognised for its professionalism, integrity and excellent client service, and these are the values that it prides itself on and that are at the core of its business.

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1. Market Overview

1.1 State of the Market

The British Virgin Islands (BVI) offers a sophisticated funds market with diverse and bespoke fund structures suitable for the needs of various managers and target investors. The available funds options include open- and closed-ended vehicles, geared for:

- sophisticated professional investors or retail investors;
- hedge funds or private equity managers;
- start-up managers;
- family offices;
- established hedge fund managers; or
- (increasingly popular) crypto-funds managers.

BVI funds will often operate as standalone funds, but may equally form part of a greater fund structure, including:

- master-feeders;
- parallel structures (US and non-US parallel vehicles); and
- mini-master fund structures (offshore feeder fund and a master entity structured as a partnership for US tax purposes).

The forms of BVI funds vehicles also provide numerous options, and may take the form of companies (including segregated portfolio companies (SPCs), limited partnerships (LPs) and trusts.

A non-BVI fund, being a fund domiciled in a jurisdiction other than the BVI, may also apply for registration as a BVI public fund or recognised foreign fund.

2023 was an active year in the BVI funds market, particularly in the crypto-funds sector. As of 30 June 2023, the BVI had 2,096 regulated funds, of which the largest subsectors were:

- open-ended professional funds (839), approved funds (304) and private funds (284); and
- closed-ended private investment funds (347).

As of that date, there were 22 registered retail public funds.

The BVI's funds offering provides a depth of experience and sophistication in diversity of legal structure, type of fund, and differing levels of supervisory oversight to accurately fit the investor risk profile. The BVI offers a wealth of professional advisers as well as ease, cost-effectiveness and speed in the funds formation process.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

BVI alternative investment funds are usually structured as a business company (including SPCs), incorporated under the BVI Business Companies Act (as amended) (BCA). LPs are also used, particularly for closed-ended funds. A unit trust structure is also available, but is used to a lesser extent in the BVI market.

BVI Fund Vehicles

BVI business company

These companies, limited by shares, are the most common structure of a BVI fund and offer a great deal of flexibility. Fund interests are constituted by shares, and are generally split between nominal numbers of non-participating voting management shares held by the manager and the larger volume in numbers of participating non-voting investor shares.

Numerous share classes may be established, as may differing series of shares within each share class. This may assist funds using series-accounting techniques in performance-fee allocations.

Creation of new or changes to the existing share classes are possible without the need to amend the constitutional documents of the BVI business company fund.

BVI corporate law has removed the historical mandatory concepts of "share capital" or "authorised share capital" (although it provides flexibility to re-introduce these concepts in the constitutional documents of the fund should the founders so wish), providing a less formalistic approach to the financial arrangements of the fund company.

It is permissible for the directors of a business company to grant security/collateral interests over the assets of the company, thereby facilitating fund-financing arrangements.

BVI segregated portfolio company (SPC)

SPCs are incorporated under the BCA, as are BVI business companies. They exist as a single company limited by shares, but provide the possibility of forming individual segregated portfolios. Assets and liabilities are attributed to individual portfolios. The assets and liabilities housed in a portfolio are legally separate and distinct from the assets and liabilities, and are attributed to other portfolios by operation of law under the BCA.

Where contractual dealings of an SPC are attributed to a particular segregated portfolio, a creditor's recourse will be limited to recovery of assets attributed and credited to that portfolio. The creditor will not be legally entitled to seek recovery against assets attributed and credited to other segregated portfolios of the SPC or (save to the extent otherwise provided in any relevant contract) against the SPC's general assets, being those assets which have not been attributed and credited to any segregated portfolio.

It is therefore crucial that allocation of assets and liabilities between assets is carefully effected and monitored, and that security/collateral arrangements are accurately recorded and allocated.

SPCs are often employed in multi-strategy umbrella funds. The segregation of assets and liabilities offers protection to an investor in a lower-risk, less aggressive investment strategy portfolio against the risks that may be adopted in a high-risk aggressive strategy portfolio of the same SPC.

An SPC may issue shares (including shares in one or more classes or series) attributable to a particular segregated portfolio. Therefore, the holders of such shares have an ownership right in the SPC and indirectly in the relevant portfolio. This right is governed by the constitutional documents of the SPC or by a specific contract containing the terms of issue of such shares.

Contracts entered into by the SPC which relate to or are binding on a specific portfolio must designate and identify that portfolio in the contract and in the execution block. Further, a segregated portfolio may enter into a contract with another portfolio of the same SPC. This would therefore enable cross-investment between sub-funds of the same SPC.

It is permissible for the directors of an SPC to grant security/collateral interests over the assets of the SPC or a specific portfolio, thereby facilitating fund-financing arrangements.

Limited partnership (LP)
The LP structure is most often utilised in the closed-ended private equity sector or by founders that are most accustomed to LP fund structures, or due to a specific flow-through tax treatment (notably the USA's).

The BVI updated its LP laws in 2017 (the Limited Partnership Act 2017 (the "LP Act")) providing a more modern flexible operating environment for funds structured as LPs. Founders are able to elect whether or not the LP fund is to have separate legal personality distinct from its partners (both general partner/s and its investor limited partners).

As with the corporate structures, this LP structure provides the founders with a degree of flexibility in that the LP agreement entered into between the general and limited partners acts as the governing document for the operations of the LP fund.

It is permissible for an LP to grant security/collateral interests over the assets of the LP, thereby facilitating fund-financing arrangements.

Unit trust
This form of fund structure is less common in the BVI funds sector. Historically, BVI unit trust funds were formed for specific clients in certain jurisdiction (for instance, funds targeted at Japanese investors).

This form of fund does not enjoy separate legal personality. The trustee of the fund holds the fund assets and the operations of the fund are generally governed under the terms of the applicable trust deed. The unit holders as investors are the beneficial owners of the fund assets, but have no direct ownership rights.

Foreign fund
A non-BVI fund, being a fund domiciled in a jurisdiction other than the BVI, may apply for registration as a BVI public fund or recognised foreign fund.

BVI Fund Types
A collective investment scheme that falls within the definition of a BVI mutual fund or closed-ended fund may fall within one of the categories of the five forms of open-ended fund or the single form of closed-ended fund. If it falls within one of those classifications, the fund must then be registered or recognised in the BVI.

In addition to the six forms of BVI fund, a foreign fund may apply to become a recognised foreign fund in the BVI.

The obligation to be registered or recognised, and the requirements applied to each type of BVI fund, are generally provided for under the following BVI statutes and regulations:

- the Securities and Investment Business Act (amended and revised) (SIBA);
- the Mutual Funds Regulations 2010 (MFR);
- the Securities and Investment Business (Incubator and Approved Funds) Regulations 2015;
- the Securities and Investment Business (Incubator and Approved Funds) (Amendment) Regulations 2019;
- the Financial Services Commission Act;
- the Financial Services (Miscellaneous Exemptions) Regulations 2010;

- the Financial Services (Miscellaneous Exemptions) (Amendment) Regulations 2019;
- the Public Funds Code;
- the Private Investment Funds Regulations (amended and revised) (the "PIF Regulations"); and
- the Segregated Portfolio Companies (Mutual Funds) Regulations 2018.

Open-Ended Funds

Private fund

This is a fund with no more than 50 investors or where an invitation to subscribe by the fund is made on a private basis only, meaning:

- to specified persons (however described) and not calculated to result in fund interests becoming available to other persons or to a large number of persons; or
- by reason of a private or business connection between the person making the invitation and the investor.

No minimum subscription is applied. There is no requirement for local auditor sign-off. It is possible to obtain exemptions (such as requirements to appoint a custodian or to audit financial statements) from the BVI Financial Services Commission (FSC) as regulator.

Professional fund

This is a fund where interests are only issued to "professional investors", and the initial investment of each investor in the fund (other than "exempted investors" – ie, the investment manager, administrator or promoter, or persons connected with them) shall not be less than USD100,000 or its equivalence in any other currency for all investors other than exempted investors.

A "professional investor" under the SIBA is a person:

- whose ordinary business involves, whether for that person's own account or the accounts of others, the acquisition or disposal of property of the same kind as the property or a substantial part of the property of the fund; or
- who has signed a declaration that they, whether individually or jointly with their spouse, has net worth in excess of USD1 million or its equivalence in any other currency and they consent to being treated as a professional investor.

There are no applicable BVI maximum thresholds for the assets under management (AUM) or relating to the investment strategies of the public fund. No restrictions apply as to the maximum number of investors permitted to subscribe. There is no requirement for local auditor sign-off. It is possible to obtain exemptions (from requirements to appoint a custodian or to audit financial statements) from the FSC.

Public fund

This is a retail fund type whose offering of fund interests may be made to:

- a large number of investors or persons other than experienced investors (licensed entities);
- those who have a private or business connection to the fund; or
- a class of persons who are not limited in such a way as to make the offering of fund interests available to persons who are "professional investors" within the meaning of the SIBA.

In addition to satisfying the requirements for recognition by the SIBA, public funds will be required to satisfy the requirements of the MFR and the Public Funds Code, including those relating to publication of a prospectus, which must be approved by and signed on behalf of the fund's directors.

There are no applicable BVI maximum thresholds as to AUM or to the investment strategies of the public fund. Being a retail fund, a higher level of regulatory oversight is applied when compared to the other BVI fund types.

Incubator fund
This is a fund designed for start-up managers. It provides the ability to set up and run a cost-efficient legal entity for trading an investment strategy with limited ongoing obligations. This product will appeal to the increasing number of pioneer managers who are looking to gain a track record before converting the incubator fund to a more sophisticated funds product.

Key features are:

- a maximum of 20 investors, each of whom must be invited to invest in the fund, and minimum initial investment thresholds of USD20,000 – also, the fund cannot exceed a cap of USD20 million AUM (these features are classed as the "20-20-20 criteria"); and
- provided it continues to meet the 20-20-20 criteria, the incubator fund can operate for a period of two years (which may, on application to the FSC, be extended by one additional year) before it needs to either convert to a more sophisticated structure (such as an approved fund, a private fund or a professional fund) or wind up its operations.

An incubator fund may be self-managed – there is no requirement to appoint a manager. Audited financial statements are not required, and no administrator is required; however, the fund itself would then be required to undertake AML checks and obtain requisite know-your-customer (KYC) on investors. A fast-track approval process is applied.

Approved fund
An approved fund is similar to a private fund. It is, however, subject to less stringent regulation, has lower ongoing costs, and targets investment managers originating out of the family office/friends and family market.

Key features are:

- a maximum of 20 investors, no minimum initial investment thresholds and a maximum cap of USD100 million AUM; and
- no maximum period of operation; however, if it exceeds its number of investors or maximum cap on aggregate investors for a period of more than two consecutive months, it needs to remedy this breach within seven days of the end of such two-month period, convert to a more sophisticated product (such as a private or professional fund) or wind up its operations.

An approved fund may be self-managed – there is no requirement to appoint a manager. Audited financial statements are not required. An administrator should be appointed, and a fast-track approval process is applied.

Foreign fund
A fund domiciled and operating in a jurisdiction other than the BVI, which is already authorised and regulated in that jurisdiction, may apply for recognition in the BVI if:

- it provides sufficient protection to investors at least equivalent to the BVI public funds regime; and

- adequate arrangements are in place for co-operation between the FSC and such foreign jurisdiction's regulatory body.

Closed-Ended Funds

Private investment fund (PIF)

This is designed to lock in investors for a set time or until the occurrence of a specific exit event, and is used predominantly for investment in non-liquid assets (such as commercial property). These closed-ended PIF funds are most commonly adopted in the private equity and venture capital sectors.

Key features are as follows.

- The PIF should distribute to investors on a private or professional basis, with the result that:
  - (a) the PIF must be limited to no more than 50 investors;
  - (b) the invitation to subscribe must be made on a private basis only, in which case there is no maximum threshold of investors; or
  - (c) the PIF must be limited to professional investors (see Professional fund above).
- The PIF must meet the criteria specified in the PIF Regulations.

It is not required that family offices, single-asset or single-investor investment funds, joint venture vehicles and special purpose acquisition companies be recognised as PIFs.

2.1.2 Common Process for Setting Up Investment Funds

General Requirements

Irrespective of whether the fund structure is a business company, SPC or LP, or regardless of the type of BVI fund adopted, the following set-up steps are required.

- The BCA requires the appointment of a BVI registered agent (RA) – essentially a registered office and corporate services provider. Only an RA is permitted to file documents with the BVI Registry of Corporate Affairs (the "Registry").
- The SIBA requires the appointment of a BVI authorised representative (AR) – essentially a point of contact for communications with the FSC.
- Submission of constitutional documents (the memorandum and articles of association (MAAs) for a company/SPC) to the Registry for incorporation – detailing the operations of the fund including subscription and redemption, valuation and dealing dates, and valuation methods for shares and assets.
- At least two directors, one of whom must be a natural person.

Fund-Specific Requirements

Following incorporation or formation (in the case of an LP without separate legal personality), application is made to the FSC for recognition or registration as follows.

Professional and private funds

Application for recognition requires submission of the applicable FSC application form. In addition, the FSC requires certified copies of:

- the certificate of incorporation or formation;
- MAAs; and
- subject to an exemption being granted by the FSC, the offering document.

The offering document should contain the form of prescribed investment warning. The fund valuation policy setting out the valuation methodology to be adopted by the fund administrator, with sufficient information, should also be submitted, together with letters from functionaries (confirmation letters from the fund's BVI legal counsel and its auditor).

The application for recognition must include information as to the fund manager, custodian, auditor and fund administrator to be appointed.

Professional fund applications are to be accompanied by the draft subscription agreement.

The initial application fee is USD850. The approval fee and subsequent annual fee is USD1,200.

Public funds

Application for registration requires submission of the applicable FSC application form. In addition, the FSC requires certified copies of:

- the certificate of incorporation or formation;
- MAAs;
- the prospectus (containing prescribed information);
- a statement noting the nature and scope of the fund's business; and
- each fund functionary agreement.

Each functionary must satisfy the FSC's "fit and proper" criteria.

The prospectus is registered with the FSC.

The initial application fee is USD1,200. The approval fee and subsequent annual fee is USD1,800. Additional fees apply in relation to registering prospectuses (USD600 and USD300 for registering a supplementary prospectus) and approvals as directors and functionaries (USD300).

Private investment fund (PIF)

Application for registration requires submission of the applicable FSC application form. In addition, the FSC requires certified copies of the certificate of incorporation or formation and the MAAs (if a company). If the applicant fund is a company, a register of directors and a resume for each director, director of the general partner or trustee (if an LP or unit trust) should be provided. In addition, the offering document or term sheet and fund valuation policy are should be submitted. If no offering document or term sheet is to be issued, an explanation as to the rationale for this should be provided in the application form.

The initial application fee is USD850. The approval fee and subsequent annual fee is USD1,200.

Incubator and approved funds

Application for registration entails submission of the applicable FSC application form, which requires information such as details of the administrator (for approved funds) and directors and/or general partners (including resumes).

The initial application fee is USD1,800. The approval fee and subsequent annual fee is USD1,200.

Grace Period for Operations

A grace period of up to 21 days applies, within which a professional fund or PIF may carry on its business or manage/administer its affairs without being recognised. No similar grace period applies to private or public funds.

Incubator and approved funds may commence business after two business days from submitting an application for recognition to the FSC.

2.1.3 Limited Liability

A BVI LP fund has separate legal personality unless the general partner elects to register the LP fund without separate legal personality. Irrespective of whether the LP fund adopts separate legal personality, it will enjoy limited liability, except in certain limited circumstances such as the limited partners taking a direct role in management and control of the LP fund.

There are no direct disclosure or reporting requirements in the BVI relating to limited liability. However, as a matter of practise, reference is made of the limited liability nature of the fund in the citation of the fund in offering documents, contracts and other relevant documents.

2.1.4 Disclosure Requirements

Disclosure or other reporting requirements that apply to BVI funds are as follows.

Incubator and Approved Funds

Unaudited financial statements are to be submitted to the FSC within six months of financial year-end (unless an extension or exemption is approved). In addition, annual reports are to be submitted confirming compliance with applicable legislation and semi-annual reports detailing key details of the fund (number of investors, net asset value (NAV), AUM, aggregate subscriptions and redemptions, and significant investor complaints). Additional reporting obligations apply on occurrence of certain events.

Professional and Private Funds

Audited financial statements are to be submitted to the FSC within six months of financial year-end (unless extension or exemption is approved).

The financial statements must comply with the International Financial Reporting Standards promulgated by the International Accounting Standards Board, UK GAAP, US GAAP and Canadian GAAP, or with equivalent internationally recognised and generally accepted accounting standards.

Written notice should be given to the FSC within seven days of any resignation or termination of a functionary of a professional or private fund. Subject to exceptions, no new functionary may be appointed by the fund without at least seven days' prior notification to the FSC.

The FSC is also required to be notified of:

- any change to the directors, AR or auditor;
- any change in the address of the fund's place of business;
- any amendment to the constitutional documents of the fund;
- the issuance of an offering document that was not previously provided to the FSC; and
- any amendment to such offer document or the fund's valuation policy.

Public Fund

Audited financial statements are to be submitted to the FSC within six months of financial year-end (unless extension or exemption is approved).

The financial statements must comply with the International Financial Reporting Standards promulgated by the International Accounting Standards Board, UK GAAP, US GAAP and Canadian GAAP, or with equivalent internationally recognised and generally accepted accounting standards.

Written notice should be given to the FSC within seven days of any resignation or termination of a functionary of a professional or private fund. Subject to exceptions, no new functionary may be appointed by the fund without at least seven days' prior notification to the FSC.

The FSC must give its prior consent to any material change to the prospectus or structure, or to any changes to the directors, functionary or auditor.

In the event that any of the prescribed information contained in the prospectus (relating to the investment decision and shareholder rights) is no longer materially accurate, the public fund must file an amended prospectus within 14 days.

Private Investment Fund (PIF)

Audited financial statements are to be submitted to the FSC within six months of financial year-end (unless extension or exemption is approved). There is no requirement for local BVI auditor sign-off.

The financial statements must comply with the International Financial Reporting Standards promulgated by the International Accounting Standards Board, UK GAAP, US GAAP and Canadian GAAP, or with equivalent internationally recognised and generally accepted accounting standards.

Written notice should be given to the FSC of any:

- changes to the directors, AR or auditor;
- change of fund address;
- change of custodial arrangements; or
- material change in the fund business.

General

All BVI funds will be BVI reporting financial institutions for the purposes of compliance with:

- the US Foreign Account Tax Compliance Act (FATCA);
- the OECD's common reporting standard for automatic exchange of financial account information (CRS); and
- the intergovernmental agreements and domestic legislation implementing FATCA and the CRS in the BVI.

This will entail annual reporting responsibilities.

Investment funds business does not fall within one of the nine categories of relevant activities for the purposes of economic substance reporting under the Economic Substance (Companies and Limited Partnerships) Act 2018 and the regulations and rules applicable thereunder. This notwithstanding, the fund RA is required to make an annual economic substance filing to the effect that the fund is not caught.

To the extent that company or LP funds grant security/collateral over their assets, these interests are to be recorded in the private register of charges maintained by the fund. These charges may also be registered publicly on the file for the company or LP fund maintained by the Registry.

A BVI company is required to file a copy of its register of directors (and any changes thereto within 30 days) with the Registry. The Business Companies (Amendment) Act and the Business Companies (Amendment) Regulations 2022 introduced a facility whereby any users of the BVI Registry online VIRRGIN filing platform will be able to access the names of the current directors of the company, for a fee.

The identities of shareholders in a company and limited partners in an LP, and the amounts of their capital commitments, are not publicly available. However, both a limited partner and a member of a company is entitled to inspect (on giving written notice):

- the records;

- the register of limited partners (in the case of an LP and subject to the LP agreement); and
- the registers of members and directors (in the case of a company).

For an LP, the LP agreement may restrict these inspection rights. For a company, subject to its MAAs, a director may refuse an inspection request if they are satisfied that it is contrary to the company's interests.

The articles of a company, or the LP agreement for an LP, may allow for further inspection or information rights for investors.

The BVI has a centralised system for recording the beneficial owners of BVI entities (being persons who ultimately own or control more than 25% of an entity). While open-ended mutual funds and any licensed BVI entities are exempt from this regime, closed-ended funds (PIF) are not. The system is not available to the public and can only be accessed following a formal request from the BVI Financial Investigation Agency, the FSC, the BVI International Tax Authority or the Attorney General's Chambers, who will in turn be bound by strict confidentiality rules. Non-compliance can result in a fine, imprisonment or both.

The valuation policy of a BVI fund must include details on how valuation information and reports shall be disseminated to investors, but there are no minimum requirements for such reports.

BVI funds will frequently incorporate wholly owned subsidiary BVI companies as single or multiple asset-holding vehicles for the fund. To the extent that such subsidiary asset-holding vehicles are employed, these non-regulated companies are now required to submit an annual financial return to their registered agent within nine months after the end of the fiscal year to which it relates.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Private Investment Fund (PIF)

This is designed to lock in investors for a set time or until the occurrence of a specific exit event, and is used predominantly for investment in non-liquid assets such as commercial property. These closed-ended PIF funds are most commonly adopted in the private equity and venture capital sectors.

Approved Fund

An approved fund targets start-up investment managers originating out of the family office/friends and family market. This is increasingly used by crypto-fund managers.

Private Fund

This is a fund with a broad cross-section of appeal to investors.

Professional Fund

This is designed for professional investors and is the most-used type of BVI fund, being utilised across all sectors.

Public Fund

This is designed for retail investors.

Incubator Fund

This is designed for start-up managers looking to gain a track record before converting the incubator fund to a more sophisticated fund product. This is increasingly used by crypto-fund managers.

See also **2.1.1 Fund Structures**.

2.2.2 Legal Structures Used by Fund Managers

BVI fund managers are predominantly structured as companies and, to a lesser extent, as LPs.

2.2.3 Restrictions on Investors

See **2.1.1 Fund Structures**.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

See **2.1.1 Fund Structures**.

2.3.2 Requirements for Non-local Service Providers

Generally, non-local service providers (including administrators, custodians, auditors and director services providers) are not subject to BVI regulation/registration requirements; however, the requirements below relating to certain BVI fund types should be noted.

Professional, Private, Incubator and Approved Funds

These must ensure that persons controlling the fund's investment function are independent from the persons controlling the valuation process, provided that if this cannot be achieved any conflicts are identified and disclosed to investors.

Public Funds

Each functionary must be functionally independent, and public funds must establish a policy for identifying and managing conflicts of interest.

Professional, Private and Public Funds

Auditors (who need not be BVI auditors) must be approved by the FSC.

2.3.3 Local Regulatory Requirements for Non-local Managers

Non-local managers are permitted to manage BVI funds, provided the manager is located in a "recognised jurisdiction" and meets the FSC's "fit and proper" criteria.

Where fund managers, advisers, administrators or appointed persons are established outside the BVI, they (and their directors and officers) will not normally need to be registered or licensed in the BVI, provided they have no physical presence in the BVI and the fund has no presence in the BVI (save for its registered office and agent).

Where a manager, adviser, administrator or appointed person either is BVI-incorporated or physically operates within the BVI, such persons will normally be required to obtain an investment business licence under the SIBA.

Licensees under the SIBA are required to (among other things) file audited financial statements and seek approval from the FSC for any change in their directors, officers or significant interest-holders, for any business carried on outside the BVI and any establishment of a subsidiary.

For BVI-incorporated investment managers or advisers, an alternative option to SIBA licensing is to register as an approved manager under the BVI Investment Business (Approved Managers) Regulations, which impose lighter requirements (including no requirement to appoint an auditor). The approved manager regime is available for BVI-incorporated investment managers or advisers to closed-ended funds whose aggregate AUM does not exceed USD1 billion, or to open-ended funds whose aggregate AUM does not exceed USD400 million (or its equivalence in another currency).

Registration under either the SIBA or the approved manager regime will require payment of an initial application fee and a recurring annual fee.

2.3.4 Regulatory Approval Process

Incubator and Approved Funds

These may commence business after two business days from submitting an application to the FSC.

Professional Funds

These may operate for 21 days prior to FSC approval, provided an application for recognition is submitted to the FSC within 14 days of commencing business. Up to three months for approval should be expected.

Public and Private Funds

These may not commence business until FSC approval is granted. Up to three months for approval should be expected for private funds, and up to six months for public funds.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

The BVI legal and regulatory regime does not apply specific requirements to firms pre-marketing funds in the BVI. However, it is likely that such activities would be regarded by the FSC as conducting licensed investment business in or from within the BVI, requiring the fund and/or distributer to be licensed within the BVI.

2.3.6 Rules Concerning Marketing of Alternative Funds

The BVI fund would need to be recognised and/or registered and entitled to market and conduct business to the class of investors to which the fund is being marketed.

2.3.7 Marketing of Alternative Funds

See **2.1.1 Fund Structures**.

2.3.8 Marketing Authorisation/Notification Process

Apart from the grace periods permitted in relation to incubator, approved, PIF and professional funds (see **2.1.2 Common Process for Setting Up Investment Funds**), pre-authorisation is required by the FSC prior to the marketing of funds in the BVI and is always subject to distribution only to permitted classes of investors.

2.3.9 Post-marketing Ongoing Requirements

Firms are required to be licensed and authorised to market funds to the relevant permitted class of investors, whether restricted or a private offering.

2.3.10 Investor Protection Rules

See **2.1.1 Fund Structures.**

2.3.11 Approach of the Regulator

The FSC encourages direct interaction with its licensees, and it is possible to arrange face-to-face meetings.

2.4 Operational Requirements

See **2.1.1 Fund Structures** and **2.3.2 Requirements for Non-local Service Providers**.

2.5 Fund Finance

Fund financing is a well-used leveraging technique for BVI funds. There is a predominance of fund finance lenders to BVI funds not operating out of the BVI but being domiciled in and operating out of well-established financing jurisdictions, including the USA and UK. The lenders to BVI funds may be private, banks or other forms of lending vehicles.

There are no direct legislative or regulatory restrictions and limitations on BVI funds entering into financing arrangements, subject to solvency, constitutional and offering-document limitations being applied. In the context of BVI economic substance requirements, credit funds should undertake a detailed analysis of their operations to ensure that they are not classified as carrying on the relevant activity of "finance and leasing business".

The BVI is an attractive jurisdiction for financing structures with lender-friendly insolvency laws (modelled on the English legal system) and comprises a simple, yet robust, regime for secured financing transactions.

Under the BCA, and subject to the constitutional documents of a BVI company or LP, the BVI entity may (by an instrument in writing) create a mortgage, charge or other encumbrance over any of its assets situated in any part of the world in accordance with the law of the relevant jurisdiction. The mortgage, charge or other encumbrance will be binding on the BVI entity to the extent, and in accordance with the requirements, of the chosen law.

Assuming that the execution and delivery of a foreign law security document ("Foreign Security Document") creates a valid charge under the chosen foreign law, such security interest will be recognised in the BVI. Upon registration of the Foreign Security Document with the Registrar, all registrations, filings and other actions necessary or desirable to protect priority of the Foreign Security Document in the BVI will have been taken, subject to any priority being afforded to pre-existing registered charges.

With the majority of BVI investment funds being structed as companies, a BVI security package will typically include an equitable mortgage or charge over shares in the BVI company. Under BVI law, there are no steps required to "perfect" a security interest; however, in order to protect a security interest granted by a chargor over shares that it holds in a BVI company, the chargor should deliver to the secured party a signed but undated share transfer form and signed directors' resolutions authorising the registered agent of the company to register the name of the secured party in the company's share register.

The BVI company's register of members is prima facie evidence of title, so it is important to ensure that steps are taken to include the entry of the secured party's name in the BVI company's register of members. If the shares are over 100% of the BVI company, or are a significant enough percentage to allow the shareholder to control the board of directors, it is prudent to also request signed but undated letters of resignation from the current directors (should the secured party wish to change the board upon enforcement of the charge).

A BVI chargor will typically also grant security over:

- bank accounts into which any distributions are placed from the underlying investments;
- contract rights under any custodian agreement (including security over the relevant custodian accounts); and
- any other asset security.

The authors would not normally expect the relevant security instruments for the above assets to be governed by BVI law, since these assets are generally not located in the BVI.

Where a BVI investment fund or obligor grants security over any of its assets, to establish the priority of a security interest created by that BVI company, the secured party should request that particulars of the security interest be publicly registered with the Registry, in accordance with the BCA. Under BVI law, public registration of a security is not necessary to perfect the security interest; however, where there are two security interests that relate to the same collateral, the timing of the public registration of the security interest will, in most cases, determine priority. Public registration in the register of registered charges also provides constructive notice to third parties.

As previously noted, an LP may be constituted with or without legal personality. Where an LP does not have legal personality, the partnership merely reflects a contractual agreement between the partners, where the general partner is vested with certain duties and powers with respect to the partnership's business and assets. Conversely, a partnership that is registered with legal personality, which is the default position unless the general partners elect not to have legal personality on registration, will be able to grant security over its assets. The legal treatment of a partnership and the corresponding role of the general partner will therefore have a number of implications for lenders offering subscription credit facilities to BVI vehicles when structuring the related security package.

Subject to the LP agreement, a partnership with legal personality may (by an instrument in writing) create a charge over the assets of the partnership, including uncalled capital commitments ("Uncalled Capital"). The contractual obligation of a limited partner to make capital contributions, to the extent that they have not already been called, and the corresponding right of the general partner on behalf of the LP to call for any Uncalled Capital ("Capital Call Rights"), are at the core of the typical subscription credit facility security package. Security over the Uncalled Capital and/or Capital Call Rights would be granted in respect of a BVI obligor's contractual obligations/rights under the subscription agreement (rather than the MAA or LP agreement). The authors note that security over contractual rights is only granted by way of an equitable assignment, since it is not possible to grant a legal assignment of contractual rights under BVI law.

2.6 Tax Regime

The BVI applies a zero corporate income or gains tax rate and a zero dividends or investment gains personal tax rate.

As a tax-neutral jurisdiction, the BVI operates a zero-rated income tax regime for all entities established in the BVI. Similarly, there is no capital gains tax payable in the BVI on any gains realised by a BVI entity or with respect to any shares, debt obligations, partnership interests or other securities of a BVI entity. Furthermore, no withholding tax is levied on interest or distributions paid by BVI entities to investors. BVI funds should consider any potential US withholding tax that may be applied under FATCA.

If a BVI fund employs anyone within the BVI, such person will be subject to payroll tax of between 10% and 14% (8% being paid by the employee, and the remainder being paid by the employer) on remuneration (including severance pay, bonuses and money paid under profit-sharing schemes) for services rendered wholly or mainly in the BVI. Contributions are also required to social security and national health insurance. It is rare for a BVI fund to have employees within the territory.

If the fund invests in real estate within the BVI, it would be required to pay BVI stamp duty at a rate of 4% for "belonger" entities and 12% for "non-belonger" entities on the appraised value of the land. Non-belonger companies, in simplified terms, are those with over one third of their members being non-BVI citizens or with any directors that are not BVI citizens. Similarly, the transfer of shares or partnership interests in a BVI entity that holds, directly or indirectly, an interest in land situated in the BVI would attract BVI stamp duty at the same rate. Property tax may also be payable on any BVI land held by a fund.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

See **2.1.1 Fund Structures**.

3.1.2 Common Process for Setting Up Investment Funds

See **2.1.2 Common Process for Setting Up Investment Funds**.

3.1.3 Limited Liability

A BVI company is treated as an entity separate from its investors, and the limited liability of shareholders will generally be respected. An investor's liability in a BVI company fund will generally be limited to:

- the amount, if any, unpaid on the shares it holds;
- any liability expressly set out in the MAA of the company; and
- any liability to repay a distribution.

A shareholder will be liable to repay a distribution if at the time of the distribution the company was insolvent, unless:

- the shareholder received the distribution in good faith, without knowledge of the company's insolvency;
- the shareholder has altered its position in reliance on the distribution; and
- it would be unfair to require repayment.

Similar to other English-law-based jurisdictions, there may be extremely unusual circumstances where the BVI courts "pierce the corporate veil" and seek to find shareholders liable for debts of a company, such as cases involving fraud or a deliberate attempt to evade legal obligations. English case law regarding this topic will have persuasive effect in the BVI.

A limited partner will be liable for the debts and liabilities of the LP only if:

- the limited partner takes part in the management of the LP; and
- at the time the liability was incurred, the person to whom the liability was incurred knew that the limited partner took part in the management of the LP and reasonably believed, based on the limited partner's conduct, that the limited partner was, in fact, a general partner.

This two-step process provides additional certainty to limited partners.

The legislation provides for a number of safe harbours for the loss of liability, including the following activities, which do not constitute "taking part in the management" of the LP, as follows.

- Holding an office (including a directorship) or interest in (including as a shareholder or partner), acting as a consultant, contractor or agent for, being an employee of, or being engaged in business with, a general partner.

- Consulting or advising a general partner about the business or activities of the LP, including as a member of an investment or advisory committee of the LP.
- Actng as a surety or guarantor for the LP.
- Serving on, appointing a person to, or removing any person from, any board or committee of the LP, or calling, requesting, attending or participating in any meeting of the partners.
- Giving advice about, or consenting or withholding consent regarding, any action proposed with respect to the LP in accordance with the LP agreement, or taking part in decisions concerning:
  (a) the winding-up of the LP;
  (b) any amendments to the LP agreement;
  (c) the acquisition or disposal of any assets or businesses by or of the LP (whether to approve or veto investments in the capacity of a member of an investment or advisory committee of the LP);
  (d) incurrence of debt;
  (e) appointment or removal of a general or limited partner; or
  (f) change in senior employees of the LP or the general partner.

The carve-out for membership of an investment or advisory committee provides greater certainty for investors who have representatives on such committees. If limited liability is lost, a limited partner will be liable to the same extent as a general partner.

A limited partner who has been repaid all or part of their contribution, or who has been released from their commitment to fund the LP, may have renewed liability for that amount or commitment if the LP was insolvent at the time of and immediately following the repayment or release, and if the limited partner was aware of this insolvency. The limited partner will only be liable to the extent that the renewed liability is necessary in order to discharge a debt or liability of the LP incurred while the contribution or commitment represented an asset of the LP. Further, the risk of renewed liability expires six months after the date of the repayment or release. Both of these requirements provide a level of certainty to the limited partner.

Aside from the above, as further provided in the LP agreement or in the event of fraud committed by or with the consent of the limited partner, the limited partner has no liability in respect of a contribution repaid or a commitment released by the LP.

3.1.4 Disclosure Requirements

See **2.1.4 Disclosure Requirements**.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

The BVI is a small island, British overseas territory with a population of approximately 35,000. Notwithstanding its small size, the BVI has one of the highest average incomes per capita, at approximately USD45,000.

Due to its demographics, the BVI-resident appetite for retail funds being distributed within the BVI is questionable. As of 30 June 2023, there were 22 retail public funds registered in the BVI.

3.2.2 Legal Structures Used by Fund Managers

See **2.2.2 Legal Structures Used by Fund Managers**.

3.2.3 Restrictions on Investors

See **2.1.1 Fund Structures**.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

See **2.1.1 Fund Structures**.

In addition to satisfying the requirements for recognition by the SIBA, public funds will be required to satisfy the requirements of the MFR and the Public Funds Code, including those relating to publication of a prospectus, which must be approved by and signed on behalf of the fund's directors.

3.3.2 Requirements for Non-local Service Providers

See **2.3.2 Requirements for Non-local Service Providers**.

3.3.3 Local Regulatory Requirements for Non-local Managers

See **2.3.3 Local Regulatory Requirements for Non-local Managers**.

3.3.4 Regulatory Approval Process

See **2.3.4 Regulatory Approval Process**.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

See **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**.

3.3.6 Rules Concerning Marketing of Retail Funds

See **2.3.6 Rules Concerning Marketing of Alternative Funds**.

3.3.7 Marketing of Retail Funds

See **2.3.7 Marketing of Alternative Funds**.

3.3.8 Marketing Authorisation/Notification Process

See **2.3.8 Marketing Authorisation/Notification Process**.

3.3.9 Post-marketing Ongoing Requirements

Firms are required to be licensed and authorised to market the funds to the relevant retail class of investors.

A public fund must issue a prospectus, which must comply with the MFR and the Public Funds Code, and which must be approved by and signed by or on behalf of the fund's board of directors. A copy thereof must be filed with the FSC. The prospectus must contain full and accurate disclosure of all information as investors would reasonably require and expect to find for the purpose of making an informed investment decision (where any such disclosure ceases to be accurate, the fund must apply to the FSC within 14 days to register an amended prospectus).

3.3.10 Investor Protection Rules

An investor in a retail public fund has a statutory right of action for rescission or damages against the fund and its directors in respect of any misrepresentation (which includes an omission to disclose required information) in the fund's prospectus; the prospectus must contain a summary statement of the investors' statutory rights under the SIBA to action for rescission or damages in the event the prospectus contains misrepresentations.

3.3.11 Approach of the Regulator

See **2.3.11 Approach of the Regulator**.

3.4 Operational Requirements

See **2.4 Operational Requirements**.

3.5 Fund Finance

See **2.5 Fund Finance**.

3.6 Tax Regime

See **2.6 Tax Regime**.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

The BVI has developed into a global hub for digital assets. A number of crypto-exchanges, currency and coin/token issuers, and other digital asset sponsors have chosen the BVI as their jurisdiction of domicile. As a result, the Virtual Asset Service Provider Act 2022 (VASP) has been promulgated to govern digital asset service providers.

Initial indications are that BVI crypto funds are not caught under VASP, but managers are encouraged to analyse the fund operations and functionaries to ensure that they are operating in accordance with VASP.

The AIMA/PwC Fifth Annual Global Crypto Hedge Fund Report (2023) notes that the BVI is the third largest jurisdiction of choice for the formation of crypto funds, with 11% of the market. The Cayman Islands and the USA are cited as first and second, with 34% and 28% market share, respectively.

The impact of economic substance requirements being imposed on managers, coupled with the fact that the BVI-approved manager falls outside the economic substance regime, has resulted in a large number of managers relocating to the BVI and setting up as approved managers. This has in turn resulted in an increase in the number of BVI funds being formed and managed by those redomiciled managers.

An area of increased focus, globally and not only in the BVI, is ESG funds. The BVI has not yet introduced regulations pertaining to investment parameters or disclosure requirements for ESG funds that have, for instance, been introduced in the European Union under the Sustainable Finance Disclosure Regulation. Whether a formal ESG regulatory framework is to be introduced, or whether the current flexible individual fund constitutional ESG framework will continue, remains to be seen.

Trends and Developments

Contributed by:
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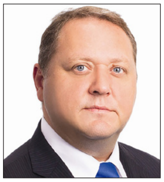
Appleby

Appleby is one of the world's leading international law firms. Its global teams of legal specialists advise public and private companies, financial institutions and private individuals. It is a full-service law firm providing comprehensive, expert advice and services across corporate, dispute resolution, property, regulatory, and private client and trusts practice areas. The firm has offices in ten highly regarded, well-regulated global locations, operating in nine and practising the laws of eight jurisdictions. Its office locations include the key international jurisdictions of Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey, Isle of Man, Jersey, Mauritius and the Seychelles, as well as the international financial centres of Hong Kong and Shanghai. Its global presence enables it to provide comprehensive, multi-jurisdictional legal advice at the most beneficial times to clients. The firm is regularly recognised for its professionalism, integrity and excellent client service, and these are the values that it prides itself on and that are at the core of its business.

Author



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Introduction

The British Virgin Islands (BVI) funds market has continued its growth and evolution amidst challenging times. The lingering financial impact of COVID-19 and the inflationary trends in the market leading to the current cost-of-living crisis, which thankfully appear to be waning, have not dampened the attractiveness of BVI funds offering.

The BVI has been known for its flexibility of operations and is one of the most popular international financial centre jurisdictions for the launch of alternative investment funds and managers. The jurisdiction has historically offered sophisticated fund products with diverse and bespoke fund structures:

- comprising open- and closed-ended vehicles;
- targeted at sophisticated professional, private offering or retail investors;
- geared for the hedge fund or private equity venture capital manager; and
- suited for the start-up manager, family office, established hedge fund manager or (increasingly popular) crypto-fund manager.

The market has adapted over recent years to meet the needs of pioneer start-up founders, particularly in digital asset classes, while continuing to grow its core funds offering of open-ended professional and private funds. It has also introduced the closed-ended private investment fund (PIF).

Digital Asset Funds

2023 was an active year in the BVI funds market, particularly in the crypto-funds sector. As of 30 June 2023 the BVI had 2,096 regulated funds, of which the largest subsectors were:

- open-ended professional funds (839), approved funds (304) and private funds (284); and
- closed-ended PIFs (347).

The focus on alternative investment funds compared to retail funds is shown by the fact that at the end of Q2 2023 there were 22 registered retail BVI public funds.

The BVI has developed into a global hub for digital assets. A number of crypto-exchanges, currency and coin/token issuers, and other digital asset sponsors have chosen the BVI as their jurisdiction of domicile. The growth of the BVI digital assets sector has continued irrespective of the collapse of FTX. However, the BVI has introduced the Virtual Asset Service Provider Act 2022 (VASP) to govern digital assets service providers.

Initial indications are that BVI crypto-funds are not caught under VASP, but managers are encouraged to analyse the fund's operations and functionaries to ensure that they are operating in accordance with VASP.

The AIMA/PwC Fifth Annual Global Crypto Hedge Fuld Report (2023) notes that the BVI is the third largest jurisdiction of choice for the formation of crypto-funds, with 11% of the market. The Cayman Islands and the USA are cited as first and second, with 34% and 28% market share, respectively. Due to the nature of the underlying assets, open-ended incubator, approved and professional funds are the vehicles of choice for BVI crypto-funds.

ESG Funds

An area of increased focus, globally as well as in the BVI, is environmental, social and governance (ESG) funds. The BVI has not yet introduced regulations pertaining to investment parameters or disclosure requirements for ESG funds that have, for instance, been introduced in the European Union under the Sustainable Finance Disclosure Regulation. Whether a formal ESG regulatory framework will be introduced, or whether the current flexible individual funds constitutional ESG framework will continue, remains to be seen.

In November 2023, the BVI government initiated its Blue Economy Roadmap with the support of the United Nations Development Programme. The Blue Economy Roadmap sets out an integrated approach to ocean-based sustainable development, which brings together economy, environment and society, consistent with the Sustainable Development Agenda (2030), Aichi Target 11 of the Convention on Biological Diversity and the Paris Agreement on Climate Change (2015).

The roadmap outlines the pathways for future investment in and development of a sustainable ocean-based economy in the BVI. Specifically, the roadmap aims to create a revitalisation process that results in healthy ecosystems able to sustain growth in a number of economic sectors, and to provide an opportunity for building equitable societies.

This Blue Economy initiative represents a unique ESG opportunity for funds to be established in the BVI and invested in a BVI environmental programme.

Investment Manager and Economic Substance

The market has also seen growth in the investment manager sector. The impact of economic substance requirements being imposed on managers, coupled with the fact that the BVI-approved manager falls outside the economic substance regime, has resulted in a large number of managers relocating to the BVI and setting up as approved managers. This in turn has resulted in an increased number of BVI funds being formed and managed by those redomiciled managers.

Fund Subsidiary Companies and Annual Financial Returns

Regarding held downstream assets, BVI funds will frequently incorporate wholly owned subsidiary BVI companies as single or multiple asset-holding vehicles for the fund. To the extent that such subsidiary asset-holding vehicles are employed in the fund structure, these non-regulated companies are now required to submit an annual financial return in prescribed form to their BVI registered agent within nine months after the end of the fiscal year to which it relates.

Fund Finance

An additional area of growth is in the BVI fund finance market. This has been driven in part by:

- expansion into a broader range of fund types;
- increasing take-up by fund sponsors who had not traditionally used the product in their fund families;
- record levels of fundraising; and
- an increasing number of bespoke transaction structures, including net asset value and hybrid facilities, and equity commitment deals.

It is apparent that as the demands and needs of sponsors and funds have diversified, lenders have become more innovative and specialised in their approach. While certain banks have continued to build their books of business, new alternative lenders have also emerged on the scene. The BVI has also seen steady increases in funds focused on climate tech (as ESG factors become an increasing priority for investors) as well as significant numbers of blockchain and cryptocurrency funds.

The BVI has ingrained its position as an attractive jurisdiction for financing structures and arrangements, with lender-friendly insolvency laws and a robust regime for secured financing transactions. With the Limited Partnership Act 2017 introducing a modern, flexible limited partnership vehicle (providing an alternative to the successful BVI business company fund vehicle), coupled with the introduction of the PIF regime in 2019, it is not surprising that this more conducive environment has led to the increase in BVI fund-financing transactions.

More Complex Fund Infrastructure

While the majority of BVI funds exist as standalone funds, these funds increasingly form part of a greater fund structure, including master-feeder, parallel structures (US and non-US parallel vehicles) and mini-master fund structures (offshore feeder fund and a master entity structured as a partnership for US tax purposes). The rationale for these more complex structures is driven by the tax and cost efficiencies achieved.

Access to Information

With effect from December 2019, the BVI regulator (the Financial Services Commission (FSC)) has maintained a register of recognised funds, identifying:

- each fund's service and business address (within and outside the BVI), authorised representative, date and status of recognition;
- whether the fund is up to date with its FSC fees; and
- such other information as the FSC considers appropriate.

This information is available for public inspection, for which the FSC may charge a fee.

Other than as set out above, limited information is publicly available regarding entities established in the BVI. Such documents are generally only accessible through the FSC's online database, which requires registration with the FSC to access and the payment of fees. The available information includes:

- registered office and agent details;
- name and registered number; and

- any publicly registered charges over the assets.

For companies, the memorandum and articles (and any resolutions amending these) will also be available.

For limited partnerships, the identities of general partners will be available (but not the limited partnership agreement).

Entities are required to keep filed information up to date and any failure to do so may result in a fine.

A BVI company is also required to file a copy of its register of directors (and any changes thereto within 30 days) with the BVI Registry. The register of directors has not previously been publicly available, except by order of the court, by written request of a competent authority (for tax compliance or other law enforcement purposes) or upon the election of the company.

However, from 1 January 2023, certain authorised users of the BVI Registry's system (generally, only BVI service providers) are now able to search for the names of the current directors of a BVI company. The search results are limited in scope to including the name of the current directors; accordingly, it will not be possible to obtain the date of birth, nationality, address and other personal information of a director or the names of former directors.

Although this remains to be determined, some form of fee to access the names of directors (as with all company searches in the BVI) is expected.

The identities of shareholders in a company and limited partners in a partnership, and the amounts of their capital commitments, are not publicly available. However, both a limited partner and a member of a company is entitled to inspect (on giving written notice):

- the records;
- the register of limited partners (in the case of a partnership and subject to the limited partnership agreement); and
- the registers of members and directors (in the case of a company).

For a partnership, the limited partnership agreement may restrict these inspection rights. For a company, subject to its memorandum and articles, a director may refuse an inspection request if they are satisfied that it is contrary to the company's interests. The articles of a company, or the limited partnership agreement for a partnership, may allow for further inspection or information rights for investors.

The BVI has introduced a centralised system for recording the beneficial owners of BVI entities (being persons who ultimately own or control more than 25% of an entity). While open-ended mutual funds and any licensed BVI entities are exempt from this regime, closed-ended funds are not. The system is not available to the public and can only be accessed following a formal request from the BVI Financial Investigation Agency, the FSC, the BVI International Tax Authority or the Attorney General's Chambers, who will in turn be bound by strict confidentiality rules. Non-compliance can result in a fine, imprisonment or both.

It is anticipated that there will be further developments over the course of 2024 in respect of disclosure of beneficial ownership in BVI entities.

Where to Now?

The BVI's attraction for fund sponsors has historically been based on the tax neutrality of the territory, with it being politically and economically stable and providing a depth of experience and sophistication to clients. This environment includes diversity of legal structure, types of fund and appropriate levels of supervisory oversight to accurately fit investors' risk profiles. Prominent examples are seen in the incubator and approved funds options.

In addition, the BVI offers a wealth of professional advisers and regulators at the FSC, offering ease, cost-effectiveness and speed in the fund-formation process.

The one constant is change. The BVI has always been flexible in its offerings and operations, and it must be more so now. As in the case of cryptocurrency funds, opportunities and sponsor/client needs must be identified and acted upon in a measured but nimble manner.

CHINA

Law and Practice

Contributed by:
Alan Du and Zixun Deng
King & Wood Mallesons

Contents

King & Wood Mallesons has its key office in Beijing and has an extensive global network of 30 international offices. The investment funds legal team of King & Wood Mallesons is equipped with in-depth local experience and has been a consistent industry leader in the establishment, investment and exiting of domestic and overseas funds. The firm's lawyers and experts have proficiency in laws, policies and regulations, both at home and abroad, and are capable of advising clients on various private equity funds, on drafting investment plans and on designing investment structures. King & Wood Mallesons also has lawyers who focus on tax, intellectual property, labour, real estate and insurance law, enabling them to offer professional one-stop support in investment funds projects at any time.

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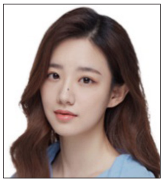

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1. Market Overview

1.1 State of the Market

In the People's Republic of China (PRC), investment funds are generally divided into two categories: public funds and private funds.

Public Funds

Subject to approval by the China Securities Regulatory Commission (CSRC), public funds may be marketed through public means (such as public media) towards the general public, including those who are not Qualified Investors (as further explained in **2.2.3 Restrictions on Investors**). Public funds may be considered the Chinese equivalent of retail funds.

According to the latest statistics published by the Asset Management Association of China (AMAC), as of 31 June 2023, the assets under management of 10,980 public funds reached CNY27.69 trillion.

Private Funds

Private funds can only be marketed to Qualified Investors by way of a private placement. Private funds may be considered the Chinese equivalent of wholesale funds or alternative investment funds.

According to the AMAC, as of 31 June 2023 there were 22,113 private fund managers registered with it, and the assets under management of 152,298 private funds that filed with the AMAC stood at CNY20.80 trillion.

Funds Market in 2023

Due to China's continuing economic downturn in 2023, the growth of funds that invest in listed securities (including public funds and private securities investment funds) remains slow. From January 2023 to September 2023, public funds increased from CNY27.25 trillion to CNY27.48 trillion – an increase of only CNY0.23 trillion. This was higher than in 2022 (an increase of only CNY0.157 trillion) but considerably lower than in 2021 (an increase of CNY4.97 trillion). From January 2023 to September 2023, the number of private securities investment funds increased from 94,264 to 97,964. At the same time, private securities investment funds increased from CNY5.61 trillion to CNY5.89 trillion – an increase of only CNY0.276 trillion.

Growth in the private equity funds industry has slowed down. By September 2023, the size of private equity funds had increased to CNY14.34 trillion, which represented an increase of 2.61% compared to the beginning of 2023; however, the increase in 2022 was 6.63%. Additionally, the number of private equity funds increased to 53,737, which represented an increase of 6.17% compared to the beginning of 2023, though in 2022 this increase was 12.25%.

Further, the polarised situation of the fundraising market has become more pronounced. Money has been gradually concentrated into top-tier private equity fund managers, who have unfortunately also slowed down their fundraising pace compared to 2022. For those less successful fund managers, 2023 was a more difficult year than 2022, and perhaps even their most difficult year yet.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

Most private funds in the PRC are structured as limited partnerships or contractual funds. Although funds can be formed as limited companies, in practice limited company funds are relatively rare because they are generally less tax-efficient, and the PRC's Company Law does not support the concept of a "management share" as is available in some other jurisdictions and that gives the holder of a management share similar power to a general partner.

Private Securities Investment Funds

Private securities investment funds typically take the form of a contractual fund. The main competitive advantages that a contractual fund has over a limited partnership are as follows:

- a contractual fund can have up to 200 investors, whereas a limited partnership only allows up to 50 partners;
- a contractual fund is not a legal entity that needs to be registered with the enterprise registration authority, the Administration for Market Regulation (AMR), and therefore its subscription and redemption processes are more efficient, without needing to go through the registration process; and
- the fund manager of a contractual fund does not withhold the income tax for individual investors as a matter of general practice, whereas a limited partnership fund must withhold income tax for individual investors.

Private Equity Funds

Limited partnership

In the PRC, most private equity funds are structured as limited partnerships, for the following reasons.

- The PRC's Partnership Law is flexible, and a limited partnership fund can accommodate most of the international practice of private equity funds.
- In examining a company looking to launch an IPO, the CSRC generally treats a shareholder in the form of a contractual fund as problematic because it is hard to trace the beneficial owners behind the contractual fund. Therefore, a fund with a strategy of exiting from its portfolio companies by way of an IPO will be formed as a limited partnership, instead of as a contractual fund.

Contractual fund

Due to the difficulties of listing real estate companies or assets in China, a real estate fund's exit strategy usually excludes an IPO or securitisation, and therefore it may be formed as a contractual fund.

Limited company

Some of the funds funded by state-owned enterprises (SOEs) may use the form of a limited company. The PRC's Partnership Law provides that an SOE shall not act as the general partner; but, in practice, an SOE under the Partnership Law is interpreted in a narrow way – eg, the subsidiary of an SOE may be exempted. However, some SOEs may still prefer a fund in the form of a limited company, where no SOE will need to act as the general partner.

Fund managers

Most private fund managers are structured as limited companies, though some may be structured as limited partnerships.

2.1.2 Common Process for Setting Up Investment Funds

Establishing a Legal Entity and Registering It With the AMAC as a Private Fund Manager

The form of a legal entity as a limited company or limited partnership must first be established. The name of such entity must include "private fund", "private fund management" or "venture capital investment", and the business scope of such entity must include "private funds management", "private securities investment funds management", "private equity funds management" or "venture capital funds management" and other words reflecting the characteristics of the private equity fund it intends to manage.

The timeline depends on the location where the entity is established, and may vary from one month to six months, or even longer. Some local governments set high standards for accepting the establishment of such entities, which makes it extremely difficult to complete such establishment. The entity should apply to the AMAC for registration as a private fund manager within 12 months from the date of establishment, except in cases where registration needs to be deferred due to changes in policies of the relevant state departments, etc. To register the legal entity with the AMAC as a fund manager, a legal opinion must be issued by a qualified PRC law firm on whether the applicant has fulfilled the AMAC's requirements regarding the applicant's:

- name;
- business scope;
- number of employees;
- capital contributions; and
- relevant investment experience of its officers, etc.

It usually takes three to four months to complete registration with the AMAC, but there is no guarantee of this timeframe. The AMAC reserves much discretion and an applicant satisfying all the written requirements may still fail to complete registration due to inconsistency with the AMAC's internal principles or otherwise.

Establishing a Fund Vehicle

For private equity funds, the fund vehicle, usually in the form of a limited partnership with a business scope containing equity investment, may be established before the first closing of the fund, so that the fund vehicle may admit investors upon first closing. Again, the timeline depends on the location where the entity is established, and may vary from one month to six months, or even longer. Some local governments set high standards for accepting the establishment of such fund vehicles, which makes it extremely difficult to complete such establishment.

Fundraising

The timeline for the fundraising process depends on various commercial factors, and is subject to various requirements regarding marketing of the fund, risk disclosure, verification of Qualified Investors, etc.

Fund-Filing With the AMAC

After the first closing and first instalment of the capital contribution, the fund is filed with the AMAC by the fund manager, and the process may take one to two months.

2.1.3 Limited Liability

Regarding the debt of private funds, investors shall generally be protected by limited liability, as follows.

Limited Partnership Funds

Limited partners shall be liable for the debt of the limited partnership fund to the extent of their subscribed capital – ie, their capital commitment.

Contractual Funds

Though a contractual fund, as a legal form, is frequently used for setting up most private securities investment funds, and occasionally for private equity funds, there is essentially no explicit law dealing with contractual funds.

According to the Securities Investment Fund Law, investors of public funds and private securities investment funds shall only be liable for the debt of the fund to the extent of their investments, which is read as applicable to a private securities investment fund in the form of a contractual fund. Also, the authors tend to believe such limited liability protection shall apply to investors of a private equity fund in the form of a contractual fund.

Limited Company Funds
For a fund in the form of a limited company, investors (ie, shareholders) are liable to the extent of their subscribed capital.

2.1.4 Disclosure Requirements
In the PRC, private funds are subject to ongoing disclosure obligations.

Fundraising Information Disclosure
Marketing documents such as the private placement memorandum must include basic information on:

- the fund and the manager;
- custody arrangements (if any):
- investment of the fund;
- distribution of proceeds; and
- performance fee arrangements, etc.

The content of these should be substantially the same as the fund contracts. In addition, a risk disclosure document is required to be signed by investors as a filing document, which must fully disclose various risks of the fund.

Fund Operation Information Disclosure
Periodic reporting obligation

The content and frequency of disclosure requirements differ according to the type of fund. For private securities investment funds, monthly reports must be submitted to the AMAC, disclosing information on the fund size, unit net value and investors. However, private equity funds are only required to report quarterly in respect of the net asset value, and key financial and investment information.

Disclosure requirement on specific events

When certain events occur, disclosures are required to be made to investors in a timely fashion. According to the AMAC's rules, such events would normally have a significant impact on investors' interest, including:

- change of investment scope of the fund;
- change of the fund manager or the custodian; and
- significant related-party transactions.

Consequences of failure to fulfil disclosure requirements

The AMAC conducts inspections on fund information disclosure from time to time and may take disciplinary actions against the responsible person, depending on the seriousness of the case.

If a private fund manager fails to submit periodic reports in a timely manner, the AMAC may suspend the fund manager's application for filing a new fund until such obligation is fulfilled.

2.2 Fund Investment
2.2.1 Types of Investors in Alternative Funds
In the PRC, private funds can only be marketed to Qualified Investors, which includes individual investors and institutional investors.

The authors see increasingly more individual investors investing in private securities investment funds, and more institutional investors (ie, corporate investors, SOEs, government guiding funds, insurance companies, etc) investing in private equity funds. Institutional investors also have different preferences depending on their type. For example, insurance companies would normally invest in funds established by top-tier fund managers, and corporate investors tend to invest in specific industrial funds for synergy with their own business.

2.2.2 Legal Structures Used by Fund Managers

Fund Managers

In the PRC, private fund managers are typically structured as limited companies, and some take the form of limited partnerships.

Fund Structures

For limited partnership funds, fund managers usually also serve as general partners, but there is a trend of separation of the fund manager and the general partner, who is often a subsidiary of the fund manager.

For contractual funds, parties to the fund contract include investors, the fund manager and the custodian.

For limited company funds, a separate fund manager may or may not be one of the shareholders of the fund. Also, it is possible for a limited company to have an internal fund management team without a separate fund manager.

2.2.3 Restrictions on Investors

Private funds can only be invested in by Qualified Investors.

Qualified Investors are those institutions and individuals who invest an amount of not less than CNY1 million in a single private fund, and accord with the following standards:

- with respect to institutions, their net assets must be no less than CNY10 million; or
- with respect to individuals, their financial assets (such as bank deposits, stocks and bonds) must be no less than CNY3 million, or their personal average annual income in the last three years must be no less than CNY500,000.

Where an investor has no legal personality (such as partnerships and contracts), such investor shall be looked through to verify whether those investors holding interests in such investor are Qualified Investors, with the exemptions applicable to certain investors, including:

- social welfare funds;
- private funds;
- bank asset management products;
- Qualified Foreign Institutional Investors (QFIIs) and Renminbi Qualified Foreign Institutional Investors (RQFIIs) approved by the CSRC; and
- private fund managers and their employees who invest in the private funds under their management.

These shall be regarded as Qualified Investors and are not subject to the above “look-through” rules. QFIIs and RQFIIs refer to foreign institutional investors that have been approved by the CSRC to make securities and futures investments in the PRC with offshore funds, including overseas fund management companies, commercial banks, insurance companies and securities companies.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

In general, the CSRC is the regulator of the listed securities and futures market, and also supervises and administers the private funds market. Under the supervision of the CSRC, the AMAC is a self-disciplinary organisation, but the authors tend to believe it is also the de facto regulator of the private funds industry. It has issued a set of self-disciplinary rules on the registration of private fund managers, the filing of private funds, disclosure requirements, etc.

In 2014, the CSRC promulgated the Interim Measures for the Supervision and Administration of Private Investment Funds, which provide a general regulatory regime for the private funds industry. The AMAC subsequently released a series of detailed rules.

In January 2021, the CSRC promulgated the Provisions on Strengthening the Supervision of Private Funds (the "Private Funds Provisions"), which outline the latest regulatory framework regarding private funds. In June 2022, the AMAC promulgated the new List of Requirements for Private Fund Manager Registration, the Key Points of Private Equity Fund Filing and the Key Points of Private Securities Investment Fund Filing, stipulating the latest regulations regarding fund manager registration and the filing of private funds.

In February 2023, the AMAC promulgated the Measures for Registration and Filing of Private Investment Funds (effective on 1 May 2023), further summarising, revising and highlighting regulations regarding fund manager registration and the filing of private funds.

In July 2023, the State Council issued the Regulation on Supervision and Administration of Private Investment Funds (effective on 1 September 2023 (the "Regulation")). The Regulation essentially follows and emphasises the pre-existing rules, but the authority of the Regulation is higher than those rules issued by the CSRC and AMAC. In September 2023, the AMAC released a series of detailed new rules regarding the filing of private funds (see **4.1 Recent Developments and Proposals for Reform**).

Under the preceding regulations, private funds are not permitted to directly or indirectly make investments that are prohibited or restricted by the government, or that are inconsistent with national industrial policies, environmental protection policies or land administration policies, with the exception of investments in listed securities. Investing in loans (including disguised loans) and providing guarantees are also prohibited by the AMAC. However, for the purpose of equity investment, if the borrowing or guarantee period is less than one year, private equity funds may provide loans or guarantees to portfolio companies. In addition, private funds may not invest in credit assets such as factoring assets, financial leasing assets or pawn assets, nor make investments that have unlimited liability.

2.3.2 Requirements for Non-local Service Providers

Generally, only local service providers are allowed to provide services in China to private funds.

For non-local service providers providing services outside China to Chinese private funds/fund managers, PRC law is silent regarding the regulation of registration requirements, etc. Considering a Chinese fund is unlikely to have an offshore account or other offshore operations, it seems unlikely that a Chinese fund would engage a non-local custodian or administrator.

2.3.3 Local Regulatory Requirements for Non-local Managers

Only fund managers that have been duly registered with the AMAC are permitted to manage private funds in China. There are no regulatory requirements expressly applicable to non-local managers of private funds. A non-local manager's marketing activities in China for their offshore funds are not clearly dealt with by PRC law, and professional advice should be sought before conducting such activities.

2.3.4 Regulatory Approval Process

See **2.1.2 Common Process for Setting Up Investment Funds**.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

Under PRC law, there is no clear definition of pre-marketing. With reference to the EU's definition, pre-marketing activities may be understood as including provision of information on investment strategies or investment ideas on behalf of a private fund manager to qualified investors, and testing investors' interest in a private fund before the commencement of fundraising, but without providing such information as contained in the fund marketing documents (see **2.1.4 Disclosure Requirements**).

For the provision of information on investment strategies or investment ideas, the Measures for the Administration of the Fundraising of Private Investment Funds (the "Fundraising Measures") expressly allow private fund managers to market their investment strategies through legitimate and public means, indicating a relaxed attitude towards regulating such activities.

PRC law is silent on the testing of investors' interest in a private fund, but before such testing it is advisable to complete the following:

- determination of specified investors; and
- suitability matching (see **2.3.10 Investor Protection Rules**).

2.3.6 Rules Concerning Marketing of Alternative Funds

In general, the marketing of private funds is regulated by:

- the Securities Investment Fund Law;
- the Fundraising Measures;
- the Measures for the Administration of the Appropriateness of Securities and Futures Investors promulgated by the CSRC (the "Appropriateness Measures"); and
- the Private Funds Provisions.

Public Offering Should Be Avoided During Private Fund Marketing

In the PRC, approval is required for marketing to the general public. According to the Securities Investment Fund Law, raising funds from non-specific targets or issuing securities to more than 200 specific targets accumulatively in the PRC will be regarded as a public offering and should be subject to the CSRC's approval.

Private fund managers and placement agents must not disseminate information to non-specific targets via public communications media (such as newspapers, radio stations, TV or the internet) or through lectures, seminars, analysis meetings, bulletins, leaflets, short messages, blogs, emails or other means. However, marketing through an official website or the internet with a mechanism that is only accessible to specific targets is not considered a public offering.

Restrictions on Content of the Presentation

Certain content is strictly forbidden to be used when marketing, including:

- direct or indirect promises to investors that there will be no losses of the investors' funds, or that there will be a minimum income; or

- using exaggerated words, such as “safe”, “promise”, “secure”, “avoidance of risks”, “guaranteed”, “high income” or “no risk”.

2.3.7 Marketing of Alternative Funds
Private funds can only be marketed to Qualified Investors.

2.3.8 Marketing Authorisation/Notification Process
Under PRC law, authorisation or notification is not required by the national regulator for marketing private funds.

2.3.9 Post-marketing Ongoing Requirements
Private fund managers who have marketed and closed a private fund must perform the following duties:

- fund filing with the AMAC (see **2.1.2 Common Process for Setting Up Investment Funds**);
- information disclosure (see **2.1.4 Disclosure Requirements**); and
- periodic reporting obligation (see **2.1.4 Disclosure Requirements**).

2.3.10 Investor Protection Rules
Special Protection for General Investors
Qualified Investors that may invest in private funds are broadly split into general investors and professional investors.

General investors can be further classified into five types (C1 to C5), based on their risk tolerances. Special protections will be provided to general investors with respect to information disclosures, risk warnings, suitability matching, etc. For example, fundraisers may not actively conduct marketing of a fund to general investors whose tolerance is lower than the risk level of the fund. Investors who belong to the lowest risk tolerance category are not allowed to invest in any fund with a risk rating above their risk tolerance. However, investors may invest in relatively riskier funds after accepting special risk warnings that are issued by fundraisers in writing.

Fair Treatment to Investors
Under the Private Funds Provisions, all investors of a private fund must receive fair treatment.

Regulatory Reporting Requirements
As well as submitting periodic reports to the AMAC (see **2.1.4 Disclosure Requirements**), private fund managers must also disclose fund operation information to investors, and must submit information disclosure reports to an AMAC online system for records. While private securities investment fund managers should issue an information disclosure report to investors monthly, quarterly and annually, private equity fund managers are only required to submit semi-annual disclosure reports and an annual disclosure report. As mentioned in **2.1.4 Disclosure Requirements**, when certain events occur, private fund managers are required to report to the AMAC within ten business days and make a disclosure to investors. In accordance with the AMAC’s rule, significant matters specifically include:

- change of the fund manager and the custodian;
- major changes to the fund contract;
- change of type of private fund;
- change of fund service institutions; and
- other events that may have a significant impact on the continued operation of the fund, the interests of investors or the net asset value of the fund.

2.3.11 Approach of the Regulator
The AMAC accepts telephone enquiries as well as email enquiries regarding the relevant regu-

lations and compliance requirements. Face-to-face meetings are generally not available.

2.4 Operational Requirements

Restrictions on Investments in Private Funds

In general, private funds are not permitted to directly or indirectly make investments that are prohibited or restricted by the government, or that are inconsistent with national industrial policies, environmental protection policies or land administration policies, except for an investment in listed securities.

Private securities investment funds

For private securities investment funds, investment is limited to:

- listed stocks;
- bonds;
- futures;
- options;
- other securities investment funds; and
- other assets recognised by the CSRC.

Private equity funds

Private equity funds must mainly invest in unlisted equity; investing in loans and other fixed-income investments has generally been banned by the AMAC, which holds the general view that any investment looking for fixed income cannot be the investment target of private funds. Specifically, private funds are not permitted to directly or indirectly make investments that are prohibited or restricted by the government, or that are inconsistent with national industrial policies, environmental protection policies or land administration policies, except for an investment in listed securities.

Investing in loans (including disguised loans) and offering guarantees is also prohibited by the AMAC. However, for the purpose of equity investment, if the borrowing or guarantee period is less than one year, private equity funds may provide loans or guarantees to portfolio companies, except for a real estate pilot fund, which may provide loans or guarantees to portfolio companies without limitations on the period. In addition, private funds may not invest in credit assets such as factoring assets, financial leasing assets or pawn assets, nor make investments that have unlimited liability.

Asset Protection

In general, unless otherwise agreed in the funds contracts of certain funds satisfying AMAC criteria, private funds may have fund custodians. Where there is no custodian, the funds contract should explicitly provide measures to protect fund assets and a dispute resolution mechanism. In practice, the majority of private funds have custodians.

In addition, in line with investor protection, where private funds conduct related-party transactions (ie, transactions that involve the private fund, the fund manager, investors, other private funds managed by the manager or under the same actual controller, or other related parties that have significant interests with these subjects), effective risk-control mechanisms such as disclosure arrangements and special decision-making procedures for related-party transactions must be established.

Other Specific Requirements

Borrowing restrictions

According to the Private Fund Provisions, private funds are generally banned from providing loans or guarantees; but for the purpose of equity investment, if the borrowing or guarantee period is less than one year, private equity funds may provide loans or guarantees for portfolio companies, except for a real estate pilot fund, which may provide loans or guarantees to portfolio companies without limitations on the period. Despite the foregoing, the expiry date of the term of borrowing or guarantee must be no later than the end of the investment, and the amount of borrowing or guarantee must not exceed 20% of the total assets of the private fund, except for more lenient restrictions for a real estate pilot fund.

Valuation of fund assets

The AMAC has published fund valuation guidelines, which are not compulsory, and provides comprehensive guidance on the valuation of fund investment targets, including stocks, restricted shares, fixed-income instruments and unlisted equity. However, because it is not compulsory, most fund managers do not use the guidelines.

Restrictions on related-party transactions

According to the Private Fund Provisions, private fund managers must not conduct related-party transactions that may cause loss of fund assets or violate the interests of investors. Private fund managers should establish mechanisms regulating related-party transactions, such as a pricing policy in relation to related-party transactions and a transaction approval system. Related-party transactions that involve fund assets must acquire pre-approvals from investors through the agreement mechanism, and must be fully disclosed to investors after the investment.

Prohibition on insider dealing and market abuse

Insider dealing, manipulating a securities and futures market, and other market abuse conduct are forbidden under the Private Fund Provisions. Violations of these rules are subject to strict administrative measures by the CSRC, and the violator shall be publicised through the capital market integrity information database. Also, criminal penalties may be imposed if the relevant conduct constitutes an offence under criminal laws.

2.5 Fund Finance

In general, private funds in the PRC are permitted to borrow for making investments. For example, private equity funds may access M&A loans, in which commercial banks can provide loans of up to 60% of the transaction price, and the borrower must provide sufficient security for the debt.

Restrictions on Borrowings

According to the Guiding Opinions on Regulating the Asset Management Business of Financial Institutions (the "Guiding Opinions"), the leverage ratio of an asset management product must be limited, and the total assets of a private product must not exceed 200% of its net assets, which means the borrowing must not exceed 100% of the capital. For graded products (products with preferred unit holders receiving distributions prior to other unit holders), the total assets must not exceed 140% of the net assets.

The Guiding Opinions do not directly apply to private funds, and the AMAC has indicated that it would issue a detailed rule applicable to private funds in accordance with the Guiding Opinions. However, such a rule has not yet been published, and it is advisable to follow the restrictions of the Guiding Opinions.

In practice, it is not common for private equity funds to borrow to make investments. Additionally, fund contracts may also set restrictions such as prior approval on each borrowing.

Security for Borrowing

In the PRC, it is common for banks to take collaterals such as real property or marketable securities, or to seek a guarantee from guarantors with capability of repayment. Sometimes, the fund manager or its affiliate may provide a bridge loan or warehousing to a fund without security.

2.6 Tax Regime

The applicable tax regime for private funds depends on the form of the fund and the type of income.

Limited Company Funds

A limited company fund itself is subject to enterprise income tax (EIT) at the rate of 25%.

Income tax also applies to investors, depending on the investor type:

- limited company investors are generally subject to a 25% EIT on their own profit, but dividends from the limited company fund may be exempted to avoid double taxation after the limited company fund has paid its EIT; and
- for individual investors, a 20% individual income tax (IIT) shall apply.

Limited Partnership Funds

Private funds structured as limited partnerships are tax-transparent for income tax, and for investors of such funds the tax treatments are as follows.

- For individual investors, due to the absence of clear tax law, the practice varies between different locations of China. Ideally, a flat rate of 20% IIT shall apply, but in some locations, a progressive rate from 5% to 35% shall apply.
- For a limited company investor, a 25% EIT applies to its profits. Though dividends received by a company from another company shall be exempted, uncertainty exists regarding the eligibility of the dividends paid by a portfolio company indirectly through a limited partnership fund to its limited company investors, which can be interpreted as distribution from the limited partnership, instead of dividends from the portfolio company. The practice may vary between different locations of China.

Contractual Funds

As with limited partnership funds, contractual funds are also tax-transparent.

- Similar to the practice of investment trust companies in China for the IIT of individual investors regarding investment trusts under their management, the fund manager does not withhold the IIT for individual investors, and each individual investor shall be responsible for their own tax declaration.
- A limited company investor is subject to a 25% EIT on its profits, except for dividends received from another company.

Preferential Tax Policy for Venture Capital Funds

An additional preferential tax policy may apply to venture capital funds investing in scientific and technological enterprises that meet certain requirements.

- For a venture capital fund structured as a limited company, where the fund has directly invested in an eligible scientific and technological enterprise for more than two years, it can have a tax credit at 70% of the investment amount against the EIT. If the amount of the granted tax credit is not fully used, that balance can be carried forward to the following tax year.
- For a venture capital fund structured as a limited partnership, a similar policy applies to the investors of the fund. Namely, a limited

company investor can claim a tax credit of 70% of the investment amount in the eligible scientific and technological enterprise against its income from the fund. An individual investor can have the same amount of tax credit against its income from the fund.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

The law is unclear about the form of public funds – eg, a limited partnership, a trust or otherwise.

Under the Securities Investment Fund Law:

- a public fund is not a legal entity;
- the fund manager is entrusted to manage the assets of the public fund; and
- the assets of the fund are separate from the assets of the fund manager.

For those issues that the Securities Investment Fund Law does not provide for, the PRC Trust Law shall apply. Therefore, the authors tend to believe that the form of a public fund should be similar to a trust.

Investors' interests in a public fund are called fund units.

Public funds can be operated as open-ended or closed-ended. After the first open-ended public fund was approved in 2001, open-ended public funds have developed rapidly and have become the most popular form of public fund. As of September 2023, there were 9,885 open-ended public funds; whereas the number of closed-ended public funds was 1,336.

As a public fund is not a legal entity, the subscription or redemption of fund units will not trigger the registration process with the AMR, which suits the operation of open-ended public funds.

Based on the list of public fund managers publicised by the AMAC, public fund managers are all structured as limited companies in the PRC.

3.1.2 Common Process for Setting Up Investment Funds

The common process for setting up a public fund in the PRC includes the following steps.

Setting Up a Public Fund Manager

A public fund manager can be set up by doing the following.

- Establishing a new public fund management company.
- Obtaining a public fund manager licence for an existing asset management institution, such as for:
  - (a) asset management subsidiaries of securities companies;
  - (b) insurance asset management companies;
  - (c) wealth management subsidiaries of commercial banks; or
  - (d) private securities investment fund managers.

In May 2022, the CSRC released Measures for Supervision and Administration of Public Securities Investment Fund Managers (effective on 20 June 2022) and supplementing rules, which impose stricter requirements for setting up a public fund manager (such as a higher requirement regarding financial status of the major shareholders of a newly established public fund manager).

Setting up a new public fund management company

To set up a public fund management company, approval of the CSRC must first be obtained after satisfying various strict requirements. High-standard requirements also apply to the company's major shareholders in respect of their registered capital, net asset scales, etc.

After the submission of the application documents, the CSRC may require the applicant to supplement the documents before it accepts the application. Once the application documents are accepted, the CSRC shall decide whether to issue the approval within six months. In practice, it is hard to obtain approval from the CSRC, which determines whether to grant the approval on a discretionary basis. Therefore, the actual time for obtaining approval is uncertain, depending on the background of the prospective shareholders of the fund manager, etc.

Within 30 days of receipt of the CSRC's approval, the applicant must register the fund management company with the AMR. The new fund management company is established upon the issuance of a business licence by the AMR.

After the establishment of the fund management company, the company must prepare for operation by satisfying various requirements regarding its office, IT system, employees, etc, to be inspected by the CSRC. The preparation period may last as long as six months or so. The public fund management company may only start business operations after passing the inspection by the CSRC.

Public fund manager licence for existing institutions

Subject to certain conditions, asset management institutions (such as asset management subsidiaries of securities companies and insurance asset management companies, wealth management subsidiaries of commercial banks, or private securities investment fund managers) can also apply for the public fund manager licence from the CSRC.

In general, an applicant must fulfil the following conditions:

- at least three years' management experience of securities assets with good performance;
- sound corporate governance, with a sophisticated internal mechanism and effective risk-control system;
- good business performance and financial standing for the last three years;
- no significant violation of the applicable laws and regulations; and
- the number of employees who have obtained the qualification for fund practice must not be less than 30 in principle.

Other requirements include a minimum scale of assets under management, construction of information systems, and so on.

After submission of the application documents, the CSRC may require the applicant to supplement the documents before it accepts the application. Once the application documents are accepted, the CSRC shall decide whether to issue the approval within 20 business days, which may be extended to 30 business days subject to the CSRC's internal approval. For similar reasons, the actual time for obtaining the approval is uncertain.

After the application is approved, the applicant must further prepare for public fund management business by satisfying various requirements, such as setting up a specific department for fund business and the establishment of a fund investment decision-making process, to be inspected by the CSRC. The preparation period may last as long as six months or so. The public fund management company may only start public fund management business after passing the inspection by the CSRC.

Fund registration with the CSRC

A licensed public fund manager may market and raise public funds subject to the relevant requirements.

A prospective public fund must be registered with the CSRC before being marketed to the general public. In general, a public fund to be marketed should have a specific investment direction, and the name must indicate its type and features. The application documents for fund registration generally include:

- an application report;
- a draft fund contract;
- a draft custody contract;
- a draft prospectus; and
- a legal opinion issued by a PRC law firm.

The CSRC may require the applicant to supplement the documents before it accepts the application for registration of a new public fund. Once the application documents are accepted, the CSRC shall decide whether the public fund can be registered for fundraising within six months. In practice, some public funds may complete registration within one month.

Fundraising and filing with the CSRC

The fundraising period must not exceed three months from the date of offering. Upon the expiry of the fundraising period, the manager must engage an accounting firm to conduct capital verification for the fund and file the public fund with the CSRC, which will grant a written confirmation within three business days.

3.1.3 Limited Liability

Regarding the debt of public funds, investors are protected by limited liability and only bear the risks to the extent of their investment in the fund.

3.1.4 Disclosure Requirements

In general, public fund managers and custodians must disclose fund information to investors and publicise fund operation information via newspapers and websites recognised by the CSRC.

Specifically, the following information must be disclosed:

- the prospectus, the fund contract and the fund custody agreement;
- the fundraising information;
- the announcement on the listed fund units;
- the net asset value of the fund and fund units;
- the subscription and redemption prices;
- the quarterly reports, semi-annual reports and annual fund reports;
- interim reports;
- the resolutions of the fund unit-holders' meeting;
- major personnel changes of the fund custodian or manager;
- legal proceedings or arbitration related to fund assets, the fund management or the fund custody; and
- other information to be disclosed as required by the CSRC.

False records, misleading statements or material omissions, predictions of investment performance and promises regarding income are strictly prohibited.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

Subject to fund marketing rules, including the Appropriateness Measures, public funds may be offered to the general public.

Based on their investment scope (as further explained in **3.3.1 Regulatory Regime**), public funds can be classified as:

- share investment funds;
- bond funds;
- money market funds;
- hybrid funds; and
- funds of funds.

Except for low-risk money market funds (which are the most popular for both individual and institutional investors), institutional investors generally prefer bond funds, while individual investors generally prefer hybrid funds (ie, funds that can invest in shares, bonds or other funds) and share investment funds.

3.2.2 Legal Structures Used by Fund Managers

Based on the list of public fund managers publicised by the AMAC, public fund managers are all structured as limited companies in the PRC.

3.2.3 Restrictions on Investors

The Appropriateness Measures also apply to public funds. As previously mentioned, investors are split into general investors and professional investors, and general investors can be further classified into five types (C1 to C5), based on their risk tolerances. Fundraisers may not market a fund to any investor whose risk tolerance is lower than the risk level of the fund without solicitation of the investor. Investors of the lowest risk-tolerance category shall not be accepted to invest in any fund with a risk rating above their risk tolerance unless a special risk warning in writing has been provided.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

The Securities Investment Fund Law is the basic law regarding the regulation of retail funds. The CSRC, as the regulator of the public fund industry, has accordingly promulgated a series of regulations in relation to the establishment of a fund management company, fund registration, and the operation and management of public funds.

A public fund may only invest in listed securities, futures and derivatives, depending on the type of the fund. Except for hybrid funds (ie, funds that can invest in shares, bonds or other funds), the limitations on different types of public funds are as follows:

- for share investment funds, 80% or more of the fund assets must be invested in stocks;
- for bond funds, 80% or more of the assets must be invested in bonds;
- for money market funds, all assets must be invested in money market instruments; and
- for funds of funds, 80% or more of the assets must be invested in other funds.

In addition, public funds are subject to certain restrictions with respect to the proportion of the investment. For example, for each public fund, the value of securities of a single company held by the fund must not exceed 10% of the fund's net asset value.

3.3.2 Requirements for Non-local Service Providers

Generally, only local service providers are allowed to provide services in China to public funds.

For non-local service providers providing services outside China to Chinese public funds/fund managers, under Shanghai-Hong Kong Stock Connect (a cross-boundary investment scheme that connects the Shanghai Stock Exchange and the Hong Kong Stock Exchange), Chinese fund managers are permitted to engage Hong Kong entities to provide investment advisory services such as issuance of a research report on southbound trading (ie, domestic investors in China investing in securities listed in Hong Kong). A Hong Kong entity providing investment advisory services must comply with the relevant provisions under PRC law and Hong Kong law.

In general, the Hong Kong service provider must have obtained the licence on providing investment advice from the Hong Kong regulatory authority, the Securities and Futures Commission (SFC). Where a Chinese public fund manager is provided with such services, it must file documents – including the service agreement, an undertaking letter issued by the Hong Kong service provider and relevant certificates – with the CSRC.

Except for the above, the law is silent regarding the registration requirements for other non-local service providers. Considering a Chinese public fund is unlikely to have an offshore account or other offshore operations, etc, it seems unlikely that a Chinese fund would engage a non-local custodian or administrator.

3.3.3 Local Regulatory Requirements for Non-local Managers

As mentioned in **3.1.2 Common Process for Setting Up Investment Funds**, only fund management companies and asset management institutions that have been approved by the CSRC are permitted to manage public funds in China.

For non-local managers' marketing activities in China for their offshore funds, according to the Interim Provisions on the Administration of Recognised Hong Kong Funds (the "Hong Kong Funds Provisions"), Hong Kong public funds – including unit trusts, mutual funds and other collective investment schemes – may be marketed to the general public in China after registration with the CSRC. The registration is subject to strict conditions regarding the fund and the fund manager. For example, the Hong Kong fund must be established and operated in compliance with Hong Kong law, and must be approved to have a public offering and be regulated by the SFC. Also, the Hong Kong fund manager must be registered in Hong Kong and licensed to conduct asset management.

In addition, a prospective Hong Kong fund manager must engage a Chinese public fund manager or a custodian approved by the CSRC as its local representative.

3.3.4 Regulatory Approval Process

See **3.1.2 Common Process for Setting Up Investment Funds**.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

Under PRC law, there is no clear definition of pre-marketing. With reference to the EU's definition, pre-marketing activities may be understood as including provision of information on investment strategies or investment ideas on behalf of a public fund manager to investors, and testing investors' interest in a public fund before the commencement of fundraising, but without providing such information as contained in the fund marketing documents (see **3.3.6 Rules Concerning Marketing of Retail Funds**).

Currently, PRC law is silent on pre-marketing activities, but it is advisable to conduct the risk assessment and suitability-matching procedure (see **3.2.3 Restrictions on Investors**) before testing investors' interest.

3.3.6 Rules Concerning Marketing of Retail Funds

In the PRC, the rules applicable to the marketing of public funds include:

- the Securities Investment Fund Law;
- the Measures for the Operation and Administration of Public Funds;
- the Measures for the Administration of Information Disclosure of Public Funds; and
- the Appropriateness Measures.

The main rules that apply to the marketing of public funds are as follows.

Fund Registration With the CSRC

As discussed in **3.1.2 Common Process for Setting Up Investment Funds**, only public funds that have been registered with the CSRC may be marketed to the general public.

Fundraising Information Disclosures

The above regulations provide detailed requirements on the information that must be disclosed for fundraising of public funds. For example, the marketing document of a public fund must include the following information:

- basic information on the fund manager and the fund custodian;
- a summary of the contents of the fund contract and the fund custody agreement;
- the price, cost and duration of the fund units;
- the proportions of the remuneration and other related expenses of the fund managers and fund custodians; and
- risk warnings.

Risk Assessment and Matching Investors With Suitable Funds

Under the Appropriateness Measures, fundraisers may not actively conduct marketing of a public fund to general investors whose tolerance is lower than the risk rating of the fund (see **3.2.3 Restrictions on Investors**).

3.3.7 Marketing of Retail Funds

Upon registration of the public fund (see **3.1.2 Common Process for Setting Up Investment Funds**), public fund managers may conduct marketing towards the general public.

3.3.8 Marketing Authorisation/Notification Process

As discussed in **3.1.2 Common Process for Setting Up Investment Funds**, only public funds that have been registered with the CSRC may be marketed to the general public.

3.3.9 Post-marketing Ongoing Requirements

Public fund managers who have marketed and closed a public fund must perform the following duties:

- information disclosure (see **3.1.4 Disclosure Requirements**);
- conducting separate management and separate accounting for different fund assets;
- distributing earnings to fund unit-holders promptly;
- convening fund unit-holders' general meetings according to the fund contract; and
- conducting accounting for the fund and preparing the financial accounting reports, the half-yearly and annual fund reports for the fund, etc.

3.3.10 Investor Protection Rules

Statutory Reporting Requirements

Public funds are subject to stricter reporting requirements than private funds. Public fund managers must publicise quarterly reports, semi-annual reports and annual reports of public funds. In addition, fund managers must publicise the net asset value of the fund and the fund units at least once a week.

3.3.11 Approach of the Regulator

The CSRC accepts both telephone and email enquiries from the general public. Face-to-face meetings are generally not available.

3.4 Operational Requirements

Restrictions on the Types of Investments for Public Funds

Public funds may only invest in listed securities, and investment scope is also restricted based on the type of public fund (see **3.3.1 Regulatory Regime**).

Asset Protection

Each public fund must appoint a bank custodian to hold the fund assets. Commercial banks and other financial institutions, including securities companies that have been approved by the CSRC, may serve as the custodian of a public fund.

Other Specific Operational Requirements

Liquidity risk control

Fund managers of open-ended public funds are required to establish and improve an internal liquidity risk-control system, including:

- a sophisticated management mechanism;
- a standardised business operations process;
- an independent and strict supervision system; and
- flexible emergency response plans.

Specific restrictions include that total investment in liquidity-restricted assets must not exceed 15% of the net asset value of an open-ended public fund.

In addition, in 2020 the CSRC issued guidelines for the side pocket mechanism of public funds, for liquidity risk-management purposes; a special account must be established for assets with high uncertainty in valuation.

Borrowing restrictions

While borrowing for making an investment is permitted, public funds are subject to certain borrowing restrictions as discussed in **3.5 Fund Finance**.

Valuation and pricing of assets of public funds

The CSRC has published a guiding opinion on public valuation, the basic principle under which is that public fund managers must determine the fair value of net assets in a timely manner, accurately and in accordance with statutory accounting rules, using valuation techniques supported by sufficient available data and other information. Other pricing guidelines are also provided with respect to specific businesses.

3.5 Fund Finance

Public funds are permitted to make borrowings for making an investment. Under the Guiding Opinions, the total assets of an open-ended public fund must not exceed 140% of its net assets, which means the borrowing must not exceed 40% of the capital, and the total assets of a closed-ended public fund must not exceed 200% of its net assets.

In the PRC, public fund managers may conduct margin trading by borrowing funds from securities companies approved by the CSRC. The securities company will require the borrower to provide the security at a certain percentage of the margin (which may be in the form of securities), and assets bought on margin in the borrower's account will also be a collateral for the margin trade.

3.6 Tax Regime

The applicable taxes mainly include stamp duty, EIT and IIT.

Tax for Funds

A stamp duty of 0.1% of the share price shall apply to the selling of shares by public funds. Gains of trading price difference of shares and bonds, as well as dividends from shares and interest from bonds, are exempted from the EIT.

Tax for Investors

Individual investors of public funds are exempted from the IIT on gain of redemption price over the subscription price, and dividends paid by the fund. However, institutional investors are not exempted from the 25% EIT on the gain of redemption price over the subscription price.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

Issuance of Regulation on Supervision and Administration of Private Investment Funds

As discussed in **2.3.1 Regulatory Regime**, in July 2023 the State Council issued the Regulation on Supervision and Administration of Private Investment Funds (effective on 1 September 2023 (the "Regulation")). The Regulation essentially follows and emphasises the pre-existing rules, but its impact is significant. The Regulation is the first administrative regulation for the private investment fund industry in China. Before the issuance of the Regulation, private investment funds were mainly governed by rules/regulations issued by the CSRC and AMAC.

Under PRC law, the authority of administrative regulations (ie, regulations issued by the State Council) is higher than those regulations/rules issued by the CSRC and AMAC. According to the PRC's Civil Code, any activities under the Civil Code that violate the mandatory provisions of laws (ie, laws adopted by the National People's Congress of the PRC) and administrative regulations shall be null and void. Therefore, the Regulation may be invoked as a direct basis for determining the validity of activities under the PRC's Civil Code, whereas those rules/regulations issued by the CSRC and AMAC cannot. Besides, the Regulation provides for stricter penalties and therefore increases the cost of non-compliance in the private investment funds sector.

A Series of New Detailed Rules Issued by the AMAC Regarding Private Investment Funds

In February 2023, the AMAC promulgated the Measures for Registration and Filing of Private Investment Funds (effective on 1 May 2023 (the "Measures")), further summarising, revising and highlighting regulations regarding fund manager registration and the filing of private funds. The Measures impose stricter requirements regarding the registration of private fund managers, such as:

- minimum paid-up capital of CNY10 million;
- shareholding requirements for senior management; and
- qualification requirements for the actual controller and senior management, etc.

Private fund managers are subject to increasingly stringent regulations. Additionally, the Measures add a new minimum requirement for the size of the initial paid-up capital of private investment funds.

Further, in September 2023 the AMAC released a series of detailed new guidelines regarding the filing of private funds (collectively, the "Filing Guidelines"):

- Guideline No 1 on Filing of Private Investment Fund – Private Equity and Venture Capital Funds;
- Guideline No 2 on Filing of Private Investment Funds – Private Equity and Venture Capital Funds; and
- Guideline No 3 on Filing of Private Investment Funds – Change of Manager for Private Investment Funds.

Since the date of implementation of the Filing Guidelines No 1 and No 2, the Instructions for the Filing of Private Investment Funds, Key Points of Filing of Private Investment Funds and related materials were abolished. The Guidelines No 1 and No 2 basically follow the pre-existing rules and formalise certain verbal instructions by the AMAC, but also revise some rules, such as relaxation of restrictions on subsequent closings.

The Pilot Programme for Real Estate Funds

On 28 November 2022, the CSRC proposed carrying out a new pilot programme that enables eligible private fund managers to set up real estate private funds, which previously was hard to complete in terms of fund filing with the AMAC. The programme aims to stabilise the debt-ridden and distressed real estate sector and to bolster the growth of real estate enterprises; the more detailed rules of the programme remain to be seen.

On 20 February 2023, in order to implement the CSRC's proposal to carry out the pilot programme for real estate funds and to regulate private investment funds to engage in the business of real estate investment, the AMAC issued the Guidelines for Filing of Real Estate Private Investment Funds Pilot (for Trial Implementation) (the "Real Estate Pilot Guidelines"). The Real Estate Pilot Guidelines came into effect on 1 March 2023, and have broadened financing channels for the real estate industry and enriched the various types of private equity funds. Under the premise of improving the qualifications of fund managers and investors, the Real Estate Pilot Guidelines have achieved a breakthrough in relaxing regulatory restrictions on investment activities of real estate pilot funds – including the restrictions on scope of investment, borrowings and guarantees, graded arrangements, etc. This has improved the flexibility for investment activities of such funds.

Trends and Developments

Contributed by:
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Grandall Law Firm

Grandall Law Firm (Grandall) is a leading law firm specialising in capital markets, investment funds and finance in China, and was founded in June 1998 through the merger of three prominent Chinese law firms. Grandall currently boasts over 680 partners and over 5,000 individuals, consisting of practising attorneys, paralegals, administrative assistants, and other support personnel in 36 locations in China, the United States and Europe. More than 90% of partners hold a doctorate or master's degree, along with other senior qualifications. Many are renowned experts and academics in specific legal areas and fields. Grandall has a long history of being placed on various legal lists such as Chambers and Partners, IFLR 1000, Legal Band, Legal 500, Asialaw Profiles, China Business Law Journal and ALB.

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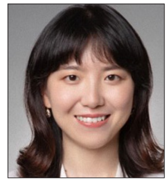

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Introduction

Benefiting from China's nearly four decades of reform and opening up, the private investment funds industry has flourished in the last decade, while many problems have also simultaneously emerged. In recent years, regulators have adopted more stringent regulatory measures and have set higher entry thresholds for the private investment funds industry.

Market Overview

As of October 2023, there were 22,000 registered private investment fund managers in Mainland China, with over 150,000 funds and assets under management, amounting to CNY21 trillion (equivalent to USD2.94 trillion). Private investment funds have been important in serving the real economy, promoting direct financing and supporting scientific and technological innovation in Mainland China. However, the tide of explosive economic growth in Mainland China has been ebbing ever since 2023. Particularly under the impact of anti-globalisation, difficulties in fundraising and exiting, and problems owing to the unregulated operations of private investment funds, have all stood out.

Regulatory Development

The year 2023 has been a milestone for the development of China's regulatory policies on private investment funds. Issued by the Asset Management Association of China (AMAC), the self-regulatory organisation of China's private investment funds industry, the *Measures for Registration and Filing of Private Investment Funds* (the "Filing Measures") and their supporting guidelines came into effect on 1 May 2023.

The Filing Measures provide detailed requirements with respect to the registration and change of private investment fund managers and the filing of private investment funds. The Filing Measures have also integrated and optimised the related rules and requirements scattered throughout current self-regulatory measures, miscellaneous notices or practical cases, from where a form of "measures, guidelines and guiding cases" has been gradually taking shape, which would make the private investment funds industry more scientific and standardised.

On 9 July 2023, China's State Council officially issued the *Regulations on the Supervision and Administration of Private Investment Funds* (the "Regulations"), which came into effect on 1 September 2023. As the first administrative regulation issued for the private investment funds industry, it fills the legislative gap in this industry at the administrative regulation level. Therefore, with the Regulations being "guiding principles", a systematic legal regulation framework has been gradually forming, including a multi-level and multi-dimensional regulatory framework of laws, administrative regulations, department rules and AMAC self-regulatory rules.

On 8 December 2023, the China Securities Regulatory Commission (CSRC) published the *Measures for the Supervision and Administration of Private Investment Funds (Exposure Draft)* (the "Exposure Draft"), which, when in effect, will replace the current *Interim Measures for the Supervision and Administration of Private Investment Funds* (the "2014 Interim Measures") implemented in August 2014, and the *Several Provisions on Strengthening the Regulation of Privately Offered Investment Funds* (the "2020 Provisions") implemented in December 2020.

Overall, the year 2023 has seen nearly all previous regulations being updated in the private investment funds industry, which reflects the regulator's focus on the balance between safety and development, and the strengthening of supervision – while delivering differentiated treatments for different types of private investment fund managers and funds, supporting those that are well-developed and restricting those that are non-compliant.

Venture Capital (VC) Funds

In China, VC funds mainly invest in the equity of unlisted companies, which differ from private equity funds in terms of investment scope, investment strategy, use of financing leverage, term of existence, etc. The Regulations and the Filing Measures further emphasise the differentiated management strategy for VC funds, as follows.

Different requirements for initial capital contribution

In principle, the Filing Measures require that the scale of the initial paid-in contribution shall not be less than CNY10 million for private equity funds. However, the requirement for initial paid-in contribution of VC funds cannot be less than CNY5 million, but it should be agreed in the fund contract that the minimum contribution threshold of CNY10 million be completed within six months of the VC fund's filing.

Venture capital funds cannot be indebted

According to the Regulations, VC funds cannot use financing leverage.

Exemption from the multi-layer investment restriction of VC funds

Since the issuance of the *Guiding Opinions on Regulating Asset Management Business of Financial Institutions* by the CSRC and other regulatory authorities in 2018, it has been legally confirmed that an asset-management product is only permitted to be invested into one additional layer of another asset-management product, which means that the nested investment structure of asset-management products cannot exceed two layers.

However, according to a Notice issued in 2019 with Circular No [2019] 1638 by the National Development and Reform Commission (NDRC) and other governmental authorities, VC funds meeting certain conditions cannot be regarded as one-layer asset-management products, so as to be exempted from such two-layer restriction. The conditions are as follows:

- it is compliant with relevant regulations and completing the filing of the VC fund;
- its investment is in line with national macro-management policies;
- its investment scope is limited to equity in unlisted companies;
- its operation is not involved in debt financing (except that its legal issuance of bonds is designed to improve its investment capability);
- its term of existence is not less than seven years;
- there is no structured arrangement of the fund shares, except for government-launched VC guide funds as a priority; and
- the words "venture capital" are included in the name of such fund, or the "venture capital" strategy is reflected in the fund contract and PPM.

VC funds can only invest in equity of unlisted companies

The 2014 Interim Measures set up a strict limitation on investment of VC funds: they are only allowed to invest in equity of unlisted start-ups. The Regulations further state that the investment scope of VC funds is limited to equity in unlisted companies, but is not restricted to start-ups. In addition, one of the guidelines issued with the aforementioned Filing Measures, the *Private*

Investment Fund Filing Guideline No 2 – Private Equity and Venture Capital Funds, also encourages VC funds to invest in early-stage enterprises, small and medium-sized enterprises (SMEs) and high-tech enterprises.

Secondary Funds ("S Funds")

Along with the rapid development and cyclical adjustment of the private equity funds market, S funds have become one channel for alleviating the exit problems in recent years; and the secondary market, which is mainly based on the transfer of private equity fund shares, has ushered in related development opportunities in China. However, the previous policies have not synchronised with the market tempo; thus, S fund transactions have faced problems and challenges in the absence of regulations.

For example, generally for the secondary share transfer of state-owned shares, investors usually comply with the rules of state-owned property transactions. However, the capital contribution by state-owned enterprises to limited liability partnership enterprises cannot be registered as state-owned property rights, and different understandings exist among local state-owned assets supervision and administration commissions and among equity exchanges on whether limited liability partnerships should comply with rules of state-owned property transactions. Therefore, it is has not yet been possible to standardise the implementation of such standards and criteria.

In 2020, the executive meeting of the State Council decided to "carry out a pilot project of transferring shares of equity investment and VC investment in regional equity markets". In December 2020 and November 2021, Beijing and Shanghai, respectively, took the lead in carrying out the pilot project of transferring shares of S funds, and issued relevant local supporting regulations. In 2023, Guangdong Province and Jiangsu Province also launched their pilot projects for transferring shares of S funds.

In August 2023, the State Council issued the *Opinions on Further Optimising the Foreign Investment Environment and Increasing Efforts to Attract Foreign Investment*, which emphasised the support for qualified foreign limited partners (QFLPs) to make related domestic investments directly, and the policy of no withholding tax on profits obtained from domestic reinvestment by foreign investors. With the support of the above policy, foreign investment institutions have also gradually participated in establishing S funds and related transactions.

The authors are pleased to see regulators continuing to expand the scope of pilot projects in the future, or promoting the corresponding experience nationwide, and introducing more supportive policies to enliven the S funds market.

Concentration of Business Operators

Since the amendment of the Anti-Monopoly Law came into effect on 1 August 2022, anti-monopoly enforcement efforts have been significantly enhanced, and penalties have been gradually increased for illegal concentration of business operators. Against this backdrop, the authors also note that in the private equity funds market there has also been a significant increase in the compliance awareness of market participants, with a gradual increase in the declaration of concentration of business operators in establishment and investment segments of private equity funds. This is becoming the norm, particularly for mainstream RMB funds.

The concentration of business operators stipulated in the Anti-Monopoly Law requires that both "control" and "turnover" criteria be met. "Control" refers to a business operator's taking control of or ability to exert decisive influence over other business operators. "Turnover" refers to the overall turnover of the group of companies to which the business operator belongs. For private equity funds, it is not difficult to satisfy both criteria at the same time.

In practice, scenarios such as common dual-GP structure, LPs appointing investment decision-making committee members while enjoying veto power over investment decisions, or minority investments enjoying veto power over specific major matters of invested companies may constitute a change of control within the scope of the Anti-Monopoly Law. Provided that the turnover criterion is met at the same time, this would be considered a concentration of business operators and would need to be declared. Due to the special characteristics of the private equity funds market, most declarations are made using the simplified procedure, which also largely improves convenience in making declarations on such a concentration.

The consequences of failing to declare in accordance with the law may be unbearable – from the perspective of legal risk, a business operator who so fails to declare may be subject to fines. They may also be required to stop performing the act of such concentration and to revert to the pre-concentration status; from a business perspective, this may have an adverse impact on the fund managers' reputation and compliance records. Moreover, it may also affect subsequent transactions and listing of target companies. Therefore, increasingly more fund managers have begun to carefully consider the making of declarations of concentration of business operators.

With China's anti-monopoly enforcement increasing in recent years, there have been precedents of penalties for private equity funds not declaring concentration in accordance with the law. The risk of failure to declare concentration, historically or in the present, has increased significantly. For fund managers, it is even more necessary to continue keeping an eye on concentration issues during the launch process and the investment transactions of private equity funds, to avoid possible anti-monopoly compliance risks.

Exiting of Funds

In recent years, as many private equity funds established in the early stage of China's investment funds industry have entered the exit and liquidation period, how private equity funds can be successfully exited and liquidated has become a key concern for fund managers. From the perspective of investment, private equity funds can adopt various strategies to dispose of their investment portfolios, including but not limited to:

- initial public offerings (IPOs);
- mergers and acquisitions (M&A); and
- the sale of fund shares in the secondary market (S strategies), etc.

However, due to the impact of many factors such as economic environment and the change of capital market policies, it may not be easy to exit from the investment side, and fund managers have begun to pay attention to the methods and possibilities of the gradual exiting of funds.

From the perspective of investment funds, there are several ways in which private equity funds can exit. The main options include the following.

Fund liquidation
The occurrence of a statutory cause of dissolution under the Company Law or the Partnership Law, or an agreed cause of dissolution written in the fund contract, will result in the dissolution of the private equity fund and the liquidation process. For both company-type funds and, more commonly, partnership-type funds, the liquidation of the funds entails the simultaneous fulfilment of the filing, reporting and deregistration processes required by the AMAC and various regulatory authorities (such as the company registry and taxation department), owing to the dual legal identities of both the private fund and the company/partnership entity.

In-kind distributions
The purpose of investors when investing in private equity funds is to obtain cash returns rather than hold and dispose of the investment portfolios at their own discretion. In the domestic RMB funds market, investors usually think that it is the fund manager's obligation to achieve cash distributions. Additionally, the current company registry system and the securities registration and settlement system cannot fully match such in-kind distributions. Therefore, the distribution of private equity funds is usually based on the principle of cash distribution, with in-kind distribution as an exception. Fund managers may decide to make in-kind distribution only when such distribution is more in the interests of all limited partners or when the cash distribution cannot be realised.

In recent years, as the CSRC has begun pilot projects for the in-kind distribution of shares by private equity funds to investors, there is clearer policy support for such distribution. This is beneficial for the differentiated needs of investors, and further optimises the environment regarding the exiting of private equity funds and VC funds.

Fund status deregistration
In addition to the regular fund liquidation procedure, the *Private Investment Fund Filing Guideline No 2 – Private Equity and Venture Capital Funds* issued by the AMAC in September 2023 allows a filed company-type or partnership-type private equity fund to terminate the entrustment relationship between fund manager and investors after mutual agreement, and to transform into a non-fund-type company or partnership.

It provides another option for fund managers: the filed private equity fund can deregister as a fund but remain as a company/partnership; meanwhile, it should delete the word "fund" from its registered business scope and name, so as to avoid the need to fulfil the fund liquidation procedure required by the AMAC, and continue to operate in the form of a company or partnership of ordinary nature. It is foreseeable that this will become one of the exit options for private equity funds in the future.

Outlook
Overall, since 2010, China's private investment funds industry has been developing rapidly, with the number of fund managers, the scale of private investment funds under management and the number of practitioners all increasing significantly. Mainstream investors have also gradually changed from individual investors to institutional investors, such as financial institutions, state-owned enterprises and listed companies. Fund managers, investors and regulators have a deeper understanding of the private investment funds market, and pay more attention to the compliance of fund managers and the protection of investors' rights.

Ten years have passed in a flash. China's private investment funds industry has travelled a road from "moderate regulation" and "moderately strict regulation" to today's "strengthened regulation", with regulatory differentiation for various types of funds. As competition in this industry intensifies and regulation tightens, China's private investment funds industry is transforming from high-speed development to high-quality development. In the context of recent macroeconomic tightening, it is expected that China's investment equity funds industry will move forward for a period of time against the backdrop of a downward trend in the fundraising and exit environment, and will look towards ushering in a new phase of high-quality development.

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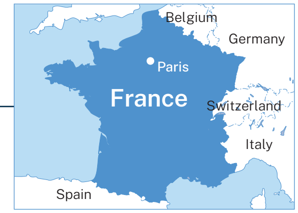

Law and Practice

Contributed by:
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Contents

Dechert LLP is a global law firm that advises asset managers, financial institutions and corporations on issues critical to managing their business and their capital – from high-stakes litigation to complex transactions and regulatory matters. More than 1,000 lawyers across 21 offices globally focus on financial services, private equity, private credit, real estate, life sciences, and technology. Dechert's Paris office, a key component of the firm's European strategy, is active in antitrust/competition and European law, corporate, financial services and asset management, financing, IP, labour and employment, litigation and compliance, regulatory and tax. The funds team advises on fund formation, product development, and regulatory compliance, in addition to handling corporate matters throughout the life cycle of investment funds and asset management (including secondary transactions and fund reviews). The team has expertise in setting up various types of investment funds and is one of the few in France integrating tax and funds lawyers, covering the entire industry spectrum.

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Dechert LLP

1. Market Overview

1.1 State of the Market

The French asset management market is one of the most sophisticated European markets in respect of fund formations and sources of fundraising. According to the 2023 Markets and Risk Outlook published by the *Autorité des marches financiers* (AMF), France is ranked as the fourth largest European market in terms of funds domiciled (around 12% of European assets under management), behind only:

- Luxembourg (funds account for around EUR5,028 billion in assets under management, or around 28% of European assets under management);
- Ireland (around 20% of the European market); and
- Germany (around 13% of the European market).

A large range of both closed-ended and open-ended investment funds are offered in France, including undertakings for collective investments in transferable securities (UCITS) and alternative investment funds (AIFs). French law provides for various legal forms of AIF depending on the asset class that is targeted by the fund managers.

AIFs tend to be structured as closed-ended funds when they invest in private strategies while AIFs investing in listed assets and UCITS tend to be open-ended. It should, however, be noted that private funds tend to be structured as "evergreen/semi-liquid" investment vehicles to offer more frequent liquidity sources when they are distributed to retail investors.

Historically, the French asset management market can be broken down into:

- traditional asset classes (including listed instruments), which are generally distributed to retail investors via UCITS or AIFs (although some fund managers manage certain separate managed accounts or dedicated funds for institutional investors); and
- private asset classes, which are generally reserved for institutional investors.

However, there has been increasing demand for access to private strategies in recent years through the "retailisation" of private strategies. Retail investors and high net worth individuals are seeking more diversification and performance than through listed investments, while fund managers are seeking diversification of their historical investors base in order to carry out successful fundraising in new ways.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

French law makes a distinction between two categories of AIF as defined under Directive 2011/61/EU (AIFMD), as amended by Directive 2019/1160/EU (CBDFD):

- per seAIFs (*FIA par nature*); and
- AIFs by object or "Other AIFs" (*FIA par objet or Autres FIA*).

The AIFMD and the CBDFD have been implemented under French law in the French Monetary and Financial Code (FMFC). This distinction is specific to French law and does not result from the AIFMD.

The FMFC provides for an exhaustive list of French legal forms which qualify as AIFs. Such AIFs are called per se AIFs (*FIA par nature*) because they are regulated by a specific layer of rules in the FMFC.

Other AIFs are not specifically regulated under the FMFC, other than through the legal definition of AIF provided in the FMFC.

Regulations implementing the provisions of the FMFC are provided for under the general regulations issued by the AMF (the "AMF General Regulation").

Per Se AIFs

The categories of per se AIFs are the following:

- AIFs open to non-professional investors;
- AIFs reserved to professional investors;
- employees savings funds (*fonds d'épargne salariale*); and
- securitisation or financing undertakings (*organismes de titrisation ou de financement*).

Each category of AIF has been "designed" to implement a particular alternative investment strategy (with specific investment ratios and eligible assets) and/or to be marketed to a specific category of eligible investors (professional or retail investors or employees).

Each per se AIF can be set up under the form of:

- a contractual fund (*fonds commun de placement – FCP*) which corresponds to a co-ownership of financial instruments issuing units; or
- an investment company with variable capital (*société d'investissement à capital variable – SICAV*) which corresponds to a French corporate form issuing shares.

French per se AIFs can also be structured as umbrella funds. Each sub-fund is subject to the regulations applicable to the legal form chosen for the AIF (it is treated as a single separate AIF for that purpose).

The FMFC provides for several sub-categories of per se AIFs as follows:

- French per se AIFs open to retail investors:
  - (a) generic investment funds (*fonds d'investissement à vocation générale – FIVG*);
  - (b) private equity investment funds (*fonds de capital investissement – FCPR, FCPI* and *FIP*);
  - (c) real estate investment funds (*organismes de placement collectif immobilier – OPCI* and *sociétés civiles de placement immobilier – SCPI*);
  - (d) forest savings companies (*sociétés d'épargne forestière – SEF* or *groupements forestiers d'investissement – GFI*);
  - (e) closed-ended investment companies with fixed share capital (*sociétés d'investissement à capital fixe – SICAF*); and
  - (f) alternative funds of funds (*fonds de fonds alternatifs – FFA*).
- French per se AIFs reserved to professional investors:
  - (a) generic professional investment funds (*fonds professionnels à vocation générale – FPVG*);
  - (b) professional real estate investment funds (*organismes professionnels de placement collectif immobilier – OPPCI*);
  - (c) professional private equity investment funds (*fonds professionnels de capital investissement – FPCI*); and
  - (d) professional specialised investment funds (*fonds professionnels spécialisés – FPS*), including French limited partnerships (*sociétés de libre partenariat – SLP*).

- French employee savings funds (*fonds d'épargne salariale*) which include *fonds commun de placement d'entreprise – FCPE* and *sociétés d'investissement à capital variable d'actionnariat salarié – SICAVAS*.
- French financing undertakings (*organismes de financement*):
  - (a) securitisation undertakings (*organismes de titrisations – OT*), the manager of which may be subject to the AIFMD if they meet certain criteria); and
  - (b) specialised financing undertakings (*organismes de financement spécialisés – OFS*).

Other AIFs

An Other AIF corresponds to an entity (irrespective of its legal form) that meets – in practice – the definition of an AIF under the AIFMD, and which therefore falls within the scope of this definition. Other AIFs were not regulated before the implementation of the AIFMD. Other AIFs cannot be structured as umbrella AIFs.

The setting up of this type of AIF is not defined from a regulatory perspective. There is no specific French authorisation or notification requirements vis-à-vis the AMF applicable to Other AIFs. However, they are subject to regulations applicable to any AIFs arising from the AIFMD, including in terms of marketing requirements.

Other AIFs must, in principle, be managed by portfolio management companies regulated by the AMF. They can, however, be managed by non-regulated managers if they are only subscribed to by professional investors. This includes both per se professional clients and opt-out professional clients treated as such upon request as defined in Annex II of Directive 2014/65/EU (MiFID). In addition, the amount of assets under management managed by the non-regulated fund manager must be below the AIFMD thresholds (ie, EUR500 million in assets and EUR100 million where the assets are leveraged).

When an Other AIF is managed by a non-regulated manager, it cannot be marketed throughout the European economic area (EEA) on a passport basis according to the AIFMD.

The ELTIF Label

Pursuant to Regulation (EU) 2015/760 (ELTIF) (as amended by Regulation (EU) 2023/606) (the "ELTIF Regulation"), French legislation allows certain French AIFs to be authorised by the AMF as ELTIFs according to the ELTIF Regulation since 2016. The most common legal forms used in practice are the FPS, SLP or OFS as these funds are relatively flexible in terms of investment restrictions (allowing such legal forms to accommodate the ELTIF Regulation's own requirements) and they can already originate loans under French law.

2.1.2 Common Process for Setting Up Investment Funds

Registration/Approval Requirements for Most AIFs

The creation of most French AIFs (ie, retail AIFs and certain AIFs reserved to professional investors) requires the AMF's prior authorisation for launch and marketing. Modifications of such funds may be subject to either the AMF's prior approval or its immediate notification, depending on classification provided by the AMF doctrine.

In terms of the AMF process, the application for French AIF approval will vary from one product to another (regulated by different AMF doctrines, a doctrine per group of legal AIF forms). Moreover, depending on whether the AIF manager

(AIFM) is regulated by the AMF or not, a filing via the GECO database (and end of Q1 2024, the ROSA Extranet) or by email to a dedicated email address, will be necessary. Nevertheless, the process is more or less similar across different products, the main differences being the type of assets that will be eligible to said product and other product-specific requirements.

Key required documentation

For AIFs open to retail investors and certain AIFs reserved to professional investors (FPVG and OPPCI), an application form must be submitted to the AMF, including the following documents (and ancillary documents):

- the relevant application form applicable to the type of AIF (which provides a list of attachments to be provided);
- an offering document (or prospectus);
- a constitutive document (by-laws for FCPs and articles of incorporation for SICAV);
- if the AIF will be marketed to retail investors, a key information document (KID) prepared according to Regulation (EU) 1286/2014 (the "PRIIPS Regulation");
- a declaration, by the AIFM certifying inter alia that the manager and the fund's service providers have the necessary regulatory approvals, that the fund legal documentation and the KID (if required) have been prepared in accordance with applicable regulation, that promotional documents comply with AMF requirements and certain declarations in relation to the liquidity management tools provided in the fund documentation;
- the acceptance letters from the depositary, the statutory auditor as well as other services providers, certifying that they have accepted their duties with the fund; and
- the working programme of the statutory auditor.

For certain AIFs open to retail investors (FCPR, FCPI, FIP) and reserved to professional investors (FPCI, SLP) the constitutive document is equivalent to the offering document/prospectus.

Process

When prior approval of the AMF is a requirement for the creation of an AIF, the regulatory approval process with the AMF is one month beginning from the acknowledgement of receipt from the AMF of a complete application. Such acknowledgement of receipt provides for the regulatory approval deadline.

The regulatory process with the AMF is free of charge. Nevertheless, in addition to the fees charged by the AMF to either French AIFMs or EEA AIFMs managing a French fund based on assets under management, a registration fee and an annual fixed fee per fund (and compartment if any) of EUR2,000 is due to the AMF.

Registration/Approval Requirements for AIFs Reserved for Professional Investors

Certain AIFs reserved to professional investors (such as the FPCI, the FPS (including the SLP) and the OFS – but with the exception of the FPVG and OPPCI), as well as Other AIFs, are not subject to the AMF's prior authorisation.

AIFs reserved to professional investors are only subject to an AMF notification process while Other AIFs are not subject to any regulatory setting up formalities vis-à-vis the AMF (but are still subject to formalities before they can be marketed in France and in the EEA). Modifications made during the life of an AIF reserved to professional investors are not subject to AMF authorisation but are only notified ex post to the AMF.

Depending on whether the AIFM is regulated by the AMF or not, a filing via the GECO database (and end of Q1 2024, the ROSA Extranet) or by email to a dedicated email address, will be necessary. Nevertheless, the process is more or less similar between the products, the main differences being the type of assets that will be eligible to said product and other product-specific requirements.

Key required documentation

See above for key required documents applicable to AIFs reserved to professional investors which are subject to a mere AMF notification process.

With respect to per se AIFs reserved to professional investors, the offering document and the constitutive document are generally the same. This is the key document for these AIFs.

With respect to Other AIFs, there is generally an information note which is prepared in order to provide the investors with all information required under Article 23 of the AIFMD. Note that some choose to set up a shareholders' agreement to cover this required information insofar as Other AIFs are often set up in the form of a French company.

Process

Although there is no approval process by the AMF, there is an ex post notification to the AMF one month after the setting up of the AIF. In practice, the notification process is generally made in two phases: (i) a first notification is made in order to obtain a marketing authorisation delivered by the AMF, and then (ii) a second notification is made in order to file the certificate of funds deposit issued by the depositary of the AIF when the minimum amount of required capital has been paid to the relevant AIF's bank account.

The fees and costs are the same as those that apply to retail AIFs.

2.1.3 Limited Liability

Liability is limited to the amount of commitment (for retail funds, the subscription commitments are generally fully paid upon the subscription). The losses that an investor will suffer will therefore be limited to the amount of its subscription.

2.1.4 Disclosure Requirements

AIFMs are subject to several disclosure and reporting requirements to the AMF and the investors as provided for in the AIFMD and applicable French laws and regulations. Those requirements aim at protecting investors before their investment in an AIF and on an ongoing basis for as long as they hold units or shares in the relevant AIF.

Disclosures/Reporting Requirements

Annual report

Pursuant to the AIFMD, an AIFM must publish an annual report per financial year for each EU AIF it manages and for each AIF it markets in the EEA within six months after the end of the financial year.

This annual report shall comprise the following:

- an annual management report;
- the summary documents defined in the chart of accounts and the certification of the fund statutory auditor;
- any material changes, within the meaning of Article 106 of Delegated Regulation (EU) 231/2013 (the "AIFMD Level 2 Regulation"), to the information referred to in Article 3 of this instruction during the financial year covered by the report; and
- the accounting information, prepared in accordance with French accounting stand-

ards (Regulation No 2017-05 and No 2018-04 of the *Autorité des normes comptables*) or the accounting standards of the country in which the AIF is established.

Half-yearly report

An AIFM shall also publish a half-yearly report for each French AIF it manages within two months after the end of the first half of the year.

This half-yearly report shall include:

- an inventory of the portfolio of assets held by the relevant AIF with details about the number and value of the financial instruments;
- the amount of the net assets;
- the number of units or shares in circulation;
- the net asset value; and
- off-balance sheet commitments.

A document entitled "asset composition" shall be established by the AIFM at the day of the latest liquidation value of each half-year period, and statutory auditors shall verify the asset composition before publication of such document. This document must be sent to any shareholder or unitholder who requests it within eight weeks of the end of each half year.

Pre-contractual information

When an AIF is managed or marketed in the EEA, the AIFM must make certain pre-contractual information available to investors before they invest in the relevant AIF as well as any amendment thereto in accordance with French laws and regulations implementing Article 23 of the AIFMD. This information also includes sustainable finance pre-contractual information set out under Regulation (EU) 2019/2088 (SFDR).

Marketing materials of AIFs

In addition to the guidelines on marketing communications issued by the European Securities and Markets Authority (ESMA) (ESMA34-45-1244), the AMF has set its own set of rules in the AMF Position No 2011-24 on the content requirements of marketing materials. The AMF is entitled to review any marketing materials relating to an AIF marketed in France prior to their release to French investors.

Additional Disclosure Requirements

Additional disclosures requirements shall apply to French AIFMs. These include the following:

- A policy on the inclusion in their investment strategy of environmental, social and governance (ESG) quality criteria and the means implemented to contribute to the energy and ecological transition; this information relates in particular to the fight against climate change (ie, level of investment in climate protection, the contribution to meeting the international objective of limiting global warming and achieving the objectives of the energy and ecological transition).
- A policy on how the voting rights attached to the financial instruments held by the AIFs are exercised.
- A shareholder commitment policy describing how they integrate their role as a shareholder into their investment strategy; each year, the AIFM publishes a report on the implementation of this policy.
- Disclosures applicable to AIFMs (to the extent that they qualify as financial market participants), which are required pursuant to the SFDR and which are not analysed in this document.

A French AIFM is also required for compliance purposes to make specific reports to the AMF on a quarterly basis of:

- any case of non-compliance with its applicable investment rules and fund asset diversification by an AIF managed by a French AIFM or by a foreign AIFM (except for cases of non-compliance beyond the control of the management company and not resulting from the maturity of a financial instrument held by the AIF); and
- indemnification paid by French AIFMs to investors in French or foreign AIFs they manage, including by delegation, and to clients to whom they provide investment services.

Please note that other disclosures and reporting requirements vis-à-vis the AMF shall apply to AIFMs in such capacity but they are not analysed in this document.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

The type of investors investing in a particular AIF will depend on the investment strategy implemented by such AIF and the existence or not of a tax incentive attached to an investment in such AIF.

Historically:

- French AIFs open to retail investors are generally structured to be marketed to French retail investors through French unit-linked life insurance contracts (please refer to 3.**2.1 Types of Investors in Retail Funds** for further details);
- French venture capital funds set up as FCPR, FCPI and FIP are mainly designed for retail investors, including those who intend to benefit from a favourable tax regime;
- AIFs reserved to professional investors (such as FPVG, FPCI, FPS and OPPCI) are mainly marketed to institutional investors (credit institutions, funds of funds, insurance companies, large corporate entities, etc) as well as family offices, other corporate companies and high net worth individuals; and
- French employees savings funds are set up in a very specific context: in order to incentivise the employees of a company or a group of companies.

2.2.2 Legal Structures Used by Fund Managers

The contractual form of the FCP (*fonds commun de placement*) and the SICAV (*société d'investissement à capital variable*) are the most common legal forms for retail funds. Nevertheless, SCPIs may be created with fixed capital.

2.2.3 Restrictions on Investors

No specific restrictions apply on subscriptions to French AIFs open to retail investors (including in regard to the minimum amount of subscription). As heavily regulated vehicles, UCITS or retails AIFs can be subscribed to by anyone (retail or professional clients) having the legal capacity and investing the minimum that is required in the fund documentation.

On the contrary, subscriptions to French AIFs reserved to professional investors are generally restricted to eligible/professional investors who qualify as:

- per se or opt-out professional clients within the meaning of MiFID;
- investors whose initial subscription or acquisition of units or shares of such AIF is equal to EUR100,000 or more; and
- investors for whom the subscription or acquisition of units is performed in their name

and on their behalf by an investment services provider in the context of discretionary portfolio management.

In addition to the foregoing, subscriptions to FPCI, OFS and FPS (excluding the SLP) are also open to specific categories of investors such as:

- investors, natural persons and legal entities, whose initial subscription is equal to EUR30,000 or more and who meet one of three specific criteria; and/or
- executives, employees or individuals acting on behalf of the AIFM, or the AIFM itself.

Subscriptions to SLP are also open to the following persons: the manager (legal representative of the SLP which is in practice the AIFM), the AIFM, the general partner, executives and employees of the AIFM or individuals and legal entities acting on behalf of the AIFM.

The categories of eligible investors in AIFs reserved to professional investors are generally referred to as "Qualified Investors" or "Eligible Investors".

When French AIFs reserved to professional investors are authorised as ELTIF, they can also be invested in by retail investors according to the ELTIF Regulation.

Furthermore, marketing of non-French AIFs in France can be made as follows:

- in accordance with the AIFMD marketing passport, to French professional investors only;
- in accordance with national private placement regime (NPPR) as set out in Article 43 of the AIFMD, to French non-professional investors (in such case, the prior authorisation of the AMF is required); and
- in accordance with the ELTIF Regulation if the non-French AIF is authorised as an ELTIF, to French professional and non-professional investors.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

The AIFMD was implemented under French law in the FMFC by ordinance No 2013-676 of 25 July 2013 and supplemented by the AMF General Regulation, the AMF doctrines issued in relation to these matters. It primarily regulates the AIFM as opposed to the AIFs directly.

All AIFs are indirectly subject to the common requirements set out in the AIFMD as implemented under French law in the FMFC and the AIFMD Level 2 Regulation (pre-marketing and marketing rules of AIFs, obligation to appoint a depositary, disclosures and reporting requirements, etc). The regulatory regime will also depend on whether AIFs are managed by an AIFM authorised pursuant to the AIFMD.

In addition to the common requirements, per seAIFs are subject to specific investment rules provided for in the FMFC and the AMF General Regulation, including:

- eligible assets;
- investment quotas regarding certain type of assets;
- diversification and control ratios; and
- limits on certain operations, such as the use of financial derivatives, cash borrowing and guarantees.

A distinction can be made between (i) AIFs open to retail investors, which are generally subject to strict investment restrictions; and (ii) AIFs reserved to professional investors, which are less regulated. FPS (including SLP) and OFS are not subject to any legal ratios or constraints.

When French AIFs reserved to professional investors are authorised as ELTIF, they are subject to the restrictions set out in the ELTIF Regulation, in addition to the regulation of the French AIF that is used as conduit.

2.3.2 Requirements for Non-local Service Providers

The depositary of a French AIF must either have its registered office in France or have a branch in France provided that its registered office is located in another EU member state.

The depositary is a regulated entity and must be chosen from a list of entities drawn up by the French Minister for the Economy.

The fund administration of French AIFs is generally handled by the AIFM but can also be delegated to third parties under the supervision of the AIFM. French law does not require that a specific licence be held in order to carry out such function on a delegated basis.

2.3.3 Local Regulatory Requirements for Non-local Managers

French AIFs may be managed by an AIFM based in a member state of the EEA according to the management passport set out in the AIFMD. To that end, such AIFM must provide a notification to its home supervisory authority which will transmit it to the AMF.

The portfolio management of French AIFs can be delegated according to the AIFMD Level 2 Regulation.

As implemented under French law, such delegate managers can be located in a member state of the EEA (other than France) or in a third country to the EEA subject to certain requirements as more fully described in the FMFC and in the AMF General Regulation.

AIFMs which intend to delegate to third parties the task of carrying out functions on their behalf must notify the supervisory authorities of their home member state before the delegation arrangements become effective.

2.3.4 Regulatory Approval Process

As mentioned above in **2.1.2 Common Process for Setting Up Investment Funds**, the regulatory approval process of AIFs open to retail investors and certain AIFs reserved to professional investors (FPVG and OPPCI) is one month.

Other AIFs reserved to professional investors are not subject to any AMF approval process (but subject to a regulatory notification process on an ex-post basis).

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

The CBDFD governing pre-marketing of AIFs managed by European AIFMs came into force in 2021 leading to a harmonised regulation of pre-marketing and of the content of marketing materials.

This new regime has been fully implemented into French law and has substantially modified the previous French (local) regime that existed before the harmonised framework came into force.

Pursuant to this new regime, an AIFM established in another member state which intends to carry out pre-marketing in France in respect of an AIF must notify the competent authority of its home member state no later than two weeks after the commencement of the pre-marketing activities. The AMF should be notified in turn by the competent authority of the AIFM's home member state.

This notification should include inter alia:

- the targeted member state(s);
- the periods of time during which the pre-marketing took place;
- a brief description of the pre-marketing activities, including information on the investment strategies and, where relevant, a list of AIFs and compartments of AIFs which were the subject of the pre-marketing.

The AMF has extended the European pre-marketing regime to non-EEA AIFMs and to UCITS. The start of pre-marketing activities of an AIF in France by a non-EEA AIFM needs therefore to be notified to the AMF directly.

For pre-marketing to be recognised as such (and allowed) under French law, it should:

- be addressed only to professional investors or non-professional investors that would qualify as Eligible Investors (ie, investing at least EUR100,000 if the AIF subject to pre-marketing is an FPCI, FPS, including SLP or OFS); and
- concern an investment idea or investment strategy of an AIF which is not yet established, or of an AIF which is established, but not yet notified for marketing in the respective country.

During pre-marketing:

- investors cannot subscribe to the units or shares of the pre-marketed AIF;
- subscription agreements or similar documents whether in draft or final form cannot be provided to potential investors; and
- legal constitutive documentation of the pre-marketed AIF cannot be provided in final form to potential investors (it must be clearly stated that the information presented is unreliable, incomplete and subject to change).

When an AIFM carries out pre-marketing activities in respect of an AIF, any subscription by professional investors within 18 months as from the start of pre-marketing activities shall be considered as the result of marketing and shall therefore be subject to the applicable AIFMD marketing passporting requirements. See **2.3.8 Marketing Authorisation/Notification Process** for further details.

2.3.6 Rules Concerning Marketing of Alternative Funds

Rules that apply to firms marketing French or foreign AIFs in France are provided for in the FMFC, the AMF General Regulation and the doctrine published by the AMF (instructions, positions and recommendations).

The marketing of AIFs in France is subject to the regulatory framework as summarised below (although this is not an exhaustive list):

- French lawmakers have implemented in the FMFC a definition of marketing which is substantially similar to the one provided under the AIFMD as amended by the CBDFD. The AMF has specified the scope of that definition in its AMF Position-Recommendation No 2014-04 and has expressly listed some situa-

tions which are not considered as marketing (such as pre-marketing activities).
- Marketing of AIFs in France is subject to either an AMF notification process (for marketing purposes to professional investors) or an AMF prior authorisation process (for marketing purposes to retail investors). See **2.3.8 Marketing Authorisation/Notification Process** for further details.
- The person marketing an AIF shall ensure that the investor satisfies the eligibility conditions to subscribe to the relevant AIF.
- Marketing of AIFs in France is subject to the provision to the investor of the by-laws and offering documents of such AIF in French. As an exception, these documents may be provided in English if (i) the marketing is geared towards professional investors and (ii) the firm marketing the AIF has ensured:
  (a) with respect to professional investors, they have agreed to receive the documents in English; and
  (b) with respect to non-professional investors, they understand English.
- Specific requirements are applicable in the content of marketing materials, which are set out in the above mentioned ESMA guidelines on marketing communications (ESMA34-45-1244) and in the AMF Position No 2011-24.
- The AMF is entitled to review any marketing materials relating to an AIF marketed in France prior to their release to French investors. The AMF is also entitled to ask for any amendment thereto in order to make sure that the information provided is accurate, clear and not misleading.

2.3.7 Marketing of Alternative Funds

French and foreign AIFs can generally be marketed in France to the following categories of investors:

- for French AIFs open to retail investors – both professional and retail investors;
- for French AIF reserved to professional investors – professional investors and investors investing a minimum amount (EUR30,000 or EUR100,000) (depending on the legal form of the AIFs) as described in **2.2.3 Restrictions on Investors**;
- for foreign AIFs located in EEA jurisdictions and managed by an EEA AIFM – (i) to professional investors only according to the AIFMD marketing passport and (ii) to retail investors subject to the prior authorisation of the AMF according to the French NPPR (see **2.3.8 Marketing Authorisation/Notification Process** for further details);
- for foreign AIFs located in third countries – to professional and retail investors, subject to the prior authorisation of the AMF.

In any case, the firm marketing an AIF in France must first ensure that the investor is eligible to invest in such AIF.

2.3.8 Marketing Authorisation/Notification Process

An AIFM intending to market AIFs to professional investors in France must submit a notification to the competent authority of its home member state in respect of each EEA AIF that it intends to market.

The notification file must contain certain information, as follows:

- a notification letter (template provided by the competent authority of its home member state) with a programme of operations identifying the AIFs identifying the AIFs the AIFM intends to market and information on where the AIFs are established;
- the AIF rules or instruments of incorporation;

- the identification of the depositary of the AIF;
- a description of, or any information on, the AIF available to investors;
- information on where the master AIF is established if the AIF is a feeder AIF;
- the indication of the member state in which the AIFM intends to market the units or shares of the AIF to professional investors; and
- information about arrangements made for the marketing of AIFs and, where relevant, information on the arrangements established to prevent units or shares of the AIF from being marketed to retail investors.

The competent authority of the home member state of the AIFM shall transmit the complete notification file to the AMF in order to implement the AIFMD marketing passport. This transmission must be made no later than 20 business days after the date of receipt of the complete file. Marketing in France can begin as from the date of notification of such transmission to the AMF.

An AIFM intending to market French AIFs to retail investors in France must comply with specific conditions set out in the AMF General Regulation. This regime requires obtaining the prior authorisation of the AMF in respect of the relevant AIFs before marketing them to retail investors in France.

Among the conditions to be satisfied:

- an instrument in relation to the exchange of information and mutual assistance in the field of asset management on behalf of third parties should have been set up between the AMF and the competent authority of the AIFM; and
- the AIFM shall meet the conditions provided in a mutual recognition agreement entered into between the AMF and the competent authority of the AIFM defining the specific requirements applicable to the approval of management companies of AIFs that may be marketed to non-professional clients.

2.3.9 Post-marketing Ongoing Requirements

When units or shares of an AIF have been marketed in France, the AMF considers that these units or shares are deemed to have been marketed in France as long as investors to whom such units or shares have been marketed in France remain investors in the relevant AIF. It is therefore necessary to maintain the marketing authorisation or marketing notification as long as investors continue to hold units or shares in the relevant AIF.

An AIFM must notify any material change in the information contained in the initial marketing notification file to its home state competent authority by indicating the change concerned.

All material changes planned by the AIFM must be notified to the AMF at least one month before their implementation or immediately after an unplanned change has occurred.

As explained in **2.1.4 Disclosure Requirements**, there are also annual and half-yearly reporting requirements for AIFMs vis-à-vis the investors and the AMF.

In order to cease marketing a passported AIF in France, notification to de-register the AIF should be made to the competent authority of the AIFM's home state according to the procedure set forth in the CBDFD. From the date of de-notification, a 36-month "black-out" period is triggered during which any pre-marketing of the relevant AIF or in respect of similar investment strategies or ideas is prohibited.

2.3.10 Investor Protection Rules
Only Eligible Investors are allowed to subscribe to AIFs reserved to professional investors. The offering documents may provide further restrictions on the types of investors that an AIF reserved to professional investors may be marketed to (eg, reserve the subscription of shares or units of such AIF for professional investors only – if so, no PRIIPS KID must be prepared and provided to them).

As explained in **2.1.4 Disclosure Requirements**, there are also annual and half-yearly reporting requirements for AIFMs vis-à-vis the investors.

Furthermore, the AIFMD provides additional investor protection rules that must be complied with by the AIFM, such as the following:

- the establishment by the AIFM of risk management, liquidity management and conflict of interests internal procedures;
- the valuation of the AIFs' assets in accordance with valuation rules compliant with the AIFMD; and
- the description of how the AIFM ensures fair treatment of investors and, whenever an investor obtains preferential treatment or the right to obtain preferential treatment, a description of that preferential treatment, the type of investors who obtain such preferential treatment and, where relevant, their legal or economic links with the AIF or AIFM.

Finally, AIFMs shall provide the following in respect of retail investors:

- the facilities required under the CBDFD (as implemented under French law) to carry out certain tasks with regard to AIFs marketed to retail investors in France; and
- a complaint handling system and information on such system (in advance of their investment).

2.3.11 Approach of the Regulator
The AMF has adopted a pragmatic approach and although the whole process is done online through a portal (or via regulator-to-regulator notification mechanism), the AMF is approachable and open to face-to-face meetings, especially for new market participants. The AMF personnel in charge of reviewing the filings can be contacted by email (contact details are provided when the filing is acknowledged as complete) or by phone.

2.4 Operational Requirements
French law provides for different types of AIFs, depending on the investment strategies envisaged and the type of assets targeted. With the exception of the SLP, which can be used to invest in any type of private strategy, each legal form of fund, depending on its specifics under French law, will be dedicated to specifically invest in listed securities, real estate, securitisation, private debt, private equity and/or infrastructure.

The legal documentation of each AIF must be drafted on the basis of a template provided by the AMF in its applicable doctrine depending on the legal form that has been chosen.

Details of the potential risks applicable to a specific AIF and its investment strategy are required to be disclosed in the legal constitutive documentation.

Protection of the Assets Held by the Fund
A French portfolio management company authorised pursuant to the AIFMD must comply with the applicable requirements set out in the AIFMD and the AIFMD Level 2 Regulation. Key

requirements are that the AIFM must maintain sufficient human and financial resources (including a minimum amount of capital requirements). Other requirements applicable include internal policies.

Any entity acting as a depositary of an AIF is required to be authorised by the *Autorité de Contrôle Prudentiel et de Résolution* to provide such services and must be listed on a list of entities drawn up by the French Minister for the Economy.

Summary of Specific Requirements Imposed by French Regulations

Borrowing restrictions depend on the chosen legal form. A distinction should be made between:

- French AIFs open to retail investors where the cash borrowing limit is generally limited to 10% or 15% of the fund's assets (and up to 40% of the value of real estate assets for OPCI); and
- French AIFs reserved to professional investors where the cash borrowing limit is either higher (up to 30% of the fund's assets for FPCIs) or not specifically limited (for FPS (including SLP) and OFS).

However, if the FPS (including the SLP) or the OFS are structured to originate loans or are approved as an ELTIF, the maximum leverage will be capped respectively to 30% of their net assets or according to the limitations set out in the ELTIF Regulation.

Details on how the AIF's assets are valued and priced are required to be set out in the legal constitutive documentation and must be compliant with the AIFMD requirements (ie, fair value), and the valuation rules will depend on the nature of the underlying assets. Unless an external valuer is appointed, the AIFM will retain responsibility for valuing the AIF's assets.

Rules relating to insider trading, market abuse and transparency are generally only applicable to AIFs which conduct an investment strategy in listed assets.

As French regulated vehicles, AIFs are subject to laws and regulations on anti-money laundering and counter terrorist financing.

2.5 Fund Finance

The growth of fund finance in France is relatively recent, since a number of legislative changes led to the creation of the SLP in 2015 (which is not subject to any specific indebtedness limit) and the increase of the borrowing ceiling for an FPCI from 10% to 30% of its assets. Fund finance transactions have been developed for closed-ended AIFs.

To date, the market includes a range of French and European lenders from credit institutions to specialist debt asset managers who provide a financing toolkit to AIFMs in order to help them create value and improve fund performance.

The most common product is an equity bridge facility allowing the AIFMs to draw funds from a lender mainly in anticipation of making a capital call. However, alternative fund financing structures have been developed in recent years, such as net asset value financing secured on the underlying assets or unsecured preferred equity.

In the French market, an equity bridge facility is generally structured as a committed term loan (which can be replenished as each loan is repaid), but the facility often also includes an uncommitted line, which reduces the costs of the loan to the fund in terms of commitment fees.

In order to avoid the AIFM being considered to be using leverage for the purposes of the AIFMD Level 2 Regulation, loans should be temporary in nature (in practice less than 364 days maturity) and be fully covered by capital commitments from investors while revolving credit facilities cannot be considered temporary in nature.

In practice fund financing can only be structured for AIFs reserved to professional investors, in particular FPCI, FPS (including SLP) and OFS. The legal constitutive documentation of the AIFs generally provides indebtedness restrictions that may be incurred by the AIF on a short-term basis. See **2.4 Operational Requirements** on cash borrowing restrictions.

With respect to the security package, the lenders under the facility agreement will usually benefit from:

- a pledge over the bank account of the fund into which the investors pay their capital calls (and possibly, over certain other bank accounts of the fund);
- a pledge over certain bank accounts of a special purpose vehicle (if any); and
- the right to draw down investors' undrawn commitments if there is a payment default or an acceleration, with the AIFM failing to send draw-down notices to the investors.

2.6 Tax Regime

French Tax Regime for French AIFs

The tax regime applicable to French AIFs depends on the legal form under which they have been established and on their respective regulatory status.

AIFs set up as contractual funds (FCP) and French limited partnerships (SLP)

As co-ownerships of assets, contractual funds (eg, FCPRs, FCPIs, FIPs, FPCIs, and FPSs, OFSs and OPCIs set up as FCPs) are outside the scope of French corporate income tax (CIT). In addition, French tax law has extended the tax regime applicable to FPCIs to SLPs, and therefore, although a SLP has a legal personality distinct from the one of its investors, it is treated as a contractual fund from a French tax perspective.

Any profits and gains realised by contractual funds and SLPs are hence not taxable at their own level, but are taxed at the level of their respective investors upon redistribution (see below).

AIFs set up as corporations

AIFs established under a corporate form are generally within the scope of CIT, and may either be (i) liable thereto, or (ii) exempted therefrom, depending on their regulatory status. Indeed, certain AIFs are effectively liable for CIT in France under standard conditions (eg, Other AIFs and OFS set up as corporations). However, most generally benefit from an exemption of CIT on gains and profits realised in accordance with their regulatory status and corporate purposes (eg, SICAVs, SPPICAVs, etc). This CIT exemption may eventually be conditional upon an obligation to distribute all (eg, for SICAFs) or part (eg, for SPPICAVs) of the AIFs' profits and gains to the investors.

AIFs set up as partnerships

Certain real estate AIFs set up as partnerships (*sociétés civiles*) are subject to the French "Article 8" tax regime (eg, SCPI and forest savings companies which do not elect for CIT), according to which profits and gains realised by the

AIFs are (i) determined, assessed and computed at the level of the AIFs, depending on the activity carried out by the AIFs, and/or the tax status of their investors; and (ii) taxed each year in the hands of the investors, whether such profits and gains are distributed or not.

French Tax Regime for Investors in French Alternative Investment Funds

Tax regime for French tax resident individual investors

Ordinary tax treatment

Irrespective of whether they invest in AIFs formed as contractual funds or corporations, French tax resident individual investors are generally taxed upon (i) gains derived from a disposal or redemption of units or shares issued by the AIFs in which they invest, and (ii) distributions of profits and gains made by these AIFs (investors holding more than 10% of a contractual fund are, however, taxed on any gains and profits realised by such funds, whether distributed or not).

Capital gains realised upon the disposal or redemption of units or shares in FCPs and SICAVs are taxable at the 30% flat tax rate (12.8% of personal income tax plus 17.2% of social security contributions), unless an election to be taxed at the progressive income tax rates is filed by the relevant taxpayer. However, units held in an OPCI set up as an FCP (FPI) are taxed as real estate gains, at the flat tax rate of 36.2% (19% of personal income tax plus 17.2% of social security contributions).

When distributed, profits and gains realised by contractual or corporate funds and SLPs most often keep their underlying source and nature (eg, dividends, interests, rents or capital gains). The tax regime applicable to such distributions will be based on that nature.

- Dividends, interest and capital gains realised upon the sale of securities in portfolio companies which are distributed by contractual funds, SLPs and corporate funds which can "ventilate" their profits and gains (eg, SICAVs) are taxable at the flat tax rate of 30% (12.8% of personal income tax plus 17.2% of social security contributions), unless an election to be taxed at the progressive income tax rates is filed by the relevant taxpayer. In addition, individual investors in FCPRs, FIPs, FCPIs, FPCIs, and SLPs may benefit from the tax-free repayment of their contributed capital.
- Real estate rental income distributed by an FPI is generally taxed at the progressive income tax rate (up to 45%) and subject to social security contributions (at the rate of 17.2%).
- Capital gains derived from the disposal of real estate assets by an FPI are taxed at the flat tax rate of 36.2% (19% of personal income tax, and 17.2% of social security contributions).

However, profits and gains distributed by Other AIFs set up under a corporate form, and by OFSs, OPCIs and OPPCIs set up as corporations (ie, SFSs, SPPICAVs and SPPPICAVs) cannot be ventilated according to their nature and source, and therefore qualify tax-wise as dividend distributions, subject to the 30% flat tax mentioned above (unless an election to be taxed at the progressive income tax rate is filed by the relevant taxpayer).

Tax exemption regimes

French tax resident individuals investing in FCPRs, FCPIs, FIPs, FPCIs, SLPs, and venture capital companies (SCR) may benefit from a personal income tax exemption (but not from an exemption from social security contributions) on sums and values derived from their investments in such funds and companies, provided that the following conditions are met:

- the investors subscribe directly to the units or shares in those funds and companies;
- the investors commit to hold these shares or units for at least five years, and shall reinvest in the fund or company any distribution made to them during this five-year period;
- investors shall not have held (alone or together with their spouse or relatives) directly or indirectly 25% or more of the share capital of the portfolio companies held by the fund; and
- the funds or companies shall satisfy certain investment ratios, and notably invest at least 50% of their subscriptions in the share capital or in securities giving access to the share capital of European/EEA companies subject to CIT in their own jurisdiction, and which are carrying out a commercial activity (as defined by French tax law) (the "Tax Quota").

In addition to the exemption regime mentioned above, individual investors may also benefit from tax exemptions and incentive regimes described in more details under **3.6 Tax Regime**.

Tax regime for French tax resident corporate investors

Ordinary tax treatment

French corporate investors that are subject to CIT in France are in principle taxable at the standard CIT rate of 25% on the annual mark-to-market spread of net asset value of shares or units held in the following AIFs: FIVGs, FCPRs, FCPIs, FIPs, FFAs, FPVGs, FPCIs, FPSs, and SLPs. This spread is assessed by reference to the net asset value of those shares or units on the opening and closing dates of each fiscal year.

However, this mark-to-market rule does not apply to:

- certain insurance companies and pension funds investors;
- corporate investors in so-called equity funds (*fonds actions*) – ie, UCITS or AIFs, at least 90% of whose assets' fair market value is made up of shares or equity certificates issued by companies subject to CIT in their respective jurisdiction; and
- corporate investors in FPCRs, FCPIs, FIPs, FPCIs and SLPs satisfying the Tax Quota mentioned above, provided that these investors hold their units in these funds for a five-year period.

In addition, subject to the exception mentioned below, corporate investors are also taxable at the standard CIT rate of 25% on any distribution received from these AIFs (such distribution correlatively reducing the net asset value of units or shares issued by these AIFs), irrespective of the underlying nature and source of profits and gains being distributed.

Tax exemption regime for investments in private equity and venture capital funds and companies

Corporate investors in FPCRs, FCPIs, FIPs, FPCIs, SLPs and SCRs that satisfy the Tax Quota mentioned above benefit from a favourable tax regime on distributions received from these funds and companies, allowing, inter alia, (i) the tax-free repayment of their contributed capital, and (ii) a full CIT exemption on distributions of capital gains made by the funds upon the disposal of shares or units held for more than two years in portfolio companies in which these funds have held at least 5% of the share capital for at least two years.

Tax regime for foreign investors

Tax regime under domestic law

Foreign investors in French AIFs are only taxable in France on sums and values distributed to them, and, as the case may be, on gains derived from the disposal or redemption of units or shares held in certain AIFs (eg, OPCIs and OPPCIs in which they hold more than 10% of the units or shares).

To the extent profits and gains realised by contractual funds, SLPs and corporate funds that ventilate their profits and gains do keep their underlying nature and source, the French tax regime applicable to these distributions will depend on the underlying income and gains which is distributed. Therefore:

- foreign source dividends, interest and capital gains flowing through the AIFs should not suffer any taxation in France;
- French source dividends received by the AIFs and distributed by them to foreign investors should be subject to withholding tax at the rate of 12.8% (for foreign individual investors), 25% (for other investors) or 75% (if paid in a non-cooperative state or territory);
- French source interest received by the AIFs and distributed by them to foreign investors are not subject to withholding tax in France, unless paid in a non-cooperative state or territory; and
- the distribution of capital gains realised by the AIF upon the sale of shares in a French portfolio company is not taxable in France, unless the foreign investor holds or has held, directly or indirectly, at any time during the five-year period preceding the distribution, at least 25% of the share capital, voting rights or financial rights in this portfolio company (which is unlikely, except for dedicated funds). If this 25% threshold were to be met nonetheless, a tax levy at the rate of 12.8% (for individual investors), 25% (for other investors) or 75% (if the distribution is paid in a non-cooperative state or territory) would be due in France on such distributions.

On the other hand, dividend distributions made by corporate funds that do not ventilate their distributions according to the source and nature of their profits and gains (eg, Other AIFs, SFSs, SPPICAVs and SPPPICAVs) are subject to the French withholding tax at the rate of 12.8% (for foreign individual investors), 15% (for dividends distributed by SPPICAVs and SPPPICAVS to certain foreign AIFs which are comparable to French AIFs), 25% (for other investors) or 75% (if paid in a non-cooperative state or territory). As the case may be, and subject to a case-by-case analysis, certain dividend distributions may eventually benefit from an exemption from withholding tax.

Distributions of real estate income and capital gains made by FPIs to foreign investors are also taxable in France.

Tax regime under double tax treaties

Although most French AIFs are not considered to be tax residents for the purpose of tax treaties entered into by France, the French tax authorities tolerate that foreign investors may seek the benefit of the relevant double tax treaty entered into between France and the jurisdiction of the investor, in order to reduce or eliminate the above-mentioned withholding taxes and levies.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

There are two main categories of retail fund structures in France: UCITS and some French

AIFs that are open to retail investors (but not only to retail investors).

UCITS

UCITS are highly regulated, with strict investment and liquidity restrictions and must be open-ended. They are managed by an approved UCITS management company, which can be either approved by the AMF or by another regulator within the EEA thanks to the UCITS management passport.

UCITS can be "passported" into any EEA country via a regulator-to-regulator process and once passported, the UCITS can normally be sold to any investor in the host country. Investors will subscribe for shares or units of French UCITS, depending on whether, respectively, the legal structure is an investment company with variable capital (SICAV) or a *fonds commun de placement* (FCP).

The harmonisation of UCITS under European law is maximised (ie, all UCITS must comply with the same minimum set of rules), and there are investment restrictions to be taken into consideration such as leverage restrictions (up to 10% of their net assets for short-term liquidity purposes) and the 5/10/40 rule (limit of 5% in any one issuer, which may be extended to 10% provided the aggregate of those issuers in which you hold more than 5% does not represent more than 40% of the net assets of the fund).

French AIFs Open to Retail Investors

France has been a very active (domestic) market for retail funds, funds that would either be eligible to French unit-linked life insurance contracts or subscribed to directly, with a tax incentive often attached. They all share a prior approval process and strict monitoring by the AMF.

The categories of French AIFs open to retail investors are listed in **2.1.1 Fund Structures**.

Investors will subscribe for shares or units of the French retails AIFs, depending on whether the legal structure is an investment company with variable capital (SICAV) or a *fonds commun de placement* (FCP). As AIFs, and provided that they are managed by full scope AIFMs, such retail funds can be passported in the EEA thanks to the AIFMD passport, but only to professional clients.

3.1.2 Common Process for Setting Up Investment Funds

Registration/Approval Requirements

As a principle, the creation and marketing of retail funds in France require the prior approval of the AMF (save to the case of ELTIFs, which are subject to a different regulation, at EU level and benefit from a specific AIFMD marketing passport for marketing to retail investors). For the purpose of this section and as an EU wide label, ELTIFs will not be analysed in detail.

See **2.1.2 Common Process for Setting Up Investment Funds** for further details on the AMF process.

An application form must be submitted to the AMF including at least the following documents (as well with some ancillary documents and the AMF may always request further information or document):

- name of the fund, and identity of the AIFM, the depositary and the statutory auditor;
- existence or not of compartments (in each case, a separate application shall be made);
- whether the retail fund is a master or a feeder;
- whether the retail fund benefits from a guarantee or protection;

- whether administration, accounting or financial management is delegated or not;
- periodicity of establishment of the net asset values;
- modalities of calculation of the risk; and
- details on the liquidity management tools.

Key required documentation and process

See **2.1.2 Common Process for Setting Up Investment Funds** for a discussion of the key required documentation and the costs involved.

As from the acknowledgement of receipt from the AMF of a complete application, the process takes one month (23 business days). The aforementioned acknowledgement of receipt provides for the regulatory approval deadline.

3.1.3 Limited Liability

Please refer to **2.1.3 Limited Liability**.

3.1.4 Disclosure Requirements

UCITS

In addition to keeping the primary offering documents (being typically the prospectus) and the KID up to date and compliant with UCITS regulations as implemented in France and AMF Instruction No 2011-19, UCITS are required to publish an annual audited report for each financial year and an unaudited biannual report. The annual report must be published within four months of the year end, the biannual report within two months of the period end, and both must be sent to the AMF.

French AIFs Open to Retail Investors

Please refer to **2.1.4 Disclosure Requirements**.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

In practice, the vast majority (if not almost all) of the investors in French retail funds are French investors, except for UCITS which can be marketed easily within the EEA. The French retail funds market for retail AIFs is typically, as of today (this may change with ELTIF 2.0), a domestic market. Distribution of French retail funds is often made via French unit-linked life insurance contracts or French personal equity saving plans (*plan d'épargne en actions – PEA*) for the UCITS, while French retails AIFs are often subscribed to directly by the end-investor, especially those funds with a tax incentive attached.

3.2.2 Legal Structures Used by Fund Managers

The contractual form of the FCP and the SICAV are the most common legal forms for retail fund. Nevertheless, SCPIs may be created with fixed capital.

3.2.3 Restrictions on Investors

There are no specific restrictions. As heavily regulated vehicles, UCITS or retail AIFs can be subscribed to by anyone (retail or professional clients) having the legal capacity and investing the minimum that is required in the fund documentation.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

UCITS

UCITS may only invest in "eligible assets" which broadly include transferable securities, money market instruments, other UCITS (or UCITS-equivalent funds) and deposits. The following restrictions shall be complied with:

- compliance with the 5/10/40 rule (see **3.1.1 Fund Structures**);
- the use of derivatives (including counterparty exposure limits) is very regulated and involves detailed global exposure calculations, as well as back testing and reporting requirements;

- UCITS may only take short positions synthetically through derivatives;
- UCITS may only borrow up to 10% of their net assets for short-term liquidity purposes; and
- UCITS are prohibited from investing directly, or through derivatives, in commodities.

AIFs Open to Retail Investors

Each type of AIF open to retail investors is subject to its own set of rules, given that these products have been created for specific purposes. For example, while the FIVG will have investment restrictions similar to the UCITS; the OPCI or the SCPI will be limited to real estate investments, including liquid assets or shares of real estate companies. FCPR will need to comply with a legal quota of private assets, although the FCPI must ensure, in addition to such legal quota, that the companies comply with certain size and innovation characteristics requirements.

To be exhaustive, a case-by-case detailed analysis of investment restrictions in such AIF open to retail investors would be necessary, given that, except for borrowings and leverage restrictions which are quite similar, each vehicle can be dramatically different from the next.

3.3.2 Requirements for Non-local Service Providers

UCITS or French AIFs may be managed respectively by a French or EEA UCITS management company or by a French or EEA AIFM according to the management passport set out in respectively the UCITS directive and the AIFMD.

The depositary of a French UCITS or AIF must either have its registered office in France or have a branch in France provided that its registered office is located in another member state of the EEA.

The depositary is a regulated entity and must be chosen from a list of entities drawn up by the French Minister for the Economy.

The fund administration of French UCITS or AIFs is generally handled by, respectively, the UCITS management company or the AIFM but can also be delegated to third parties under the supervision of the UCITS management company or the AIFM. French law does not require any specific licence to be held to carry out such function on a delegated basis.

3.3.3 Local Regulatory Requirements for Non-local Managers

French UCITS and French AIFs may be managed by, respectively, a UCITS management company or an AIFM based in a member state of the EEA according to the management passports set out respectively in the UCITS directive or in the AIFMD. To that end, such UCITS management company or AIFM must provide a notification to its home supervisory authority which will transmit it to the AMF.

The portfolio management of French UCITS and AIFs can be delegated to delegate managers according to the regime set forth under, respectively, the UCITS regulation and the AIFMD Level 2 Regulation.

As implemented under French law, such delegate managers can be located in a member state of the EEA (other than France) or in a third country to the EEA subject to certain requirements as more fully described in the FMFC and in the AMF General Regulation.

UCITS management companies and AIFMs which intend to delegate to third parties the task of carrying out functions on their behalf must notify the supervisory authorities of their home member state before the delegation arrangements become effective.

3.3.4 Regulatory Approval Process

Please refer to **2.1.2 Common Process for Setting Up Investment Funds.**

3.3.5 Rules Concerning Pre-marketing of Retail Funds

This is not applicable in France as pre-marketing of UCITS or AIFs to retail investors is not allowed.

3.3.6 Rules Concerning Marketing of Retail Funds

UCITS

French UCITS must receive an authorisation issued by the AMF prior to marketing their units or shares in France. Notification of this authorisation therefore constitutes authorisation of marketing in France. UCITS incorporated under foreign law must be the subject, prior to marketing their units or shares in France, of a notification of the AMF by the competent authority of the home EU member state of the UCITS.

AIFs Open to Retail Investors

French AIFs open to retail investors must receive an authorisation issued by the AMF prior to marketing their units or shares in France. Notification of this authorisation therefore constitutes authorisation of marketing in France.

With respect to the marketing of foreign AIFs to French retail clients, there is no marketing passport available. Therefore, prior authorisation by the AMF shall be sought and, in practice, it is a very lengthy and complicated process.

3.3.7 Marketing of Retail Funds

UCITS and AIFs can be marketed to professional (as defined under MiFID) or non-professional investors. Specific attention shall be drawn to the fact that distributors of the funds shall ensure that such investment corresponds to the profile of the investor, following a suitability test.

3.3.8 Marketing Authorisation/Notification Process

An AIFM intending to market AIFs to retail investors in France must comply with NPPR (if available) which generally requires the prior authorisation of the competent authority of its host member state where it is envisaged that the AIF will be marketed. No passporting regime is available for AIFs for marketing purposes to retail investors.

For UCITS, the passport authorisation process is a regulator-to-regulator process.

Please refer to **3.1.2 Common Process for Setting Up Investment Funds** and **3.3.6 Rules Concerning Marketing of Retail Funds** for further details.

3.3.9 Post-marketing Ongoing Requirements

UCITS & AIFs Open to Retail Investors

Please refer to **2.3.9 Post-marketing Ongoing Requirements.**

Marketing authorisation or marketing notification shall be maintained as long as French shareholders or unitholders continue to hold units or shares in the relevant UCITS or retail AIF. Therefore, until this time, a payment of an ongoing fee to the AMF (in 2023, EUR2,000 per fund or sub-fund and per year) until the marketing of the fund is closed is required.

Depending on the changes to the UCITS or the retail AIFs, the AMF must be either immediately notified or give its prior approval.

At the latest one month after the end of every quarter, French AIFMs with respect to French UCITS or French retails AIFS, or EEA AIFMs managing a French UCITS via the UCITS management passport, must send the AMF the form on compensation paid out for any non-compliance with investment restrictions, via the ROSA Extranet.

Please also refer to **3.1.4 Disclosure Requirements** for ongoing reporting requirements.

In order to cease marketing a passported UCITS in France, notification to de-register the UCITS should be made to the competent authority of the UCITS manager's home state according to the procedure set out in the CBDFD as implemented under French law. From the date of denotification, a 36-month "black-out" period is triggered during which any pre-marketing of the relevant AIF or in respect of similar investment strategies or ideas is prohibited.

3.3.10 Investor Protection Rules

As heavily regulated vehicles, UCITS or retails AIFs can be subscribed to by anyone (retail or professional clients) having the legal capacity and investing the minimum that is required in the fund documentation.

Please also refer to **3.1.4 Disclosure Requirements** for ongoing reporting requirements and to **2.3.10 Investor Protection Rules**.

3.3.11 Approach of the Regulator

See **2.3.11 Approach of the Regulator**.

3.4 Operational Requirements

Please refer to **3.1.4 Disclosure Requirements**, **3.3.1 Regulatory Regime** and **2.4 Operational Requirements** (Protection of the Assets Held by the Fund – generally applicable to French UCITS management companies).

UCITS may only borrow up to 10% of their net assets for short-term liquidity purposes. With respect to French retails AIFs, the cash borrowing limit is generally limited to 10–15% of the fund's assets (and up to 40% of the value of real estate assets for OPCI).

As explained in **2.4 Operational Requirements**, a depositary is a requirement for UCITS and AIFs (whether such AIFs are open to retail investors or reserved to professional investors).

As French regulated vehicles, French UCITS or French retails AIFs are subject to laws and regulations on anti-money laundering and counter terrorist financing.

3.5 Fund Finance

UCITS may only borrow up to 10% of their net assets for short-term liquidity purposes.

With respect to French retails AIFs, the cash borrowing limit is generally limited to 10–15% of the fund's assets (and up to 40% of the value of real estate assets for OPCI) and is generally guaranteed by a pledge over the fund's assets (subject to limitations provided under French law as well as leverage limits at the level of the AIFM).

3.6 Tax Regime

French Tax Regime for French AIFs

The tax regime applicable to French AIFs does not depend on the category of investors (eg, professionals or retail investors). Please refer to **2.6 Tax Regime**.

French Tax Regime for Investors in French AIFs

The tax regime applicable to investors in French AIFs does not depend on the category of investors (eg, professionals or retail investors). Please refer to **2.6 Tax Regime**.

However, French tax resident retail investors may benefit from certain tax incentives for investing in retail funds. Hence, in addition to the tax exemption mentioned under **2.6 Tax Regime** for sums and values derived from private equity and venture capital funds and companies which satisfy the Tax Quota, units and shares issued by certain UCITS and AIFs may also be subscribed to or acquired via French personal equity savings plans (eg, PEA) or French unit-linked life insurance contracts, in which case (i) gains made upon the disposal or redemption of these shares or units, and (ii) distributions made by these UCITS and AIFs within the framework of these plans or contracts are neither taxable nor subject to social security contributions as long as these sums and values remain invested therein. However, the withdrawal of any sum or amount from these plans or contracts may eventually be chargeable to tax and/or social security contributions at the level of the investor.

Subject to certain conditions, the subscription of units in certain private equity and venture capital funds (FIPs and FCPIs) may also give rise to a tax credit for the investors, in an amount equal to 18%, 25% or 30% of the amount subscribed to (within the annual limit of EUR12,000 or EUR24,000 depending on whether the investor is single or married/subject to joint taxation). The applicable tax credit rate depends on the date on which the subscription takes place, and on the investment strategy pursued by the fund. However, this tax credit regime does not apply to investors that invested in eligible FIPs and FCPIs via French personal equity savings plans or French unit-linked insurance life contracts.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

French lawmakers constantly implement EU Directives and modernise and adapt applicable French law in order to comply with European legislation, including in respect of the recent entry into force of the ELTIF Regulation (ELTIF 2.0) on 10 January 2024.

Recent amendments to the FMFC and the French Insurance Code have been made through the adoption of French law No 2023-973 of 23 October 2023 on green industry. Further amendments to the implementing regulations of the FMFC and the French Insurance Code are currently being considered in order to modernise the legal forms of AIFs reserved to professional investors and make their structuring more flexible when they are authorised as an ELTIF or structured as unit-linked products for distribution to retail investors through French unit-linked life insurance contracts or the French personal equity savings plan (PEA).

Other European initiatives (such as AIFMD II and developments on sustainable finance (CS3D, SFDR, and Taxonomy)) will have an impact on the French legal and regulatory aspects applicable to AIFMs and AIFs in the next coming years.

GERMANY

Law and Practice

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POELLATH

Contents

POELLATH has one of the largest and most experienced fund structuring practices in continental Europe, with locations in Berlin, Frankfurt and Munich, and around 60 professionals. It is a market leader in the structuring of private equity funds in Germany, and maintains strong relationships with local law firms in jurisdictions outside the country. The firm advises initiators of, and investors in, private equity funds and worldwide fund participations in the area of alternative investments. The team has extensive expertise in fund structuring; advice regarding the Alternative Investment Fund Managers Directive (AIFMD), the German Capital Investment Act (KAGB) and the Markets in Financial Instruments Directive II (MiFID II); asset management; and secondary transactions. This includes all relevant fund structures in private equity, mezzanine/private debt, distressed debt, real estate, infrastructure, natural resources/energy, education, hybrid funds, hedge funds, crypto/digital assets funds, captive funds, master-feeder structures, separate accounts, annex funds and specialised funds, as well as primary and secondary funds of funds.

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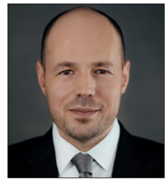

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POELLATH+

1. Market Overview

1.1 State of the Market

Germany is frequently used by advisers and managers for the formation of venture capital, private equity and similar closed-end alternative investment funds, as well as for retail funds wherever the manager of the respective investment fund is located in Germany – ie, Germany is generally not used as a domicile for structuring alternative investment funds or retail funds by non-German advisers or managers. Typically, German private equity or venture capital funds are structured as limited partnerships that are transparent for German tax purposes.

German resident institutional investors and German family offices are frequent targets of fundraising activities for venture capital, private equity and similar alternative investment funds located in Germany or various other jurisdictions around the world.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

The typical legal forms of investment funds used in Germany are limited partnerships, investment stock corporations and contractual funds with no legal personality of their own (*Sondervermögen*). The most frequently used legal form for private funds is the limited partnership, whereas retail funds, undertakings for the collective investment in transferable securities (UCITS) funds and real estate funds are more often structured as contractual funds. A key difference is that a limited partnership is transparent for German tax purposes, whereas the rules of the German Investment Tax Act apply in respect of corporate fund structures and contractual funds treating such funds as opaque entities.

2.1.2 Common Process for Setting Up Investment Funds

The process for setting up an investment fund in Germany differs for registered sub-threshold managers and fully licensed managers of alternative investment funds. The regulation of investment funds in Germany is primarily exercised through the regulation of the respective manager, who is required to apply for a full licence or to be registered with the German supervisory authority for financial services (BaFin) under the German Investment Code (KAGB). The KAGB implements the European Alternative Investment Fund Managers Directive (AIFMD) rules into German law.

Registered Managers – Registration Process

Availability

This registration process is available to certain small or medium-sized managers only. The most important category of these small to medium-sized managers is known as a "sub-threshold manager" under the AIFMD and KAGB. In practice, most German alternative investment fund managers outside the real estate area still fall within this category.

Sub-threshold managers under the KAGB are managers with assets under management of not more than EUR500 million with no leverage at fund level, or not more than EUR100 million if there is leverage at fund level, and who manage so-called special alternative investment funds ("Special AIFs") only. Special AIFs are AIFs whose interests or shares may only be acquired by professional investors or semi-professional investors (ie, non-retail funds).

Registration procedure

The registration process is relatively simple. It requires the submission of a registration request together with certain documents on the manager and the investment fund(s) the manager intends to manage (such as the fund's limited partnership agreement and the manager's articles of association). In addition, a Special AIF may not require the investors to pay in capital in excess of their respective original capital commitment.

Ongoing compliance issues

An advantage of the registration is that only a few provisions of the KAGB apply to "registered-only" managers – mainly the provisions on the registration requirements, some ongoing reporting requirements and the general supervisory powers of BaFin. However, fund-specific requirements do not apply to "registered-only" managers and their funds. In particular, the depository requirements and marketing requirements do not apply, and nor do the additional requirements of the KAGB for fully licensed managers, except that certain additional internal governance and reporting obligations apply to the extent that any debt funds are managed.

In exchange for such light regulation, "registered-only" managers do not benefit from the European marketing passport under the AIFMD. A registered manager can, however, opt to become a fully licensed manager (or upgrade to an EU European venture capital fund (EuVECA) manager). Since 2021, "registered-only" managers have been required to audit their annual financial statements. Such audit must include a review of compliance with the KAGB and German anti-money laundering law.

Fully Licensed Manager – Licensing Process

Availability

Fund managers who do not qualify for a registration or who opt to upgrade must apply for a full fund management licence with BaFin under the KAGB. A full fund management licence opens a door for managers to market funds to retail investors, and also gives access to the marketing passport under the AIFMD. Retail investors are neither professional nor semi-professional investors.

Licensing procedure

The licensing procedure is a fully fledged authorisation process with requirements equivalent to the requirements for granting permission under Article 8 of the AIFMD or Article 6 of the UCITS Directive. The licensing procedure checks requirements such as sufficient initial capital or owned funds, adequate experience of the directors, sufficiently good repute of the directors and shareholders, and organisational structure of the manager.

Ongoing issues

The licensing of the manager results in the manager being subject to the entirety of the KAGB, which entails the following in particular:

- the appointment of a depositary for the funds;
- access to setting up contractual funds;
- adherence to the corporate governance rules for funds set up as investment corporations or investment limited partnerships (so-called Investment KGs);
- adherence to the fund-related requirements of the KAGB;
- adherence to the pre-marketing and marketing rules of the KAGB;
- access to the marketing passport under the AIFMD or UCITS Directive;

- access to the managing passport under the AIFMD or UCITS Directive; and
- adherence to the reporting requirements of the KAGB.

2.1.3 Limited Liability
Investors admitted to investment funds in Germany typically benefit from limited liability. As limited partners of a limited partnership, which is the most frequently used structure for alternative investment funds in Germany, their liability in relation to third parties for obligations of the fund is limited to their respective liability amount registered with the commercial register of the respective fund partnership. The liability amount is typically a small portion (ie, 0.1%) of their capital commitment or a small fixed amount. Once this portion of their capital commitment has been contributed to the alternative investment fund, their liability in relation to third parties ceases to exist.

Regarding the relationship of the investors to the alternative investment fund itself, the liability is restricted to the unpaid portion of the investor's capital commitment. For fund structures other than limited partnerships, an even stricter limitation of liability applies. Legal opinions are commonly issued to confirm such limitation of liability.

2.1.4 Disclosure Requirements
For the usual AIFs that are marketed to non-retail investors, there is no legal requirement to issue a private placement memorandum (PPM); however, all fund managers are subject to the SFDR disclosure obligations and disclosures under Article 23 of the AIFMD must be provided if the fund is marketed under the AIFMD. In any case, a PPM is commonly produced for all AIFs to ensure that the investors are informed – completely and correctly, and in a non-misleading manner – about the respective AIF, its management, its investment strategy, the risks associated with an investment and the expected tax consequences of the investment. These disclosures are recommended in order to avoid the liability of the sponsor or managers under general prospectus liability rules.

If the fund is marketed to semi-professional investors, a key information document must be produced.

There are annual reporting requirements for managers of retail funds and managers of non-retail funds. There are also semi-annual reporting requirements for contractual funds and investment stock corporations (AG) with variable capital. The reports need to be published.

Furthermore, new notification requirements implementing Council Directive (EU) 2018/822 for cross-border tax arrangements have applied for intermediaries of funds (usually the fund manager) since 1 July 2020.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds
During the last two decades, alternative funds have experienced a considerable and increasing capital inflow from German institutional investors. A significant portion of the institutional investors are professional pension schemes (*berufsständische Versorgungswerke*), insurance companies, tax-exempt or taxable pension funds (*Pensionskassen, Pensionsfonds*) and, increasingly, banks. Furthermore, industrial companies can be found as investors in alternative investment funds, especially in specialised private equity or venture capital funds, which promise strategically interesting investment opportunities. Finally, public investors (*öffentlich-rechtliche Geldgeber*) invest in alternative funds, often motivated by

reasons of broader structural economic policy. Rather than investing directly, institutional investors often invest through managed accounts set up as single or group investor funds.

2.2.2 Legal Structures Used by Fund Managers

Legal structures depend on investors' specific requirements and preferences. The legal structures for private funds in which most types of investors are usually prepared to invest are limited partnerships and, particularly regarding real estate, contractual funds. However, specific structural requirements apply for certain types of investors.

For example, certain non-taxable or tax-exempt investors, including pension funds (*Pensionskassen*), can only invest in business-type partnerships if certain conditions and thresholds are met. Investments by investment funds intending to be treated as tax-transparent (*Spezial-Investmentfonds*) have to check the eligibility of investments in closed-end funds on a case-by-case basis. Generally, feasible ways exist for *Spezial-Investmentfonds* to invest in partnerships as well as corporate or contractual fund structures, subject to certain restrictions and thresholds.

Based on applicable product requirements, investments by *Spezial-Investmentfonds* via corporate funds or holding vehicles might be challenged, depending on the respective *Spezial-Investmentfond*'s share in such fund or holding vehicle. Statements by the Federal Ministry of Finance confirm that interests in alternative funds in general can be treated as eligible investments for *Spezial-Investmentfonds* if they qualify as transferable securities under the UCITS Directive.

German pension funds that are subject to German domestic insurance regulation (Solvency I investors) usually prefer investment funds that are managed by a regulated manager. Requirements regarding the provenance and regulatory status of the fund depend on the classification of the fund. For private equity funds, fund vehicles and managers that have their seats within an EU/EEA country or Organisation for Economic Co-operation and Development (OECD) member state and that have a manager regulation that is at least comparable to the regulation of a sub-threshold alternative investment fund manager (AIFM) are sufficient. For a fund to qualify as a private equity fund, it needs to be closed-ended and may only invest in certain types of corporate finance instruments. Funds with investment policies covering instruments beyond equity and equity-like instruments require special scrutiny in this respect. For all other types of funds, only EU/EEA vehicles with full-scope AIFMs with an EU/EEA seat are eligible as AIF investments.

Interests in closed-end funds held by Solvency I investors or Solvency II investors need to be transferable without the prior consent of the general partner, manager or any other investor, as long as the interests are transferred to another institutional (or other creditworthy) investor. At the same time, the fund documents might need to contain specific language clarifying that an interest can only be transferred upon the prior written consent of a trustee appointed by the investor to safeguard the investor's assets, dedicated to covering a client's claims against the insurer.

2.2.3 Restrictions on Investors

There are no general restrictions for investors investing in investment funds. However, certain restrictions apply to specific types of investors – eg, Solvency I investors may not invest in investment funds that directly invest in working capital or consumer credits.

German insurance companies (Solvency II investors) have certain transparency requirements due to the prudent person principle under Solvency II. Investors usually require look-through information on the basis of a standardised tripartite reporting template. Moreover, Solvency II investors are subject to capital requirements, which are determined by risks in connection with investments, among other factors. Unleveraged closed-end funds are privileged in that respect.

Due to rules implementing further Basel III rules in 2021, fund managers must also accommodate the increasing transparency requirements of the growing group of banks reaching out for investments in AIFs – eg, in order to avoid investing banks having to fully back their investments with regulatory own funds.

Last but not least, ESG concerns are on the agenda of an increasing number of investors. Some institutional investors are already subject to statutory ESG obligations – eg, pension funds have to consider ESG aspects in connection with their business organisation and risk management, and are obliged to be transparent with regard to their handling of ESG factors. Solvency II investors have to consider sustainability aspects as part of the prudent person principle.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

BaFin is responsible for regulating funds and fund managers.

In Germany, the management of investment funds is regulated by the KAGB, which implements the AIFMD and the UCITS Directive. The law requires that the manager is fully licensed or registered with BaFin under the KAGB. If a fund is internally managed, then the fund itself needs a licence or registration.

For details on investment limitations and other rules applicable to alternative funds, see **2.4 Operational Requirements**.

2.3.2 Requirements for Non-local Service Providers

There is, in general, no registration or regulation requirement for non-local service providers such as administrators, custodians and director services providers. However, when a German manager outsources portfolio or risk management, the delegate must be authorised or registered in their home country. In addition, any delegate domiciled outside of the EU must appoint a domestic authorised agent to whom notifications and service of process can be effected by the respective German authority.

An outsourcing delegate who provides services falling under the Markets in Financial Instruments Directive (MiFID) will be subject to a licence requirement under the German Banking Act (KWG) or the recently introduced German Securities Institutions Act (WpIG) if they actively solicited the relationship with the manager (as opposed to reverse solicitation).

If German regulatory law requires a depositary for a German AIF, the depositary – or at least a branch of the depositary – must be domiciled in Germany.

2.3.3 Local Regulatory Requirements for Non-local Managers

EU Fund Managers

EU fund managers are allowed to perform fund management services under the AIFMD passport regime with regard to German Special AIFs.

They may also use the AIFMD passport to provide other services and ancillary services (such as MiFID investment advice or discretionary individual portfolio management).

Non-EU Managers

Non-EU managers are currently not allowed to perform fund management services in Germany. This might change in the future with regard to AIFMs in those countries for which the passporting regime under the AIFMD for third-country managers will eventually become effective.

Outside of providing fund management services (eg, managed account solutions), non-EU managers may provide certain regulated services in Germany, such as investment advice or discretionary individual portfolio management. This requires either that the services are in the scope of an existing relationship with the German manager or that the relationship is established at the initiative of the German client (reverse solicitation). As an alternative, such service providers may apply to BaFin for an exemption from the German licence requirements (which is a lengthy process).

2.3.4 Regulatory Approval Process

The registration procedure for a sub-threshold manager is comparatively simple and takes about one month. A full licensing procedure varies between six and 12 months, or even more. For the details on registered and fully licensed managers, see **2.1.2 Common Process for Setting Up Investment Funds**.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

A stricter regulation of pre-marketing activities and of the content of marketing materials has applied since the harmonised European regime for pre-marketing of alternative investment funds came into force in August 2021 (Directive (EU) 2019/1160 and the related Regulation (EU) 2019/1156)). The European marketing regime provided by the EU Directive only applies to marketing activities by, or on behalf of, EU managers.

The German Implementation Act, however, extends the EU pre-marketing rules to non-EU managers. The commencement of pre-marketing of an AIF in Germany by a German or non-German manager (except for "registered-only" managers) needs to be notified to BaFin directly or through the respective regulator of an EU manager, and any subscription by German investors within 18 months following the commencement of pre-marketing will require adherence to the formal marketing notification and, thus, precludes reverse solicitation.

2.3.6 Rules Concerning Marketing of Alternative Funds

Germany understands marketing activities to be any direct or indirect offering or placement of units or shares in an investment fund. Reverse solicitation is currently not regarded as marketing, but its scope is further limited due to the pre-marketing regime.

Marketing materials must be in line with the European Securities and Markets Authority (ESMA) guidelines on the fair and not misleading standard of the content of marketing materials. These guidelines mirror the rather strict rules under the MiFID regime.

For placement activities in Germany by EU "registered-only" or non-EU managers, the BaFin FAQs maintain the position that placement by a manager, in particular, takes place with regard to a fund if:

- the fund has been established (ie, first closing with investors); or
- the terms of the fund are ready to be sent for acceptance to investors.

Such FAQs also stipulate that reverse solicitation – ie, the approach of a manager by a German investor on its own initiative – will be permissible even on the basis of general advertisement activities of such manager if unrelated to particular funds.

2.3.7 Marketing of Alternative Funds
AIFs can basically be marketed to retail and non-retail investors. However, alternative funds that are closed-end Special AIFs can only be marketed to professional and semi-professional investors. The EU EuVECA regime and the European long-term investment funds (ELTIF) regime apply to the marketing of EuVECA funds and ELTIF funds in the EU and in the EEA.

2.3.8 Marketing Authorisation/Notification Process
The marketing of alternative funds requires an authorisation by BaFin or at least a European marketing passport under the AIFMD, except for marketing by German sub-threshold managers.

Depending on the type of investment fund and whether retail investors are targeted, the notification process and the materials to be presented to BaFin vary.

To the extent an EU-AIFM has notified the marketing of an AIF in Germany to its local regulator, BaFin generally only reviews whether the notification and materials provided by such local regulator are complete, and marketing may already commence when such local regulator has informed the EU-AIFM of the submission to BaFin.

2.3.9 Post-marketing Ongoing Requirements
As explained in **2.1.4 Disclosure Requirements**, there are annual reporting requirements for managers of retail funds and managers of non-retail funds. There are also semi-annual reporting requirements for contractual funds and AG with variable capital. The reports need to be published.

2.3.10 Investor Protection Rules
As explained in **2.3.1 Regulatory Regime**, Germany recognises the concept of Special AIFs, which are AIFs whose interests or shares may only be acquired according to the fund documents by professional investors within the meaning of the AIFMD or by semi-professional investors. Special AIFs themselves are either subject to a lighter regulatory regime than retail funds (in the case of fully licensed managers) or are not subject to a regulatory regime at all (in the case of a German sub-threshold manager, except for debt funds).

2.3.11 Approach of the Regulator
In the authors' experience, BaFin is generally co-operative and open to discussions. Expected timeframes can sometimes be an issue, particularly where BaFin is requested to answer questions on new issues.

BaFin regularly takes enforcement actions, with enforcement usually being a proportionate, step-by-step approach. Often, BaFin just issues a request for explanations as a warning and takes further actions only if the answers are not satisfactory.

2.4 Operational Requirements
The investment-type restrictions for regulated general special funds translate only into assets that can be valued at fair value and risk diversification. In practice, regulated special funds are

often set up under a specific fund category (eg, special funds with fixed investment guidelines). Accordingly, for these funds, investment-type restrictions apply based on the chosen fund category and individualised investment guidelines (eg, real estate focus or debt fund).

Borrowing restrictions depend on the chosen fund category. For instance, special funds with fixed investment guidelines allow short-term borrowing of up to 30% of their net asset value and, for real estate, up to 60% of the real estate value. For German debt funds, the borrowing restriction is 30% of the capital available for investment.

If the fund manager is fully licensed, they must appoint a depositary or special private equity custodian for each of its funds (as required by the AIFMD).

The valuation and pricing of the fund's assets must be in line with the AIFMD requirements – ie, fair value.

The operational requirements of a fully licensed manager are in line with the AIFMD. In addition, fund managers must adhere to rules that apply to all market participants, such as the EU-based rules on insider dealing and market abuse, transparency, money laundering and short selling. Special manager-internal rules apply to the manager as regards debt funds.

Sub-threshold managers are only subject to a light-touch regulatory regime. Accordingly, no operational requirements apply, in principle, from a regulatory perspective (except as regards debt funds).

2.5 Fund Finance

Accessibility to Borrowing for Funds

Funds that are eligible for non-trading treatment from a tax perspective (see also **2.6 Tax Regime**) are generally not permitted to raise debt at fund level nor to provide guarantees or other forms of collateral for the indebtedness of portfolio companies. As an exception, tax authorities have accepted that funds can enter into a capital call facility subject to certain restrictions, and the number of funds making use of this concession has increased, as has the number of financial institutions offering capital call facilities to German funds. Leverage is not permitted for tax reasons and is restricted for regulatory reasons.

Restrictions on Borrowings

The criteria for non-trading treatment from a tax perspective do not allow borrowings at fund level. As an exception, short-term borrowings to bridge capital calls are accepted by tax authorities. While "short-term" has not been defined, borrowings cannot remain outstanding for more than 270 calendar days. Fund managers need to first issue the capital call and can thereafter draw down the amount under the capital call facility. The amount so borrowed is then repaid out of the capital contributions.

Lenders Taking Security

Under German law, the investors' commitment to the capital of a fund is not an asset that can be pledged in favour of the capital call facility provider. As a consequence, capital call facility agreements entered into by German funds typically provide that payments of capital contributions shall be made to a bank account maintained with the facility provider that is pledged in its favour. In addition, the facility provider reserves the right to claim payment of capital contributions directly from investors when due, and to enforce the fund's rights under the fund agreement in the event of default. Assets and investments held by the fund are typically not pledged as collateral.

Common Issues in Relation to Fund Finance

Common issues include the following:

- financial covenants regarding excused investors in respect of an investment by reference to the number of excused investors and the total amount; and
- default situations pending at the time of a drawdown under the facility agreement by reference to the number of defaulting investors and the total amount.

Investors typically object to the requirement to provide financial information unless publicly accessible.

Because of the general restriction on providing guarantees and other forms of collateral for the indebtedness of portfolio companies, equity commitment letters are very often used as an alternative. They should not interfere with the general restrictions on providing guarantees if structured as an agreement between the fund and its portfolio company whereby the fund undertakes to provide additional capital in the event that the portfolio company is in payment default or in breach of financial covenants. Such undertaking, however, should not be pledged by the portfolio company in favour of its creditors, in order to avoid being treated as a guarantee of the fund. The portfolio company can undertake in the agreement with its creditors not to change, amend or waive the fund's equity commitment letter other than with the consent of its creditors.

2.6 Tax Regime

The tax regime applicable to fund structures depends on whether a fund is organised as a corporate entity or a partnership.

Funds Organised as Partnerships

The tax regime applicable to funds organised as partnerships is as follows.

Fund structures

Consistent with international standards, German funds are typically structured as partnerships that are eligible for non-trading treatment and avoid their investment activities constituting a trade or business attributable to a permanent establishment. The non-trading requirements for private equity and venture capital funds are set out in an administrative pronouncement and include the following:

- no borrowings and guarantees on fund level (other than fund finance, as described in **2.5 Fund Finance**);
- no reinvestment of proceeds, subject to two exceptions:
  - (a) proceeds up to an amount previously drawn down to fund management fees and fund expenses can be reinvested to ensure that an amount representing 100% of the total capital commitments can be invested in portfolio companies; and
  - (b) an additional amount not exceeding 20% of the total capital commitments can be reinvested to fund follow-on investments;
- a weighted average holding period of investments of at least three years; and
- no involvement in the operating management of portfolio companies whereby representation on the supervisory or advisory board of portfolio companies in a non-executive, monitoring capacity is permitted.

While the administrative pronouncement has recently been questioned by the courts, it is still applied by the fiscal authorities.

Management of private equity and venture capital funds by German managers used to be subject to VAT in Germany. However, a general exemption in line with European laws was introduced in 2023, and fund management services are generally no longer subject to VAT.

Allocations and distributions to investors

Funds structured as partnerships are treated as transparent for German tax purposes, so taxable income allocated to the investors is subject to tax regardless of whether or not the fund made distributions. Non-resident investors of funds that are eligible for non-trading treatment are generally not subject to a German tax filing obligation in respect of their allocable share of the fund's taxable profit. The fund files a partnership return showing the items of taxable income received by the fund partnership and each investor's allocable share thereof. Non-German investors are included in the partnership return only for information purposes. They are subject to tax in their country of residence in accordance with their personal tax status.

Distributions by the fund to investors are not subject to German withholding tax. Dividends received by the fund from German portfolio companies as well as payments by German portfolio companies on certain German-source profit-linked debt instruments (such as silent partnership interests, jouissance rights and profit-sharing loans) are subject to withholding tax at the rate of approximately 26.4% (including solidarity surcharge) at source. Generally, the withholding agent (German portfolio companies or a German issuer of a profit-linked debt instrument) is not permitted to apply a reduced rate of withholding (eg, under an applicable tax treaty). Non-German investors that are entitled to treaty benefits with respect to such items of income must file a refund application with the German federal tax office, which is awarded subject to the fulfilment of certain procedural requirements.

Carried interest participants

The German fiscal authorities characterise carried interest payments as a compensation for professional services, and carried interest payments are not taxed in accordance with the rules applicable to the source from which such payments are derived. Carried interest payments by private equity funds and venture capital funds that are eligible for non-trading treatment are eligible for a partial tax exemption of 40%, and the remaining 60% is subject to tax at the marginal income tax rate of the carried interest participant.

According to German fiscal authorities, carried interest payments by funds that are treated as trading are fully subject to tax at the marginal income tax rate of the carried interest participant. According to a decision rendered by the German federal tax court in December 2018, carried interest payments by funds that are treated as trading are subject to tax in accordance with the tax rules applicable to the source from which the carried interest payments are derived. It is an open issue whether this favourable court decision will be generally applied by the German fiscal authorities.

Carried interest payments are not subject to VAT.

Taxation of Investors of Domestic and International Partnership-Type Funds

The following description is limited to funds organised as partnerships.

Domestic funds eligible for non-trading treatment

Partnership-type funds are treated as transparent for German tax purposes. Therefore, taxable income allocated to the investors is subject to tax at its level and in accordance with its tax status, regardless of whether or not the fund made distributions.

Resident corporate investors

95% of a resident corporate investor's allocable share of equity capital gains is exempt from tax; the remaining 5% and all other items of income (interest, dividends) are subject to German corporate income tax and trade tax. The 95% exemption does not apply to life and healthcare insurance companies.

Non-resident corporate investors

A non-resident corporate investor's allocable share of German equity capital gains is exempt from German tax. Dividends received from German portfolio companies and payments on certain profit-linked debt instruments by German issuers are subject to German withholding tax at the rate of approximately 26.4%. Tax treaty-protected investors may file an application with the German federal tax office for a refund of German withholding tax under the applicable tax treaty. Income derived from non-German portfolio companies is not taxable in Germany for non-resident corporate investors.

Non-German funds

Regardless of the qualification of their investment activities, non-German funds are typically deemed to be trading from a German tax perspective due to their legal structure.

Resident corporate investors

The allocable share of a non-German (deemed) trading fund's taxable profits is subject to German tax. 95% of equity capital gains is exempt from corporate income tax and 100% is exempt from trade tax. These exemptions do not apply to life and healthcare insurance companies. The full amount of interest and dividends is subject to corporate income tax, but trade tax is levied only on interest and on dividends where the fund holds less than 10% of the company paying the dividend.

Non-resident corporate investors

The deemed trading status of non-German funds does not affect their taxation in Germany. Their allocable share of German equity capital gains is exempt from German tax. However, they may be required to file a German tax return where they have held 1% or more of the share capital of the German company, the shares of which were sold or disposed of (determined on a look-through basis) during the last five years prior to such sale or disposition. They are only subject to tax in Germany in respect of items of income derived from German sources that are subject to German withholding tax at a rate of approximately 26.4% – ie, German dividends and payments on certain profit-linked debt instruments by German issuers. Tax treaty-protected investors may apply to the German federal tax office for a refund under an applicable tax treaty.

Corporate-Type Funds

The taxation of corporate-type funds (including funds of a contractual type such as the German *Sondervermögen* and non-German fund vehicles that resemble a German *Sondervermögen*, including trusts) and their investors is governed by the German Investment Tax Act.

Fund level

A corporate-type fund is a taxpayer in and of itself. Regardless of whether its place of business management is located in or outside Germany, only certain items of German-source income are subject to tax at the level of the fund:

- German-source dividends;
- income derived from German real estate (not dealt with herein); and
- trading income attributable to a German permanent establishment, but excluding capital gains realised upon the sale of shares of companies. However, if such shares form part of a trade or business and are attributable to a German permanent establishment, the full amount of capital gains from the sale of such shares by a corporate-type fund and any other trading income attributable to such German permanent establishment is subject to German tax at the level of such corporate-type fund.

Investor level

Non-resident corporate investors

Distributions by corporate-type German or non-German funds to non-resident investors are not subject to (withholding) tax in Germany.

Resident corporate investors

Resident investors are subject to German tax on the following three items of income derived from a corporate-type fund:

- all distributions;
- a lump-sum advance amount that represents a minimum yield and is only subject to tax if the corporate-type fund does not make distributions equal to, or exceeding, the lump-sum advance amount; and
- capital gains realised upon the sale of shares of the corporate-type fund either in a secondary transaction with a third party or in connection with a redemption of shares or a share buy-back by the corporate-type fund.

These three items of income subject to tax at the level of resident investors are eligible for a partial tax exemption in order to mitigate double taxation at fund and investor level if the corporate-type fund qualifies as a so-called equity fund or mixed fund. An equity fund is a corporate-type fund whose binding investment guidelines provide that more than 50% of the total net assets is directly invested throughout the entire fiscal year in equity instruments issued by companies. For a mixed fund, the relevant threshold for direct equity investments is at least 25%.

For equity funds, the partial tax exemptions for taxable resident corporate investors (other than life or healthcare insurance companies) amount to 80% for corporate income tax purposes and 40% for trade tax purposes. In respect of mixed funds, the partial tax exemptions amount to half of the exemptions applicable to equity funds.

Germany's Tax Treaty Network and Its Impact on the Funds Industry

Germany's tax treaty network is extensive and covers, among others, all member states of the EU and the OECD. German tax treaties generally follow the OECD Model Convention. German corporate-type funds should be eligible for protection by German tax treaties regardless of the fact that their tax bases only include certain items of German-source income. Because distributions by German corporate-type funds to non-resident investors are not taxable in Germany under German domestic tax law, non-resident investors need not rely on treaty benefits in this regard.

Funds organised as partnerships are transparent for income tax purposes. German investors benefit from Germany's tax treaty network because the geographic focus of funds typically relates to tax treaty countries. Funds investing in Germany benefit from Germany's tax treaty network because their fundraising very often relates to investors resident in tax treaty countries.

FATCA and CRS Regimes in Germany

Germany has entered into a Model-1 intergovernmental agreement (IGA) with the USA and has incorporated the reporting and disclosure requirements under the Foreign Account Tax Compliance Act (FATCA) as modified by the IGA into German domestic law. Accordingly, German fund managers have to file information under FATCA with the German federal tax office, which exchanges such information with the US Internal Revenue Service (IRS). As a consequence, German fund managers do not have a direct obligation towards the IRS regarding FATCA reporting and disclosure.

Germany has also incorporated the Common Reporting Standard (CRS) into domestic law. As a result, German fund managers have an obligation under German domestic law to file information under the CRS with the German federal tax office, which exchanges this information with the competent tax authorities of the participating countries of the CRS.

DAC 6

The tax treatment and tax structure of partnership-type funds is typically not subject to filing requirements under DAC 6 (EU Council Directive 2011/16 in relation to cross-border tax arrangements). In particular, the trading or non-trading status of a partnership-type fund should not give rise to filing obligations under DAC 6. Moreover, the German tax authorities have provided guidance that the PPM or a similar document that outlines the risks and benefits of an investment does not constitute standardised documentation within the meaning of Hallmark A 3 of Part II of Annex IV to DAC 6.

Currently, there are discussions to extend filing requirements similar to DAC 6 to merely domestic tax arrangements. Respective legislation is still pending and it is not entirely clear if and when such filing requirements will enter into force.

The Anti-Tax Avoidance Directive (ATAD)

As Germany, like most other countries, treats partnerships as being tax-transparent, an investment in a partnership-type fund should not give rise to hybrid mismatches. However, if an investor is residing in a country that treats partnerships as opaque, any income of a German partnership-type fund attributable to such investor is subject to German tax to the same extent as if such investor were resident in Germany.

Investments in funds of a contractual type, such as the German *Sondervermögen* or non-German fund vehicles that resemble a German *Sondervermögen*, may give rise to hybrid mismatches, particularly in situations where the home jurisdiction of a non-German fund of a contractual type treats this fund as tax-transparent while Germany treats such funds as opaque under the German Investment Tax Act.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

As a starting point, retail investors are neither professional nor semi-professional investors (see **2.3.1 Regulatory Regime**).

Retail funds are typically set up as UCITS funds or as so-called Public AIFs (as opposed to Special AIFs). Legal vehicles are mostly contractual-type funds (*Sondervermögen*) for open-end structures, and investment limited partnerships for closed-end retail funds. Corporate structures are less common in the retail sector as they are more complicated.

The choice of the vehicle is, in principle, dependent on whether an open-end fund or a closed-end fund is desired.

Arrangements and Vehicles for Open-End Funds
For open-end funds, the contractual fund and the investment corporation with variable capital structures are available. They can have different classes of units or shares, and can also establish sub-funds (umbrella structure). For open-end funds, most fund managers prefer a contractual fund to a corporation as the setting up and operation are easier.

Vehicles for Closed-End Funds
For closed-end funds, the only available vehicles for retail funds are the investment corporation with fixed capital and the closed-end investment limited partnership. Managers can only set up a closed-end fund in the form of a contractual fund for non-retail investors.

Both vehicles can issue different classes of shares or interests and establish sub-funds (umbrella structure).

3.1.2 Common Process for Setting Up Investment Funds
The contractual fund is established by the fund manager on a contractual basis with the investor. The contractual fund is a pool of assets separated by statute and contract from the (other) assets of the fund manager. The investment guidelines for contractual funds set out the details of the contractual relationship between the fund manager and the investors, particularly the applicable investment restrictions.

Investment corporations and investment limited partnerships are basically corporations and limited partnerships, with some modifications required by investment law. They are established in accordance with the applicable procedures for establishing corporations and partnerships (with some modifications because of investment law). In addition to the articles of incorporation or the limited partnership agreement (LPA), separate investment guidelines are necessary.

The investment guidelines and marketing of retail funds need BaFin approval. BaFin also has to approve the selection of the depositary for the respective retail fund. The approvals are usually obtained in parallel with each other.

Depending on the type of fund, the process can be rather short in the case of a standardised fund product, or it can be rather lengthy and expensive in the case of a bespoke alternative asset retail fund (in particular, a closed-end fund).

3.1.3 Limited Liability
As further described in **2.1.3 Limited Liability**, investors admitted to investment funds in Germany benefit from limited liability.

3.1.4 Disclosure Requirements
An extensive disclosure document (prospectus) is required if an AIF is marketed to retail investors. The prospectus must contain the following minimum information, where applicable:

- general information on the investment fund;
- the investment policy of the investment fund;
- risks and investor profile;
- the manager, depositary and auditor;
- outsourcing;
- the issue, redemption and conversion of units; and
- past performance.

There are also specific minimum information requirements for the prospectus of closed-end Public AIFs.

In addition to the prospectus, so-called key investor information must also be provided. The key investor information was supplemented by the key information document (KID) in accordance with the European PRIIP (packaged retail and insurance-based investment products) Regulation.

For UCITS, Germany follows the disclosure rules of the UCITS Directive, and since 2 August 2021 has required that the UCITS prospectus informs the investors about the "facilities" established for local investors under the EU Directive on cross-border distribution of investment funds (Directive (EU) 2019/1160).

As described in **2.1.4 Disclosure Requirements**, there are annual reporting requirements for managers of retail funds and managers of non-retail funds. There are also semi-annual reporting requirements for contractual funds and AG with variable capital. The reports need to be published.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

Retail funds can be subscribed by retail investors as well as by professional and semi-professional investors.

3.2.2 Legal Structures Used by Fund Managers

For open-end funds, the contractual fund and the investment corporation with variable capital structures are available.

For closed-end funds, the only available vehicles for retail funds are the investment corporation with fixed capital and the closed-end investment limited partnership.

For details concerning operational requirements regarding retail funds, please see **3.1.1 Fund Structures** and **3.1.2 Common Process for Setting Up Investment Funds**.

3.2.3 Restrictions on Investors

There are only a few restrictions for investors investing in retail funds – eg, German Solvency I investors may not invest in retail open-ended real estate investment funds.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

The main law governing retail funds is the KAGB, which is based on the AIFMD and the UCITS Directive and which is supplemented by German-specific rules for retail funds. In addition, several lower-level ordinances apply (the Derivative Ordinance, the Organisational and Rules of Conduct Ordinance and the Mediation Ordinance).

This set of laws is supplemented by self-regulatory standards, mainly the Rules of Good Conduct issued by the German Investment Funds Association and the Association's sample investment guidelines.

As described in **2.3.1 Regulatory Regime**, a full fund management licence opens the door for a manager to market funds to retail investors.

3.3.2 Requirements for Non-local Service Providers

Please see **2.3.2 Requirements for Non-local Service Providers**.

3.3.3 Local Regulatory Requirements for Non-local Managers
The management of a retail AIF is not permitted for non-local managers.

For UCITS, management by non-local UCITS managers is possible via the cross-border passport under the UCITS Directive.

3.3.4 Regulatory Approval Process
The licensing procedure can take from six to 12 months, or sometimes longer.

3.3.5 Rules Concerning Pre-marketing of Retail Funds
The rules concerning pre-marketing only apply to AIFs, as noted in **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**.

3.3.6 Rules Concerning Marketing of Retail Funds
Retail funds can be marketed only by the following three categories of "marketers".

- The fund manager itself can always market its "own" funds and, if fully licensed (ie, not only registered as a sub-threshold manager), may also market investment funds of other managers.
- MiFID firms are entitled to market investment funds (provided they have a MiFID licence or passport for investment advice and the transmission or receipt of orders).
- Firms or individuals with a financial intermediary licence under the German Commerce Act (GewO) may also market retail funds. The financial intermediary licence is a non-MiFID licence and is based on the optional exemption from MiFID II stipulated in Article 3 of MiFID II. However, since 2 August 2021, these firms or individuals may no longer engage in pre-marketing on behalf of a manager.

If the retail fund is marketed by the fund manager itself, the fund manager must make the fund documents and the latest semi-annual and annual fund reports available to the prospective investor. In addition, certain ongoing publication requirements apply (such as the publication of fund documents and fund reports on the manager's website).

For MiFID firms, Germany considers the prospective investor as the regulatory client of the MiFID firm. Accordingly, MiFID firms have to adhere to the MiFID II rules of good conduct towards the prospective investor (requiring items such as suitability or appropriateness checks). This applies in a broadly similar fashion to the above-mentioned GewO firms. The MiFID application further means that marketing materials provided by the fund manager must comply with the MiFID II requirements on marketing materials (eg, with regard to past or simulated performance). As mentioned in **2.3.6 Rules Concerning Marketing of Alternative Funds**, since 2 August 2021, managers have been subject to similar requirements on the content of their marketing materials as MiFID firms.

3.3.7 Marketing of Retail Funds
Retail funds can be marketed to any investor in Germany (regardless of whether the investor is professional, semi-professional or retail).

3.3.8 Marketing Authorisation/Notification Process
The marketing of alternative funds or UCITS to retail investors requires either an authorisation by BaFin or, with respect to UCITS, a European marketing passport under the UCITS Directive.

3.3.9 Post-marketing Ongoing Requirements
There are annual and semi-annual reporting requirements for managers of retail funds. The

reports need to be published. Furthermore, the redemption price must be published as well as any disclosures made in the home country of such manager.

3.3.10 Investor Protection Rules

In addition to as previously discussed in **2.3.10 Investor Protection Rules**, civil law prospectus liability rules offer effective protection for retail investors. Basically, civil law prospectus rules impose a liability on the manager and initiator of the fund. The measuring stick is whether the prospectus is incomplete or misleading in aspects that are material for the investment decision of a typical investor.

3.3.11 Approach of the Regulator

As noted in **2.3.11 Approach of the Regulator**, BaFin is generally co-operative and open to discussions.

3.4 Operational Requirements

Germany offers different types of retail funds – eg, UCITS, real estate funds, funds of hedge funds, closed-end funds and infrastructure funds. The fund types are based on the UCITS investment and borrowing restrictions as the default rules. The investment and borrowing restrictions are then modified to fit each fund type.

The KAGB contains a catalogue of assets in which a closed-end Public AIF may invest. The investment in other funds by a closed-end Public AIF is restricted (ie, the structuring of a fund of funds or feeder fund as a retail fund).

For a further overview, see **2.4 Operational Requirements**.

3.5 Fund Finance

The explanations given in **2.5 Fund Finance** (regarding alternative investment funds) also apply to fund finance for retail funds.

3.6 Tax Regime

German tax law does not provide for a specific tax regime applying to funds targeting retail investors. However, for taxation at investor level, different tax rules apply to institutional corporate investors and retail individual investors. The rules for retail individual investors are as follows.

Funds Organised as Partnerships

Domestic funds eligible for non-trading treatment

Resident retail individual investors

A resident retail individual investor's allocable share of interest, dividends, capital gains relating to debt instruments and equity capital gains of shareholdings representing an indirect interest of less than 1% are subject to German income tax at a flat rate of approximately 26.4% (including solidarity surcharge) plus church tax, if applicable. Equity capital gains of shareholdings representing an indirect interest of 1% or more are subject to German income tax levied at the marginal tax rate, but 40% of such capital gains are exempt from income tax.

Non-resident retail individual investors

A non-resident retail individual investor's allocable share of interest (other than profit-linked), dividends from non-German portfolio companies, capital gains relating to debt instruments and equity capital gains aside from shareholdings in German portfolio companies representing an indirect interest of less than 1% are not subject to German income tax.

Equity capital gains of shareholdings in German portfolio companies representing an indirect interest of 1% or more are subject to German income tax at the marginal tax rate, but 40% is exempt from income tax. Tax will be levied by way of assessment, based upon a German tax return to be filed by the non-resident retail individual investor. Such German tax-paying obligation does not apply to non-resident retail individual investors who are entitled to tax treaty benefits.

A non-resident retail individual investor's allocable share of dividends from German portfolio companies is subject to German withholding tax at the rate of approximately 26.4%, and investors who are entitled to tax treaty benefits can file an application with the German federal tax office for a refund of the excess of the German withholding tax over the amount permitted under the applicable tax treaty.

Non-German funds

Resident retail individual investors

As set forth in **2.6 Tax Regime**, non-German funds are typically trading from a German tax perspective. Accordingly, a resident retail individual investor's allocable share of a non-German fund's taxable profits is subject to German income tax as follows: 60% of equity capital gains and dividends, and the full amount of interest is subject to German income tax at the marginal tax rate.

Non-resident retail individual investors

While non-German funds are typically trading from a German tax perspective, they typically do not operate a German permanent establishment to which their income would be attributable. Accordingly, a non-resident retail individual investor's allocable share of the taxable profits of a non-German fund is subject to German tax only on German-source items of income, in accordance with the rules explained above for German funds that are eligible for non-trading treatment.

Corporate-Type Funds

Non-resident retail individual investors

Income derived from German or non-German corporate-type funds (including funds of a contractual type such as the German *Sondervermögen* and non-German fund vehicles that resemble a German *Sondervermögen*) is not subject to tax in Germany.

Resident retail individual investors

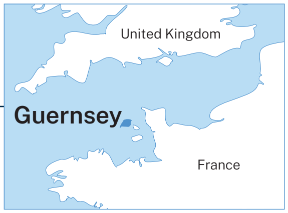
The three items of income described in **2.6 Tax Regime** and derived by them from a German or non-German corporate-type fund are subject to German income tax at a flat rate of approximately 26.4% (including solidarity surcharge) plus church tax, if applicable. The partial tax exemptions for which they may be eligible amount to 30% in respect of equity funds and 15% in respect of mixed funds. Resident retail individual investors are not subject to trade tax.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

Germany is constantly implementing any EU directives and modernising its rules, by a number of amendments to the KAGB. Recent changes have already been discussed throughout this article, where relevant. In addition, BaFin reviews and updates its administrative pronouncements and FAQs on a regular basis.

GUERNSEY



Law and Practice

Contributed by:
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Contents

Carey Olsen is a leading offshore law firm that advises financial institutions, corporations and private clients on Bermuda, British Virgin Islands, Cayman Islands, Guernsey and Jersey law, from a network of nine international offices. The firm's clients include global financial institutions, investment funds, private equity houses, multinational corporations, public organisations, sovereign wealth funds, ultra-high net worth individuals, family offices, directors, trustees and private clients. It works alongside all major onshore law firms, accountancy firms and insolvency practitioners on corporate transactions and matters involving its jurisdictions. Carey Olsen Guernsey is the leading legal adviser to the Guernsey investment funds industry, advising nearly 74% of the market by total number of Guernsey-domiciled funds, and over 81% of the entire Guernsey-domiciled funds market by aggregate assets under management (AUM).

Author

Matthew Brehaut is a partner in the corporate team at Carey Olsen's London office. He advises on corporate and investment funds matters, and provides funds, fund service providers and fund promoters with advice on all aspects of the establishment, regulation and operation of investment funds. Matt trained at Clifford Chance in London and New York, where he specialised in the establishment of institutional closed-ended investment funds. He qualified as an English solicitor in the Private Funds Group in 2004. In 2005 he was seconded to ABN AMRO's investment bank legal department, where he advised on the structuring and launching of a broad range of bespoke and multi-investor institutional fund-linked products. Matt joined Carey Olsen in May 2016.

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CAREY OLSEN

1. Market Overview

1.1 State of the Market

Guernsey is frequently used by advisers and managers globally for the formation/domiciling of investment funds. Guernsey is one of the world's largest offshore finance centres, with a thriving funds industry.

As of 30 June 2023, over 1,300 investment funds and over 1,550 sub-funds are currently domiciled and/or administered in the island. The most recent aggregate value of funds under management and administration in Guernsey is reported as over USD500 billion, of which over GBP378 billion is in closed-ended Guernsey funds.

Guernsey attracts all types of fund sponsors/managers – ie, sponsors/managers of:

- private funds;
- hedge funds;
- listed funds; and
- quasi-retail funds (although there is no UCITS equivalent offering in Guernsey).

Additionally, the fund "types" include the full span of asset classes and strategies, such as:

- alternatives (including private equity, buyout, debt, infrastructure, real estate, venture capital, tech, etc); and
- open-ended funds (again, with a broad range of asset classes).

Closed-ended alternative/private funds are the most common fund type attracted to Guernsey as a funds domicile, with the remainder being Guernsey open-ended funds and non-Guernsey schemes.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

The principal legal vehicles used to set up alternative investment funds are as follows:

- open-ended – most open-ended funds established in Guernsey are structured as limited companies, protected cell companies or incorporated cell companies;
- closed-ended – most closed-ended funds established in Guernsey are structured as limited partnerships; and
- unit trusts are also used for both open and closed-ended Guernsey funds.

The Advantages and Disadvantages of Using Such Structures

Companies

All types of company:

- offer limited liability to investors;
- are managed by a board of directors;
- are non-tax transparent; and
- (unless they elect otherwise) are deemed Guernsey-resident for Guernsey tax purposes.

A protected cell company provides (by way of statute) for the creation, within the single legal entity of that company, of separate pools of assets segregated from the other assets and liabilities of the company and its other cells, with creditors having recourse limited to the assets of a particular cell.

An incorporated cell company takes this statutory segregation one step further such that each cell is a separately registered legal entity with:

- its own memorandum and articles of incorporation;
- its own registration number; and
- its own board of directors (though the board composition of each incorporated cell must have one director in common with the board of the core).

In a protected cell company, the cells are not separately registered legal entities, and the protected cell company (as a single legal entity) has a single board of directors and memorandum and articles of incorporation.

Limited partnerships
A limited partnership is comprised of:

- one or more general partners who are jointly and severally liable for all debts of the limited partnership without limitation; and
- one or more limited partners who contribute (or agree to contribute) a specified sum to the capital of the limited partnership, and who are not liable for any debts of the limited partnership beyond the amounts contributed (or agreed to be contributed).

The property of the limited partnership is held on trust by the general partners jointly as assets of the limited partnership in accordance with the terms of the limited partnership agreement. Limited partnerships are tax-transparent for Guernsey tax purposes.

Unit trusts
A unit trust is not a separate legal entity but is a fiduciary relationship between a trustee and one or more beneficiaries in relation to particular assets. This relationship is constituted by an agreement in writing, commonly known as a "trust instrument". In the context of a fund established as a unit trust, the trust instrument will contain (in addition to elements/provisions relating to the relevant trust law) contractual provisions that will exist between a manager (appointed by the trustee to manage the assets) and the trustee.

The assets of a unit trust are held by its trustee on trust for the benefit of the beneficiaries (the unit-holders (investors)) and are managed by the manager, who may appoint one or more investment managers or advisers to assist it. Contracts in relation to the management and administration of the trust will be entered into by the manager; whereas the trustee will enter into contracts in relation to the assets themselves, such as bank deposits, borrowings and security agreements.

The participants' interests in the above vehicles are referred to accordingly:

- for companies – shares;
- for limited partnerships – limited partnership interests; and
- for unit trusts – units.

Guernsey investment managers and/or investment advisers of alternative investment funds are principally established as companies or limited liability partnerships.

2.1.2 Common Process for Setting Up Investment Funds
Every "collective investment scheme" ("fund") domiciled in Guernsey will be subject to the provisions of Guernsey's principal funds legislation (the Protection of Investors (Bailiwick of Guernsey) Law, 2020, as amended (the "POI Law")) and regulated by Guernsey's regulatory body for the finance sector (the Guernsey Financial Services Commission (GFSC)). The POI Law splits Guernsey funds into two categories:

- "registered funds", which are registered with the GFSC; and
- "authorised funds", which are authorised by the GFSC.

Essentially, the difference between authorised funds and registered funds is that authorised funds receive their *authorisation* following a substantive review of their suitability by the GFSC, whereas registered funds follow a "fast track" regime whereby they receive their *registration* following a representation of suitability from a Guernsey body holding a POI Law licence. Such body would be the administrator, which scrutinises the fund and its promoter in lieu of the GFSC, and takes on the ongoing responsibility for monitoring the fund – effectively a form of "self-certification" by a Guernsey licensed administrator. One exception to this is authorised funds which opt into the "qualifying investor fund" regime – these also benefit from the "fast track" regime.

The rules governing the different classes of Guernsey funds also distinguish between whether they are open-ended or closed-ended (or can choose from either). A Guernsey fund is open-ended if the investors are entitled to have their units redeemed or repurchased by the fund at a price related to the value of the property to which they relate (ie, the NAV).

The POI Law grants the GFSC the ability to develop different classes of authorised and registered funds, and to determine the rules applicable to such classes. The following types of authorised and registered funds are currently available.

Authorised Funds

Authorised fund types are as follows.

- Class A: retail funds offering. Class A funds have largely been superseded by the AIFMD regime. These are open-ended only.
- Class B: these can be structured as retail products marketed to the public, or established as strictly private or institutional funds. They are open-ended only.
- Class Q: these are not retail funds as they can only be beneficially owned by qualifying professional investors (essentially, government bodies or high net worth individuals or entities, with a minimum investment of USD100,000). They are open-ended only.
- ACIS: authorised closed-ended investment schemes. These are closed-ended funds which are subject to the GFSC's permanent and continuing supervision.

Registered Funds

Registered fund types are as follows.

- RCIS funds: registered closed-ended investment schemes, commonly referred to as "registered funds" (as they were the only type of registered fund until the introduction of private investment funds). RCIS funds may be open or closed-ended.
- Private investment funds (PIFs): intended for funds with a small number of investors. They are not suitable to be used as retail funds.

Originally introduced in 2016, there are now three types of PIFs, as follows.

Route 1

The "POI Licensed Manager" PIF is suited to fund managers that have a closer relationship with their investors. Its distinguishing features include:

- no requirement for minimum investment;
- no requirement for a prospectus;
- a maximum of 50 legal or natural persons holding an economic interest (with no more than 30 admitted in a 12-month period); and
- no limit imposed on the number of potential investors to which the fund can be marketed.

Route 2

A "Qualifying Private Investor" PIF is available to investors who can evaluate the risks and strategy of investing in a PIF and bear the consequences of investment, including the possibility of any loss arising from the investment. The relevant rules contain related definitions of "professional investor", "experienced investor" and "knowledgeable employee" regarding how an investor can be categorised as a Qualifying Professional Investor.

Qualifying Private Investor PIFs are also subject to a maximum of 50 legal or natural persons holding an economic interest in the fund. Marketing can take place to a maximum of 200 people. Investors must be provided with a disclosure statement that states all material information (including risk disclosures) that an investor would reasonably require to make an informed judgement about the merits and risks of investing in the PIF, as well as certain prescribed disclosures. The administrator must make a declaration to the GFSC that effective procedures are in place to restrict the fund to Qualifying Professional Investors. The administrator should also receive written acknowledgement of receipt of the above-mentioned disclosure statement from investors.

Route 3

A "Family Relationship" PIF is available to investors who share a family relationship or are an employee of the family. The Family Relationship PIF cannot be marketed outside the family group. The administrator must make a declaration to the GFSC that effective procedures are in place to ensure that all investors fulfil the requirement of being related as a family.

Qualifying Investor Funds (QIFs)

An authorised fund may apply to the GFSC to be approved as a QIF, following which the GFSC's QIF Guidance will apply to it in addition to the authorised rules to which it is already subject. QIFs may only admit investors which are: "professional investors", "experienced investors", or "knowledgeable employees".

The QIF must have a promoter (ie, the party ultimately responsible for the fund's success) that is fit and proper. There must be effective procedures in place to ensure that only qualifying investors are admitted, and the economic rationale for the fund and any attendant risks must be clearly disclosed. QIFs may be open- or closed-ended.

Manager-Led Products (MLPs)

Consistent with the approach taken by the EU in the AIFM Directive, the MLP regime regulates only the primary alternative investment fund manager (AIFM) in respect of one or more alternative investment funds (AIFs). The MLP regime is intended to be used by AIFMs seeking to market an AIF into the EEA under the national private placement regimes. AIFMs wishing to access the MLP regime must comply with Guernsey's AIFMD Rules – which mirror the rules of the AIFMD.

The GFSC's standard application procedure for authorised funds (ie, Class A funds, Class B funds, Class Q funds and ACIS funds) that do not elect to be approved as QIFs is a three-stage process:

- stage one – outline authorisation;
- stage two – interim authorisation; and
- stage three – formal authorisation once all issues have been resolved and final documentation has been received.

Core documents are as follows:

- constitutional documents of the fund vehicle;
- information particulars/offering memorandum;
- application form/subscription agreement; and
- material contracts – eg, investment management agreement, administration agreement, custody agreement (as applicable).

The GFSC provides the following indicative timeframes:

- outline authorisation within 28 days business days;
- interim authorisation within ten business days; and
- formal authorisation within seven business days.

The GFSC offers fast-track applications in respect of:

- RCIS funds and authorised funds which elect to be approved as QIFs (three business days);
- fast-track POI licence applications, where the manager of RCIS funds and QIFs applies for its licence under the POI Law simultaneously with the funds' application (ten business days, which runs concurrently with the relevant fund application); and
- PIFs, including the manager's licence (one business day).

Core documents for registered funds are as follows.

For RCIS funds:

- constitutional documents of the fund vehicle;
- information particulars/offering memorandum;
- subscription agreement; and
- material contracts – eg, investment management agreement, administration agreement.

For PIFs:

- constitutional documents of the fund vehicle;
- subscription agreement; and
- material contracts – eg, investment management agreement, administration agreement.

Note that PIFs are not required to produce information particulars/offering memorandums (although a Route 2 PIF must produce a disclosure statement).

2.1.3 Limited Liability

Investor limited liability is provided by the fund vehicle. The most used fund vehicles – limited companies, limited partnerships and unit trusts – all offer limited liability to investors. In general terms, the limits or restrictions on benefiting from limited liability are typically related to whether or not investors participate in the "management" of the fund – eg, a limited partner in a fund that is a limited partnership may lose their limited liability status if they participate in the management of the limited partnership.

Guernsey's limited partnership law provides for specific safe harbours permitting limited partner involvement in decisions without jeopardising their limited liability status.

2.1.4 Disclosure Requirements

An offering document (made up of one or more documents, which may include the core documents of the fund – see **2.1.2 Common Process for Setting Up Investment Funds**), containing the requisite disclosures, must be produced for all types of authorised funds and for registered funds other than PIFs. In each case, the specific disclosure requirements for each fund type must be met.

For a Class A fund, the fund's prospectus must state/contain:

- a description of the fund;
- its investment objective and policy;
- reporting, distributions and accounting dates;
- characteristics of the units;
- particulars of the manager;
- particulars of the directors where the fund is a company;
- particulars of the trustee;
- particulars of any investment adviser;
- the name of the auditor;
- material contract summaries;
- details of the name and address of the registrar;
- details of payments to be made out of fund property;
- disclosure of any decision to treat income expense payments as a capital expense;
- an estimate of the expenses to be incurred by a company fund in respect of its movable and immovable property;
- details of the valuation policy and procedures;
- details of the dealing policy and procedures;
- for a single-priced fund, disclosures in respect of dilution;
- the manager's normal basis of pricing (forward and historic);
- details of any preliminary charge;
- details of any redemption charge;
- information on the umbrella fund, if relevant;
- application of the prospectus contents to an umbrella fund;
- details of any marketing arrangements into the EEA; and
- any other material information reasonably required by an investor to make an informed investment decision.

For a Class B fund, the fund's information particulars must state/contain:

- the name and structure of the fund;
- the names and addresses of key service providers to the fund;
- the investment objectives and restrictions;
- the hedging powers and restrictions (or an appropriate negative statement);
- the borrowing powers and restrictions (or an appropriate negative statement);
- certain accounting and reporting matters;
- the issue and redemption procedure;
- the valuation procedure;
- holders' rights;
- the distribution policy;
- directors' and other material interests;
- fees and expenses;
- sufficient risk warnings;
- the fund's tax status and tax treatments in jurisdictions where it will be marketed; and
- any other material information reasonably required by an investor to make an informed investment decision.

For a Class Q fund, the fund's offering documents must state:

- the name and status of the fund as a Class Q fund;
- the names and addresses of key service providers to the fund;

- a definition of qualifying professional investors and a statement that only qualifying professional investors are eligible to invest;
- the constitution and objectives of the fund;
- the characteristics of units in the fund;
- disclosures in respect of the valuation of the property, charges and distributions;
- the sale and redemption procedure;
- when annual accounts will be published;
- sufficient risk warnings; and
- any other material information reasonably required by an investor to make an informed investment decision.

For an ACIS fund, the fund's information particulars must state/contain:

- the name and structure of the fund;
- the names and addresses of key service providers to the fund;
- the investment objectives and policy;
- the duration of the fund;
- details of the accounting and reporting policies and procedures;
- the subscription procedures;
- the valuation procedures (if any);
- shareholders' rights;
- the distribution policy;
- details of the fees and expenses;
- the fund's tax status and tax treatments in jurisdictions where it will be marketed; and
- any other material information reasonably required by an investor to make an informed investment decision.

For an RCIS fund, the fund's information particulars must state/contain:

- details relating to the offer;
- particulars of the share capital, etc;
- a statement of the value of any goodwill and preliminary expenses;
- a material contract summary;
- directors' and other material interests;
- any options and prior interests;
- details of all borrowings and borrowing powers;
- details of the accounting and reporting policies and procedures;
- registered office details;
- principal establishments;
- details of the designated administrator and custodian (if any);
- details of the directors and secretary of the fund company, corporate general partner or corporate trustee;
- details of the general partner or trustee (if any);
- details of the auditor, legal advisers and principal bankers;
- details of significant beneficial ownership;
- voting and other rights; and
- any other material information reasonably required by an investor to make an informed investment decision.

For a Qualifying Private Investor PIF, the fund's disclosure statement should state all material information (including risk disclosures) that an investor would reasonably require to enable such investor to make an informed judgement about the merits and risks of investing in the PIF.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Institutional investors represent the largest single category of investors in Guernsey-domiciled funds, although sovereign wealth funds, high net worth individuals and family offices are also very active in Guernsey's investment funds market.

2.2.2 Legal Structures Used by Fund Managers

Guernsey investment managers and/or investment advisers of alternative investment funds are principally established as companies or limited liability partnerships.

2.2.3 Restrictions on Investors

Restrictions on ownership of fund interests only apply in relation to funds regulated under the following regulatory regimes in Guernsey.

Class Q Funds

Admission is limited to qualifying professional investors, defined as:

- governments, local authorities or public authorities (in the Bailiwick or elsewhere);
- trustees of trusts which, at the time of investment, have net assets in excess of GBP2 million (or currency equivalent);
- a body corporate or limited partnership, if it or any holding company or subsidiary of it has, at the time of investment, net assets in excess of GBP2 million (or currency equivalent); or
- an individual who has, together with any spouse, at the time of investment, a minimum net worth (which excludes that individual's main residence and household goods) of GBP500,000 (or currency equivalent).

QIFs

Admission is limited to qualifying investors, which are defined as professional investors, experienced investors and knowledgeable employees.

A professional investor is:

- a government, local authority, public authority or supra-national body (in the Bailiwick or elsewhere);
- a person, partnership or other unincorporated association or body corporate, (whether incorporated, listed or regulated in an OECD country or otherwise) whose ordinary business or professional activity includes, or it is reasonable to expect that it includes, acquiring, underwriting, managing, holding or disposing of investments whether as principal or agent, or the giving of advice on investments;
- an affiliate of the Qualifying Investor Fund or an associate of an affiliate of the Qualifying Investor Fund (the terms "affiliate" and "associate of an affiliate" are intended to refer to financial services businesses or financial services professionals associated, directly or indirectly, with the operation of the fund in question); or
- an individual investor who makes an initial investment of not less than USD100,000 or equivalent in the fund in question – provided the initial test has been met, subsequent investments by the same investor may be of lower amounts.

An experienced investor is a person, partnership or other unincorporated association or body corporate which has in any period of 12 months (whether on their own behalf or in the course of their employment by another person) so frequently entered into transactions of a particular type in connection with:

- open-ended and closed-ended collective investment schemes; and/or
- general securities and derivatives as defined in Schedule 1 of the POI Law (in summary, that definition includes equities, bonds, war-

rants, options, futures, contracts for differences and rights on any of those investments).

This means transactions of substantial size entered into with, or through the agency of, reputable persons who carry on investment business, where they can reasonably be expected to understand the nature of, and the risks involved in, transactions of that description. Alternatively, it means persons who provide a certificate from an appropriately qualified investment adviser confirming that the investor has obtained independent advice.

A knowledgeable employee is:

- a person who is (or has been within a period of three years up to the date of application for investment in the Qualifying Investor Fund) an employee, director, general partner, consultant or shareholder of, or to, an affiliate appointed by the Qualifying Investor Fund to advise, manage or administer the investment activities of the Qualifying Investor Fund, and who is acquiring an investment in the Qualifying Investor Fund as part of their remuneration or an incentive arrangement or by way of co-investment, either directly or indirectly, through a personal investment vehicle (such as a trust) for or substantially for that person; or
- any employee, director, partner or consultant to or of any person referred to above, or anyone who has fulfilled such a role in respect of any person referred to above, within a period of three years up to the date of application for investment in the Qualifying Investor Fund (the term "employee" only covers persons who are, or have been, employed in a relevant role and would not extend to clerical, secretarial or administrative roles).

Route 1 PIFs

Admission is limited to investors able to sustain any losses incurred on their investment at the time they make their investment.

Route 2 PIFs

Admission is limited to "qualifying private investors", which are defined as professional investors, experienced investors and knowledgeable employees. The definitions of these categories of investors are essentially the same as for QIFs, as set out above.

Route 3 PIFs

Admission is limited to investors sharing a family relationship, or who are eligible employees of the family (who must also meet the definition of a "qualifying private investor").

2.3 Regulatory Environment

2.3.1 Regulatory Regime

Investment business in Guernsey is regulated by the GFSC, and the principal legislation governing the conduct of investment business (including funds and associated entities) is the POI Law. Each type of collective investment scheme is subject to particular rules issued by the GFSC – for example, in respect of RCIS funds, the Registered Collective Investment Scheme Rules and Guidance, 2020.

Only Class A funds, which have been largely superseded by the AIFMD regime, are subject to regulatory limitations on their investments.

2.3.2 Requirements for Non-local Service Providers

The requirement to have a Guernsey-based manager depends on the particular regulatory regime chosen to regulate the fund. For the most part, the regulatory regimes do not require a Guernsey-based manager (save for

Route 1 PIFs, as described below). However, as indicated in **1.1 State of the Market**, the most common fund type is the closed-ended private fund, which is generally structured as a limited partnership or corporate. Consequently, in the context of the limited partnership structure, the Guernsey-based general partner of these funds is usually the "manager" of the fund, which is then advised by a non-Guernsey adviser (generally UK-based). In the corporate structure, the manager is usually non-Guernsey-based (again, generally UK- or US-based).

All Guernsey funds must appoint a local designated administrator, which must be licensed by the GFSC. The designated administrator conducts the day-to-day administration of the fund and has certain oversight responsibilities to ensure that the fund is operated in accordance with its constitutional and offering documents and with Guernsey law and regulation.

All open-ended funds must appoint a Guernsey custodian, licensed by the GFSC. Institutional or expert investor hedge funds can be permitted to appoint a foreign prime broker rather than a local custodian or trustee, which is not required to offer physical segregation of fund assets from its own, so long as the fund prospectus makes clear the risks of such arrangement. Retail or less-sophisticated investor hedge funds can be permitted to appoint a foreign prime broker to take control of the fund's property, but will normally be expected to appoint a local custodian or trustee to oversee the prime broker.

All Route 1 PIFs must appoint a Guernsey-based manager, licensed by the GFSC, and which is responsible for making certain representations and warranties to the GFSC on the ability of investors to suffer losses.

As expected from a jurisdiction with over GBP500 billion of funds under management and administration, Guernsey has a wealth of first-class fund service providers, including administrators, lawyers, auditors and custodians. This creates a virtuous circle – as funds under management increase, so does the depth of expertise, which in turn attracts further funds under management.

Guernsey also benefits from a large number of highly experienced, independent non-executive directors providing additional investment management experience, as well as guidance and oversight for funds, and ensuring that the highest standards of corporate governance are observed.

2.3.3 Local Regulatory Requirements for Non-local Managers

As is the case with regulators of most other jurisdictions, the GFSC has direct authority only over those entities which it has licensed or authorised, and which conduct business in or from within Guernsey; and those entities are answerable to the GFSC.

The POI Law makes it a criminal offence, subject to certain exceptions, for any person to carry on or hold himself out as carrying on any "controlled investment business" in or from within Guernsey without a POI licence issued by the GFSC. Additionally, it is an offence for a Guernsey body to carry on or hold itself out as carrying on any controlled investment business in or from within a territory outside Guernsey, unless that body is licensed to carry on that business in Guernsey and the business would be lawfully carried on if it were carried on in Guernsey.

As such, in terms of services (eg, investment management or advisory) being provided by non-Guernsey entities from outside Guernsey, the GFSC does not have direct authority over those providers, whose authority rightly sits with the regulator in their home jurisdiction. However, in regulating the relevant fund the GFSC will consider (as one of the elements in authorising or registering the fund and on an ongoing basis) the quality of the non-service providers. The home jurisdiction, home regulatory body and the size and reputation of the provider are all considered by the GFSC. Funds domiciled in Guernsey are, therefore, free to contract the services of any provider in another jurisdiction, subject always to both a determination by the relevant fund of the "fit and properness" of the service provider and to the oversight of the GFSC over the relevant fund.

2.3.4 Regulatory Approval Process

The time required to obtain regulatory approval depends on the type of fund registration/authorisation being sought. More detail is provided in respect of each fund type in **2.1.2 Common Process for Setting Up Investment Funds**.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

There is no legal definition of pre-marketing. However, by convention the GFSC makes a distinction between pre-marketing activities and marketing activities in determining whether the restricted activity of "promotion" is being undertaken by a person.

Pre-marketing activities (such as the circulation of "red herring" documentation) are generally permitted without the need for the person undertaking those activities to obtain a licence or rely on an exemption under the POI Law, provided it is made clear that:

- no offer is being made to investors to subscribe for shares in the collective investment scheme; or
- no invitation is being made to apply to participate in the collective investment scheme by any person.

The authors note, however, that this is not a matter of law but of regulatory practice, so advice should be taken on the specific facts.

2.3.6 Rules Concerning Marketing of Alternative Funds

Pursuant to the POI Law, the promotion of collective investment schemes is a restricted activity and requires a licence under the POI Law (a POI licence) if carried on in or from within the Bailiwick, unless one of the statutory exemptions applies.

If certain conditions are met, including registration with the GFSC, the following may be promoted in the Bailiwick by an overseas promoter to the public without a POI licence:

- EEA AIFs;
- certain UK unit trusts;
- certain Jersey collective investment schemes; and
- certain Isle of Man and Republic of Ireland authorised schemes.

Similarly, if certain conditions are met, including notification to the GFSC, a wider range of funds can be promoted, provided such promotion is restricted to entities licensed by the GFSC.

In addition, neither a POI licence nor a notification to the GFSC would be required by an overseas promoter if the marketing were carried out on a non-solicitation basis. The GFSC would not normally consider marketing campaigns by an overseas promoter that do not originate from within the Bailiwick and that do not specifically target Bailiwick residents (but might include the Bailiwick as part of a wider population) as constituting a restricted activity or requiring a POI licence.

2.3.7 Marketing of Alternative Funds

Subject to the regulatory requirements summarised in **2.3.6 Rules Concerning Marketing of Alternative Funds** and **2.3.8 Marketing Authorisation/Notification Process**, and the restrictions specific to certain types of funds summarised in **2.1.2 Common Process for Setting Up Investment Funds**, there are no restrictions on the types of the investors in Guernsey to whom alternative funds may be marketed.

2.3.8 Marketing Authorisation/Notification Process

Authorisation or notification is required by the national regulator prior to the marketing of alternative funds, if not relying on reverse solicitation.

Promotion to the public of certain categories of funds as mentioned in **2.3.6 Rules Concerning Marketing of Alternative Funds** requires a GFSC notification (to which the GFSC must issue a confirmation), and the promoter must be able to satisfy the following:

- that it carries on that activity (ie, the promotion of the funds) in or from within the Bailiwick, in a manner in which it is permitted to carry on such activity in or from within, and under the law of, a designated country or territory which, in the opinion of the Committee for Economic Development, affords (in relation to activities of that description) adequate protection to investors;
- that it has its main place of business in that country or territory and does not carry on any restricted activity from a permanent place of business in the Bailiwick; and
- that it is recognised as a national of that country or territory by its law.

Promotion to entities licensed by the GFSC by a firm with a main place of business in one of the countries or territories designated for the purposes of Section 44(1)(d) of the POI Law (which includes the UK) does not require a licence, provided that a GFSC notification is made and that the promoter is able to satisfy the following.

- The firm does not have a permanent place of business within the Bailiwick.
- The firm is an entity established in a country or territory designated and listed in the first column of the Schedule to the Investor Protection (Designated Countries and Territories) (Bailiwick of Guernsey) Regulations, 2017. This list is extensive and includes signatory countries to the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, established by the International Organisation of Securities Commissions in May 2002 – the authors note that the UK is included.
- The promotion is carried out in accordance with the laws of that designated country or territory.

2.3.9 Post-marketing Ongoing Requirements

Firms making use of marketing to the public regime must pay an annual fee (following an initial fee). Otherwise, there are no ongoing requirements, provided the circumstances do not change.

2.3.10 Investor Protection Rules

Regarding investor protection provisions, see **2.2.3 Restrictions on Investors**.

Regulatory reporting requirements depend on the relevant fund type and may be summarised as follows.

- For Class A funds, Class B funds and Class Q funds, the manager must provide to the GFSC:
  - (a) reports issued to investors; and
  - (b) either an annual notification of any changes to the information contained in the application form, or a confirmation that there are no changes.
- For RCIS funds and PIFs, the manager must provide to the GFSC:
  - (a) either an annual notification of any changes to the information contained in the application form, or a confirmation that there are no changes;
  - (b) an audited annual report and accounts within six months of the year-end; and
  - (c) a quarterly statistical return.
- Audited financial statements must be submitted annually to the GFSC.
- Statistical returns must be filed quarterly with the GFSC.
- Proposals for material changes to Guernsey funds must be notified to the GFSC.
- Companies, limited partnerships and partnerships are subject to annual return filing requirements with the Registrar of Companies.
- Annual tax filings must be made by all companies.

Of the above, only the Guernsey Registry annual return is publicly available.

2.3.11 Approach of the Regulator

Guernsey maintains a robust, proportionate, flexible and competitive funds regulatory regime, adopting a risk-based approach to ensure that appropriate levels of investor protection are maintained, while at the same time avoiding unnecessarily complex, prescriptive or burdensome regulation (or granting waivers of certain regulatory requirements where considered appropriate).

The attitude of the regulator continues to be one of fostering constructive approachability. This is built firmly on the basis of a transparent, open and co-operative approach. The GFSC's view has always been to understand at an early stage where there are potential issues, and to identify, with the relevant section of industry, solutions to those issues that will ultimately produce the best outcome for all stakeholders and thereby protect the reputation of Guernsey. As such, the regulator is always open to discussions on regulatory questions, opens issues to consultation and publishes guidance on regulatory matters where such guidance would be helpful to practitioners or the industry as a whole.

The GFSC works closely with the funds industry to ensure that the regulatory regime continues to evolve and provide the kinds of structures required by today's investors, with the protection of those investors (commensurate with their sophistication) at the forefront. There is ongoing engagement between the GFSC and industry experts to further the island's interests.

This engagement has given Guernsey a strong track record in innovation, having created the protected cell company over 25 years ago (now copied globally). More recently, the PIF regime was launched (and subsequently expanded in scope), providing a fund class specifically designed to reflect the often-close relationship between fund managers and their investors, and to facilitate smaller funds with sophisticated investors.

The close relationship between the GFSC and Guernsey's funds industry also ensures a high level of responsiveness. Fund vehicles can be established on a same-day basis and regulatory approval times can be as little as one day. By and large, the GFSC adheres to stated timeframes.

The regulator approaches enforcement on a proportionality basis. This means that "enforcement" spans a range of actions from remediation of breaches to sanctions and criminal proceedings.

2.4 Operational Requirements

Restrictions on types of activity or types of investment, and asset-protection requirements, depend on the relevant fund type and are summarised in **2.2.1 Types of Investors in Alternative Funds**.

2.5 Fund Finance

Subject to certain restrictions in respect of Class A funds (see below), Guernsey alternative funds may access fund finance for subscription financing and/or leveraging, provided the appropriate borrowing powers and limits are set out in the fund's offering documents and constitutional documents.

A Class A fund may borrow up to 10% of the value of the fund's property on a temporary basis, subject to any restriction in its constitutional or offering documents, from an eligible institution or an approved bank. Any period of borrowing that exceeds three months must be approved by the fund's trustee/custodian.

Other than the above, there are no statutory or regulatory limits in relation to borrowing, and any such limitations would be a matter for the powers/constitution of the relevant fund.

Finance has traditionally been obtained from banks and/or banking institutions. However, borrowing by Guernsey funds is influenced by the trends in the finance market as a whole; as such, Guernsey-domiciled funds have access to finance from banks and other alternative institutional or personal lenders, including other funds and specialist debt providers, domiciled both in Guernsey and elsewhere.

No common issues are experienced in relation to fund finance.

2.6 Tax Regime

If the fund is structured as a company, it will be subject to income tax at 0% unless it obtains tax-exempt status (where no tax will be applicable) for an annual fee of (currently) GBP1,600. Funds structured as limited partnerships or unit trusts are not themselves subject to Guernsey tax.

Distributions made by a Guernsey fund to Guernsey-resident shareholders may be taxed on the shareholder at the standard income tax rate of 20% for individuals and 0% for corporations, irrespective of whether the corporation is itself taxable in Guernsey on sources of income at a rate other than 0%. Distributions made by a fund to non-Guernsey-resident investors, whether made during the life of the fund or by distribution on liquidation, will not be subject to Guernsey tax, provided such payments are not taken into account in computing the profits of any permanent establishment situated in Guernsey through which such investor carries on a business in Guernsey.

A Guernsey fund that is structured as a company, and that has not obtained tax-exempt status at the time a distribution is made, would be required to withhold tax at the applicable rate in respect of any distributions made (or deemed to have been made) to shareholders who are Guernsey-resident individuals. Under Guernsey tax law, no withholding of tax should be required in respect of distributions to Guernsey-resident unit-holders of Guernsey funds which are not structured as companies or if, at the time a distribution is made, the Guernsey fund structured as a company has tax-exempt status.

There is no stamp duty or equivalent tax payable in Guernsey on the issuance, transfer or redemption of units in Guernsey funds. Guernsey charges no document duty on the creation or increase of authorised share capital.

The States of Guernsey has passed enabling legislation for the introduction of a system of goods and services tax (GST); however, no decision as to the introduction of GST has been made.

Under current Guernsey tax law, there is no liability to capital gains tax, wealth tax, capital transfer tax or estate or inheritance tax on the issuance, transfer or realisation of units in Guernsey funds (save for registration fees and ad valorem duty for a Guernsey grant of representation when the deceased dies leaving assets in Guernsey which required presentation of such a grant).

Guernsey has a wide-ranging anti-avoidance provision. This provision targets transactions where the effect of the transaction or series of transactions is the avoidance, reduction or deferral of a tax liability. At their discretion, the Director of the Revenue Service will make such adjustments to the tax liability to counteract the effect of the avoidance, reduction or deferral of the tax liability.

Guernsey is committed to adopting the base erosion and profit shifting (BEPS) minimum standards. Guernsey implemented country-by-country reporting in respect of accounting periods commencing on or after 1 January 2016, and has also adopted the spontaneous exchange of tax rulings with other jurisdictions. On 7 June 2017, Guernsey, along with over 60 other jurisdictions, signed the OECD's Multilateral Instrument to Implement Tax Treaty-Related Measures to Combat BEPS and Treaty Abuse.

Like other offshore jurisdictions, Guernsey implemented legislative economic substance requirements, effective from 1 January 2019, to address concerns raised by the EU's Code of Conduct Group on Business Taxation that Guernsey's corporate tax system could facilitate offshore structures aimed at attracting profits which do not reflect real economic substance. Guernsey tax-resident companies and limited partnerships registered in Guernsey will be subject to substance requirements where and to the extent that they carry on a relevant activity. For the funds industry, the most relevant of the above activities will be:

- fund management;
- financing;
- headquartering; and
- distribution and service centres.

However, collective investment schemes (other than self-managed collective investment schemes) are not within the scope of substance requirements, and nor are trusts (although a corporate trustee may be).

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

Guernsey does not specifically offer retail funds other than Class A funds, which have largely been superseded by the AIFMD regime. Otherwise, all fund types are open to retail investors, subject to the relevant rules specific to each fund type (other than Class Q funds, QIFs and PIFs, which would not be suitable to retail investors).

Subject to those considerations, the previously discussed responses regarding alternative investment funds apply equally to retail funds.

3.1.2 Common Process for Setting Up Investment Funds

See **2.1.2 Common Process for Setting Up Investment Funds**.

3.1.3 Limited Liability

See **2.1.3 Limited Liability**.

3.1.4 Disclosure Requirements

See **2.1.4 Disclosure Requirements**.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

See **2.2.1 Types of Investors in Alternative Funds**.

3.2.2 Legal Structures Used by Fund Managers

See **2.2.2 Legal Structures Used by Fund Managers**.

3.2.3 Restrictions on Investors

See **2.2.3 Restrictions on Investors**.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

See **2.3.1 Regulatory Regime**.

3.3.2 Requirements for Non-local Service Providers

See **2.3.2 Requirements for Non-local Service Providers**.

3.3.3 Local Regulatory Requirements for Non-local Managers

See **2.3.3 Local Regulatory Requirements for Non-local Managers**.

3.3.4 Regulatory Approval Process

See **2.3.4 Regulatory Approval Process**.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

See **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**.

3.3.6 Rules Concerning Marketing of Retail Funds

See **2.3.6 Rules Concerning Marketing of Alternative Funds**.

3.3.7 Marketing of Retail Funds

See **2.3.7 Marketing of Alternative Funds**.

3.3.8 Marketing Authorisation/Notification Process

See **2.3.8 Marketing Authorisation/Notification Process**.

3.3.9 Post-marketing Ongoing Requirements

See **2.3.9 Post-marketing Ongoing Requirements**.

3.3.10 Investor Protection Rules

See **2.3.10 Investor Protection Rules**.

3.3.11 Approach of the Regulator
See **2.3.11 Approach of the Regulator**.

3.4 Operational Requirements
See **2.4 Operational Requirements.**

3.5 Fund Finance
See **2.5 Fund Finance.**

3.6 Tax Regime
See **2.6 Tax Regime.**

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform
See **2.1.2 Common Process for Setting Up Investment Funds.**

HONG KONG SAR, CHINA

Law and Practice

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Contents

Shearman & Sterling LLP has over 700 lawyers around the world, nearly half of whom practise outside the USA, speaking more than 60 languages and practising US, English, French, German, Italian, Hong Kong, OHADA and Saudi law. The firm's full-service investment funds team is led by lawyers based in Hong Kong, London, New York and Tokyo, with support from the firm's global network of office. It advises clients across the full spectrum of investment funds, including private equity, hedge, real estate, infrastructure, growth and venture capital, credit and special situations, registered mutual (both open-end and closed-end) and UCITS funds. In addition to a deep bench and broad coverage across strategies, the firm has expertise in launching complex policy funds, leading sovereign wealth fund investments and providing advice to ambitious, growing PRC and Hong Kong-based asset managers, as well as advising on funds in other parts of Asia, including Japan, India and Singapore.

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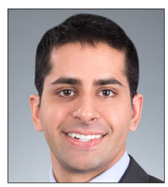

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SHEARMAN & STERLING

1. Market Overview

1.1 State of the Market

Hong Kong is a leading international financial centre, known for its strategic position as a hub and gateway to Mainland China, and for being one of the world's largest capital markets. Hong Kong is also a principal centre for alternative investments, ranking second in Asia after Mainland China for total capital under management by private equity funds (excluding real estate funds), which amounted to USD212 billion in 2022 (see Asset and Wealth Management Activities Survey 2022, released by the Hong Kong Securities and Futures Commission (SFC) in August 2023, available at www.sfc.hk). The Hong Kong industry for alternative asset management is strengthened by its diversity. For these reasons, Hong Kong is an important jurisdiction for leading pension funds, insurance companies, sovereign wealth funds, family offices and other investors.

Hong Kong's asset and wealth management business remained resilient in 2022 despite the challenges facing global markets. For example, according to the SFC's Asset and Wealth Management Activities Survey 2022, the total assets under management (AUM) of Hong Kong's asset and wealth management industry amounted to HKD30,541 billion as of 31 December 2022, and net fund inflows of HKD88 billion were recorded. The AUM drop of 14% year-on-year was similar to the 15% drop in the AUM of worldwide fund markets and slightly outran major market indices, while many other major fund markets saw net fund outflows. The AUM of Hong Kong's asset and wealth management industry recorded long-term healthy growth of 143% over the last ten years.

Furthermore, from September 2022 to September 2023, the number of corporations licensed in Hong Kong for Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities dropped by 2.85%, increased by 2.4% and increased by 1.75%, respectively (see Table C2 Statistics on Number of Regulated Activities of Licensed Corporations, released by the SFC, available at www.sfc.hk); these three types of licences are most relevant to alternative asset managers. Over the same period, the number of Type 1 licensed representatives in Hong Kong dropped by 2.44%, while such number for Types 4 and 9 regulated activities increased by 1.86% and 0.17%, respectively (see Table C4 Statistics on Number of Regulated Activities of Licensed Representatives, released by the SFC, available at www.sfc.hk).

With its geographical and cultural proximity to Mainland China, Hong Kong continues to be an unparalleled gateway, enabling global capital to access Mainland China. In addition, the rapid development of the Guangdong–Hong Kong–Macau Greater Bay Area (GBA) has created an additional need for private investment capital among start-ups in the innovation and technology field. Hong Kong is well positioned heading into 2024, thanks in part to legal and tax changes initiated in recent years by the Hong Kong authorities, including:

- a re-domiciliation mechanism that enables foreign funds to relocate to Hong Kong and, in connection therewith, to be registered as open-end fund companies (OFCs) or limited partnership funds (LPFs);
- a special concession for carried interest distributable by private equity funds operating in Hong Kong not to be subject to taxation; and

- the introduction of a licensing regime for virtual asset service providers.

The first two changes have helped to promote and support industry adoption of the LPF form, pursuant to the Limited Partnership Fund Ordinance (LPFO), which took effect on 31 August 2020. With the passage of time and the benefit of these governmental initiatives, the LPFO is coming closer towards realising its objectives of bringing Hong Kong's limited partnership form in line with global standards and encouraging the use of vehicles formed locally in Hong Kong.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

With the enactment of the LPFO, Hong Kong is expected to be used more often by advisers and managers for the formation of fund entities. As of 13 September 2023, there were over 700 LPFs registered with the Hong Kong Company Registry (see Companies Registry, Statistics for Number of Limited Partnership Funds that have Remained Registered on the LPF Register, available at www.cr.gov.hk).

2.1.2 Common Process for Setting Up Investment Funds

The common structure of a private fund that has a managerial or advisory presence in Hong Kong consists of:

- a fund entity formed as an LPF in Hong Kong;
- a general partner (GP) formed as a limited partnership or as a company; and
- an investment manager or adviser licensed by the Hong Kong Securities and Futures Commission (SFC).

Core fund documents include:

- a limited partnership agreement;
- subscription documents;
- a private placement memorandum (where applicable);
- side letters entered into with investors (where applicable);
- an investment management agreement; and/or
- an investment advisory agreement.

2.1.3 Limited Liability

Persons investing in private funds set up in Hong Kong will not generally be deemed to be taking part in the management of the business of these funds (and will therefore benefit from the safeguard of limited liability) so long as these persons act as passive, economic investors in connection with the investment.

As in other leading funds jurisdictions, the LPFO sets out a non-exhaustive list of safe harbour activities that are not to be regarded as taking part in the LPF's management, including:

- serving on a board or committee of the LPF or the GP;
- acting as an agent of the LPF or the GP;
- advising the GP in relation to the LPF's business;
- voting on any of the LPF's proposed transactions; and
- taking part in certain decisions, such as:
  - (a) the admission or removal of partners;
  - (b) the extension or end of the LPF's term;
  - (c) the incurrence of indebtedness by the LPF;
  - (d) a change in the LPF's investment scope; and
  - (e) the exercise of the LPF's rights in respect of an investment.

2.1.4 Disclosure Requirements

The SFC is the primary regulator of private funds, fund managers and advisers in Hong Kong. Hong Kong-based investment managers and advisers with SFC licences are subject to regulation under certain codes of conduct, including the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code) and the Fund Manager Code of Conduct (FMCC), which prescribe a set of matters that are required to be disclosed to investors. The FMCC, for example, requires the disclosure of cross-trades, leverage arrangements, securities lending, repo and reverse repo transactions, risk management policies, custody arrangements, climate-related risks and so forth, which are usually contained in marketing documents, such as a term sheet or private placement memorandum.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Hong Kong is an international market with many of the same key investor types that operate in other important jurisdictions, including pension funds, insurance companies, private banks, wealth management firms, funds of funds, high net worth individuals and family offices. Some of these institutional investors are branch offices of Mainland China-based operations.

2.2.2 Legal Structures Used by Fund Managers

With the enactment of the LPFO, Hong Kong is expected to be used more often by advisers and managers for the formation of fund entities.

As described in **2.1.2 Common Process for Setting Up Investment Funds**, the common structure of a private fund that has a managerial or advisory presence in Hong Kong would consist of:

- a fund entity structured as an LPF in Hong Kong;
- a general partner structured as a limited partnership or as a company; and
- an investment manager or adviser licensed by the SFC.

2.2.3 Restrictions on Investors

Due to the periodic tightening of RMB capital outflows by the monetary regulators in Mainland China, investors that have to source capital from their Mainland China affiliate(s) may encounter difficulty in funding capital calls on a timely basis. In recent years, regulators in Mainland China have revisited and tightened control on inbound and outbound investments. Prior to making a private fund investment, investors would be advised to carefully review and understand the impact of these rules, updates thereto and relevant law enforcement actions. Certain investors are subject to special regulations based on their investor type.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

Private funds set up in Hong Kong that have a Hong Kong-based team of investment professionals would typically retain, directly or indirectly, a Hong Kong investment manager or adviser.

The primary securities legislation in Hong Kong is the Securities and Futures Ordinance (SFO). Depending on the facts and circumstances, the activities of an investment manager or adviser could come within various categories of regulated activities under the SFO, including:

- selling fund interests to residents in Hong Kong;
- conducting selling activities in Hong Kong;
- deal sourcing and execution of transactions;

- making recommendations and advising with respect to potential deals; and
- making investment decisions for the investment fund under management.

A Hong Kong investment manager or adviser entity will therefore usually be licensed under the SFC for conducting regulated activities in Hong Kong. The three types of licences that such manager or adviser is most likely to hold are Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management). Moreover, a manager registered in a jurisdiction other than Hong Kong that intends to conduct a regulated activity in Hong Kong, such as offering private fund interests to residents in Hong Kong or providing fund management or advisory services, must still comply with the private placement rule as detailed in **2.3.7 Marketing of Alternative Funds** and the SFC licensing regime as detailed in **2.3 Regulatory Environment**, as applicable.

The core principle behind the Hong Kong licensing regime is that applicants must demonstrate, to the satisfaction of the SFC, that they are fit and proper (Section 129 of the SFO) to be licensed, which broadly involves being financially sound, competent, honest, reputable and reliable. To obtain an SFC licence, an applicant would need to satisfy standards relating to the competence of responsible officers and other senior management, and relating also to the adequacy of financial resources.

An applicant must appoint at least two responsible officers (ROs) to be tasked with direct supervision of the conduct of each proposed regulated activity, with at least one RO being available at all times to supervise each of the proposed regulated activities and at least one RO being designated as an executive director.

In addition to ROs, any individual who carries on a regulated activity on behalf of the corporation will similarly be required to obtain a licence as a representative (LR) accredited to such corporation. As with ROs, LR applicants must satisfy the SFC that they have fulfilled the fit and proper requirement and must pass a related competency test.

2.3.2 Requirements for Non-local Service Providers

To register a fund as an LPF, the proposed GP must arrange for a local Hong Kong law firm or solicitor to submit an application to the Hong Kong Company Registry, and must appoint an independent and local auditor to perform an audit of the LPF's annual financial statements.

Non-local service providers operating in Hong Kong, where permitted, are not subject to an additional legal registration requirement solely on account of being non-local.

2.3.3 Local Regulatory Requirements for Non-local Managers

As indicated in **2.3.1 Regulatory Regime**, if a non-local manager engages in a regulated activity from outside Hong Kong (eg, by actively marketing its services or products to the public, whether by itself or through another person on its behalf), and if such activity, if undertaken in Hong Kong, would constitute the carrying on of a business in regulated activity under the SFO, then such non-local manager should adhere to the Hong Kong licensing regime as discussed herein.

2.3.4 Regulatory Approval Process

As indicated in **2.3.1 Regulatory Regime**, the SFO prohibits undertaking an activity (eg, the "active marketing" of a service to the public, including through persons operating outside

Hong Kong) where it would constitute a regulated activity if undertaken in Hong Kong, unless such person has obtained an appropriate licence.

SFC guidance suggests that the following factors would be considered in reaching the conclusion that this "active marketing" threshold has been crossed:

- there is a detailed marketing plan to promote the relevant services;
- the services are extensively advertised via marketing means such as direct mail, advertisements in local newspapers, the use of broadcasts or other "push" technology over the internet (compared to situations where such services are only passively available – eg, on a "take it or leave it" basis);
- the related marketing is conducted in a concerted manner and executed in accordance with a plan or schedule that indicates a continuing service rather than a one-off exercise;
- the services are packaged to target the public of Hong Kong – eg, written in Chinese and denominated in Hong Kong dollars; and
- the services are not sought out by the customers on their own initiative.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

The SFO makes no distinction between the pre-marketing and marketing of alternative funds.

2.3.6 Rules Concerning Marketing of Alternative Funds

The SFO stipulates 12 types of regulated activities, the most relevant of which for a private equity fund sponsor are Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management).

Type 1 regulated activity includes the making of, or offering to make, an agreement with another person or inducing, or attempting to induce, another person to enter into an agreement for, or with the view to, acquiring or disposing of securities. If a company engages in the distribution and sale of securities, such as limited partnership interests or shares in a company, a Type 1 licence would thus be required. In addition, if a company engages in deal sourcing and the execution of private equity transactions, including negotiations with a target company, this conduct may also constitute Type 1 regulated activity.

Type 4 regulated activity includes the giving of advice on whether to acquire or dispose of securities. A company that provides investment advice will need to apply for and obtain a Type 4 licence, unless such advisory activities are wholly incidental to Type 1 regulated activity.

Type 9 regulated activity includes the managing of a real estate investment scheme or securities or futures contracts. A company will need a Type 9 licence if it provides portfolio management services and exercises discretionary investment authority to make investment decisions for its clients.

As the profile of each private fund management team or sponsor with a managerial or advisory presence in Hong Kong may differ depending on factors such as strategy, personnel, business capabilities and operational models, many firms decide to apply for one or a combination of the Type 1, 4 or 9 licences, while some other firms instead seek to rely on an exemption from the licensing requirements. Alternatively, some firms may choose to acquire a corporation that is already licensed and conduct the desired type of regulated activity through the acquisition. The SFO sets out various exemptions from the licensing requirements, the most relevant of which are profiled below.

A company may not need a licence for certain regulated activities if these activities are performed in a manner that is wholly incidental to the carrying out of another regulated activity for which the company is already licensed. For example, a company that holds a Type 9 licence may rely on the incidental exemption to carry out related Type 1 and Type 4 regulated activities, provided that the preceding activities are undertaken solely for the purposes of the company's asset management business.

A company may not need a licence for Type 4 or Type 9 regulated activity if it provides the relevant advice or services solely to:

- the company's wholly owned subsidiaries;
- the company's holding company that holds all of the company's issued shares; or
- other wholly owned subsidiaries of the company's holding company.

2.3.7 Marketing of Alternative Funds

Offerings in Hong Kong of interests in private funds structured as partnerships or trusts (in the case of closed-end funds) are subject to regulation under the SFO. Offerings in Hong Kong of shares or debentures issued by private investment funds structured as companies (in the case of open-end funds, such as hedge funds) are subject to regulation under both the SFO and the Companies Ordinance.

Offering documents relating to securities offered to members of the Hong Kong public, whether offered by a licensed person or not, must be authorised by the SFC unless an exemption applies.

One of the most commonly used exemptions applies to offers made solely to "professional investors", within the meaning of the SFO and its relevant subsidiary legislation. "Professional investors" broadly encompasses:

- financial institutions;
- insurance companies;
- investment companies;
- retirement schemes;
- pension plans;
- government entities; and
- certain high net worth individuals and large entities.

If fund interests are marketed in Hong Kong, the relevant investors should be provided with a supplemental Hong Kong investor questionnaire to confirm and document their professional investor status. It should be noted, however, that the admission by a fund of certain types of professional investors, including individuals, may cause such fund to be subject to enhanced compliance and due diligence requirements.

To the extent all Hong Kong offerees cannot meet the professional investor standard, another exemption is available under current market practices for offerings to not more than 50 offerees in Hong Kong. Although the offering documents for the types of private offers listed above are not required to comply with prospectus content requirements, they should include an appropriate securities legend to highlight that the offering documents have not been reviewed by any regulatory authority in Hong Kong and that investors are encouraged to seek independent professional advice.

2.3.8 Marketing Authorisation/Notification Process

Please refer to the private placement rule as detailed in **2.3.7 Marketing of Alternative Funds** and the SFC licensing regime as detailed in **2.3.1 Regulatory Regime**.

2.3.9 Post-marketing Ongoing Requirements

Please see **2.4 Operational Requirements** regarding ongoing requirements.

2.3.10 Investor Protection Rules

As mentioned in **2.3.7 Marketing of Alternative Funds**, one exemption commonly relied upon by a private fund to facilitate private placement in Hong Kong is an offering limited to "professional investors". The term "professional investor", for this purpose, is defined in the SFO and its relevant subsidiary legislation, and is broadly split into three categories:

- institutional professional investors;
- individual professional investors; and
- corporate professional investors.

Institutional professional investors generally include authorised or regulated entities, such as:

- recognised exchange companies;
- recognised clearing houses;
- recognised exchange controllers;
- recognised investor compensation companies;
- authorised financial institutions; and
- authorised collective investment schemes.

Individual professional investors and corporate professional investors are usually determined based on their asset value or portfolio size, including:

- a trust corporation having been entrusted under one or more trusts of which it acts as a trustee with total assets of not less than HKD40 million;
- an individual, either alone or with any of their associates on a joint account, having a portfolio of not less than HKD8 million;
- a corporation or partnership having a portfolio of not less than HKD8 million or total assets of not less than HKD40 million; and
- a corporation whose principal business is to hold investments and that is wholly owned by a professional investor under the three points above.

2.3.11 Approach of the Regulator

The SFC is the main regulator of funds, fund managers and advisers in Hong Kong, and derives its investigative, remedial and disciplinary powers from the SFO and subsidiary legislation. The SFO has empowered the SFC with multiple roles. The SFC's principal responsibilities include maintaining and promoting the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry. The SFC's scope of work includes licensing and supervising persons that conduct activities under the SFC's regulatory purview.

The SFC often publishes guidance on regulatory matters and is quick to act when dealing with pressing concerns. It often consults the industry and public at large prior to enacting significant changes in regulation. In recent years, the SFC has focused on addressing irregularities in the market, developing regulatory approaches towards new, emerging asset classes such as virtual assets, strengthening oversight of fund managers and advisers, and taking account of the multi-jurisdictional nature of private equity.

Where applicable, the SFC initiates disciplinary actions against fund managers and advisers for misconduct. For example, the SFC recently reprimanded and imposed a HKD3.4 million fine on an asset management company holding Type 4 and Type 9 licences for regulatory breaches and internal control failings in relation to the segregation of client money and the provision of statements of accounts to clients (see SFC Enforcement News, SFC reprimands and fines Changjiang Asset Management (HK) Limited $3.4 million for regulatory breaches and internal control failures, available at apps.sfc.hk). The SFC posts notices of enforcement actions on its website as a way of offering and providing insight into its regulatory approach and priorities.

2.4 Operational Requirements

Fund managers in Hong Kong have certain reporting obligations under the SFO, the Code, the FMCC and other applicable codes and guidelines. For example, the SFC requires licensed or registered persons to submit records of audited accounts, on an ongoing basis. Pursuant to the FMCC, fund managers may also be requested by the SFC to provide additional information to help enable the SFC to monitor systemic risk, on an ongoing basis. Such information may cover matters such as fund-level leverage, the terms of securities lending and the substance and balance of other assets and liabilities. In addition, the Code requires licensed or registered persons to report to the SFC immediately following certain specified events, such as compliance breaches and the initiation of legal proceedings.

The FMCC, in particular, requires a fund manager that is responsible for overall fund operations to disclose to investors the expected maximum level of leverage that may be employed on behalf of such fund and the basis for calculating this leverage, which should be reasonable and prudent. Moreover, the FMCC provides that a fund manager should not borrow funds from a connected person on behalf of a fund, unless interest charged and fees levied in connection with the relevant loan are no higher than the prevailing commercial rate for a similar loan.

It is also worth noting that, under the latest version of the FMCC dated August 2022, fund managers are required to assess climate-related risks associated with their investment strategies and portfolios, and to make appropriate investor disclosures with respect thereto. These requirements for fund managers reflect industry demand for asset managers to be mindful of their climate risk exposures, as well as the SFC's efforts to keep ahead of global regulatory developments in this space.

Although a breach of the Code or the FMCC should not directly cause the relevant licensed or registered persons to become subject to legal action, such a breach could reflect negatively on the fitness and propriety of the sanctioned persons and may thus create a basis for disciplinary action.

2.5 Fund Finance

Asian private equity or venture capital funds have traditionally sought financing to bridge a funding gap, by way of either a capital call or a subscription credit facility. Such facilities are useful to private equity and venture capital funds as they can access funds quickly to capitalise on investment opportunities while waiting for capital calls from limited partners to arrive. Drawdown under a capital call facility could be arranged within as little as one business day, whereas a capital call could take ten business days or more. The authors have also seen capital call facilities being utilised to bridge the funding gap between the time in which an acquisition is completed and drawdown under a permanent asset-level financing.

When seeking to incur financing or leverage, these funds are most likely to do so by entering into capital call and subscription credit facilities from banks, including international banks with a Hong Kong presence. Capital call and subscription facilities are structured as revolving facilities with the private equity or venture capital fund as borrower. The facilities are secured by an assignment of capital call rights under the limited partnership agreement and unfunded commitments of the limited partners, together with a charge over the accounts to which capital calls are to be deposited. The facilities are not usually secured by any of the fund's underlying investment assets.

2.6 Tax Regime

Under the LPFO, an LPF is eligible for an exemption from Hong Kong profits tax on qualifying income. Relatedly, cash contributions and distributions to and from an LPF will not incur Hong Kong stamp duty.

Management fees, if not sourced in Hong Kong, are generally not subject to Hong Kong profits tax. Carried interest received on or after 1 April 2020 is generally exempt from Hong Kong profits tax and salaries tax (and excluded from employment income for purposes of calculating salaries tax), pursuant to the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance 2021. To qualify for the exemption under this ordinance, eligible carried interest must relate to the provision of investment management services to certified investment funds. A certified investment fund is a fund within the meaning of Section 20AM of the Inland Revenue Ordinance (IRO) that is certified by the Hong Kong Monetary Authority (HKMA) as being in compliance with the criteria for certification published by the HKMA. On 16 July 2021, the HKMA issued a guideline setting out the criteria for the certification of funds in relation to the tax concessions for carried interest.

As there are views that the details and procedures for applying for tax concessions are complicated and the vetting standards are overly stringent, the Inland Revenue Department announced in March 2023 that it has consulted the industry on the Departmental Interpretation and Practice Notes (DIPN) being prepared for the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance 2021, and will formally publish the DIPN to facilitate the industry's better understanding of the application of the rules and to benefit from the tax concession (see Inland Revenue Department, Press Release on LCQ15: Attracting overseas private equity funds to re-domicile to Hong Kong, available at www.ird.gov.hk).

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

This topic is outside the coverage scope for this chapter.

3.1.2 Common Process for Setting Up Investment Funds

This topic is outside the coverage scope for this chapter.

3.1.3 Limited Liability

This topic is outside the coverage scope for this chapter.

3.1.4 Disclosure Requirements
This topic is outside the coverage scope for this chapter.

3.2 Fund Investment
3.2.1 Types of Investors in Retail Funds
This topic is outside the coverage scope for this chapter.

3.2.2 Legal Structures Used by Fund Managers
This topic is outside the coverage scope for this chapter.

3.2.3 Restrictions on Investors
This topic is outside the coverage scope for this chapter.

3.3 Regulatory Environment
3.3.1 Regulatory Regime
This topic is outside the coverage scope for this chapter.

3.3.2 Requirements for Non-local Service Providers
This topic is outside the coverage scope for this chapter.

3.3.3 Local Regulatory Requirements for Non-local Managers
This topic is outside the coverage scope for this chapter.

3.3.4 Regulatory Approval Process
This topic is outside the coverage scope for this chapter.

3.3.5 Rules Concerning Pre-marketing of Retail Funds
This topic is outside the coverage scope for this chapter.

3.3.6 Rules Concerning Marketing of Retail Funds
This topic is outside the coverage scope for this chapter.

3.3.7 Marketing of Retail Funds
This topic is outside the coverage scope for this chapter.

3.3.8 Marketing Authorisation/Notification Process
This topic is outside the coverage scope for this chapter.

3.3.9 Post-marketing Ongoing Requirements
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3.3.10 Investor Protection Rules
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3.3.11 Approach of the Regulator
This topic is outside the coverage scope for this chapter.

3.4 Operational Requirements
This topic is outside the coverage scope for this chapter.

3.5 Fund Finance
This topic is outside the coverage scope for this chapter.

3.6 Tax Regime
This topic is outside the coverage scope for this chapter.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

The LPFO has been in operation since 31 August 2020. With the advent of the LPF, fund sponsors have the ability to form a streamlined fund structure with legal domicile, business operations and management personnel all in the single jurisdiction of Hong Kong, with resulting cost and other efficiency benefits.

Relatedly, in recognition that many private funds set up in foreign jurisdictions may wish to re-domicile to Hong Kong during their term of operation, the fund re-domiciliation mechanism came into effect on 1 November 2021. This set of ordinances allows a foreign fund to relocate to Hong Kong and be registered as an OFC or LPF, as applicable, via the submission of a relatively straightforward application. Investors' rights and liabilities in a converted vehicle would not be adversely affected by such conversion, and no additional stamp duty would be incurred. According to the Inland Revenue Department, as of February 2023, the Hong Kong Company Registry and the SFC have received over 60 enquiries on fund re-domiciliation to Hong Kong, and four applications (including two OFCs and two LPFs) which were all approved. In addition, the Hong Kong government plans to introduce a mechanism to facilitate companies domiciled overseas seeking re-domiciliation to Hong Kong, and the legislative proposals are expected to be submitted to the legislative council of Hong Kong in the first half of 2024. The corporate general partner of an offshore partnership fund may utilise this mechanism to re-domicile itself to Hong Kong in parallel with the re-domiciliation of the fund to Hong Kong.

The SFC has been supporting sustainable finance regulatory developments. Much industry attention was drawn by the SFC's announcement on 31 October 2023 to sponsor the development of a code of conduct for voluntary adoption by environmental, social and governance (ESG) ratings and data products providers providing products and services in Hong Kong. This voluntary code will be developed via an industry-led working group and is expected to track international best practices and recommendations. The first draft will be issued in Q1 2024 for public consultation. The voluntary code will provide transparent and standardised ESG information for fund managers to conduct due diligence on ESG service providers and comply with their ESG policies and obligations (see SFC News, SFC Supports and Sponsors the Development of An Industry-Led Voluntary Code of Conduct for ESG Ratings and Data Products Providers, available at apps.sfc.hk).

The authors are optimistic that the combination of Hong Kong's favourable global position, expanding treaty network, tax concessions and well-designed LPF Ordinance may cause many fund sponsors to look to Hong Kong for their next generation of private funds.

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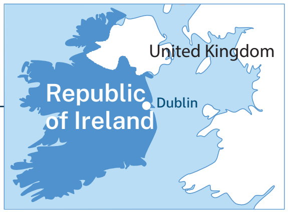

Law and Practice

Contributed by:
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Walkers

Contents

Walkers is a market-leading financial services law firm that practises law across six jurisdictions and has ten offices across the Americas, EMEA and Asia. The Irish office provides Irish legal, tax, listing and professional services solutions to local and international financial institutions, investment managers, hedge funds, private equity groups and corporations. Walkers' experienced asset management and investment funds group offers expert advice and commercial solutions to many prominent asset managers, fund promoters and institutional investors, on investment fund strategies such as private equity, hedge and real estate as well as more traditional retail-focused products such as UCITS and retail AIFs. It is well placed to advise on the commercial and regulatory implications of the establishment and operation of investment fund structures in Ireland. The firm's independent corporate services offering, Walkers Professional Services, provides a broad range of corporate, fiduciary and administration services to structured and asset finance vehicles.

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Nicholas Blake-Knox is a partner and head of the asset management and investment funds group at Walkers. He advises asset management firms on asset management and investment fund-related matters, such as the establishment, authorisation and operation of all types of Irish investment funds. Nicholas has experience across a wide range of asset classes and investment strategies, with particular expertise in advising managers of fixed income and debt-focused investment strategies, as well as less liquid alternative strategies. In 2022, he was elected for a three-year term to the Council of Irish Funds having previously sat on a variety of working and steering groups, and is currently IF Vice-Chair. He has spoken at a wide range of investment fund conferences and is a member of the faculty of the Certified Investment Fund Director Institute.

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Walkers

1. Market Overview

1.1 State of the Market

The latest statistics published by the Central Bank of Ireland ("Central Bank") show that the net asset value (NAV) of Irish-domiciled funds increased for the fourth successive quarter, driven mainly by transaction inflows, to EUR3.854 trillion at the end of the third quarter of 2023, representing a 6% increase (EUR219 billion) from EUR3.635 trillion at the end of Q3 2022. The number of Irish-domiciled funds (including sub-funds) grew from 8,447 at the end of 2022 to 8,766 at the end of the third quarter of 2023.

In terms of the number of Irish-domiciled funds by category, Irish-domiciled alternative investment funds (AIFs) (including sub-funds) reached 3,391 at the end of the third quarter of 2023 and the total number of Irish-domiciled undertakings for collective investment in transferable securities (UCITS) (including sub-funds) reached 5,375.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

AIFs that are domiciled in Ireland are predominantly established as regulated funds and are required to be authorised by the Central Bank. Regulated AIFs in Ireland are sub-divided into retail investor alternative investment funds (RIAIFs) and qualifying investor alternative investment funds (QIAIFs), with the vast majority of Ireland-domiciled AIFs being established as QIAIFs. As RIAIFs are generally targeted at retail investors, this type of fund will be discussed in **3. Retail Funds**.

Five legal structures are currently available when establishing a regulated AIF in Ireland:

- investment company;
- Irish collective asset-management vehicle (ICAV);
- unit trust;
- common contractual fund (CCF); and
- investment limited partnership (ILP).

Investment Company

Historically, the investment company was the vehicle of choice for investors looking for an Irish corporate fund vehicle. However, this changed in 2015 with the introduction of the ICAV as a bespoke corporate structure that caters specifically for the needs of the funds industry.

ICAV

The key advantages of the ICAV versus the investment company include:

- the ability to elect to dispense with the holding of an annual general meeting;
- the ability to file a "check the box" election to be treated as a partnership (or a disregarded entity if a single shareholder) for US federal income tax purposes;
- the ability to amend the ICAV's constitutional document, known as the instrument of incorporation, without shareholder approval for certain types of changes;
- the ability to prepare separate financial statements for separate sub-funds of the ICAV; and
- not being required to make the audited financial statements publicly available.

Unit Trust

Investors seeking to use a trust structure for their investment fund can establish an AIF in Ireland structured as a unit trust. Unlike the investment company and the ICAV, which issue shares to their investors, unit trusts issue investors units representing a beneficial interest in the assets of the trust. As it is a trust arrangement, a unit trust is not a separate legal entity, meaning that it does not have power to enter into contracts in its own name. In practice, the board of directors of the fund manager acts on behalf of the unit trust.

CCF

While CCFs were initially developed in 2003 to facilitate the pooling of pension fund assets in a tax-efficient manner, this structure may be used by any entity seeking a tax-transparent structure; however, individuals cannot invest in CCFs. A CCF is a contractual arrangement constituted by a deed of constitution entered into between a management company and a depositary. Units in a CCF identify the proportion of the underlying investments of the CCF to which an investor is beneficially entitled.

Through contractual arrangements entered into with the management company, the investors participate and share in the property of the investment fund as co-owners of the assets of the fund. As a co-owner, each investor in the CCF holds an undivided co-ownership interest as a tenant in common with the other investors.

The CCF is a tax-transparent structure, which means that investors in a CCF are treated as if they directly own a proportionate share of the underlying investments of the CCF rather than shares, units or interests in an entity that itself owns the underlying investments.

ILP

The Investment Limited Partnerships (Amendment) Act 2020 took effect in early 2021, amending the legislation governing ILPs, Ireland's regulated investment funds partnership product. These amendments have enhanced the product offering by bringing it more in line with the partnership structures in other fund jurisdictions and introducing best in class features.

While partnership structures are generally used for investment funds with strategies relating to private equity or debt, real estate, infrastructure or other types of illiquid assets, the ILP is a flexible structure that can be utilised by asset managers seeking to establish either open-ended or closed-ended investment funds through a regulated partnership structure. An ILP can now be structured as an umbrella fund, offering greater flexibility for those seeking to establish funds in Ireland. Investors in an ILP hold interests in the limited partnership by entering into a partnership agreement with the general partner as limited partners.

An Irish fund can be established as either a standalone fund or an umbrella fund comprising one or more sub-funds, each with segregated liability. Each sub-fund will generally have a different investment objective and policies, and may comprise different classes of shares/units/interests. Typically, classes of shares/units/interests are issued to allow for different fee arrangements, different minimum subscription amounts, different currencies and/or different distribution arrangements within the same sub-fund. The legislative regime enables the assets and liabilities of each sub-fund of an umbrella investment fund established as an investment company, ICAV, unit trust, CCF or ILP to be segregated from the assets and liabilities of the other sub-funds of that umbrella, meaning that the liabilities of a sub-fund are discharged solely from the assets of that sub-fund. A sub-fund of an umbrella fund is not a separate legal entity, but an umbrella fund may sue and be sued in respect of a particular sub-fund.

General

There are certain restrictions on Irish alternative funds being structured as either open-ended or closed-ended. For example, a loan origination QIAIF must be closed-ended and the Central Bank will only authorise property funds structured as (i) closed-ended or (ii) open-ended with limited liquidity as per the Central Bank's AIF Rulebook.

Funds that have the ability to implement a redemption settlement period of more than 90 days are categorised as open-ended with limited liquidity. Master-feeder structures can be established for a variety of reasons, such as to cater for the different tax reporting requirements of certain categories of investors, including US taxable persons, non-US investors and US tax-exempt investors.

AIFs are increasingly being established in Ireland to act as the master fund in master-feeder structures, which include an Irish feeder fund for European investors alongside feeder funds that are domiciled in other jurisdictions, generally Delaware or the Cayman Islands. The use of an Irish master fund in the structure enables the passporting of the Irish master and/or Irish feeder fund throughout Europe using the Alternative Investment Fund Managers Directive (AIFMD) marketing passport.

The majority of investment managers and investment advisers appointed to act for Irish funds are domiciled in other jurisdictions, as the portfolio management activities are often performed outside of Ireland. However, the number of Irish-domiciled investment managers and investment advisers is on the rise, and such entities are generally structured as private companies limited by shares. It is also possible for the alternative investment fund manager (AIFM) to retain portfolio management responsibilities; this is a relatively common model, particularly for less active and/or less liquid portfolios. In such cases, the AIFM may establish an investment committee with input from an investment adviser.

2.1.2 Common Process for Setting Up Investment Funds

If an AIF is structured as an investment company or an ICAV, it will need to be incorporated or registered with the Irish Companies Registration Office or the Central Bank, respectively, prior to an application being submitted to the Central Bank for authorisation of the fund as a QIAIF.

With the exception of limited asset classes that require a pre-submission (namely QIAIFs proposing to invest in Irish property assets or in digital assets), there is a fast-track authorisation process under which QIAIFs can be authorised by the Central Bank within 24 hours (by close of business on the day after submission of the application for authorisation) of filing the requisite documentation with the Central Bank. The prospectus, constitutional document and all material contracts being entered into in respect of the QIAIF must be submitted to the Central Bank as part of the application for authorisation of the fund. The Central Bank relies on confirmations from the fund's directors or manager (as relevant) and its Irish legal counsel that the fund complies with the requirements of the Central Bank.

Prior to the submission of the application for authorisation of a QIAIF, it is necessary to ensure that all service providers have received any requisite approvals from the Central Bank to act for Irish-domiciled funds. This is most relevant for discretionary investment managers that have not previously provided such services to Irish-domiciled funds. Further details of the clearance process for discretionary investment managers are set out in **2.3.3 Local Regulatory Requirements for Non-local Managers**.

The timeframe for the establishment and authorisation of a QIAIF (not subject to any pre-submission requirements) generally ranges between six and 12 weeks, taking into account the various operational steps that need to be completed, such as the onboarding of service providers and the opening of various custody accounts, where required.

2.1.3 Limited Liability

Investors are generally only liable for any amounts outstanding on partly paid shares or, in a capital call structure, for any amounts committed but not yet called. The losses that an investor will suffer will be limited to the subscription or commitment amount.

In addition, umbrella funds have segregated liability between sub-funds, which means that the assets and liabilities of a sub-fund are ring-fenced and such assets cannot be used to satisfy the liabilities of another sub-fund.

2.1.4 Disclosure Requirements

Irish investment funds are required to provide investors with a prospectus disclosing key information about the investment strategy, the parties involved and the potential risks relevant to investing in the fund. Certain UCITS and AIFs are also required to provide a key information document (KID) to investors prior to accepting their investment in the fund, in accordance with the requirements of the amended Packaged Retail and Insurance-based Products (PRIIPs) Regulation where those products are made available to investors in the EEA that are not classified as professional investors under MiFID. The rules concerning the UCITS key investor information document (KIID) still apply in certain specific situations.

Irish investment funds are also required to provide financial statements and an annual report on the financial state of the entity to investors. In contrast to the position applicable to an investment company, umbrella ICAVs may publish separate financial statements for each sub-fund.

The disclosure and reporting requirements set out in the AIFMD are applicable to Irish AIFs, including the disclosure requirements set out in Article 23 and the reporting requirements set out in Articles 3 and 24 (also known as Annex IV reporting).

In addition, the Central Bank requires monthly and quarterly returns to be submitted, including details on the gross and net asset value, investor dealing activity, and fees and expenses accrued during the period. Ad hoc regulatory reporting is also required in certain circumstances, such as the suspension of an investment fund, material breaches of the investment policy, or material errors in the calculation of the investment fund's NAV.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Investors in QIAIFs are not confined to any particular geographic region, and QIAIFs have also proved popular to investors outside of Europe, including in the Americas and Asia. QIAIFs can be used to invest in a wide range of asset classes and have proved particularly popular for a variety of hedge fund strategies, amongst others.

As investment in QIAIFs is limited to qualifying investors, a wide variety of institutional investors invest in such funds, such as pension schemes and insurance companies, together with private wealth investment comprising family offices and high net worth individuals.

2.2.2 Legal Structures Used by Fund Managers
Entities seeking authorisation as Irish AIFMs in accordance with the AIFMD are typically established as private companies limited by shares.

2.2.3 Restrictions on Investors
Investments in QIAIFs can only be made by qualifying investors, which are typically institutional investors or sophisticated high net worth individuals. QIAIFs require a minimum subscription of EUR100,000, although exemptions can be granted to:

- the fund's manager or general partner;
- any entity providing investment management or advisory services to the fund; and
- a director or employee of any of the above, in certain circumstances.

2.3 Regulatory Environment
2.3.1 Regulatory Regime
The AIFMD was transposed in Ireland by the European Union (Alternative Investment Fund Managers) Regulations 2013, as amended (the "AIFM Regulations"), and is the key legislation governing the regulation of AIFs in Ireland. It primarily regulates the AIFM as opposed to the AIF directly, and is supplemented in Ireland by the Central Bank's AIF Rulebook. The Central Bank is the regulatory body responsible for the initial authorisation and ongoing supervision of all Irish investment funds, whether alternative or retail investment funds.

The Central Bank does not set any investment, borrowing or leverage limits for QIAIFs, except for loan origination QIAIFs and QIAIFs proposing to invest over 50% of the portfolio in directly or indirectly held Irish property assets. The activities in which an investment fund established to originate loans can be involved are limited, as detailed in **2.4 Operational Requirements**.

In addition to the general rules applicable to QIAIFs contained in Part 1 of Chapter 2 of the AIF Rulebook, there are specific fund type requirements for money market QIAIFs, QIAIFs that invest more than 50% of their assets in another investment fund, closed-ended QIAIFs and loan origination QIAIFs. In addition, specific requirements are applied in respect of QIAIFs proposing to invest in Irish property assets or obtaining exposure to digital assets.

2.3.2 Requirements for Non-local Service Providers
Whether alternative funds or retail funds, Irish investment funds must have an Irish-domiciled depositary and administrator, regulated and supervised by the Central Bank.

While Irish investment funds structured as investment companies and ICAVs may be self-managed, there has been a move towards funds that are externally managed by an AIFM, in the case of an AIF. A non-Irish AIFM based in the EU can manage Irish investment funds if it has made the requisite application to its home state competent authority. Non-EU AIFMs can also manage Irish funds, subject to compliance with certain requirements. However, the AIFMD marketing passport is not available to non-EU AIFMs, and Irish AIFs with non-EU AIFMs may only be offered in Europe under the available national private placement regimes.

A person must be approved by the Central Bank to act as a director of an Irish regulated entity or of a general partner of an ILP. The process involves submitting an individual questionnaire to the Central Bank for consideration. Directors and other individuals performing controlled functions, such as persons selected to act as designated persons for an AIFM, are required to comply with the requirements of the Central Bank's fitness and probity regime. If an investment fund is self-managed, the Central Bank's fund management companies guidance will apply, which includes a broad range of governance requirements. Where the investment fund has appointed an AIFM, the requirements of the Central Bank's Fund Management Companies Guidance will apply, other than the section relating to externally managed funds.

Prime brokers may be appointed to provide services directly to an AIF and – provided that their services do not constitute discretionary portfolio management, which typically they would not – are not required to obtain any separate funds-related regulatory approval to provide these services to an Irish AIF. Irish investment funds are required to file any material contracts entered into by the fund with the Central Bank.

2.3.3 Local Regulatory Requirements for Non-local Managers

The approval process for a discretionary investment manager depends on the entity's country of establishment. An Irish investment fund may typically only delegate investment management services to an entity that is authorised or registered for the purpose of asset management and subject to prudential supervision in its home jurisdiction. In addition, there must be supervisory co-operation between the Central Bank and the supervisory authority in the entity's home jurisdiction, which generally takes the form of a memorandum of understanding or a co-operation agreement between the jurisdictions. The Central Bank has accepted the following jurisdictions as having a comparable regulatory regime to Ireland: Abu Dhabi, Australia, the Bahamas, Bermuda, Brazil, Canada, Dubai, Guernsey, Hong Kong, India, Japan, Jersey, Malaysia, Qatar, Singapore, South Africa, South Korea, Switzerland, the United States and the United Kingdom.

A fast-track application is available to entities that are based in the EU and authorised as an investment firm under MiFID to provide portfolio management, and to externally appointed AIFMs, UCITS management companies or credit institutions authorised under Directive 2006/48/EC with approval to provide portfolio management under MiFID.

The fast-track application process is not available to non-EU entities, including UK-based entities. Non-EU-based entities must submit an application to the Central Bank prior to being appointed to act as a discretionary investment manager for Irish investment funds.

An entity cleared to act as an investment manager for Irish investment funds is required to notify the Central Bank in advance of a change of name, registered address or regulatory status.

2.3.4 Regulatory Approval Process

With the exception of limited asset classes that require a pre-submission (namely QIAIFs proposing to invest in Irish property assets or in digital assets), a fast-track authorisation process applies to QIAIFs, whereby new investment funds can be authorised by the Central Bank within 24 hours of the application for authorisation of the fund being submitted. This process also applies to the approval of new sub-funds of existing umbrella funds and to amendments to the investment fund's documentation post-authorisation.

From an operational perspective, it generally takes between eight and 12 weeks for the establishment and authorisation of a new QIAIF umbrella (not subject to any pre-submission requirements). Sub-funds of an existing umbrella structure can be established more quickly, depending on the circumstances.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

The AIFM Regulations provide for pre-marketing in Ireland in accordance with the Cross-Border Distribution Directive ((EU) 2019/1160), transposed into Irish law on 6 August 2021, whereby an EU AIFM or certain third parties on behalf of an EU AIFM can engage in the provision of information or communication, directly or indirectly, on investment strategies or investment ideas in order to test investor interest, provided that such activity does not amount to an offer or placement to the potential investor to invest in that AIF.

The transposing legislation in Ireland did not introduce any additional regulatory measures.

2.3.6 Rules Concerning Marketing of Alternative Funds

The marketing rules contained in the AIFMD apply to entities seeking to market AIFs in Ireland. The AIF Rulebook and other Central Bank guidance provide additional information on the marketing of AIFs to investors in Ireland. Further requirements have been introduced by the framework for the cross-border distribution of investment funds (consisting of the Cross-Border Distribution Regulation ((EU) 2019/1156) and the Cross-Border Distribution Directive), including in relation to the pre-marketing to AIFs, marketing communications and local facilities arrangements. The transposing legislation did not introduce any additional "gold-plating" measures. The firm carrying out the marketing activity will also need to consider whether it is performing any other regulatory activities that may need to be licensed under MiFID – eg, the provision of investment advice.

2.3.7 Marketing of Alternative Funds

In accordance with the AIFMD, authorised EU AIFMs are permitted to market Irish AIFs to professional investors in EU member states using the AIFMD marketing passport, but there are currently no passporting rights available to non-EU AIFMs. However, marketing by non-EU AIFMs and registered EU AIFMs of Irish AIFs may be carried out under the national private placement regimes in EU member states, where those are available.

Marketing retail AIFs not domiciled in Ireland to retail investors in Ireland is permitted in limited circumstances, but an application must be submitted to the Central Bank before any marketing takes place.

The Cross-Border Distribution Regulation provides that all marketing communications addressed to investors should be identifiable as such and describe the risks and rewards of purchasing units or shares of an AIF in an equally prominent manner. It also states that all information included in marketing communications needs to be fair, clear and not misleading. ESMA has published guidelines on marketing communication requirements, which came into force in February 2022.

2.3.8 Marketing Authorisation/Notification Process

The marketing of EEA AIFs (including Irish AIFs) to professional investors in Ireland benefits from the notification process to the AIFM's home state competent authority, as contemplated under the AIFMD and transposed into Irish law.

An Irish AIFM seeking to market an AIF authorised in the EEA should submit a notification to the Central Bank in accordance with Regulation 32 of the AIFM Regulations. A non-Irish AIFM seeking to market a non-Irish AIF authorised in the EEA in Ireland should submit a notification to its own competent authority. Upon the transmission of the notification file to the Central Bank, the AIFM may commence marketing in Ireland. An Irish AIFM or an AIFM authorised in another EEA member state seeking to market a non-EEA AIF in Ireland should submit a notification in accordance with Regulation 37 of the AIFM Regulations. A non-EEA AIFM seeking to market AIFs in Ireland should submit a notification in accordance with Regulation 43 of the AIFM Regulations.

The Central Bank does not impose additional requirements in relation to passported EEA AIFs other than those laid down in the AIFMD. The Central Bank does not impose local service provider requirements, such as a local representative and/or paying agent, nor does it levy any regulatory fees (either initial or ongoing) to avail of marketing rights under the passport.

2.3.9 Post-marketing Ongoing Requirements

The AIFM must give written notice of a material change to any of the particulars communicated in the original passport notification to the competent authorities of its home state at least one month before implementing a planned change or, where it is not possible to do so, immediately after such an unplanned change has occurred.

Similarly, a material change to the details of marketing in accordance with Regulation 43 of the AIFM Regulations should be notified by the non-EU AIFM to the Central Bank without delay.

In order to cease marketing a passported AIF in Ireland, a notification to de-register should be made to the competent authority of the AIFM's home state. From the date of de-notification, a three-year "black-out" period is triggered, during which any pre-marketing of the relevant AIF or in respect of similar investment strategies or investment ideas is prohibited.

2.3.10 Investor Protection Rules

Only qualifying investors can subscribe for shares, units or interests in a QIAIF – see **2.2.3 Restrictions on Investors**.

Any further restrictions on the types of investors that a QIAIF may be marketed to will be set out in the fund's prospectus.

Please see **2.1.4 Disclosure Requirements** for a summary of the regulatory reporting requirements applicable to QIAIFs.

2.3.11 Approach of the Regulator

Under the fast-track process, applications for the authorisation of QIAIFs, approvals of new sub-funds for existing umbrella QIAIFs and post-authorisation amendments for QIAIFs are processed within 24 hours of receipt, with the exception of submissions relating to limited asset classes (as detailed in **2.1.2 Common Process for Setting Up Investment Funds**), for which a pre-submission is required.

The Central Bank is generally available to answer specific queries relating to the authorisation and ongoing supervision of AIFs. Such queries generally need to be submitted in writing to the Central Bank for consideration, and the timeframe within which the Central Bank will respond depends on the nature of the query received. The Central Bank will typically not address technical or complex queries on a "no names" basis.

Face-to-face meetings are not typically required for the authorisation of AIFs, but are generally set up to discuss the proposed establishment and authorisation of an AIFM.

2.4 Operational Requirements

AIFs being established as money market funds are subject to the requirements of the Money Market Funds Regulation ((EU) 2017/1131), which limits the types of assets in which such funds may invest.

The AIF Rulebook limits the activities of a loan origination QIAIF to issuing loans, participating in loans, investment in debt and credit instruments, and participations in lending and operations relating thereto, including investing in equity securities of entities or groups to which the loan origination QIAIF lends or in instruments that are held for treasury, cash management or hedging purposes.

Irish investment funds established as QIAIFs or RIAIFs are required to appoint an Irish-based depositary that is responsible for the safekeeping of the fund's assets, and are subject to the full AIFMD depositary regime. However, an Irish-based depositary of assets other than financial instruments (DAoFI or a real asset depositary) may be appointed to act for a specific type of QIAIF (those funds that have no redemption rights exercisable for at least five years from the date of initial investment and that generally do not invest in financial instruments that can be held in custody). Any entity acting as a depositary or DAoFI for Irish investment funds is required to be authorised by the Central Bank to provide such services. There are also rules relating to the holding of investors' money in collection accounts and umbrella cash accounts.

Details of how an investment fund's assets are valued are required to be set out in the investment fund's constitutional document, and should comply with the valuation rules set out in the AIF Rulebook. Unless an external valuer is appointed, the AIFM will retain responsibility for valuing the fund's assets. The administrator will assist in calculating the NAV of the fund but will not have any discretion in relation to how assets are valued, and will adhere to the valuation policy adopted by the AIFM in respect of the fund.

Details of the potential risks relevant to the investment fund are required to be disclosed in the fund's prospectus.

Rules relating to insider trading, market abuse and transparency are generally only applicable to Irish listed investment funds.

As Irish regulated entities, Irish investment funds (whether AIFs or UCITS) are subject to anti-money laundering and counter-terrorism financing (AML/CFT) legislation. As they generally delegate transfer agency activities including investor services to an administrator, Irish investment funds need to be aware of the administrator's policy in relation to AML/CFT, in addition to having their own policy in place.

2.5 Fund Finance

There are generally no restrictions on AIFs entering into financing arrangements to fund the purchase of investments or for liquidity management purposes. In accordance with the AIFMD, QIAIFs are required to disclose their maximum level of leverage using both the gross method and the commitment approach.

Loan origination QIAIFs are restricted in terms of the amount that can be borrowed, as such funds must not have gross assets of more than 200% of their NAV.

Lenders will typically take security as part of financing arrangements with QIAIFs, with the types taken depending on the purpose of the financing and the fund structure. For example, if financing is being obtained to fund investment, it is common for security to be granted over the assets of the investment fund, including any cash accounts held by the depositary on behalf of the fund. If the fund has a capital call structure, it is common for security to be granted over the capital commitment account(s) into which commitments are drawn, as well as over any uncalled commitments. Lenders would typically also have the right to call uncalled capital commitments.

QIAIFs are not permitted to act as a guarantor for third parties; this includes a sub-fund acting as guarantor for another sub-fund in the same umbrella. This restriction can create challenges in relation to the use of financing structures that require cross-collateralisation between borrowing entities falling within the same borrowing group. Depending on the structure, a cascading pledge mechanism can be used to overcome such challenges. The prohibition on acting as a guarantor for third parties does not apply to wholly owned subsidiaries of the QIAIF.

It is necessary to register a security interest with the relevant authority, which will be either the Irish Companies Registration Office or the Central Bank, depending on the structure of the investment fund.

2.6 Tax Regime

Irish investment funds structured as authorised investment companies, ICAVs and authorised unit trusts (both AIFs and retail funds) are subject to the Investment Undertaking Tax (IUT) regime and are exempt from Irish tax on their income and gains, assuming they do not invest in Irish real estate – see below with respect to the Irish real estate fund (IREF) regime. No stamp duty is payable on transfers of shares or units of an Irish investment fund (other than of an IREF in certain circumstances), and no subscription tax is payable on the issue of shares or units of an Irish investment fund.

If a declaration of non-Irish residence is provided to the fund, Irish tax is not payable on distributions or redemption payments to non-Irish resident investors in Irish funds. Distributions or redemption payments to certain classes of exempt Irish resident investors (eg, pension funds, charities and other Irish regulated funds) may also be paid by the fund free from Irish tax, provided a relevant declaration is in place.

The IUT Regime

Where an investor is resident (or ordinarily resident) in Ireland for Irish tax purposes and is not an “exempt Irish investor”, an Irish investment fund must deduct Irish tax on certain “chargeable events” (eg, distributions, redemptions and transfers) and on a “deemed disposal”, which takes place eight years from the date of each acquisition of shares or units in an Irish fund, and each subsequent period of eight years thereafter.

Simplification measures to dispense with the IUT withholding obligation for the fund on a deemed disposal are available where the shares or units held by non-exempt Irish investors are worth less than 10% of the value of the total shares or units in the fund. Such investors must instead pay tax on the deemed disposal on a self-assessment basis. Irish tax at the rate of 41% must be deducted from all distributions and redemptions, and in respect of any gains arising by virtue of a transfer of shares or units in the fund held by Irish resident individuals who are not otherwise exempt. If the distribution, redemption or proceeds of transfer are paid to a company, the rate of withholding tax is 25%.

Irish investment funds structured as CCFs or ILPs are transparent for Irish tax purposes, and profits are treated as arising directly to investors. Investors in investment funds structured as CCFs may be able to claim double tax treaty relief at investor level in respect of the underlying investments of a CCF. Ireland has an extensive and growing network of double taxation treaties that provide, inter alia, access to favourable tax reclaim rates (comprehensive double taxation treaties are currently signed with 76 countries, of which 73 are in effect).

Finance Act 2021 introduced ATAD-compliant reverse hybrid mismatch provisions into Irish law for tax periods commencing on or after 1 January 2022. The provisions apply in limited circumstances only and should only be relevant to Irish regulated funds that are considered transparent for Irish tax purposes, such as a CCF or an ILP; see **4.1 Recent Developments and Proposals for Reform**.

Finance Act 2021 also introduced an ATAD-compliant interest limitation rule into Irish law in respect of companies within the charge to corporation tax for accounting periods commencing on or after 1 January 2022. While Irish regulated funds that are companies such as authorised investment companies and ICAVs may technically be within the scope of the provisions as they are subject to the IUT regime, they should not be subject to adjustment under the rule.

The IREF Regime

A further specific tax regime applies to Irish AIFs structured as ICAVs, investment companies or unit trusts that invest in Irish real estate (IREFs). Introduced in the Finance Act 2016, the IREF regime applies where 25% or more of the value of the assets of the investment fund (or of a sub-fund in the case of an umbrella fund) is made up of Irish real estate assets, or where it would be reasonable to consider that the main purpose or one of the main purposes of the fund is to acquire IREF assets or carry on an IREF business (ie, activities involving IREF assets, including dealing in or developing land or a property rental business).

Where the IREF rules apply, withholding tax ("IREF withholding tax") at the rate of 20% of the "IREF taxable amount" must be deducted from payments made to unitholders on an "IREF taxable event", such as a distribution or redemption, and on a sale of shares or units in the IREF. As the regime operates in parallel with the IUT regime, broadly, IREF withholding tax applies in relation to those investors that are exempt from IUT, such as non-Irish resident investors and certain classes of exempt Irish investor. However, certain of those investors are also exempt under the IREF regime. The categories of exempt persons are restricted broadly to widely held EEA/EU regulated pension funds, life assurance companies, other authorised funds and their EU/EEA equivalents, exempt charities, credit unions and companies benefitting from the Irish securitisation tax regime in Section 110 of the Taxes Consolidation Act 1997, as amended.

An investor in an EU member state (other than Ireland) or a country with which Ireland has a double tax treaty may reclaim IREF withholding tax under the dividends article of the relevant double tax treaty, and the Irish tax will be reduced to the treaty rate. However, beneficial owners of 10% or more of the shares or units in an IREF (directly or indirectly) are technically precluded from claiming treaty relief as the Irish rules treat the payment from the IREF to such persons as income from immovable property to which the source country (Ireland) would typically be given taxing rights under a double tax treaty.

The Finance Act 2019 introduced further changes to the IREF regime, including anti-avoidance provisions that apply a 20% income tax charge at fund/sub-fund level to combat excessive debt and financing cost deductions, and non-IREF business-related expenses that can reduce the profits that would otherwise be subject to IREF withholding tax on distributions/redemption payments. The debt/financing cost restrictions comprise both a debt-to-cost threshold and a profit financing cost ratio, with financing costs in excess of the applicable ratios being treated as deemed income subject to income tax at 20%. Financing costs on genuine third-party debt are excluded from the provisions.

Stamp Duty

The transfer of units in an investment undertaking (such as an authorised ICAV or investment company), a CCF or an ILP is exempt from stamp duty, but it can apply in respect of the transfer of units in an IREF in certain circumstances.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

There are two types of Irish investment funds available to retail investors: RIAIFs and UCITS.

A RIAIF can be structured as any of the fund structures detailed in **2. Alternative Investment Funds** – ie, an investment company, ICAV, unit trust, CCF or ILP.

UCITS in Ireland can adopt any of these fund structures, except the ILP.

The descriptions of each fund structure in **2.1.1 Fund Structures** are also applicable to RIAIFs and UCITS. On a legislative basis, all UCITS are required to operate on the principle of risk spreading, regardless of what legal structure is used, as opposed to QIAIFs and RIAIFs, where only investment companies are required to spread investment risk. However, in the case of RIAIFs, compliance with this principle is implied through requiring the RIAIF to comply with a series of investment and concentration limits in the AIF Rulebook, which are similar to those contained in UCITS legislation, albeit slightly less restrictive. The AIF Rulebook provides that a RIAIF may derogate from complying with certain investment restrictions for six months following the date of its launch, provided that it complies with the principle of risk spreading.

While RIAIFs can be structured as either open-ended, open-ended with limited liquidity or closed-ended, UCITS are open-ended structures where dealing must – at a minimum – be offered twice a month at regular intervals. In practice, the majority of UCITS are structured as daily dealing funds.

As mentioned in **2.1.1 Fund Structures**, the majority of investment managers and investment advisers appointed to act for Irish investment funds are domiciled in other jurisdictions, but any such Irish incorporated entities are generally structured as private companies limited by shares.

3.1.2 Common Process for Setting Up Investment Funds

A RIAIF or UCITS that is structured as an investment company or an ICAV will need to be incorporated or registered with the Irish Companies Registration Office or the Central Bank, respectively, prior to an application being submitted to the Central Bank.

Unlike an application for authorisation of a QIAIF, which can generally avail of the Central Bank's fast-track authorisation process (see **2.1.2 Common Process for Setting Up Investment Funds**), an application for authorisation of a UCITS or a RIAIF is subject to a detailed review of the investment fund's key documentation by the Central Bank. After its initial review of the draft documentation, the Central Bank will issue comments, which need to be dealt with before the investment fund can be authorised. All other material contracts entered into by the UCITS or RIAIF will need to be submitted to the Central Bank on authorisation day, with corresponding certifications being made as to their compliance with the requirements of the Central Bank.

Before a UCITS or a RIAIF is approved by the Central Bank, it is necessary to ensure that all service providers have obtained any requisite pre-approvals from the Central Bank to act for Irish-domiciled investment funds. This is most relevant for discretionary investment managers that have not previously provided such services to Irish domiciled investment funds. Please see **2.3.3 Local Regulatory Requirements for Non-local Managers** for further details of the clearance process for discretionary investment managers.

For applications for new UCITS or RIAIFs that are not clones of previously authorised funds, the Central Bank aims to respond to initial comments within 20 business days of receiving a complete application, and to respond to all subsequent comments within ten business days of receipt. The timeframe for the establishment and authorisation of a UCITS or a RIAIF generally ranges between 12 and 24 weeks.

3.1.3 Limited Liability

As with QIAIFs, investors in RIAIFs are generally only liable for any amounts outstanding on partly paid shares or, in a capital call structure, for any amounts committed but not yet called. The losses that an investor will suffer will be limited to the subscription or commitment amount.

Investors in UCITS are generally only liable for any amounts subscribed for, so that any losses suffered by an investor will be limited to the subscription amount.

In addition, umbrella funds have segregated liability between sub-funds as a matter of Irish law, which means that the assets and liabilities of a sub-fund are ring-fenced and such assets cannot be used to satisfy the liabilities of another sub-fund.

3.1.4 Disclosure Requirements

As set out in **2.1.4 Disclosure Requirements**, Irish investment funds are required to provide investors with a prospectus that discloses key information about the investment strategy, the parties involved and the potential risks relevant to investing in the investment fund. UCITS and RIAIFs may be required to provide a PRIIPs KID to investors prior to accepting their investment in the investment fund, in accordance with the recent changes in the requirements of the PRIIPs regime. Prior to accepting an investment in the fund, all UCITS must provide investors with either a PRIIPs KID or a KIID, which are short form offering documents summarising the key features of the UCITS.

Although similar to the KIID, there are certain differences between the PRIIPs KID and the KIID and, under legislative measures, UCITS are required to make an annual submission of KIIDs to the Central Bank (to the extent KIIDs continue to be produced), and to submit an annual report detailing the types of financial derivative instruments invested in by the fund during the period. Funds that have not previously been required to file a PRIIPs KID with the Central Bank, namely UCITS and RIAIFs approved by the Central Bank prior to 1 January 2023, that are required to provide PRIIPs KIDs to retail investors will be required to submit any updates to the Central Bank from 1 January 2024.

Irish investment funds are also required to provide financial statements and an annual report on the financial state of the entity to investors. Umbrella ICAVs may publish separate financial statements for each sub-fund.

The disclosure and reporting requirements set out in the AIFMD are applicable to RIAIFs, including the disclosure requirements set out in Article 23 and the reporting requirements set out in Articles 3 and 24 (also known as Annex IV reporting).

In addition, the Central Bank requires ad hoc regulatory reporting in certain circumstances, such as the suspension of a fund, material breaches of the investment policy, and if there are material errors in the calculation of the fund's NAV.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

Investment in Irish UCITS is not limited to retail investors: all types of institutional investors and high net worth individuals invest in UCITS, which are the most popular fund type in Ireland. According to figures published by the Central Bank, the total assets held by Irish UCITS at the end of September 2023 amounted to EUR3,804 trillion, an increase of EUR192 billion from the end of 2022, largely driven by transaction inflows and positive re-valuations.

The number of RIAIFs that have been established is relatively low, with either the UCITS or QIAIF being the product of choice for investors, depending on the investment strategy and target investors. There is no limit on the types of investors that can invest in RIAIFs, which can target retail, institutional and high net worth investors.

3.2.2 Legal Structures Used by Fund Managers

UCITS management companies are typically established as private companies limited by shares, as are AIFMs that manage RIAIFs.

3.2.3 Restrictions on Investors

There are no regulatory restrictions on the types of investors that can invest in Irish retail investment funds, provided they comply with onboarding and anti-money laundering due diligence requirements.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

UCITS established in Ireland are authorised under the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 as amended (the "UCITS Regulations"), which transpose the UCITS Directive (2009/65/EC). The Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2019 (the "Central Bank UCITS Regulations") together with the

Central Bank's Q&As on UCITS and other guidance provide information on the specific requirements relating to UCITS.

UCITS may invest in transferable securities and other liquid financial assets, but the following restrictions apply in terms of permitted investments:

- limits on the types of investments in which UCITS can invest;
- diversification limits;
- limits on the use of financial derivative instruments; and
- limited use of leverage.

For example, a UCITS may invest no more than 10% of its net assets in securities that are not listed, traded or dealt in on a regulated market, and is precluded from investing more than 10% of its assets in any one issuer, other than in the case of certain exempted categories of issuers where higher limits are applied. Where a UCITS invests more than 5% of its assets in any issuer, the maximum amount of any such holdings in excess of 5% is limited to 40% of the NAV of the investment fund (known as the 5/10/40 rule), other than in the case of certain exempted categories of issuers where higher limits are applied.

As a type of AIF, RIAIFs are subject to the requirements of the AIFM Regulations and the AIF Rulebook. The regulatory regime applicable to RIAIFs is more restrictive than that for QIAIFs, but less restrictive than the UCITS regime. For example, a RIAIF may invest no more than 20% of its assets in securities that are not traded in or dealt on a regulated market and is precluded from investing more than 20% of its assets in any one issuer (the UCITS limit for both is 10%). RIAIFs are generally obliged to ensure that they are sufficiently diversified.

3.3.2 Requirements for Non-local Service Providers

All Irish investment funds (whether AIFs or UCITS) must have an Irish-domiciled depositary and administrator, which are regulated and supervised by the Central Bank.

While Irish investment funds structured as investment companies and ICAVs may be self-managed, there has been a move towards funds that are managed by a UCITS management company, in the case of a UCITS. A non-Irish UCITS management company based in the EU can manage Irish investment funds if it has made the requisite application to its home regulator. In recent years, there has been a rise in so-called "Super ManCos", which are entities seeking authorisation from the Central Bank as both an AIFM and a UCITS management company in order to act for QIAIFs, RIAIFs and UCITS.

A person must be approved by the Central Bank to act as a director of an Irish regulated entity or of a general partner of an ILP, the process for which involves submitting an individual questionnaire to the Central Bank for consideration. Directors and other individuals performing controlled functions, such as persons selected to act as designated persons for a UCITS management company, are required to comply with the requirements of the Central Bank's fitness and probity regime. If an investment fund is self-managed, the Central Bank's Fund Management Companies guidance will apply, and the restrictions on the numbers of non-Irish directors and designated persons that can be appointed will apply to the investment fund. Where the investment fund has appointed a UCITS management company, such restrictions will apply to the board of directors of the UCITS management company rather than to the investment fund itself.

Irish investment funds are required to file any material contracts they enter into with the Central Bank.

3.3.3 Local Regulatory Requirements for Non-local Managers

The approval process for a discretionary investment manager of a UCITS or a RIAIF is the same as the process for a QIAIF, as set out in **2.3.3 Local Regulatory Requirements for Non-local Managers**.

3.3.4 Regulatory Approval Process

As the Central Bank reviews key fund documentation as part of the application for authorisation of a UCITS and a RIAIF, the timeframe for obtaining authorisation depends on the level of comment received from the Central Bank on the documentation submitted.

For applications for new UCITS or RIAIFs that are not clones of previously authorised funds, the Central Bank aims to respond to initial comments within 20 business days of receiving a complete application, and to respond to all subsequent comments within ten business days of receipt. This timeframe also applies to applications for the approval of new sub-funds that are considered to be complex.

Where it is intended to invest in contracts for difference (CFDs), collateralised loan obligations (CLOs), contingent convertible securities (CoCos), binary options, or such other asset classes as the Central Bank may prescribe from time to time, the application will be subject to enhanced scrutiny by the Central Bank and additional information may be sought, including portfolio information. For new sub-funds that are clones of previously approved sub-funds or are considered to be non-complex, the Central Bank aims to respond to initial comments within ten business days of receiving a complete application, and to respond to all subsequent comments within five business days of receipt.

The establishment and authorisation of a UCITS or a RIAIF generally take between 12 and 24 weeks.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

There is no pre-marketing regime available for UCITS, nor for AIFs pre-marketing to non-professional investors.

3.3.6 Rules Concerning Marketing of Retail Funds

The marketing rules contained in the UCITS Directive apply to entities seeking to market UCITS in Ireland. The Central Bank UCITS Regulations and other Central Bank guidance provide additional information on the marketing of UCITS to investors in Ireland. As set out in **2.3.6 Rules Concerning Marketing of Alternative Funds**, additional requirements have been introduced for the cross-border distribution of investment funds, including in relation to marketing communications and local facilities arrangements. A prior notification period of one month for certain changes, including the marketing of additional share classes, was also introduced in respect of UCITS. In addition, the firm carrying out the marketing activity will need to consider whether it is performing any other regulatory activities that may need to be licensed under MiFID – eg, the provision of investment advice.

3.3.7 Marketing of Retail Funds

A UCITS can generally be sold without any material restriction to any category or number of investors in any EU member state, subject to the filing of appropriate documentation with the relevant competent authority in the EU member state(s) where it is intended to market the investment fund.

As set out in **2.3.7 Marketing of Alternative Funds**, the Cross-Border Distribution Regulation and ESMA's guidelines on marketing communication requirements apply rules in respect of the marketing of retail funds.

Although RIAIFs may be marketed to retail investors in Ireland, they may only be marketed to professional investors in other EU member states using the AIFMD marketing passport, as set out in **2.3.7 Marketing of Alternative Funds**. Certain EU member states may permit the marketing of AIFs to retail investors where additional steps are complied with, but this differs by jurisdiction on a case-by-case basis. RIAIFs must appoint a fully authorised AIFM, and non-EU managers or registered AIFMs are prevented from managing RIAIFs.

The marketing of retail AIFs not domiciled in Ireland is permitted in limited circumstances, but an application must be submitted to the Central Bank before any marketing takes place.

3.3.8 Marketing Authorisation/Notification Process

Ireland has implemented Article 43 of the AIFMD, which permits the marketing of AIFs to retail investors. Accordingly, it is possible for a non-Irish AIF to market in Ireland to retail investors.

An AIF situated in another jurisdiction that proposes to market its units in Ireland to retail investors must apply to the Central Bank in writing, and may not conduct marketing in Ireland until it has received a letter of approval from the Central Bank. The Central Bank requires that such AIFs must be authorised by a supervisory authority to ensure the protection of unitholders; such protection must be equivalent to that provided under Irish laws, regulations and conditions governing Irish authorised RIAIFs.

The AIF shall include the following information for Irish retail investors in its prospectus:

- details of the facilities agent and the facilities maintained;
- provisions of Irish tax laws, if applicable; and
- details of the places where issue and repurchase prices can be obtained or are published.

When an AIF has received approval from the Central Bank to market units in Ireland to retail investors, the name of the AIF and the name and address of the facilities agent will be placed on a list of AIFs marketing in Ireland to retail investors, which will be made available to the public on request.

In order to market a UCITS in Ireland, a marketing application must be submitted to the competent authority in its home state for onward submission to the Central Bank prior to the commencement of marketing in Ireland. The notification file is submitted electronically, consisting of a standard form notification letter and fund documentation. It is transmitted from the home state authority to the Central Bank, which will issue its confirmation, after which the notified class(es) of the UCITS may be marketed in Ireland.

The prospectus of a UCITS that is authorised in another member state and markets its units in Ireland must provide the following information for Irish investors:

- details of the facilities agent and of the facilities that are being maintained; and
- relevant provisions of Irish tax laws.

3.3.9 Post-marketing Ongoing Requirements
Funds marketing their units in Ireland must comply with the law, regulations and administrative provisions in force in Ireland, including but not limited to the Consumer Protection Code of the Central Bank.

UCITS and AIFs marketing in Ireland to retail investors must submit a copy of their annual and any half-yearly reports to the Central Bank, as soon as they are available.

UCITS availing of the marketing passport in Ireland must keep the key fund documents in the notification file up to date, and must give one month's advance written notice to the host member state of any changes to be made to the classes that will be marketed in the host member state. Accordingly, changes in information in the original notification letter or a change in the share classes to be marketed should be submitted to the home and host state competent authorities at least one month before the implementation of the change.

UCITS must ensure compliance with the Central Bank UCITS Regulations regarding the contents, format and manner of presentation of marketing communications, including compulsory warnings and restrictions on the use of certain words or phrases and the advertising standards set out in Schedule 6 of the Central Bank UCITS Regulations.

A de-registration process (as detailed in **2.3.9 Post-marketing Ongoing Requirements**) must also be followed where it is proposed that UCITS will cease cross-border marketing, pursuant to the marketing passport.

3.3.10 Investor Protection Rules
There are no Irish regulatory restrictions on the categories of investors that can invest in UCITS or RIAIFs. Any restrictions on the categories of investors that a UCITS or RIAIF may be marketed to will be set out in the fund's prospectus.

Please see **3.1.4 Disclosure Requirements** for a summary of the regulatory reporting requirements applicable to UCITS and RIAIFs.

3.3.11 Approach of the Regulator
The Central Bank is generally available to answer specific queries relating to the authorisation and ongoing supervision of UCITS. Such queries generally need to be submitted in writing to the Central Bank for consideration, and the timeframe within which the Central Bank will respond depends on the nature of the query. The Central Bank is reluctant to deal with substantive or complex queries on a "no names" basis.

Face-to-face meetings are not typically required in respect of the authorisation of UCITS funds, unless there is something particularly significant associated with the project, but are more typically set up to discuss the establishment and authorisation of a UCITS management company.

3.4 Operational Requirements
Retail investment funds in Ireland are limited in terms of not only the types of assets that can be invested in but also the exposure to particular securities and issuers. UCITS are permitted to invest in transferable securities and other liquid financial assets but are not permitted to invest directly in real estate or commodities, nor to engage in physical short selling.

Investments by UCITS in other open-ended collective investment schemes that are not established as UCITS are subject to additional requirements, including requirements relating to those underlying funds being subject to equivalent supervision and investor protection measures. Investment in closed-ended funds by UCITS is limited to circumstances where the underlying closed-ended funds meet the definition of a transferable security and fulfil certain corporate governance and regulatory requirements.

As detailed in **3.3.1 Regulatory Regime**, UCITS are subject to a more stringent regulatory regime than AIFs in terms of permitted investments and investment restrictions.

Whether established as AIFs or UCITS, Irish investment funds are required to appoint an Irish-based depositary that is responsible for the safekeeping of the fund's assets, which must be authorised by the Central Bank to provide such services. There are also rules relating to the holding of investors' money in collection accounts and umbrella cash accounts.

Details of how an investment fund's assets are valued need to be set out in the fund's constitutional document, and should comply with the valuation rules set out in the UCITS Regulations or the AIF Rulebook, as relevant. Details of the potential risks relevant to the investment fund must be disclosed in the fund's prospectus. Rules relating to insider trading, market abuse and transparency are generally only applicable to Irish listed funds.

As Irish regulated entities, Irish investment funds (whether AIFs or UCITS) are subject to AML/CFT legislation. As Irish investment funds generally delegate investor services activities to an administrator, such funds need to be aware of the administrator's policy in relation to AML/CFT, in addition to having their own policy in place.

3.5 Fund Finance

Retail investment funds in Ireland have limited borrowing powers. RIAIFs are not permitted to borrow an amount exceeding 25% of the fund's net assets, while UCITS are only permitted to borrow up to 10% of the fund's net assets on a temporary basis. Typically, UCITS may use temporary borrowing facilities for short-term liquidity purposes – eg, to ensure the timely payment of redemptions, particularly where less liquid investments are being disposed of.

3.6 Tax Regime

The tax regime for retail investment funds in Ireland does not differ from that applicable to AIFs – see **2.6 Tax Regime**, although the IREF regime referred to therein does not apply to Irish retail investment funds regulated as UCITS funds.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

A number of European initiatives will have an impact on Irish domiciled funds, including proposed amendments to the AIFMD, the Sustainable Finance Disclosure Regulation (EU) 2019/2088 and the UCITS Directive, and initiatives seeking to promote supervisory convergence at a European level, including in the areas of sustainable finance, the supervision of costs and fund valuations, but they are not considered in detail in this chapter as they are at a European level.

The Central Bank has recently published the following:

- finalised rules on the Individual Accountability Framework;

- new Q&As, including new guidance on topics concerning:
  - (a) PRIIPs KID filing requirements;
  - (b) an increase in investment limits for QIAIFs seeking exposure to digital assets;
  - (c) QIAIFs investing via subsidiaries; and
  - (d) certain ILP enhancements;
- final rules on additional capital requirements for fund management companies authorised to provide individual portfolio management services;
- a public statement on its recent enforcement action reprimanding and penalising for the first time an ICAV concerning a breach of EMIR reporting obligations;
- consultation paper CP155 on a new ELTIF chapter in the AIF Rulebook to provide, for the first time, for an ELTIF that will be authorised under domestic funds legislation (from 10 January 2024);
- consultation paper CP156 on its approach to innovative engagement in financial services;
- consultation paper CP157 on macroprudential measures for GBP LDI funds; and
- industry letters on (a) review of costs and fees and b) asset valuation.

The proposals contained in CP155 will facilitate Irish ELTIFs being established in Ireland as a separate category of regulated AIF, pursuant to the amended European Long-Term Investment Funds Regulation ((EU) 2023/606). The Central Bank has indicated that the Irish ELTIF will be a standalone product, so it will not need to be separately authorised as a RIAIF or as a QIAIF. The existing range of investment fund structures will be available to establish ELTIFs, including the ICAV and the ILP.

In June 2023, the Department of Finance issued a public consultation document as part of a wide-ranging review of Ireland's funds sector, entitled "Funds Sector 2030: A Framework for Open, Resilient & Developing Markets". The key objectives of the review include developing a framework within which Ireland can maintain its leading position in fund management and fund servicing, and ensuring that the sector continues to support economic activity at both regional and national levels in Ireland. The requirement for specific legislative changes was signalled by many different parties in response to this consultation. The responses to the public consultation will form the basis for a series of targeted engagements by the Department's multidisciplinary review team with respondents as well as national and international stakeholders into Q1 of 2024. The review team expects to present its draft report to the Minister for Finance by summer 2024.

As is the case with most EU member states and multiple jurisdictions globally, Ireland is introducing new OECD Pillar Two rules, including a 15% global minimum corporate tax rate for large multinationals for accounting periods commencing on or after 31 December 2023. The draft legislation in Finance (No 2) Bill 2023 is complex and is subject to change before it is enacted into law. The draft rules will apply to members of groups that have annual consolidated revenues in excess of the EUR 750 million threshold; standalone non-consolidated entities with annual revenues in excess of EUR750 million will also likely be in scope.

The principle of tax neutrality for collective investment vehicles has been recognised in the draft rules as there is a carve out for an "investment entity" (as defined). In practice, it is expected that many investment funds and entities within investment fund structures should fall outside the scope of the rules. However, it is not clear whether all collective investment vehicles will satisfy the conditions to be considered an "investment entity" (the Irish Revenue Commissioners is expected to release guidance on the conditions to assist with this analysis). There is no exclusion applicable to investment management entities, which need to be assessed based on the relevant facts and circumstances. Each structure should be assessed on a case-by-case basis to determine the potential impact, if any, of these new rules.

Draft legislation has also been included in Finance (No 2) Bill 2023 to apply new tax defensive measures (eg, withholding tax) to certain outbound payments of interest, royalties and distributions (including dividends) towards jurisdictions on the EU list of non-cooperative jurisdictions (the "EU Blacklist"), no-tax, and zero-tax jurisdictions. These measures are being introduced following recommendations by the European Commission that certain EU member states take actions to reduce aggressive tax planning. Similar measure are being introduced by other EU member states. In short, the measures could impose withholding tax on certain payments of interest, royalties and dividends by an Irish company to an "associated entity" located in a relevant jurisdiction.

The provisions are to apply to payments made on or after 1 April 2024. However, grandfathering applies in the case of existing arrangements in place on or before 19 October 2023, such that the provisions would only apply to payments made on or after 1 January 2025 under such arrangements. These measures will not apply to the long-standing withholding tax exemption that applies to distributions and redemption payments made by regulated funds to non-resident investors, which remains in place. Once introduced, the draft measures are not expected to have an impact on the vast majority of Irish funds. However, they could be relevant for debt financing of regulated Irish funds by associated entities in no-tax and zero-tax jurisdictions.

JAPAN

Law and Practice

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Anderson Mori & Tomotsune

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Anderson Mori & Tomotsune

Anderson Mori & Tomotsune (AMT) is one of the largest and most international Japanese law firms, with a long history of advising overseas companies that conduct business in Japan and in cross-border transactions. The main office in Tokyo is supported by two regional offices, in Osaka and Nagoya, and nine overseas offices. AMT has considerable experience and expertise in investment funds and trusts, including investment corporations such as J-REITs, infrastructure funds, ETFs, partnerships and other forms of collective investment schemes. The firm works with increasingly diversified international and Japanese-based investment funds, comprising private equity funds, venture capital funds, hedge funds, funds of funds and commodity funds. Consisting of 15 partners and 45 associates, the team provides comprehensive advice at all stages of the procedures to which investment funds are subject, and supports clients in navigating a broad range of regulatory matters concerning asset management.

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Masayuki Hashimoto is a key partner at AMT, who specialises in the establishment and marketing of domestic and foreign investment trusts and other investment fund vehicles. He oversees the incorporating and listing of J-REITs, the issuance, offering and sale of investment units of J-REITs, the establishment and registration of investment companies, and the compliance of securities firms and other financial institutions. He also has substantial experience in capital markets, securities and financial regulations, with in-depth knowledge of the Financial Instruments and Exchange Act and the Investment Trusts Act.

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1. Market Overview

1.1 State of the Market

Financial assets held by Japanese households have been increasing steadily for years, now reaching over JPY2,000 trillion. Building on this, a number of various types of investment funds are being marketed, offered and distributed in the Japanese market. The most widely used form of investment fund in Japan is an investment Trusts (*toushi shintaku*), created pursuant to the Act on Investment Trusts and Investment Corporations of Japan (the Investment Trusts Act), which is offered on both retail markets (through public offerings) and institutional markets (mostly through private placements).

The Investment Trusts Act also provides for an investment corporation (*toushi houjin*), which is typically used for real estate investments and is popularly known as a Japanese Real Estate Investment Trust (J-REIT), which is something of a misnomer given that all existing J-REITs use the form of an investment corporation rather than being structured as trusts.

In addition, offshore investment funds domiciled in jurisdictions such as the Cayman Islands, Luxembourg and Ireland and qualified as foreign investment trusts/corporations under the Investment Trusts Act have long been used to provide access to the global market for Japanese investors.

Lastly, collective investment schemes such as investment limited partnerships under the Limited Partnership Act for Investment of Japan (LPAI) and silent partnerships under the Commercial Code also account for a substantial portion of investment funds in certain areas, such as private equity funds, as do leasing funds such as aircraft leasing funds, because those are generally treated as pass-through entities for Japanese taxation purposes. Furthermore, offshore collective investment schemes such as Cayman limited partnerships and Luxembourg common and special limited partnerships are preferred in cross-border transactions because of their flexibility and global recognition.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

While there is no specific category analogous to alternative investment funds under Japanese law, privately placed investment funds are used in practice to provide alternate investment opportunities to Japanese investors.

With respect to publicly offered investment trusts/corporations, the Investment Trusts Association, Japan (ITAJ – a self-regulatory organisation of investment trust managers and asset management companies for investment corporations) provides detailed requirements on the management and administration of portfolio assets of publicly offered investment trusts/corporations. Please see **3.3.1 Regulatory Regime** for more details on the rules of the ITAJ.

On the other hand, privately placed investment trusts/corporations are often created and tailored to meet specific investment purposes, strategies and risk allowances of potential investors.

In addition, collective investment schemes are, in general, offered by way of private placement because of their nature and their high flexibility in terms of their organisation, capital structure, types of underlying assets, dividend policies and fee schedules.

Therefore, for the purpose of this article, privately placed investment funds are treated as alternative investment funds.

2.1.2 Common Process for Setting Up Investment Funds

Investment Trusts

An investment trust is generally established by a trust agreement between an investment trust manager and a trustee. An investment trust manager must be a person registered as an investment management business under the Financial Instruments and Exchange Act of Japan (FIEA) ("Registered Investment Manager"), and a trustee must be a trust company licensed under the Trust Business Act or a financial institution authorised to engage in trust business under the Act on Engagement in Trust Business by Financial Institutions.

An investment trust must invest more than half of its assets in securities, derivatives, real estate, commodities and other assets specified by the regulation under the Investment Trusts Act ("Specified Assets").

An investment trust manager intending to enter into a trust agreement has to notify the regulator of the terms and conditions thereof in advance, and these must contain items such as the investment objective, policy, restrictions, dividend policy, method of calculation of net asset value and procedures for the issuance and redemption of units.

Investment Corporations

In order to incorporate an investment corporation, promoters must prepare a certificate of incorporation, which must be executed by all of the promoters; the promoters must notify the regulator of their intention to that effect. At least one promoter must be a Registered Investment Manager or must have the experience and knowledge specified by the Investment Trusts Act.

A certificate of incorporation must include the investment corporation's purpose, investment policy and types of assets, dividend policy, valuation method of assets, and fees and charges. As with an investment trust, an investment corporation must invest more than half of its assets in the Specified Assets.

Subscribers for shares must contribute capital in cash into an investment corporation at the time of incorporation in exchange for an issuance of new shares. The minimum contributed capital and the net asset value at the incorporation are JPY100 million and JPY50 million, respectively.

An investment corporation is established upon the registration of its incorporation.

In order to ensure that an investment corporation functions solely as an investment vehicle, the Investment Trusts Act prohibits it from engaging in business other than asset management and the hiring of employees. As such, an investment corporation must retain an asset management company, a custody company and an administrative agent, and must delegate the relevant functions to them. An investment corporation must be registered by the regulator with the basic terms of its certificate of incorporation, the names of executive and supervisory directors, and the name of an asset management company before commencement of its operations.

Foreign Investment Trust/Corporations

The Investment Trusts Act defines a foreign investment trust/corporation as an investment fund established or incorporated outside Japan under the laws and regulations of a foreign jurisdiction, which is similar to an investment trust/corporation. Therefore, a close review of whether an offshore investment fund is treated as a foreign investment trust/corporation under the Investment Trusts Act is required before introducing it into Japan.

A foreign investment trust/corporation must file a "notification" with the regulator before conducting an offering (whether private placement or public offering) in Japan under the Investment Trusts Act, containing basic terms such as its investment objective, restrictions, dividend policy, procedures of subscription and redemptions, and costs and expenses.

No regulatory requirement is imposed on a manager, investment manager, asset management company or trustee in respect of a foreign investment trust/corporation.

Collective Investment Schemes

The establishment process and notification requirements for collective investment schemes are prescribed by the relevant laws governing such collective investment schemes. For example, an investment limited partnership formed pursuant to the LPAI becomes effective upon the execution of a partnership agreement by at least one general partner and one limited partner. When a partnership agreement takes effect, its business, duration and the name of its general partner must be registered within two weeks.

The general partner of an investment limited partnership under the LPAI must be a Registered Investment Manager under the FIEA, unless an exemption from registration requirements is available.

An offshore partnership established under a foreign law can also be offered for private placement in Japan, although a general partner is required to be a Registered Investment Manager if any Japanese investor acquires and holds an interest in it, unless an exemption from registration requirements is available.

2.1.3 Limited Liability

Holders of units/shares in an investment trust/corporation are liable only to the extent of the amount contributed by them.

Liabilities of investors in collective investment schemes are determined by the relevant governing law. For example, a general partner of an investment limited partnership formed pursuant to the LPAI is jointly and severally liable for the obligations of the partnership, while a limited partner thereof is liable for the partnership's obligations only to the extent of its contribution of or commitment to contribute a capital to the partnership.

2.1.4 Disclosure Requirements

In contrast to publicly offered investment funds (please see **3.1.4 Disclosure Requirements**), the disclosure requirements for privately placed investment funds are limited. However, in case of a Professional Investors Placement, certain information must be disclosed in accordance with the Japan Securities Dealers Association (JSDA) rules (please see **2.3.6 Rules Concerning Marketing of Alternative Funds**).

An investment trust manager must provide a document detailing the trust agreement to investors seeking a subscription of units of an investment trust, except where the units are offered by way of a QII Placement (please see **2.3.6 Rules Concerning Marketing of Alternative Funds**).

An investment trust manager must prepare and deliver a management report containing performance results, market conditions and its financial statements for the relevant fiscal year to known unitholders, and must also send this report to the regulator after the end of the fiscal year without delay, unless the units of the investment trust are offered by way of a QII Placement and the terms and conditions of the trust agreement provide that a management report will not be delivered.

A management report is comprised of two types of reports:

- a summary management report, which contains material information; and
- a full management report.

In addition, the ITAJ provides detailed rules on matters to be included in a management report, and the forms necessary for drafting one. A full management report may be delivered to known unitholders through electronic means, including by posting the report on an issuer's website, as long as the terms and conditions of the trust agreement so allow.

An investment corporation must notify investors seeking a subscription of shares of the basic terms of a certificate of incorporation, such as its investment objective and its dividend policy, as well as its subscription requirements.

An investment corporation must prepare financial statements, an asset investment report and a statement on the distribution of funds for each fiscal period, and must send them to the shareholders once approved by a board of directors. An asset investment report must include material issues on the situation of the investment corporation and other matters relating to the current situation, on the directors and on its shares.

A foreign investment trust must deliver a document containing a constitutional document, such as the trust deed of a unit trust or a management regulation for a fonds communs de placement (FCP), to a prospective investor, and must prepare a management report and deliver it to known unitholders. A foreign investment corporation is not required to prepare an asset investment report.

With respect to a collective investment scheme, there is no general obligation of disclosure to a prospective investor, but a prospective investor is normally provided with a partnership agreement to review before executing it.

Ongoing disclosure obligations applicable to a collective investment scheme depend on the relevant governing law. For example, a general partner of an investment limited partnership formed pursuant to the LPAI must prepare a balance sheet, profit and loss statement and business report, and must maintain these at its principal office; a limited partner may inspect or request their own copies at any time during normal business hours.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

In the case of private placements for qualified institutional investors only ("QII Placements") and those intended for professional investors ("Professional Investor Placements"), permitted investors are limited to qualified institutional investors (QIIs) and Professional Investors, respectively, as defined in the FIEA. Please see **2.3.6 Rules Concerning Marketing of Alternative Funds** regarding the requirements of private placement and **2.3.7 Marketing of Alternative Funds** for the scopes of QIIs and Professional Investors.

With respect to privately placed investment funds, most investors are persons who have knowledge and experience of investment in investment funds, such as banks, insurance companies, trust companies, Registered Financial Instruments Business Operators (as defined in **2.3.2 Requirements for Non-local Service Providers**), wealthy individuals and general business companies with sufficient cash supplies.

2.2.2 Legal Structures Used by Fund Managers

Please see **2.1.2 Common Process for Setting Up Investment Funds**.

2.2.3 Restrictions on Investors

Please see **2.3.7 Marketing of Alternative Funds.**

2.3 Regulatory Environment

2.3.1 Regulatory Regime

Most investment trusts are established as securities investment trusts for Japanese taxation purposes. In order to be qualified as a securities investment trust, a trust must invest more than half of its assets in securities (excluding certain “deemed securities” such as trust beneficiary interests in a trust and interests in a collective investment scheme such as an investment limited partnership) and in securities-related derivatives.

The rules of the ITAJ require a real estate investment corporation to prescribe in its certificate of incorporation that its purpose is to invest more than half of its assets in real estate, lease rights and other real estate-related assets, such as asset-backed securities, more than half of the underlying assets of which are real estate and lease rights.

An investment limited partnership may acquire and hold stocks in joint stock companies (*kabushiki kaisha*), bonds issued by or loans issued to business entities, and other properties that facilitate the business of the entities. However, under the LPAI, unless the approval of the competent authorities is obtained, it is prohibited from acquiring and holding shares or convertible bonds in foreign companies to the extent that such securities represent half or more of its assets.

2.3.2 Requirements for Non-local Service Providers

The FIEA provides four categories of financial instruments businesses:

- type I financial instruments business;
- type II financial instruments business;
- investment management business; and
- investment advisory business.

It requires a person intending to be engaged in any such business to be registered under the FIEA as a Registered Financial Instruments Business Operator. Type I and II financial instruments businesses are involved in the services of brokerage, intermediary activity and the trading of liquid and illiquid securities (as the case may be), and their derivatives.

The Trust Business Act requires a trust company to be licensed thereunder in order to conduct a trust business.

Accordingly, if a non-local service provider wants to carry out any such business in Japan or to provide the services of such business to clients resident in Japan, it must be registered under the FIEA or licensed under the Trust Business Act, as the case may be, unless it is exempted under applicable Japanese law.

2.3.3 Local Regulatory Requirements for Non-local Managers

As mentioned in **2.3.2 Requirements for Non-local Service Providers**, registration is necessary in order to conduct an investment management business in Japan or to provide the services of such business to clients resident in Japan under the FIEA. Therefore, if a non-local manager intends to act as an investment trust manager of an investment trust, an asset management company of an investment corporation or a general partner of an investment limited partnership, it must generally be a Registered Investment Manager under the FIEA.

On the other hand, acting as a manager or investment manager of a foreign investment trust or an asset management company of a foreign investment corporation outside of Japan does not require registration as an investment management business under the FIEA, while acting as a general partner of offshore collective investment schemes requires the registration if it involves accepting investments from residents in Japan.

2.3.4 Regulatory Approval Process

Generally speaking, the establishment processes for an investment trust and an investment corporation take one to two months and three to six months, respectively.

For a foreign investment trust/corporation, it usually takes one to two months to prepare and file a notification.

The length of time for the creation of a collective investment scheme depends on its type, its complexity and the number of investors involved, among other factors.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

Assuming that pre-marketing activities mean those which are conducted towards the promotion and sale of securities but do not amount to solicitation thereof, they do not constitute public offerings or private placements under Japanese law.

However, the solicitation of securities is not expressly defined in the FIEA or in any related law or guidelines. Nonetheless, under current practice, it is generally understood to mean any act carried out with a view to inducing or pressuring a targeted person to purchase a specific product or to agree to enter into a transaction. Accordingly, activities that are not within the parameters of such conduct would be regarded as pre-marketing activities under Japanese law.

In practice, however, it is difficult to draw a clear line between the solicitation of securities and pre-marketing activities, and this should be determined on a substantive basis considering all of the facts, including the wording used, the addressee of the information provided, and the reasons for the provision of the information.

In light of the above, activities such as simply answering questions posed by a potential investor (at the instigation of such potential investor) would be treated as pre-marketing. On the other hand, delivering a prospectus or sending marketing material containing past performance details of a specific investment fund is likely to be treated as solicitation of securities and must follow the requirements of the relevant private placement.

In the case of a foreign investment trust/corporation, an advance notification must be filed before conducting a private placement in Japan under the Investment Trusts Act (please see **2.1.2 Common Process for Setting Up Investment Funds**).

2.3.6 Rules Concerning Marketing of Alternative Funds

With respect to investment trusts/corporations, the FIEA principally provides for the following three methods of private placements:

- QII Placements;
- Professional Investor Placements; and
- private placements of small numbers of investors ("Small Number Placements").

It should be noted that any solicitation of securities that does not meet the requirements for private placements will generally be treated as public offerings under the FIEA.

Pursuant to a QII Placement, an issuer of an investment trust/corporation may offer its units/shares to an unlimited number of QIIs. An investor acquiring units/shares under the QII Placement is subject to a transfer restriction prohibiting any sale or transfer of units/shares to any person who is not a QII.

Professional Investor Placements have been made available relatively recently with respect to units/shares of investment trusts/corporations. Pursuant to a Professional Investor Placement, an issuer of such units/shares must disclose basic information regarding the units/shares and the issuer to the offerees, and must disclose information regarding the issuer on an annual basis to the holders of the units/shares, in accordance with the JSDA rules. In a Professional Investor Placement, the issuer may offer its units/shares to an unlimited number of Professional Investors. An investor acquiring units/shares under the Professional Investor Placement is subject to a transfer restriction prohibiting any sale or transfer of units/shares to any person other than a Professional Investor.

Pursuant to a Small Number Placement, an issuer may offer its units/shares to fewer than 50 offerees. This limitation is based on the number of offerees but not acquirers, and the number of QIIs can be excluded in calculating the number of offerees if they are subject to the requirements specified for a QII Placement (including transfer restriction). In addition, if units/shares of the same kind as the units/shares to be offered were issued during the three-month period preceding the scheduled issue date of the relevant private placement, the number of offerees of such preceding issue will be aggregated in calculating the number of offerees, which must be fewer than 50.

An investor acquiring units of an investment trust under a Small Number Placement is subject to a transfer restriction prohibiting any sale or transfer of units, unless it transfers all of its units as a whole, or unless certificates of units are unable to be divided. No transfer restriction is imposed on shares of an investment corporation issued pursuant to a Small Number Placement.

A foreign investment trust/corporation follows the same requirements as stated above (in case of a Professional Investor Placement, it must meet certain requirements provided by the JSDA rules applicable to a publicly offered foreign investment trust/corporation – please see **3.3.1 Regulatory Regime**).

With respect to collective investment schemes and offshore collective investment schemes, only Small Number Placements are available, pursuant to which an issuer may offer interests therein to up to 499 investors acquiring them.

In the case of a private placement, a written notification stating that a securities registration statement (SRS) has not been made because the offering is being made by way of a private placement must be delivered to an investor; said notification must include the applicable transfer restrictions.

2.3.7 Marketing of Alternative Funds

Under a QII Placement, units/shares can only be offered to QIIs, which include the following persons or institutions:

- Registered Financial Instruments Business Operators with registrations of type I financial instruments businesses and investment management businesses;
- investment corporations and foreign investment corporations;
- banks;
- insurance companies and foreign insurance companies;
- credit associations and labour credit associations;
- credit co-operative associations and agricultural co-operative associations;
- the Government Pension Investment Fund;
- the Japan Bank for International Cooperation;
- the Development Bank of Japan Inc.;
- investment limited partnerships;
- certain employee and corporate pension funds that have submitted a notification to the regulator;
- certain corporations that have submitted a notification to the regulator; and
- certain individuals that have submitted a notification to the regulator.

In a Professional Investor placement, the units/shares can only be offered to Professional Investors, including the following persons or institutions:

- QIIs;
- the government of Japan;
- the Bank of Japan;
- corporations incorporated under a specific law;
- investor protection funds;
- the Deposit Insurance Corporation of Japan;
- the Agricultural and Fishery Cooperative Savings Insurance Corporation;
- the Insurance Policyholders Protection Corporation of Japan;
- specific purpose companies;
- companies listed on a Japanese stock exchange;
- Japanese stock companies whose stated capital is reasonably expected to be equal to at least JPY500 million;
- Registered Financial Instruments Business Operators or corporations that are allowed to act as general partners of collective investment schemes by submitting notifications under the FIEA;
- foreign corporations;
- corporations that have requested to be treated as Professional Investors and have been approved by the Registered Financial Instruments Business Operator; and
- individuals who are operators of silent partnerships or equivalent to Professional Investors in terms of knowledge, experience and financial conditions and have requested to be treated as Professional Investors and been approved by the Registered Financial Instruments Business Operator.

2.3.8 Marketing Authorisation/Notification Process

In the case of a foreign investment trust/corporation, a notification is required to be filed with the regulator before conducting an offering (please see **2.1.2 Common Process for Setting Up Investment Funds**).

2.3.9 Post-marketing Ongoing Requirements

If an investment trust manager intends to change the terms and conditions of a trust agreement or implement a consolidation of investment trusts, the trustees of which are the same, it has to notify the regulator of its intention and the contents of the change or consolidation in advance. If such changes to the terms and conditions are material, an investment trust manager has to give at least two weeks' prior written notice to known unitholders and hold a vote on a written resolution on such change or consolidation, unless such consolidation has only a minor influence on the unitholders' interests.

If an investment trust manager intends to terminate a trust agreement, it has to notify the regulator of this intention in advance. An investment trust manager has to give at least two weeks' prior written notice to known unitholders and hold a vote on a written resolution on such termination, except in cases where it is truly unavoidable to terminate a trust agreement without sending a notice or except when otherwise the conditions prescribed in advance by the terms and conditions of the trust agreement are met.

If any change is made to items that have been registered with the regulator, an investment corporation has to notify these to the regulator within two weeks of said change.

If an investment corporation is extinguished as a result of a merger or is dissolved, it must notify the regulator to that effect within 30 days after this takes place.

If any change is intended to be made to a constitutional document of a foreign investment trust, the issuer must notify these to the regulator in advance. If such change to a constitutional document is material, an issuer has to give at least two weeks' prior written notice to known unitholders. If an issuer intends to terminate a constitutional document, it has to notify the regulator of its intention in advance and give at least two weeks' prior written notice to known unitholders.

If any change is intended to be made to the items included in a notification in respect of a foreign investment corporation having been filed with the regulator, an issuer must notify the regulator of its intention in advance. If a foreign investment corporation is dissolved as a result of bankruptcy or similar proceedings, or will be dissolved for another reason, it has to notify this to the regulator.

Collective investment schemes must follow the ongoing requirements as prescribed by the relevant governing law. For example, in the case of an investment limited partnership formed under the LPAI, if any change is made to items that have been registered with the regulator, the investment limited partnership must apply for registration of such change within two weeks of such change.

2.3.10 Investor Protection Rules

There is no regulation that sets a specific limitation on investors for a certain investment fund.

However, a Registered Financial Instruments Business Operator has to comply with the general principle of suitability in the marketing and selling of financial instruments to investors under the FIEA. Pursuant to this, it must determine whether it is acceptable to market and sell a particular financial instrument to targeted investors, considering their knowledge and experience of investing in financial instruments, their asset situation and their purpose of investment, and provide an explanation to the investors in a manner and to the extent necessary for them to understand it.

Prior to entering into a contract with an investor, a Registered Financial Instruments Business Operator must, in general, deliver a document to the investor containing an outline of such contract, charges and fees, and major risk factors associated with the contract.

Upon concluding a contract, a Registered Financial Instruments Business Operator must, in general, deliver a document containing an outline of such contract, charges and fees, and provide a method for allowing communications between the operator and the investor.

2.3.11 Approach of the Regulator

The Financial Services Agency of Japan (FSA) has authority over the administration of the FIEA, and responsibility for regulating the financial markets and financial institutions. The FSA delegates certain authorities to a local finance bureau of the Ministry of Finance, such as that of regulating Registered Financial Instruments Business Operators and disclosure obligations in respect of financial instruments.

There is no general limitation on access to the regulator, but it may take time to obtain its conclusions on matters that are innovative or unprecedented. In some cases, the regulator prefers to hold preliminary consultations prior to an official filing or application.

2.4 Operational Requirements

A Registered Investment Manager owes a general duty of sincerity and fairness to its clients and must work faithfully on behalf of its investors and carry out its investment management business with the due care of a prudent manager under the FIEA.

As part of this, the FIEA specifically prohibits a Registered Investment Manager from:

- conducting a transaction with itself or its offices;
- conducting a transaction between investment funds both of which are managed by it;
- conducting a transaction with the aim of benefitting itself or a third party;
- conducting a transaction that is detrimental to investors;
- purchasing or selling securities on its own account using information about a transaction that it has conducted as an investment;
- providing, or promising to provide, loss compensation or additional benefits to investors; or
- taking any other act deemed to be insufficient as a form of investor protection, harming the fairness of transactions, or causing a loss of confidence in the financial instruments business.

In addition, a Registered Investment Manager of collective investment schemes must manage invested assets separately from its own assets and other invested assets in the manner prescribed by the FIEA.

2.5 Fund Finance

While there is no restriction on borrowing in respect of an investment trust/corporation under the Investment Trusts Act, the rules of the ITAJ provide that a securities investment trust/corporation may borrow funds only to the extent that doing so is necessary for the purpose of providing funds for payment of redemption and distribution.

Collective investment schemes have no restrictions on borrowing.

2.6 Tax Regime

Taxation of Investment Funds

Investment trusts are generally exempted from Japanese taxation.

Investment corporations are subject to income tax, but distributions payable to investors can be included in tax deductible expenses if certain conditions are met, such as distributing an amount equal to more than 90% of profit available for dividend to investors.

Collective investment schemes are pass-through entities and are non-taxable at the investment fund level.

Taxation of Investors

For Japanese tax purposes, investment trusts are classified into public and corporate bond investment trusts and stock investment trusts. The former invest in public and corporate bonds, but may not invest in any stocks, shares or equities, while the latter comprise investment trusts other than public and corporate bond investment trusts.

There is no such classification for investment corporations, which are generally treated in the same way as stock investment trusts for tax purposes.

For individual investors, investment in a stock investment trust is treated the same as a direct investment in unlisted stocks for tax purposes. Ordinary distributions are subject to withholding taxes at the rate of 20.42% and, thereafter, to an aggregate taxation whereby tax is calculated in combination with other types of income by a final return. Special distributions are exempted from taxes because they are, in substance, a refund of capital.

Capital gains are subject to separate self-assessed taxation at the rate of 20.315%, whereby tax is calculated separately from other types of income by a final return.

Investment in a public and corporate bond investment trust is treated the same as a direct investment in public and corporate bonds for tax purposes. Ordinary distributions are subject to a withholding tax at a rate of 20.315%. Capital gains are subject to a separate self-assessed taxation at the rate of 20.315%.

For corporate investors, ordinary distributions and capital gains arising from an investment trust are subject to a withholding tax at a rate of 15.315%.

Collective investment schemes are transparent for Japanese tax purposes. Profits or losses of collective investment schemes are attributed directly to investors and recognised as their own profits or losses by them.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

Traditionally, most publicly offered investment funds in Japan are securities investment trusts, while investment corporations are predominantly used as J-REITs. Many foreign investment trusts are also publicly offered in Japan, while foreign investment corporations such as SICAVs domiciled in Luxembourg are sometimes used.

Collective investment schemes are seldom publicly offered in Japan.

3.1.2 Common Process for Setting Up Investment Funds

The statutory establishment processes for publicly offered investment funds are the same as those for privately placed investment funds; please see **2.1.2 Common Process for Setting Up Investment Funds**. However, due to the rules of the ITAJ and the JSDA, the self-regulatory organisation of securities firms, banks and other financial institutions operating in the securities business apply to investment trusts/corporations and foreign investment trusts/corporations, respectively, and they have to satisfy the detailed requirements provided for by them; please see **3.3.1 Regulatory Regime**.

3.1.3 Limited Liability

Please see **2.1.3 Limited Liability**.

3.1.4 Disclosure Requirements

In addition to the general disclosure requirements applicable to investment funds (please see **2.1.4 Disclosure Requirements**), an issuer of an investment fund who intends to conduct a public offering in Japan must file a securities registration statement in the form prescribed based on the types of securities enumerated by the FIEA prior to conducting solicitation in Japan. The SRS generally becomes effective 15 days after the filing, and thereafter an issuer can accept subscription orders placed by investors.

However, for an investment fund that is offered on a continuous basis, the SRS becomes effective on the day following the filing, on the condition that one year has elapsed since the previous SRS was filed. Accordingly, an investment fund can continue its public offering by filing a new SRS annually.

The SRS requires full disclosure of publicly offered investment funds, enabling investors to make reasonable investment decisions. For example, the SRS with respect to an investment trust must contain the following information:

- the terms and conditions of the public offering;
- the investment objective, fund structure, types of assets, management system, dividend policy, investment restrictions, risk factors, charges and costs, taxation, performance results, procedures of subscription and redemption, valuation of assets, term, and description of an investment trust manager, a trustee and related parties; and
- audited financial statements of an investment trust as well as an investment trust manager.

The SRS is filed through an electronic filing system, the Electronic Disclosure for Investors' NETwork (EDINET), and is made available for public inspection via the internet.

If there is a change to material facts that must be stated on the SRS after it has been filed (including cases where new financial statements are prepared and an important lawsuit has been resolved), or if an issuer recognises there is an item on the SRS that needs amending, an amendment to the SRS must be filed.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

There is no restriction on types of investors in respect of public offered investment funds. General investors may apply for subscription, including a wide range of individual investors and institutional investors.

3.2.2 Legal Structures Used by Fund Managers

Please see **3.1.1 Fund Structures**.

3.2.3 Restrictions on Investors

Please see **3.2.1 Types of Investors in Retail Funds**.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

In general, a publicly offered securities investment trust must comply with the following requirements provided by the rules of the ITAJ.

- It may invest only in shares listed on a stock exchange and registered on an over-the-counter market established in a foreign country, and in unlisted shares or unregistered shares subject to disclosure obligations in accordance with the FIEA, the Companies Act of Japan or similar laws, or those issued in foreign countries that are deemed similar to these.
- It may invest in an aggregate amount of units/shares of investment funds up to 5% of its net assets. This limitation does not apply to fund-of-funds type securities investment trusts, but they must invest in multiple investment funds and comply with the credit risk limitations stated below.
- The amount of risk arising from derivative transactions calculated in a reasonable manner may not exceed its net asset value (the "derivative transaction limitation").
- Ratios of the exposure to a single entity to the total amount of net assets may not exceed 10% for each of the following categories, or 20% in total (the "credit risk limitation"):
  - (a) shares and units/shares of investment trusts/corporations;
  - (b) other securities and liabilities; and
  - (c) derivative transactions.

A publicly offered foreign investment trust/corporation must comply with the following requirements provided by the rules of the JSDA:

- the total value of securities sold short shall not at any time exceed its net asset value;
- no more than 15% of the net assets may be invested in illiquid assets such as privately placed equity securities or unlisted securities, unless appropriate measures have been taken to ensure price transparency;
- any transactions that are contrary to the protection of unitholders or prejudicial to the proper management of assets, such as transactions made for the benefit of a manager or any third party, shall be prohibited;
- a manager shall not acquire shares of any one company if doing so would result in the total number of shares of such company held by all funds managed by a manager exceeding 50% of the total number of all issued and outstanding shares of such company;
- derivative transaction limitations; and
- credit risk limitations.

In addition, if an issuer of an investment trust/corporation intends to list their units/shares on a stock exchange (eg, ETF or J-REIT), they must apply for a listing examination from the relevant stock exchange. To be qualified as listed units/shares, they have to meet criteria for the listing examination provided by the securities listing regulations and related rules issued by the relevant stock exchange.

3.3.2 Requirements for Non-local Service Providers

Please see **2.3.2 Requirements for Non-local Service Providers**.

3.3.3 Local Regulatory Requirements for Non-local Managers

Please see **2.3.3 Local Regulatory Requirements for Non-local Managers**.

3.3.4 Regulatory Approval Process
Please see **2.3.4 Regulatory Approval Process**. An additional one to three months are required to prepare the SRS and a prospectus, depending on the complexity and risk character of an investment fund.

3.3.5 Rules Concerning Pre-marketing of Retail Funds
The solicitation of securities before the filing of the SRS is strictly prohibited under the FIEA. Therefore, it is important to distinguish between the solicitation of securities and pre-marketing in a public offering. However, as it is difficult to draw a clear line between them, it is important to take all the relevant factors into account (please see **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**).

3.3.6 Rules Concerning Marketing of Retail Funds
An issuer must prepare a prospectus in connection with a public offering of an investment fund.

A prospectus in respect of an investment fund comprises a summary prospectus and a full prospectus. A summary prospectus must contain substantially material information, such as an outline of investment objectives and features, selected information on the investment trust manager, material risk factors, selected performance results and charges and costs in the case of an investment trust.

An issuer or distributor must deliver a summary prospectus to prospective investors before or at the same time as the sale. A full prospectus must contain almost the same information as the SRS, and an issuer or distributor must, upon request, deliver this to a prospective investor immediately.

3.3.7 Marketing of Retail Funds
Please see **3.3.3 Local Regulatory Requirements for Non-local Managers**.

3.3.8 Marketing Authorisation/Notification Process
Please see **3.1.4 Disclosure Requirements**.

3.3.9 Post-marketing Ongoing Requirements
An issuer of investment funds for which the SRS has been filed is subject to an ongoing disclosure obligation to file the annual securities report and semi-annual report every year within three months (or six months for an offshore investment funds) after the fiscal year end and the interim fiscal year end, respectively (where the fiscal period is six months or less, an issuer must file an annual securities report every six months).

An annual securities report with respect to an investment trust must contain the following information:

- investment objective, fund structure, types of assets, management system, dividend policy, investment restrictions, risk factors, charges and costs, taxation, performance results, procedures of subscription and redemption, valuation of assets, term, and description of the investment trust manager, the trustee and related parties; and
- audited financial statements of the investment trust as well as the investment trust manager.

A semi-annual report with respect to an investment trust must contain the following information:

- performance results for a six-month period;
- a description of the investment trust manager; and

- unaudited interim financial statements of the investment trust and the latest financial statements of the investment trust manager.

The annual securities report and semi-annual report are filed through EDINET and made available for public inspection via the internet.

In addition, an issuer must file an extraordinary report if a certain event occurs as prescribed by the law, including a change to a major investment fund-related corporation, a material change to basic policies, restrictions or dividend policies, a dissolution of the investment corporation or termination of the investment trust.

Furthermore, if units/shares of an investment trust/corporation are listed on a stock exchange, they are subject to timely disclosure obligations provided by the securities listing regulations and related rules issued by the relevant stock exchange. For example, an issuer of an exchange traded fund (ETF) listed on the Tokyo stock exchange must disclose details of secondary offerings, borrowing of funds, revision of terms and conditions of a trust agreement, cancellation of a trust agreement, or the merger or dissolution of an issuer immediately after the occurrence thereof.

3.3.10 Investor Protection Rules

If the SRS or a prospectus contains a false statement regarding a material fact, or omits a statement regarding a material fact that is required to be stated or is necessary to prevent the SRS or prospectus from being misleading, an issuer is liable for damages suffered by an investor, whether or not there is an absence of intent or negligence on the part of the issuer, unless it can be shown that the investor was aware of such false statement or such omission at the time of purchase. Furthermore, the directors of the issuer filing such SRS, or the distributors using such prospectus, are liable for damages suffered by an investor, except in cases where such directors or distributors can prove that they did not know or could not have known of such false statement or omission had they exercised reasonable care.

In addition, it is prohibited for any person to make a false or misleading representation in documents, in drawings, via audio media, or by means other than the prospectus used for the public offering.

Apart from this, an issuer that has filed an SRS containing a false statement or misleading omission would be subject to criminal penalties and administrative fines.

3.3.11 Approach of the Regulator

Please see **2.3.11 Approach of the Regulator**.

3.4 Operational Requirements

Please see **2.4 Operational Requirements**.

3.5 Fund Finance

Please see **2.5 Fund Finance**.

A publicly offered foreign investment trust may borrow up to 10% of the net asset value.

3.6 Tax Regime

The taxation of publicly offered investment funds is basically the same as for privately placed investment funds.

Nonetheless, for individual investors, in respect of stock investment trusts, ordinary distributions are subject to a withholding tax at the rate of 20.315%; thereafter, the taxpayer may select an aggregate taxation, a separate self-assessed taxation, or a separate taxation at source. If separate taxation at source is selected, the taxpayer's tax obligations are thereby fulfilled.

Capital gains are subject to a separate self-assessed taxation at the rate of 20.315%. In respect of public and corporate bond investment trusts, ordinary distributions are subject to a withholding tax at the rate of 20.315%; thereafter, the taxpayer may select a separate self-assessed taxation or a separate taxation at source. Capital gains are subject to a separate self-assessed taxation at the rate of 20.315%.

In respect of investment corporations, ordinary distributions are subject to a withholding tax at the rate of 20.315%; thereafter, the taxpayer may select an aggregate taxation, a separate self-assessed taxation or a separate taxation at source. Capital gains are subject to a separate self-assessed taxation at the rate of 20.315%.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

Asset Management Nation

The Basic Policy on Economic and Fiscal Management and Reform 2023 formulated by the Council on Economic and Fiscal Policy and adopted by the Japanese Cabinet on 16 June 2023 includes a policy aiming to open up the financial assets of households, which amounts to JPY2,000 trillion, and create an asset management nation that will contribute to sustainable growth. To this end, the policy intends to work towards increasing the sophistication of the asset management industry and strengthening the functions of asset owners managing household financial assets as institutional investors.

As part of the initiative to expand support for the new entry and to promote competition among domestic and overseas asset management companies, the following measures will be undertaken going forward:

- the establishment of special business zones tailored specifically for asset management businesses where administrative procedures can be completed solely in English;
- the correction of unique Japanese business practices and barriers to entry;
- the relaxation of entry requirements for investment management businesses; and
- the outsourcing of middle and back office operations.

Trends and Developments

Contributed by:
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Mori Hamada & Matsumoto is one of the largest full-service Tokyo-headquartered international law firms. A significant proportion of its work is international in nature, representing clients in cross-border transactions, litigation and other dispute resolution proceedings. MHM has more than 700 lawyers and other professionals, and more than 600 support staff. The firm's senior lawyers include highly respected practitioners and leaders in the Japanese and international legal community, including prominent law professors at the University of Tokyo and a former Prosecutor-General of the Public Prosecutors Office. MHM is highly recognised by clients and legal professionals in the following practice areas: asset management/investment funds, M&A, capital markets, securitisations, private equity, infrastructure/energy, insolvency/restructuring, and antitrust and competition. MHM has a strong presence in Asia, with offices in Beijing, Shanghai, Singapore, Yangon, Bangkok, Ho Chi Minh City, Hanoi, Jakarta and New York. It also has domestic offices in Takamatsu, Fukuoka, Osaka, Nagoya and Sapporo.

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Growing Demand for Alternative Investment Funds in Japan: From Private Placements to Public Offerings

Introduction

State of the investment funds market

For a long time in Japan, investment funds for retail investors only invested in traditional assets and their derivatives, while alternative investment funds (AIFs) were only marketed to institutional investors. However, this trend has begun to change in recent years. This article will discuss these changing trends, but will first briefly describe the basic information of investment funds in Japan.

In Japan, investment funds are one of the most popular financial instruments for both institutional and retail investors.

Types of private placement and public offering

Under the laws of Japan, units/shares of investment funds may be offered by way of public offering or private placement. In a private placement, an issuer may be exempted from certain disclosure requirements that apply to public offerings.

There are basically three different types of private placement exemption:

- Private Placement to a Small Number of Persons;
- Private Placement to Professional Investors; and
- Private Placement to Qualified Institutional Investors.

In general, a Private Placement to a Small Number of Persons focuses on the number of offerees, while a Private Placement to Professional Investors Qualified Institutional Investors focuses on the offerees' qualification.

Fund structures

According to the laws of Japan, investment funds are generally divided into three different categories:

- investment trusts;
- investment companies; and
- limited partnerships.

The investment trust (sometimes referred to as a contractual type investment fund) is one of the most popular investment funds for Japanese investors. In fact, numerous investment trusts are established in Japan every year, and units of these investment trusts are actively offered/sold to Japanese investors by securities companies and banks.

It should be noted that not only investment funds established in Japan but also investment funds established outside Japan (such as an FCP in Luxembourg or a unit trust in the Cayman Islands) are offered to investors in Japan, and a significant amount of money is invested into those foreign investment funds from Japan. According to statistical data released by the Japan Securities Dealers' Association (JSDA) on 12 June 2023, the total net asset value of publicly offered investment funds established outside Japan (for Japanese domestic investors) as of the end of March 2023 was JPY6,660.3 billion.

In Japan, an investment company (sometimes referred to as a corporate type investment fund) is mainly used in the context of REITs. In other words, an investment company established in Japan is not generally utilised for the purpose of investment into securities (such as equities or bonds). However, it is also true that some securities firms actively offer various types of SICAVs established in Luxembourg to Japanese retail investors.

A limited partnership (sometimes referred to as a partnership type investment fund) is mainly utilised for the purpose of private equity investments and infrastructure investments. This type of investment fund is not so common for Japanese retail investors, and most investors are institutional. As with other types of investment funds, not only Japanese domestic funds but also limited partnerships established outside Japan are offered in Japan. Recently, a certain number of limited partnerships established outside Japan were introduced for wealthy individuals through feeder vehicles such as a Cayman unit trust on a private placement basis.

Alternative investment funds

Overview

As mentioned at the beginning of this article, for a long time, most of the investment funds sold to retail investors only invested in traditional assets and their derivatives, while alternative investment funds were sold only to institutional investors in Japan.

There are several reasons for this, but one of the most important reasons is that alternative investment funds are considered to carry a greater degree of risk than traditional investment funds, and therefore they should only be sold to institutional investors with a high risk tolerance.

However, especially in a zero-interest rate environment, the potential for greater returns of alternative investments is very attractive not only to institutional investors but also to high net worth individuals, and in the current situation where it is difficult to make a profit by investing in traditional assets such as bonds, more and more wealthy individuals are willing to take risks and invest in potentially profitable products.

For this reason, the public offering of alternative investment funds specifically targeted at high net worth individuals has begun to be considered by distributors and asset managers in Japan; in fact, a non-listed US REIT was publicly offered in Japan through a Cayman unit trust in 2022. This trend will most likely spread not only to real estate investments but also to private equity, private credit and hedge funds investments.

Generally, investment funds solicited in Japan do not invest directly in these alternative assets but rather in alternative investment funds (ie, in the form of a fund of funds) or performance-linked notes whose performance is linked to alternative investments.

Considerations for investing in alternative investment funds

It may be true that alternative investment funds offer investors potentially large profit opportunities. However, it is also true that alternative investment funds have several considerations that are generally not found in traditional investment funds, including higher fees, significant initial investment requirements, low liquidity and low transparency.

As discussed below, publicly offered funds are subject to strict investment restrictions, but it is possible under the laws of Japan to publicly offer alternative investment funds, provided that the key characteristics of alternative investment funds are disclosed in an appropriate and sufficient manner to enable investors to make accurate investment decisions.

Investment restrictions

Publicly offered non-Japanese investment trusts (such as an FCP in Luxembourg or a unit trust in the Cayman Islands) and investment companies (such as SICAVs established in Luxembourg) are subject to certain investment restrictions under the rule of the JSDA, which include but are not limited to the following (note that there is no statutory investment restriction applicable to privately placed non-Japanese investment funds):

- short sale (applicable only to non-Japanese investment trusts) – the total market value of securities sold short for the account of such fund shall not exceed its net asset value;
- borrowings (applicable only to non-Japanese investment trust) – borrowing for the account of such fund shall not exceed 10% of its net asset value;
- derivative transactions – the global risk amount of outstanding derivative transactions and other similar transactions entered into for the account of a non-Japanese fund, which is to be calculated in accordance with a reasonable method, shall not exceed a certain ratio of their respective net asset value;
- credit risk – credit exposures to any single issuer of portfolio securities or counterparty of derivative transactions shall be managed and administered in accordance with a reasonable method;
- voting rights of a single issuer – acquiring the shares of any one company is not allowed if such acquisition would result in the total number of shares of such company carrying voting rights held by either (a) all foreign investment trusts managed by the same manager or (b) a foreign investment company exceeding 50% of the total number of all issued and outstanding shares of such company carrying voting rights;
- transparency requirement – this is applicable only to non-Japanese investment trusts, which shall not acquire any investment that is not listed on an exchange or not readily realisable, such as privately placed shares, unlisted shares or real estate, if doing so would result in the total value of all such investments held by the non-Japanese investment trust immediately following such acquisition exceeding 15% of the latest available net asset value, providing that this restriction shall not prevent any acquisition of an investment where the method of valuation of such investment is clearly disclosed in offering documents;
- acquisition of shares issued by itself – this is applicable only to non-Japanese investment companies, which shall not acquire shares issued by themselves; and
- inappropriate transactions – non-Japanese investment trusts and investment companies shall not enter into inappropriate transactions that are detrimental to investors or that would be contrary to the proper management of the assets of those funds, including, without limitation, transactions that are intended to benefit the asset manager or any third parties other than investors.

As mentioned above, the investment targets of alternative investment funds (such as real estate, private equity, private credit) are illiquid and cannot be readily realisable. Therefore, under the transparency requirement, the method of valuation of such investment must be clearly disclosed in offering documents in order for alternative investment funds to be publicly offered in Japan.

Having said that, it is difficult to precisely calculate the value of the investment targets (ultimate underlying investments) of alternative investment funds, and there is always a risk that the calculated value and the actual sale price may differ significantly. Thus, it is necessary to describe this consideration as one of the risk factors in offering documents. Needless to say, it is also necessary to alert investors to the risk that investments in alternative investment funds cannot be easily redeemed.

Investor protection rules

There are no rules in Japan that specify certain classes of investors as being inappropriate to invest in certain types of funds.

However, the laws of Japan require a financial instruments business operator (such as distributors in Japan) to conduct its business in such a manner that it does not issue solicitations in connection with an act that constitutes a financial instruments transaction that is found to be inappropriate in light of customer knowledge, customer experience, the state of customer assets or the purpose for which a financial instruments transaction contract is concluded, which would result in or be likely to result in insufficient investor protection.

Therefore, even if the required procedures have been completed, it does not mean that the alternative investment fund can be sold to anyone.

Tax regime: investment trusts

Under the Corporation Tax Act, collective investment trusts are treated as tax-exempt trusts. The following investment trusts are categorised as collective investment trusts under the Corporation Tax Act:

- securities investment trusts (regardless of publicly offered or privately placed);
- investment trusts publicly offered in Japan; and
- foreign investment trusts.

Collective investment trusts are not treated as pass-through entities but they are tax-exempt, so are not taxed in respect of capital gains and income paid to them. Investors in a collective investment trust are subject to the relevant withholding taxes in respect of profit distribution.

Tax regime: investment companies

Taxation is imposed on investment companies at the fund level. However, if certain conditions are fulfilled (eg, more than 90% of distributable profits must be distributed to investors), dividends paid to investors may be deducted for Japanese corporation tax purposes. Investors in investment companies are subject to the relevant withholding taxes in respect of profit distribution.

Tax regime: limited partnership

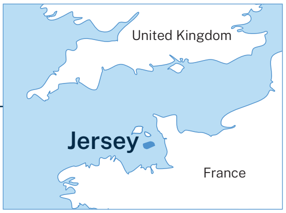
Limited partnerships are pass-through entities for Japanese tax purposes, with taxes being levied on the investors in the fund rather than on the fund itself. Non-resident investors (both individuals and corporates) are subject to relevant withholding taxes in respect of profit distribution, whereas resident investors are not subject to withholding taxes.

Summary

As described, the appetite for alternative investment funds focusing on real estate, private equity, private credit and hedge funds has been increasing in the retail market in Japan, and this trend is likely to continue for the foreseeable future.

It is certainly attractive for investors that alternative investments can provide potentially high returns, which are difficult to achieve through investments in traditional assets. However, it should be emphasised that an investment in alternative investment funds involves a higher degree of risk than investments in traditional investment funds, and therefore it is important to strive to provide investors with accurate information on this points. For the sustainable growth of the Japanese investment fund industry, there should be a market situation where Japanese investors are provided with sufficient and accurate information on the funds, to enable them to make their own investment decisions and invest in suitable funds from among various investment funds, including alternative investment funds.

JERSEY



Law and Practice

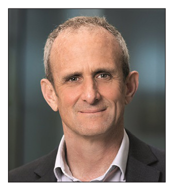
Contributed by:
Nienke Malan and Christopher Griffin
Carey Olsen

Contents

Carey Olsen is a leading offshore law firm that advises financial institutions, corporations and private clients on Bermuda, British Virgin Islands, Cayman Islands, Guernsey and Jersey law, from a network of nine international offices. The firm's clients include global financial institutions, investment funds, private equity houses, multinational corporations, public organisations, sovereign wealth funds, ultra-high net worth individuals, family offices, directors, trustees and private clients. It works alongside all major onshore law firms, accountancy firms and insolvency practitioners on corporate transactions and matters involving its jurisdictions. Carey Olsen Jersey is the leading legal adviser to investment funds domiciled in Jersey, advising 610 such funds, which represents over 38% of the market by total number of funds.

Authors

Nienke Malan is counsel in Carey Olsen Jersey's corporate team and is a Jersey-qualified lawyer with over a decade of experience in investment funds, corporate and international commercial matters. She helps experienced and emerging fund managers achieve their goals through a client-centric and practical solution-driven approach, and advises on the full spectrum of generalist funds and sector funds, including real estate, private equity, buyout, venture capital, infrastructure, housing, technology, healthcare and impact funds. Having practised in South Africa, New York and Jersey, Nienke has worked with global clients across multiple asset classes, and creates lasting relationships with her clients.



Christopher Griffin has broad experience of general international corporate and funds work. He has particular expertise in private equity, hedge and digital asset funds, having spent ten years as a corporate and funds lawyer in London. Chris advises on all aspects of fund and corporate transactions (including the legal and regulatory aspects of fund launches) and joint ventures. As part of the Jersey funds team, he also has considerable experience in dealing with the Jersey Financial Services Commission as regards navigating investment vehicles through the Jersey regulatory approval process. He also spearheads Carey Olsen's digital assets practice, having advised on a series of token issuances, digital asset funds and exchanges.

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1. Market Overview

1.1 State of the Market

Jersey is one of the world's major international finance centres, and offers expertise extending across all asset classes, with recent growth being particularly focused on alternative asset classes. Jersey is widely considered to be a key player in the world of domiciling, administering and managing various types of investment funds. This growth is underpinned by Jersey's tax neutrality and a legal framework that provides certainty both to investors and managers. The Jersey government's determination to encourage high-quality business, coupled with Jersey's comprehensive and forward-thinking legal infrastructure, has been pivotal in driving investor confidence and capital inflows into the island. Over the past year, the market has shown remarkable resilience and adaptability, cementing Jersey's status as a premier choice for fund domiciliation and management.

Regulatory versatility is a cornerstone of Jersey's appeal. From highly regulated retail funds (which may be offered to the general public) to those with minimal supervision for sophisticated investors, Jersey caters to a wide spectrum of investor preferences. The Jersey Financial Services Commission (JFSC) plays a vital role, authorising and overseeing investment funds with an ethos of protecting investors while promoting competition and innovation.

The Jersey private fund (JPF), with a 48-hour regulatory consent turnaround, continues to attract significant interest, offering a streamlined and cost-effective solution for managers targeting "professional investors" or investors who invest at least GBP250,000 (or currency equivalent). Since their inception in 2017, JPFs have gained popularity for their quick set-up process and operational flexibility, meeting the needs of emerging managers and established institutions. As an additional benefit, the JPF regime provides an exemption to the Financial Services (Jersey) Law 1998 (FSJL), which permits SPV managers, general partners and other service providers to act for JPFs without being regulated in Jersey.

Other popular fund types in Jersey include the notification-only Jersey unregulated eligible investor funds ("notification-only funds") and Jersey expert funds, which may be offered to an unlimited number of qualifying investors who invest a minimum of USD1 million (in the case of notification-only funds) or USD100,000 (in the case of expert funds), or who meet certain other criteria.

Jersey has a particular relationship with both the UK and the EU. It has been treated by the EU as a "third country" for financial service purposes for many years, and since the introduction of the Alternative Investment Funds Managers Directive (AIFMD) has proven a popular location for managers and funds wishing to access EU/EEA markets using national private placement routes.

Jersey's strategy in relation to the AIFMD and, more recently, the UK AIFM Regulations is to have the correct frameworks in place to continue to provide fund establishment, management and administration services on a "business as usual" basis. Jersey has achieved this by placing an AIFMD/UK AIFM Regulations "overlay" on existing regulatory frameworks such that a Jersey fund need only comply with the AIFMD/UK AIFM Regulations to the extent that it is necessary, and without imposing any additional Jersey-specific reporting or other requirements.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

Alternative investment funds in Jersey are typically structured as companies (including protected cell and incorporated cell companies), limited partnerships or unit trusts, each offering distinct advantages tailored to specific investment strategies and investor requirements.

Company

Overview

A Jersey company has its own separate legal personality and may sue, and be sued, in its own name.

Advantages

The Companies (Jersey) Law 1991 is based on the familiar UK company law but with certain enhancements that allow for a more flexible and practical regime. There are a number of advantages to Jersey companies, including as follows.

- The law provides for a flexible capital maintenance regime and, subject to the board giving a 12-month forward-looking cash-flow-based solvency test, a Jersey company may fund a distribution from any source other than its nominal capital account (in the case of a company whose shares have a nominal value) or any capital redemption reserve. This means a Jersey company may still be able to make distributions when it has accumulated losses (including where it has a negative profit and loss account).
- There is no requirement for distributable profits in order to fund a repurchase or redemption of shares out of a non-capital account, and there is no requirement for available profits in order to fund a repurchase or redemption out of capital. Subject to a solvency statement requirement, shares can be repurchased out of any company account (including capital accounts).
- A private company is not required to appoint an auditor or file its accounts.
- Jersey does not levy stamp duty or any equivalent transfer tax on transfers of shares (subject to limited exceptions in respect of local property).

Interests

A Jersey company issues shares, which can consist of different classes of shares with different rights attached to each class. Investors usually hold redeemable participating shares, whereas the manager holds non-redeemable shares.

Types
In addition to private and public, par value and no par value limited companies, Jersey also offers two types of cell companies, namely:

- protected cell companies – the protected cell company and its protected cells together form a single company, but the assets of each are legally segregated; and
- incorporated cell companies – each cell is a separate company in its own right.

Open-ended funds, including hedge funds, are often established as limited companies, and it is a requirement that listed funds be structured as companies.

Cell company structures are popular for umbrella funds, as they enable multiple cells to be created with administrative ease and minimal cost, while enabling each cell to be ring-fenced for liability purposes. The cells may have different capital structures, boards of directors and articles of association, but must have the same registered office and company secretary.

Limited Partnership

Overview
The Jersey limited partnership is familiar to investors worldwide, and usually comprises:

- one or more general partners, which are jointly and severally liable for the partnership's debts; and
- one or more limited partners, which are only liable to the partnership to the extent of their agreed contribution.

Advantages
The main advantages of a Jersey limited partnership are as follows:

- treated as transparent for UK tax purposes;
- publicly available information does not include the identity of the limited partners or the limited partnership agreement (LPA), and therefore confidentiality is preserved;
- extremely flexible in respect of the commercial terms that can be provided for;
- no limit on the number of limited partners which can be admitted, subject to regulatory restrictions;
- Jersey law contains a helpful list of "safe harbours" which allows the limited partner a greater degree of involvement in the management of the limited partnership compared to some other jurisdictions, without them losing their limited liability; and
- the legislation, regulation and policy governing this area are subject to regular review and updated to maintain Jersey's international reputation and competitive advantage.

Interests
Investors hold limited partnership interests, and different classes or series of limited partnership interests are possible.

Types
A limited partnership can be established as any of the following:

- limited partnership (in the traditional sense, similar to an English limited partnership) established under the Limited Partnerships (Jersey) Law 1994;
- separate limited partnership under the Separate Limited Partnerships (Jersey) Law 2011, which has separate legal personality and is therefore similar to Scottish limited partnerships;
- incorporated limited partnership under the Incorporated Limited Partnerships (Jersey)

Law 2011, which has separate legal personality and is a body corporate; and
- limited liability partnership (LLP) under the Limited Liability Partnerships (Jersey) Law 2017, whereby a partner of the LLP is generally not liable for the LLP's debts or losses (including those caused by another partner).

Jersey limited partnerships are commonly utilised by fund managers for closed-ended funds – particularly private equity, venture capital, private credit and real estate funds. Separate limited partnerships are also used for closed-ended funds (particularly "fund of fund" vehicles) and carried interest vehicles.

Unit Trusts

Overview

A unit trust has no separate legal personality and is constituted by a trust instrument entered into by the trustee(s) and the manager, if one has been appointed.

Advantages

Jersey unit trusts are popular for the following reasons:

- easy and quick to establish;
- extremely flexible in respect of the commercial terms that can be provided for;
- can be structured to be treated as transparent for UK tax purposes;
- publicly available information does not include the identity of the unit-holders or the trust instrument, and therefore confidentiality is preserved; and
- no limit on the number of unit-holders which can be admitted, subject to regulatory restrictions.

Interests

Investors are issued units, and different classes or series of units are possible.

Jersey property unit trusts (JPUTs) remain a popular structure for real estate funds. Unit trusts can be used for any regulatory category and, in the context of retail funds, can be structured as open-ended unclassified collective investment funds (OCIFs).

Limited Liability Companies (LLCs)

Overview

The Jersey limited liability company has recently been introduced and combines the limited liability protection of a company with the constitutional flexibility and privacy of a partnership, while enabling a choice between the management structure and tax treatment of both. An LLC consists of one or more members who are bound, together with a manager (if any), by an LLC agreement.

Interests

Investors hold an "LLC interest".

Advantages

The LLC will be familiar to US investors, and has the following additional advantages:

- the LLC agreement is not publicly fileable;
- the LLC agreement can supersede statutory default positions – for example, all debts of the LLC will lie solely with the LLC, unless the members agree otherwise;
- no limit on the number of members which can be admitted, subject to regulatory restrictions; and
- treated as tax-transparent, but can elect to be a body corporate.

An LLC can be established as a JPF, but is more likely to be used as the general partner, fund manager, carried interest recipient or holding vehicle.

2.1.2 Common Process for Setting Up Investment Funds

Regulatory Categories

The key features of each main regulatory category of Jersey funds are set out below, including, where relevant, indicative application timescales. The fund type most suitable for a promoter will depend largely upon commercial factors, such as the types of investors sought and the level of flexibility required.

All Jersey funds (other than notification-only funds) are eligible to be marketed into the European Union and European Economic Area (EU/EEA), in accordance with the AIFMD through individual EU member states' national private placement regimes (NPPRs) and (once available) through the passporting regime. Jersey funds with a Jersey manager that are not actively marketed into the EU/EEA fall outside the scope of the AIFMD.

Jersey Private Funds

A JPF is quick to establish, flexible and cost-efficient, and has minimal regulatory requirements for funds with 50 investors or less. The key features of a JPF are as follows.

- Maximum of 50 investors at any time and a maximum of 50 initial offers. The JPF may not be listed on a stock exchange.
- Investors must qualify as "professional" investors and/or make an initial investment of at least GBP250,000 (or currency equivalent), and must sign a simple investment warning (usually included in the subscription document).
- No limit on fund size.
- No investment or borrowing restrictions.
- May be open or closed for redemptions by investors.
- No need for Jersey directors or Jersey service providers, other than a Jersey-regulated "designated service provider" (DSP) who must be appointed to ensure compliance with the necessary criteria and applicable anti-money laundering legislation, to carry out due diligence on the promoter and to file an annual compliance statement.
- Jersey "special purpose" vehicles can be established to act as service providers (such as a general partner, trustee or investment manager/adviser) and are generally not required to be regulated.
- "Fast track" approval, as indicated below (self-certification by the fund administrator).

The following are key features for establishing a JPF without active EU/EEA marketing:

- 48-hour regulatory approval following an online application by the DSP;
- no requirement to prepare an offering memorandum;
- no need for Jersey resident directors or service providers, and no audit requirement; and
- the fund is not regulated by the JFSC on an ongoing basis.

The following are key features for establishing a JPF with EU/EEA marketing (where there is a sub-threshold Jersey AIFM):

- ten-day regulatory approval for an AIF certificate;
- no requirement for Jersey directors or service providers, and no audit requirement;
- for a Jersey AIFM, simple JFSC consent is required (there is no ongoing regulation); and

- minimal requirements will apply under the Code of Practice for Alternative Investment Funds and AIF Services Business published by the JFSC (the "AIF Code").

The following are key features for establishing a JPF with EU/EEA marketing (where the Jersey AIFM is *not* sub-threshold).

- Ten-day regulatory approval for an AIF certificate, plus a JFSC personal questionnaire review process (four to six weeks) for directors and 10% beneficial owners of the Jersey AIFM (if applicable).
- Two resident Jersey directors required.
- Where the AIFM is a Jersey entity (such as a general partner or trustee, or an external manager), it must obtain a licence under the JFSC's AIFMD regime.
- An AIF certificate is needed to permit EU/EEA marketing. Ongoing JFSC regulation is limited to compliance with the limited applicable AIFMD provisions.
- The JFSC assesses the suitability of the fund's promoter, having regard to its track record and relevant experience, reputation, financial resources and spread of ultimate ownership, in light of the level of sophistication of the target investor group.
- Audit and certain regulatory and investor disclosure requirements will also apply.

Regulated Public Funds

Public funds are governed by Jersey's collective investment funds law and are suitable for funds with more than 50 investors or where a regulated product is needed. They include expert funds, listed funds and eligible investor funds (each, a "Regulated Fund"). The JFSC has published a Code of Practice which includes guides (together, the "JFSC Guides") in relation to Jersey Regulated Funds, setting out the structural and ongoing requirements applicable to the relevant fund type.

The key features of a Regulated Fund are as follows:

- published three-day approval timeframe following completed application (ten days for a new "special purpose" service provider company);
- no investment or borrowing restrictions;
- suitable for EU/EEA marketing;
- unlimited number of investors;
- relatively light-touch regulatory approach;
- audit requirement;
- the offer document must comply with certain content requirements (please see **2.1.4 Disclosure Requirements**) and investors must sign a prescribed investment warning; and
- derogations from the relevant JFSC Guide may be sought on a "case-by-case" basis.

Jersey service providers to a Regulated Fund will need to hold a licence to conduct the relevant class(es) of fund service business (an "FSB Licence"). Accordingly, if any SPV service providers, such as a general partner or manager, will be established to act for the fund, an FSB Licence will need to be sought for each such entity. Such service providers are also required to comply with the Code of Practice issued by the JFSC, which covers fund service businesses and AIFs (including their AIFMs and depositaries, where these are Jersey entities).

Expert Funds

The expert fund is attractive for non-retail schemes, whether hedge funds, private equity funds or other schemes aimed at "expert investors". An expert fund can be established quickly and cost-effectively, and must comply with the Jersey Expert Fund Guide (the "EF Guide"). The

JFSC does not need to review the fund structure, documentation or the promoter. Instead, the fund administrator certifies to the JFSC that the fund complies with the EF Guide, and once the certification and the fund's offer document are filed, the JFSC aims for a three-day turnaround on the application for approval. The EF Guide provides fund promoters with certainty, efficiency and cost-effectiveness in the establishment of a new fund. The key features of an expert fund are as follows.

- Open only to those investing at least USD100,000 or who otherwise qualify as expert investors (that is, investors with a net worth of more than USD1 million, excluding their principal place of residence, or who are in the business of buying or selling investments). Investors must sign a prescribed form of investment warning (usually contained in the subscription document).
- Discretionary investment managers may invest on behalf of non-expert investors, provided they are satisfied that the investment is suitable for them and they are able to bear the economic consequences of the investment.
- May be open-ended (open for redemption at the option of investors) or closed-ended (no absolute investor right to redeem).
- At least two Jersey resident directors with appropriate experience must be appointed to the fund board (or, if applicable, the board of the general partner or trustee).
- A licensed Jersey manager or administrator which has two Jersey resident directors with appropriate experience and staff and a physical presence in Jersey is required (unless the fund is a unit trust with a Jersey trustee).
- A Jersey custodian is needed if the fund is open-ended (or an international prime broker, in the case of a hedge fund).
- The offer document must set out all material information in respect of the fund.
- The fund must be audited.
- The investment manager/adviser must be:
  (a) established in an Organisation for the Economic Co-operation and Development (OECD) member or any other state or jurisdiction with which the JFSC has entered into a memorandum of understanding;
  (b) regulated in its home jurisdiction (or, if not required to be so regulated, approved by the JFSC);
  (c) without convictions or disciplinary sanctions;
  (d) solvent; and
  (e) experienced in using similar investment strategies to those adopted by the fund.
- If the investment manager/adviser does not meet the above requirements, it may approach the JFSC on a case-by-case basis. Of course, if permission is then granted, in the absence of any material change, the investment manager/adviser will not need specific approval to establish further Expert Funds.
- An investment manager/adviser is not required for certain self-managed funds, such as direct real estate or feeder funds.
- There are no investment or borrowing restrictions imposed on the fund, nor is there any limitation on the number of investors the fund may have.
- The EF Guide aims to make a "safe harbour" available to most non-retail funds. On occasion, where derogations from the EF Guide are required, these are considered on an expedited basis.
- Ongoing requirements are limited. Future changes to the fund generally do not require regulatory approval unless they are contrary

to the EF Guide or there is a change to the fund's directors or service providers.
- The fund may be marketed into the EU/EEA in accordance with the AIFMD through individual EU member states' NPPR (and, when available, third-country passporting).

Listed Funds

A listed fund must comply with the Jersey Listed Fund Guide (the "LF Guide"). The LF Guide does not place any restrictions or qualification criteria on who can invest in a listed fund, and provides certainty to those wishing to establish a listed fund in a quick and cost-effective manner. A listed fund is established on certification by the fund administrator that the fund complies with the criteria set out in the LF Guide. The JFSC issues the relevant certificate on receipt of the certification and the fund's offer document. As a result, a listed fund can be established in Jersey within three days. There is no minimum investment requirement. The key features of a listed fund are as follows.

- The fund must be a closed-ended Jersey company (no absolute investor right to redeem).
- The fund's offering document must carry a clear investment warning and contain all information necessary for potential investors to make an informed decision.
- At least two Jersey resident directors with appropriate experience must be appointed to the fund's board, including the chair. A majority of the board must be independent (in particular, independent directors should not be an employee or recent employee of the manager, investment manager or any of their associates).
- The fund must be listed on an exchange or market recognised by the JFSC. The list of pre-approved exchanges is numerous and global in scope, and includes all exchanges upon which listings are ordinarily sought, including the London Stock Exchange (the Main Market, AIM and the SFM), NYSE, NASDAQ, HKEx, Euronext, Johannesburg Stock Exchange and The International Stock Exchange (TISE).
- The fund's investment manager/adviser must be of good standing, established and regulated (if appropriate) in an OECD member state or a jurisdiction with which the JFSC has a memorandum of understanding.
- A licensed Jersey manager or administrator which has two Jersey-resident directors with appropriate experience and staff, and has a physical presence in Jersey, is required.
- Adequate arrangements must be made for the safe custody of the fund's property, though there is no requirement to appoint a custodian.
- The fund must be audited.
- The fund may be marketed into the EU/EEA in accordance with the AIFMD through the NPPR (and, when available, through third-country passporting).

The JFSC understands that some investment managers/advisers may not be regulated because the type of activity they undertake is not regulated in their home jurisdiction – real property investment management being one example. In such cases, the investment manager will remain eligible for the fast-track authorisation process provided it is:

- the subsidiary of an entity that is regulated in relation to managing or advising on investment funds in its home jurisdiction;
- an entity or the subsidiary of an entity with a market capitalisation of above USD500 million; or

- a manager with a trading record of at least five years or whose principal persons can demonstrate relevant experience or qualifications.

If an investment manager/adviser does not meet these requirements, it may approach the JFSC on a case-by-case basis. If permission is then granted, in the absence any material change, the investment manager/adviser will not need specific approval to establish further listed funds. An investment manager/adviser is not required for certain self-managed funds, such as direct real estate or feeder funds.

Eligible Investor Funds

The structural, authorisation and ongoing regulatory requirements of the Jersey eligible investor fund is similar to those for the expert fund, save that there is a higher threshold for qualifying as an "eligible investor" compared to as an "expert investor". Like the expert fund, the eligible investor fund is used for non-retail schemes (including hedge funds, private equity funds and other schemes aimed at "eligible investors") and can be established quickly and cost-effectively. It has the following key features.

- Must be an AIF and marketed into at least one EU/EEA country for the purposes of the AIFMD.
- For "eligible investors" only – any one of 11 categories, including:
  - (a) an investor of USD1 million or more;
  - (b) investors with a net worth of more than USD10 million (excluding their principal place of residence); and
  - (c) those whose ordinary business or professional activity includes dealing in, managing, underwriting or giving advice on investments (same as for notification-only funds, see below).
- Reduced requirements apply to the fund's offering document, given the sophisticated nature of investors in such funds.
- Open or closed for redemptions by investors.
- The regime expressly recognises that a discretionary investment manager may make investments on behalf of investors who do not qualify as "eligible investors", provided it is satisfied that the investment is suitable for the underlying investors and they are able to bear the economic consequences of the investment.
- The fund may be marketed into the EU/EEA in accordance with the AIFMD through the NPPR (and, when available, through third-country passporting).

Notification-Only Funds

This fund is highly flexible and provides a low-cost structure ideal for sophisticated investors where the fund will not be marketed into the EU/EEA. A notification-only fund may be open/closed-ended, and is restricted to sophisticated investors. The JFSC Guides do not apply to notification-only funds. The key benefits of this regime for fund promoters are that it provides unparalleled flexibility coupled with the certainty of being able to establish the fund at any time simply by filing the required notice, and without the need to obtain JFSC approval.

The key features are as follows.

- No need for JFSC approval and no ongoing regulation, established on a "notification only" basis.
- For "eligible investors" only – any one of 11 categories, including:
  - (a) an investor of USD1 million or more;
  - (b) investors with a net worth of more than USD10 million (excluding their principal place of residence); and

(c) those whose ordinary business or professional activity includes dealing in, managing, underwriting or giving advice on investments.

- A discretionary investment manager may make investments on behalf of investors who do not qualify as "eligible investors", provided it is satisfied that the investment is suitable for such investors and they are able to bear the economic consequences of the investment.
- No need for Jersey directors or service providers, but a local administrator must be appointed to provide the registered office for any fund company.
- May be listed, provided that the stock exchange allows restrictions on transfers (such that only "eligible investors" may invest).
- There is no audit requirement (unless the fund is a company) and no investment or borrowing restrictions.
- No limitation on the number of investors.

Please refer to **3. Retail Funds** for details of Jersey regulatory classifications suitable for retail funds.

Investment Vehicles That Are Not Funds

An investment vehicle will not be regulated as a fund in Jersey unless it is a scheme or arrangement for the investment of capital which has as its object or as one of its objects the collective investment of capital, and:

- operates on the principle of risk-spreading; or
- where units are to be bought back or redeemed continuously or in blocks at short intervals upon the request of the holder and out of the assets of the fund; or
- where units will be issued continuously or in blocks at short intervals.

Joint ventures, single-asset vehicles, single-investor vehicles or vehicles which carry on a business (such as property development) also generally fall outside Jersey's funds regulatory regime.

The Application Process

As a first step, personal questionnaires should be submitted to the JFSC in respect of:

- each director of a corporate Regulated Fund or corporate JPF which is not a sub-threshold AIFM; and
- the directors and 10%-plus beneficial owners of any Jersey service provider to a Regulated Fund which is seeking an FSB licence.

These should be submitted in advance of the fund application, as the JFSC's regulatory checks typically take four to six weeks where the proposed director is not already known to it. The requirement for personal questionnaires does not apply to JPFs, unless marketed into the EU/EEA and not sub-threshold. A JPF is subject to a fast-track process whereby the JPF's proposed "designated service provider" makes an application via the JFSC's online portal.

In respect of a Regulated Fund, a formal application to the JFSC enclosing (among other things) the fund's offering document and the relevant JFSC application forms would follow. The cost of the application will vary according to the number of pools of assets (if the fund is an umbrella fund) and the fund's intended Jersey service providers.

Core Documents

The core documents for a Jersey fund are as follows:

- offering document (not required for a JPF or a notification-only fund);
- constitutional documents (eg, memorandum and articles of association, limited partnership agreement or trust instrument);
- subscription documentation for investors and any side letters;
- fund rules, in the case of umbrella funds; and
- material contracts appointing the fund service providers (eg, management agreement, administration agreement, custody agreement and investment management/advisory agreement).

2.1.3 Limited Liability

Jersey fund structures are designed to limit investor liability to their capital contribution.

For a limited partnership, this is contingent upon the limited partners not engaging in the active management of the fund. Jersey's limited partnership law expressly provides for "safe harbours" for a number of specific activities which may otherwise constitute management by a limited partner, including the following (among others):

- Consulting with and advising a general partner with respect to the activities of the limited partnership.
- Voting on, or otherwise signifying approval or disapproval of, matters such as:
  - (a) the dissolution and winding-up of the limited partnership;
  - (b) the purchase, sale or other dealing in any asset by or of the limited partnership;
  - (c) the creation or renewal of an obligation by the limited partnership; or
  - (d) a change in the nature of the activities of the limited partnership.

A Jersey company provides investors (as shareholders) with a natural limitation of liability due to the company's distinct legal personality. The circumstances in which the courts may "pierce the corporate veil" and have recourse to shareholders are broadly the same in Jersey as in England – for instance, where a person who is subject to an existing legal obligation deliberately attempts to evade that obligation by interposing a company under their control.

2.1.4 Disclosure Requirements

Jersey Private Funds

A private placement memorandum (PPM) or other offering document is not required for a JPF (although certain AIF Code investor disclosures need to be made, if relevant). However, a PPM may be issued provided the document contains a directors' responsibility statement, together with all of the material information which investors and their professional investors would reasonably require to make an informed judgement about the merits of investing in the fund, and the nature and level of the risks accepted by so investing.

There are also ongoing investor notification requirements if the fund is marketed into the EU under the NPPR. Under the AIF Code, a Jersey AIFM from among Jersey AIFs (that is not sub-threshold) is required to periodically disclose matters such as the fund's liquidity arrangements (including special arrangements such as side pockets) and risk-profile and risk-management systems to investors and the JFSC.

Regulated Funds

A PPM is required to be issued in relation to a Regulated Fund. The PPM will need to contain the content and disclosures set out in:

- the Collective Investment Funds (Certified Funds – Prospectuses) (Jersey) Order 2012 (unless the fund is an eligible investor fund);
- the relevant JFSC Guide; and
- the AIF Code if the fund is an AIF that is not sub-threshold.

Investors should also be notified of any material changes which may affect their investment. Additional reporting requirements apply in the case of retail funds (please refer to **3.1.4 Disclosure Requirements**).

Finally, the JFSC Guides set out details of matters which need to be notified to the JFSC or which require its prior consent.

Public Companies

A fund which is a public company (of any regulatory classification) must file and send to investors annual audited financial statements, and Regulated Funds must file audited accounts with the JFSC.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Jersey's alternative funds attract a sophisticated investor base, predominantly comprising institutional investors, high net worth individuals, and family offices. The island's stable regulatory environment and tax neutrality make it particularly appealing for these discerning investor categories.

2.2.2 Legal Structures Used by Fund Managers

Fund managers and/or investment advisers of alternative investment funds are commonly established in Jersey as companies or limited partnerships, providing them with the flexibility and governance structure conducive to fund-management activities.

Where a special purpose Jersey entity needs to be regulated to be appointed as manager or adviser (for example, where acting as AIFM to a JPF which is not sub-threshold, or for a Regulated Fund), a simplified licensing regime applies under the JFSC's "managed entity" regime. The key features of this regime are as follows.

- The entity must be administered by a regulated Jersey administrator, which assumes responsibility for ongoing regulatory compliance and often provides one or more directors.
- There is no minimum regulatory capital requirement, but the entity should have such financial resources as are, in the opinion of the directors, sufficient to meet commitments.
- Each director of the entity (and each of its beneficial owners with a 10% or greater interest) is required to submit a personal questionnaire and obtain approval from the JFSC. As international regulatory checks often take three weeks or more to complete for individuals who have not already been approved by the JFSC, these should be completed and submitted as early as possible.
- Registration under the FSJL typically takes two weeks (if, as is usual, personal questionnaires are filed in advance).

2.2.3 Restrictions on Investors

The investor eligibility requirements for each type of fund are summarised below.

Jersey Private Funds

Each investor in a JPF must be a person who invests at least GBP250,000 (or currency equivalent) or who qualifies as a "professional investor". A "professional investor" includes:

- a natural or legal person, partnership, trust or other unincorporated association whose

ordinary business or professional activity includes, or it is reasonable to expect that it includes, acquiring, underwriting, managing, holding or disposing of investments whether as principal or agent, or the giving of advice on investments and their senior employees, directors, partners or expert consultants;
- certain appropriately regulated service providers and their senior employees, directors, partners, expert consultants or shareholders (in each case, as part of remuneration or as an incentive, benefit or reward for acting in such a role);
- a family trust settled by or for the benefit of one or more persons referred to above or their spouses, civil partners or dependants;
- a trustee of an employment benefit or executive incentive arrangement/scheme established for the benefit of one or more persons referred to above or their spouses, civil partners or dependants;
- an individual who has a net worth, or joint net worth with that person's spouse or civil partner, greater than USD1 million (or currency equivalent) excluding that person's principal place of residence, as well as any rights under a contract of insurance;
- a body corporate, partnership, trust or other unincorporated association which has assets available for investment of not less than USD1 million (or currency equivalent);
- a carried interest scheme or arrangement established in relation to a JPF;
- a government, local authority, public authority or supra-national body in Jersey or elsewhere;
- a "professional client" within the meaning of Annex II to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments; or
- on application to the JFSC, such other natural or legal persons as the JFSC may deem appropriate on a case-by-case basis.

The JPF regime also expressly recognises that a discretionary investment manager may make investments on behalf of investors who do not qualify as "professional investors", provided that the manager is satisfied that the investment is suitable for the underlying investors and they are able to bear the economic consequences of the investment.

Expert Funds
An expert fund investor must be one of the following:

- an investor making a minimum initial investment or commitment of USD100,000 (or its foreign currency equivalent);
- in the business of acquiring, underwriting, managing, holding or disposing of investments, whether as principal or agent, or giving advice on investments;
- a person with a net worth (or joint net worth with that person's spouse) of more than USD1 million (or its foreign currency equivalent), excluding their principal residence;
- an entity with at least USD1 million (or its foreign currency equivalent) of assets available for investment, connected with the fund or a service provider of the fund (there is a flexible approach for carried interest arrangements); or
- a government, local authority, public authority or supra-national body in Jersey or elsewhere.

Listed Funds
The JFSC Guides do not impose any restrictions on who can invest in a Jersey listed fund.

Notification-Only Funds

An "eligible investor" who may invest in a notification-only fund is a person:

- who makes a minimum initial investment or commitment of USD1 million (or its foreign currency equivalent);
- whose ordinary business or professional activity includes dealing in, managing, underwriting or giving advice on investments (or an employee, director, consultant or shareholder of such a person);
- who is an individual with a net worth of over USD10 million or its foreign currency equivalent (calculated alone or jointly with their spouse and excluding their principal place of residence);
- which is a company, limited partnership, trust or other unincorporated association, and which either has a market value of USD10 million or equivalent (calculated either alone or together with its associates) or has only "eligible investors" as members, partners or beneficiaries;
- who is, or acts for, a public sector body;
- who is the trustee of a trust that was either established by an "eligible investor" or was established for the benefit of one or more eligible investors; or
- who is, or is an associate of, a service provider to the fund (or an employee, director, consultant or shareholder of such a service provider or associate, and who acquires the relevant investment by way of remuneration or reward).

2.3 Regulatory Environment

2.3.1 Regulatory Regime

Please refer to **2.1.2 Common Process for Setting Up Investment Funds**. Details of the regulatory classification of a Jersey fund will determine which investment limitations or other restrictions (if any) apply to it.

2.3.2 Requirements for Non-local Service Providers

Jersey's financial services legislation applies to companies incorporated in Jersey carrying out financial services business anywhere in the world, and to all persons carrying out financial services business in or from within Jersey.

Accordingly, non-Jersey managers or investment managers/advisers of a Jersey fund are not required to become regulated in Jersey under the FSJL, provided that their functions are not carried out in or from within Jersey.

However, the JFSC's prior approval is needed for the appointment of any service providers to a Regulated Fund of any category. An investment manager/adviser of a Regulated Fund is required to provide a confirmation to the JFSC regarding various matters, including that it is:

- regulated in its home jurisdiction (or otherwise approved by the JFSC);
- without convictions or disciplinary sanctions;
- solvent; and
- experienced in using similar investment strategies to those adopted by the fund.

Please refer to **2.1.2 Common Process for Setting Up Investment Funds** regarding the requirement for arranging for a Jersey SPV manager or other service provider to be licensed by the JFSC.

2.3.3 Local Regulatory Requirements for Non-local Managers

Please refer to **2.3.2 Requirements for Non-local Service Providers**.

A manager registered in another jurisdiction may, in principle, provide services to a Jersey fund, provided that the requirements of the relevant JFSC Guide are met (for example, a manager which retains the investment management function must be able to provide the confirmations referred to in **2.1.2 Common Process for Setting Up Investment Funds** if acting for a Regulated Fund).

However, certain fund types must have a Jersey manager or administrator with two appropriately experienced directors, staff and a physical presence in Jersey, unless a derogation from the relevant JFSC Guide is obtained (please see **2.1.2 Common Process for Setting Up Investment Funds** for further information on this point).

2.3.4 Regulatory Approval Process

The regulatory approval process is efficient, with varying timeframes depending on the type of fund. Fast-track authorisation for JPFs can be 48 hours or less; whereas for Regulated Funds it can take several weeks for final JFSC approval, if the JFSC raises questions on the fund's application for regulatory approval.

Please refer to **2.1.2 Common Process for Setting Up Investment Funds** for details of the approximate lead time for obtaining regulatory approval for a given category of fund, together with details of which such categories have a fast-track authorisation process.

Retail funds (see **3. Retail Funds**) are more heavily regulated in Jersey, and this is reflected in the time it typically takes to obtain regulatory approval for such funds.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

There is no Jersey legal definition of "pre-marketing". The EU Pre-marketing Directive does not apply to Jersey managers marketing funds into the EU under the NPPR; however, individual member states may impose their own pre-marketing requirements.

2.3.6 Rules Concerning Marketing of Alternative Funds

Marketing Jersey Funds to Jersey Investors

There are no marketing restrictions on promoting a Jersey fund to Jersey investors, provided that where relevant (for example, in relation to an expert fund), those persons meet the investor eligibility criteria.

Any marketing of the fund in Jersey should be undertaken by a distributor which holds the relevant registration in Jersey, or by the fund itself (if a company). Otherwise, any marketing activities in Jersey should be minimal, such that they fall outside the scope of the FSJL.

Marketing Non-domiciled Funds to Jersey Investors

Jersey funds are generally used to raise capital from investors internationally. However, many non-domiciled funds are marketed to Jersey investors each year, and each such fund is required to obtain consent from the Jersey Registry in relation to the circulation of its offering documents in Jersey (subject to certain exemptions available to funds structured as companies or unit trusts).

The processing time for an application for consent is usually around five working days, and a statutory fee is payable.

As mentioned, there is an exemption for funds structured as companies or unit trusts where the fund has no "relevant connection" with Jersey (for example, the management or administration of the fund is not carried on in Jersey) and where the offer is one of the following.

- The offer is not an offer to the public (it must be made personally to a maximum of 50 persons in Jersey).
- The offer is valid in the UK or Guernsey. In summary, this test requires that:
  - (a) the offer complies with the Financial Services and Markets Act 2000 in the UK (FSMA), or the fund is authorised under the Protection of Investors (Bailiwick of Guernsey) Law 1987 in Guernsey; and
  - (b) the offer is made to a similar type of investor and in a similar manner in Jersey as in the UK or Guernsey (as applicable).

Persons Permitted to Market Non-domiciled Funds Into Jersey
The considerations set out above in relation to Jersey funds apply.

Regulated, non-Jersey distributors who wish to market certain fund categories to Jersey investors (such as UCITS funds, authorised unit trusts or authorised open-ended investment companies within the meaning of the FSMA) are exempt from regulation in Jersey as "overseas distributors". Such marketing must take place on a reverse solicitation basis or by way of advertisements meeting certain content requirements.

2.3.7 Marketing of Alternative Funds
Alternative investment funds in Jersey can be marketed to a wide range of investors, provided they meet the eligibility criteria for the specific fund type being promoted.

Please refer to **2.3.6 Rules Concerning Marketing of Alternative Funds**.

2.3.8 Marketing Authorisation/Notification Process
Please refer to **2.3.6 Rules Concerning Marketing of Alternative Funds**.

2.3.9 Post-marketing Ongoing Requirements
Please refer to **2.1.4 Disclosure Requirements**.

2.3.10 Investor Protection Rules
Please refer to **2.1.3 Common Process for Setting Up Investment Funds** and **2.2.3 Restrictions on Investors**. Any ownership and other restrictions imposed on funds will depend on the regulatory classification of the fund, rather than on its structure.

The JFSC Certified Funds Code of Practice requires Regulated Funds to:

- conduct their business with integrity;
- always act in the best interests of unit-holders;
- organise and control their affairs effectively for the proper performance of their activities, and be able to demonstrate the existence of adequate risk-management systems;
- be transparent in their business arrangements with unit-holders;
- maintain, and be able to demonstrate the existence of, both adequate financial resources and adequate insurance;
- deal with the JFSC and other authorities in Jersey in an open and co-operative manner;
- not make statements that are misleading, false or deceptive;
- at all times comply and be operated in accordance with any applicable JFSC Guide; and

- comply, where relevant, with the applicable sections of the AIF Code.

The JFSC Guides set out details of matters which need to be notified to the JFSC or which require its prior consent – these include any change of fund service provider and any changes to the fund that are not in accordance with the applicable JFSC Guide. The JFSC Guides relating to funds which target retail investors naturally contain more stringent structural and other restrictions than those aimed at sophisticated or expert investors, for investor protection reasons.

In respect of a Regulated Fund, the following must be provided to the JFSC:

- the audited financial statements of the fund; and
- any interim report and accounts of the fund that may be prepared and provided to investors.

In respect of JPFs, the regulated designated service provider (DSP) is required to complete and submit a JPF annual compliance return with the JFSC in each relevant year. In addition, the DSP must submit a notice of change or event to the JFSC on the occurrence of any:

- material change in relation to the JPF which would impact on the accuracy of the information provided to the JFSC in the JPF application (including the termination of the JPF (under any circumstances) or any change to the JPF's Jersey service provider(s) other than the DSP (on the basis that there shall be no change in the DSP without the prior approval of an officer of the JFSC));
- non-compliance with the JPF's Jersey AML/CFT obligations;
- material/unresolved complaint(s) made in relation to the JPF; or
- qualified audit of the JPF's annual accounts and financial statements (where the JPF has appointed an auditor).

2.3.11 Approach of the Regulator

The JFSC takes a pragmatic and co-operative approach, and Carey Olsen works closely with the JFSC's Authorisations team to resolve any regulatory questions or issues as and when they arise during a fund application. The JFSC generally publishes guidance whenever it issues a new policy, and tends to be punctual in processing applications, particularly where a degree of commercial urgency is involved.

2.4 Operational Requirements

Any restrictions are mostly contained in the relevant JFSC Guide, although the JFSC's Sound Business Practice Policy also sets out principles regarding the activities that the JFSC considers sensitive from a reputation perspective (including, for example, investments in certain goods or services which require payment in advance and pose a risk of fraud, or in weapons, mining or certain crypto-assets).

Please refer to **2.1.2 Common Process for Setting Up Investment Funds** for details of investment restrictions and any specific requirements relating to the custodian.

As mentioned previously, Jersey service providers to Regulated Funds are required to be licensed under the FSJL, which provides for matters such as:

- insider dealing;
- market manipulation; and
- the provision of misleading information to persons for the purpose of inducing them to

enter into an agreement, the performance of which may constitute financial services business under the FSJL.

2.5 Fund Finance

There are generally no restrictions in regard to access to fund finance.

Borrowing Restrictions/Requirements

From a regulatory perspective, there are generally no restrictions in the context of non-retail funds. However, the JFSC may undertake additional scrutiny where the permitted borrowing level is high (for example, where an expert fund or a listed fund is permitted to borrow more than 200% of the fund's NAV).

A full review of the limited partnership agreement (or other constitutional documents) of the fund would be required to ensure that there were no restrictions on borrowing or granting security, and, in the case of a feeder fund or parallel fund, that there were no restrictions on that fund granting security to secure the borrowings of the main fund.

It is now common for limited partnership agreements, and for constitutional documents of Jersey funds structured as companies and unit trusts, to contain provisions permitting:

- borrowing (albeit with restrictions in some cases – for example, as to amount or term);
- the granting of security; and
- the provision of guarantees in respect of borrowings.

Securing Finance

A typical security package would consist of:

- the granting of a security interest over the general partner's right to issue call notices to investors in respect of undrawn capital contributions;
- the proceeds of the issue of such call notices; and
- the bank account(s) into which capital call proceeds are paid.

The security interest agreement would include the granting of a power of attorney from the general partner or manager of the fund, so that the secured party could step into the shoes of the general partner to issue capital call notices to investors on an enforcement of the security, if the general partner or manager failed to do so.

A financing statement in respect of the security would usually be registered on the Jersey Security Interests Register.

Common Issues in Relation to Fund Finance

Lenders will usually require a review of any side letters entered into with investors, to ensure there are no provisions that may cut across any security which may be granted, or which could affect the general partner's rights to make capital calls from investors.

In order to perfect any capital call security, it is not necessary for notice of such security to be provided to investors. However, there remain advantages to electing to give notice to investors.

Any other relevant regulatory issues should be considered – for example, where a fund is an AIF, the AIFMD analysis may require that the fund be unleveraged or that leverage be kept to below a certain level.

2.6 Tax Regime

Tax Framework

Jersey funds (regardless of their structure) are not generally subject to any Jersey tax. There are no capital gains, capital transfer, wealth or inheritance taxes which are payable in relation to the issuance or realisation of investments in a Jersey fund (assuming that the fund does not invest in Jersey property or buildings). Additionally, no corporation tax, profits tax or stamp duty is payable, and distributions may be made without withholding or deduction for payment of Jersey income tax.

There is no distinction between types of investor for tax purposes. If distributions are of an income nature, investors who are Jersey-resident individuals will need to declare and pay Jersey income tax in the usual manner (this is the case regardless of whether the fund is domiciled in Jersey or elsewhere), but there is no capital gains tax in Jersey. Non-Jersey investors should seek taxation advice in their own countries of residence to ensure that an investment is suitable for them.

Tax Treaty Network

Please refer to the FATCA and CRS regimes, for details of the information exchange arrangements relating to FATCA and the CRS. The main impact of those arrangements is that certain information regarding funds' investors is required to be collected and reported by Jersey funds, and that information may, in turn, be shared between Jersey's and other countries' taxation authorities.

Jersey also has information exchange and/or double taxation agreements with a number of countries, and is able to comply with all required international reporting and transparency requirements.

The FATCA and CRS Regimes

Jersey has concluded an intergovernmental agreement (IGA) with the USA to implement FATCA. Jersey funds are generally foreign (non-US) financial institutions for these purposes, and will need to provide information about the identity of limited partners who are US persons or limited partners with beneficial owners who are US persons to the Comptroller of Revenue in Jersey. The Comptroller will then forward that information to the competent authority in the USA. Provided that a fund complies with its obligations, it should not suffer any FATCA withholding taxes.

In addition to the inter-governmental agreement (IGA) entered into with the USA, the States of Jersey and the UK government have entered into an IGA (UK IGA, and together with the US IGA, the "IGAs") for the implementation of information-exchange arrangements, based on FATCA, whereby relevant information reported to the Jersey authorities in respect of a person or entity resident in the UK for tax purposes is shared with the UK's HMRC. Under the UK IGA, Jersey funds may be required to provide information to the Jersey authorities about their investors and about such persons' beneficial owners and interests in the fund in order to fully discharge their reporting obligations. In the event of any failure or inability to comply with the proposed arrangements, they may suffer a financial penalty or other sanction under Jersey law.

The OECD has since released the Standard for Automatic Exchange of Financial Account Information in Tax Matters (CRS), following approval by the OECD Council. This includes a model regime to serve as the common standard for reporting and due diligence regarding financial account information. Like FATCA and the IGAs, the CRS requires financial institutions in participating jurisdictions to follow common due diligence procedures and to report specified financial information to their tax authorities, which is then automatically exchanged with other participating jurisdictions. Jersey is committed to domestic implementation of the CRS, and Jersey funds are usually expected to be financial institutions for CRS purposes.

Economic Substance Regime

Jersey has implemented economic substance legislation, whereby any company which is resident in Jersey for tax purposes, and which receives income from activities such as fund management in Jersey, is required to meet an economic substance test. The test therefore applies to Jersey fund managers (and general partners if the fund has not appointed a separate manager). Self-managed funds (ie, those which have not appointed a separate manager) have subsequently been brought within scope.

The legislation came into effect in response to the EU Code of Conduct Group's assessment of Jersey's tax policy framework, aimed at ensuring the island adheres to the principles of fair taxation and aligns with the EU's and OECD's standards to prevent base erosion and profit shifting (BEPS). Although Jersey received the highest possible rating in all ten assessed areas and was confirmed as a co-operative tax jurisdiction, the Code Group expressed concern that the absence of a statutory substance requirement increased the risk of profits being registered in Jersey which do not reflect real economic activity in the jurisdiction. While these changes present new compliance considerations, they are in line with Jersey's commitment to upholding international tax co-operation and maintaining its status as a co-operative jurisdiction. The adjustments reinforce the island's reputation as a transparent and well-regulated financial centre.

The economic substance test is met if:

- the company is directed and managed in Jersey (for example, most board meetings are held in Jersey and the quorum is met by those physically present at the meeting);
- core-income generating activity (for example, taking decisions on the holding and selling of investments, calculating risks and reserves and/or preparing reports and returns to investors and the JFSC) in relation to fund management is principally carried out in Jersey; and
- there are adequate employees and physical assets, and an adequate level of expenditure is incurred, in Jersey.

As most fund managers in Jersey already meet the above requirements, the economic substance law has not had a substantial impact on the funds industry in Jersey.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

Please refer to **2.1.1 Fund Structures**. The same types of legal vehicles are available to retail funds and, in experience, OCIFs are typically established as unit trusts or companies.

3.1.2 Common Process for Setting Up Investment Funds

Retail Funds in Jersey

Retail funds in Jersey encompass open-ended funds to be offered to retail investors and which do not qualify as an expert fund, listed fund or eligible investor fund. The first stage of the approval process is the approval of the promoter. This approval can be sought simultaneously with the submission of documents for review by the

JFSC. Once such approval has been obtained, any JFSC comments on the documents have been resolved and the JFSC has approved the identity of the fund's service providers, the JFSC will issue the necessary consents. The extent of the JFSC's review and of the regulatory requirements it imposes will depend on the nature of the fund and, in particular, on any minimum level of investment or other restrictions on who can invest and whether the fund is open- or closed-ended.

Under the JFSC's Guide for Open-Ended Collective Investment Funds (the "OCIF Guide"), in assessing a proposed promoter or promoting group, the JFSC will have regard to its:

- track record and relevant experience;
- reputation;
- financial resources; and
- spread of ultimate ownership.

The JFSC's assessment will depend on the type of investor to which the proposed fund is targeted – the higher the minimum investment and/or the more the fund is targeted towards professional or institutional investors who have knowledge of the industry and the experience and resources to look after themselves, the more the JFSC will be inclined to relax its requirements.

OCIFs

Funds which do not fall into any of the regulatory classifications referred to in **2.1.2 Common Process for Setting Up Investment Funds** and which may be offered to retail investors (OCIFs) can be established under the OCIF Guide.

This is a more heavily regulated category of fund, which contains additional investor protections, such as:

- criteria applicable to the promoter;
- investment restrictions (which vary according to the fund type – for example, special rules apply to feeder funds and to funds of funds); and
- a requirement for the JFSC to approve all the material fund documentation.

Derogations may be sought from the OCIF Guide, but the JFSC will have regard to matters such as minimum investment when deciding whether to grant these.

Recognised Funds

Recognised funds are rarely established in Jersey, and a number of prescriptive rules apply to them. This category of fund is intended to be freely marketable to retail investors in the UK and elsewhere. Given the rarity of recognised funds in Jersey, they are not considered further in this section.

3.1.3 Limited Liability

Please refer to **2.1.3 Limited Liability**.

3.1.4 Disclosure Requirements

Please refer to **2.1.4 Disclosure Requirements**. The fund documents should be carefully checked against the OCIF Guide to ensure compliance with the various requirements set out therein (which cover, among other things, the matters referred to in **3.4 Operational Requirements**).

Various investor reporting requirements are also contained in the OCIF Guide, including that at least two reports must be published and sent to investors each year. Investors must be notified of all changes to the fund's constitutive documents, unless the trustee or custodian certifies that in its opinion the changes will not prejudice investors' interests, and files that certification with the JFSC.

The latest available selling and redemption prices or net asset value must be available to all investors.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

The market in Jersey generally targets sophisticated investors who fall within the institutional or high net worth categories (in the authors' experience, there is currently less investor appetite for Jersey retail funds than for non-retail options).

3.2.2 Legal Structures Used by Fund Managers

Please refer to **2.1.1 Fund Structures**.

3.2.3 Restrictions on Investors

OCIFs are available to a broad range of potential investors, subject to any eligibility requirements provided for in the constitutive documents of the OCIF.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

The OCIF Guide contains a number of investment and borrowing restrictions which vary according to the type of fund – for example, whether it is a general securities fund, a fund of funds or a feeder fund. However, Carey Olsen has successfully obtained derogations from certain investment restrictions set out in the OCIF Guide (noting that such derogations must be applied for on a case-by-case basis and are not available in every instance).

Where the OCIF is an umbrella fund, each of its sub-funds will be treated separately for the purposes of determining which restrictions apply to that sub-fund.

3.3.2 Requirements for Non-local Service Providers

Please refer to **2.3.2 Local Regulatory Requirements for Non-local Service Providers**.

The OCIF Guide sets out specific requirements regarding service providers such as the manager (see **3.3.3 Local Regulatory Requirements for Non-local Managers**) and the trustee/custodian, which must be a company that is a member of a major banking or insurance group of companies, or be an institution that is acceptable to the JFSC.

The OCIF Guide also contains the requirement that certain service providers, including the manager/administrator and trustee/custodian must be an appropriately licensed Jersey company with staff and premises in Jersey. Again, it is possible to seek a derogation from such requirements.

3.3.3 Local Regulatory Requirements for Non-local Managers

Please refer to **2.3.3 Local Regulatory Requirements for Non-local Managers**.

A manager of an OCIF is required to be engaged primarily in the business of fund management, and to have sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities. In particular, it must be in compliance with the financial resource requirements of the relevant JFSC Code of Practice.

As mentioned previously, the manager is required to be a company incorporated and resident in Jersey. It is not, however, essential for the manager to have staff and premises on the island if a Jersey-incorporated company which does have staff and premises on the island is appointed as administrator.

3.3.4 Regulatory Approval Process

Retail funds are more heavily regulated in Jersey, and this is reflected in the time it typically takes to obtain regulatory approval in relation to them.

There is a two-stage JFSC review process and an application generally takes a matter of weeks to process.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

Please refer to **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**.

3.3.6 Rules Concerning Marketing of Retail Funds

There are no specific restrictions. The OCIF Guide contains the criteria the JFSC would expect to be met in relation to an OCIF that is to be marketed to members of the general public who might be regarded as inexperienced in matters of investment, and as least able to bear the consequences of any loss of their investments.

3.3.7 Marketing of Retail Funds

Please refer to **3.3.6 Rules Concerning Marketing of Retail Funds.**

3.3.8 Marketing Authorisation/Notification Process

Please refer to **2.3.6 Rules Concerning Marketing of Alternative Funds**.

3.3.9 Post-marketing Ongoing Requirements

Please refer to **2.1.4 Disclosure Requirements.**

3.3.10 Investor Protection Rules

Please refer to **2.3.10 Investor Protection Rules** and **3.4 Operational Requirements**. Given the nature of an OCIF's potential investors, the OCIF Guide is more prescriptive in terms of structural and investment restrictions than is the case for non-retail funds (for example, an OCIF may not lend, guarantee or otherwise become liable for any obligations or indebtedness of any person without the prior, written consent of its trustee or custodian).

The JFSC's prior consent is typically required for any material changes to the fund documents.

3.3.11 Approach of the Regulator

Please refer to **2.3.11 Approach of the Regulator**. The JFSC typically takes a more stringent approach when considering issues which arise or material changes in the context of an OCIF.

3.4 Operational Requirements

Please refer to **2.4 Operational Requirements** and **3.3.2 Requirements for Non-local Service Providers**.

The OCIF Guide contains specific requirements regarding the valuation and pricing of an OCIF's assets, and regarding matters such as:

- meetings;
- charges and fees;
- investment limits;
- borrowing powers;
- the frequency of dealing; and
- redemptions.

Additionally, the OCIF Guide applies safeguards in certain cases – for example, where an OCIF permits the issuance of units to investors for assets other than cash.

3.5 Fund Finance

Please refer to **2.5 Fund Finance**. In the case of an OCIF, there are certain additional restrictions (for example, a feeder fund or a fund of funds may only borrow up to 10% of its NAV on a temporary basis for the purposes of meeting redemption requests or defraying operating expenses).

3.6 Tax Regime

Please refer to **2.6 Tax Regime**.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

In light of the UK's departure from the EU, Jersey's regulatory framework continues to provide stability and a degree of certainty for investment funds. The island's authorities remain engaged in dialogue with industry stakeholders, to ensure that Jersey's regulatory environment stays conducive to investment and aligned with international standards. Looking ahead, discussions are ongoing about refining the regulatory framework governing investment funds. The aim is to streamline processes, where feasible, to encourage efficiency and accessibility without compromising the robust oversight integral to investor protection.

Jersey's ability to adapt its legislative and regulatory structures is indicative of the island's forward-thinking approach. This agility ensures that Jersey remains a competitive jurisdiction for fund establishment and management. The focus remains on ensuring that regulatory changes protect investors and the integrity of the market, while also facilitating business growth and innovation within the funds sector.

The JFSC continues to provide clear guidance on these changes, assisting entities in understanding and implementing the necessary measures to comply with the economic substance requirements. The JFSC's approach is to work in collaboration with industry professionals to ensure that any reforms are pragmatic and reflective of the needs of the industry, while meeting international regulatory standards.

Carey Olsen, as a legal firm deeply engaged in the funds industry, remains prepared to assist clients in interpreting these reforms and understanding their implications. The firm is expected to continue playing an active role in providing feedback on proposed legislative changes, ensuring that the views and concerns of industry participants are considered.

In summary, the recent and proposed changes to Jersey's legal, regulatory and tax framework are designed to ensure that the jurisdiction remains compliant with international standards, fostering a secure and attractive environment for investment funds.

LUXEMBOURG

Law and Practice

Contributed by:
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BSP

Contents

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BSP is an independent full-service law firm based in Luxembourg, and is committed to providing the best possible legal services to its domestic and international clients in all aspects of Luxembourg business law. The firm's lawyers have developed particular expertise in banking and finance, capital markets, corporate law, dispute resolution, employment law, investment funds, intellectual property, private wealth, real estate and tax. In these practice areas, as in others, the firm's know-how and its ability to work in cross-practice teams and to swiftly adapt to new laws and regulations allow it to provide clients with timely and integrated legal assistance vital to the success of their business. Building on the synergy of its different professional experiences and the richness of its diverse cultural background, BSP stands ready to meet its clients' legal needs, no matter how challenging they are.

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1. Market Overview

1.1 State of the Market

As the second largest fund market in the world after the US, Luxembourg has earned itself a reputation for stability, a business-friendly environment and excellence in the provision of services to the investment management industry. The world's leading asset managers have chosen Luxembourg as a centre for their international fund ranges, and Luxembourg regulated funds are now distributed in more than 80 countries throughout the world. As of October 2023, Luxembourg had approximately EUR5.07 trillion in assets under management in regulated funds.

Since the first UCITS Directive in 1985, Luxembourg has been at the forefront of the implementation of European financial legislation, showing an ability to evolve and adapt quickly to changing requirements. A wide choice of vehicles now exists, allowing managers to structure a fund – both alternative investment funds (AIFs) and retail funds – in Luxembourg that best suits their own needs as well as the needs of their investors.

The success of Luxembourg as a financial centre is testament to the strong regulatory and operational environment that Luxembourg has created. Its willingness to adapt to change will ensure that the industry will continue to thrive over the coming years.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

The principal legal vehicles used to set up alternative funds in Luxembourg are as follows.

- Undertakings for collective investment (Part II UCI) governed by Part II of the Law of 17 December 2010 (the "UCI Law"), which may be constituted in the form of a common fund (*fonds commun de placement* – FCP), an investment company with variable capital (*société d'investissement à capital variable* – SICAV) or an investment company with fixed capital (*société d'investissement à capital fixe* – SICAF). A 2023 amendment to the UCI Law broadened the range of corporate forms available for a Part II UCI. They may now be established as SICAVs in the form of an SCA, SCS, SCSp, *société coopérative* organised as an SA and Sàrl, as opposed to just SAs. Part II UCIs are supervised by the *Commission de Surveillance du Secteur Financier* (CSSF), which is the supervisory authority in Luxembourg. The main advantage of these funds is that they are open to all types of investors, including retail.
- Specialised investment funds (*fonds d'investissement spécialisé* – SIF) governed by the Law of 13 February 2007 (the "SIF Law"), which may be constituted as an FCP, SICAV or SICAF. While SIFs have the advantage of having almost no restrictions in terms of what they can invest in, they are only open to well-informed investors. Like the Part II UCI, they are supervised by the CSSF.
- The investment company in risk capital (*société d'investissement en capital à risque* – SICAR) governed by the Law of 15 June 2004 (the "SICAR Law"), which may only be constituted as a corporate or partnership entity (ie, it cannot be an FCP). It has the advantage of having no investment diversification rules, but it must invest in risk capital. As such, it is generally used for investments in venture capital and private equity. The SICAR is supervised by the CSSF and is only open to well-informed investors.

- Reserved alternative investment funds (*fonds d'investissement alternatif réservé* – RAIF) governed by the Luxembourg Law of 23 July 2016 (the "RAIF Law"), which may be constituted as an FCP, SICAV or SICAF (in the case of a SICAV or SICAF it can choose any of the available corporate or partnership forms). The RAIF can choose to follow the SIF or SICAR regime in terms of the type of assets it invests in. Its particular advantage is that it is not subject to the supervision of the CSSF and, as such, a RAIF can potentially be brought to the market more quickly than the supervised entities. Unlike the Part II UCI, SIF and SICAR, the RAIF is always obliged to appoint an authorised external alternative investment fund manager (AIFM).
- The Luxembourg special limited partnership (*société en commandite spéciale* – SLP), which is an unregulated and unsupervised entity. It is characterised by its contractual freedom and is not subject to any investment or diversification constraints.

RAIFs, Part II UCIs, SIFs, SICARs and SLPs that have designated an AIFM established in the European Economic Area (EEA) can market their shares, units or limited partnership interests to professional investors throughout the EEA, pursuant to the specific notification procedure provided for by the Alternative Investment Fund Managers Directive (AIFMD).

Each Part II UCI, SIF, SICAR and RAIF may be established as an umbrella fund, allowing the creation of multiple compartments. This option is not available to the unregulated SLP.

Any of these vehicles which are set up in the form of an FCP issues units. Those in corporate form issue shares, and those in the form of partnerships issue limited partnership interests.

2.1.2 Common Process for Setting Up Investment Funds

The Part II UCI, the SIF and the SICAR are subject to authorisation by the CSSF prior to establishment. An application file must be submitted to the CSSF consisting of at least the following documents (there are certain ancillary documents and the CSSF may always request further information):

- an offering document;
- a constitutive document;
- agreements with key service providers, including the depositary, the AIFM, any delegated portfolio manager and the central administration agent;
- information on the directors or managers, who must be of sufficiently good repute and be sufficiently experienced;
- a PRIIPs key information document (KID) if retail investors are targeted; and
- application forms.

The RAIF is not subject to approval by the CSSF, but the following documents will still be required:

- an offering document;
- a constitutive document; and
- agreements with key service providers, including the depositary, the AIFM, any delegated portfolio manager and the central administration agent.

The SLP is frequently structured as an unregulated AIF, which is not authorised and not regulated by the CSSF. There is no requirement to have an offering document, although one is frequently prepared for marketing reasons. The limited partnership agreement is the key document for an SLP. As there is no approval process at the CSSF, the set-up time is shorter for the RAIF and the SLP.

However, for all vehicles, the establishment process needs to factor in time for due diligence to be performed by the service providers as well as time to complete bank account opening processes.

The largest set-up costs are generally legal costs, although service providers also sometimes charge a set-up or on-boarding fee. In addition, there are fees payable to the CSSF for regulated funds. For a Part II UCI, SIF and SICAR, the CSSF charges an examination fee and an annual fee for its supervisory activity. The fee amount differs depending on whether the fund is a standalone or an umbrella fund, and on whether or not it is self-managed. For example, the examination fee for a standalone Part II UCI, SIF or SICAR is EUR4,650, whereas for an umbrella fund it is EUR9,250.

2.1.3 Limited Liability
The liability of an investor is generally limited to its commitment or subscription to the fund. In the case of an AIF in the form of an SCA, SCSp or SCS, there will always be an unlimited partner, which is generally an entity controlled by the fund initiators and usually referred to as the general partner. The general partner has unlimited and joint and several liability for all the obligations of the fund.

2.1.4 Disclosure Requirements
For a Part II UCI, SIF, RAIF and SICAR, a prospectus or offering document and an audited annual report must be made available to investors. A PRIIPs KID must also be made available if the fund is to be marketed to retail investors.

The Part II UCI must also prepare a semi-annual report.

There are no specific disclosure requirements for an SLP, unless it has appointed a fully authorised AIFM, in which case it is obliged to also prepare audited annual accounts.

Pursuant to the AIFMD, certain disclosures must be made to investors in the offering documents of those funds managed by an AIFM.

In addition, regulated vehicles (SIF, SICAR and Part II UCI) are subject to periodic reporting to the CSSF for statistical and oversight purposes.

Finally, any fund vehicles that are managed by a fully authorised AIFM will be indirectly subject to the Annex IV reporting required to be submitted to the CSSF, pursuant to the AIFMD.

2.2 Fund Investment
2.2.1 Types of Investors in Alternative Funds
There has been increased demand for access to AIFs in recent years, as investors seek more diversification than is offered by retail funds. Well-informed and institutional investors represent the majority of investors in AIFs in Luxembourg, although there has been a trend towards the retailisation of AIFs.

2.2.2 Legal Structures Used by Fund Managers
The legal structure used will depend on the type and location of the investors, as well as the nature of the investment. SIFs, SICARs and RAIFs are intended for well-informed investors, and Part II UCIs are often used if there is an intention to target retail investors.

Increasingly, unregulated RAIFs or SLPs (managed by an authorised AIFM) are used as they offer more certainty in terms of time to market.

2.2.3 Restrictions on Investors

SIFs, SICARs and RAIFs are restricted to investment by well-informed investors. The Part II UCI can be marketed to both professional and retail investors in Luxembourg. There are no restrictions under Luxembourg law on who the limited partnership interests of an SLP can be sold to. However, for marketing in other jurisdictions, the AIFMD marketing passport will only allow the marketing of the interests in an SLP to professional investors.

Pursuant to the Law of 12 July 2013 on alternative investment fund managers (the "AIFM Law"), authorised AIFMs established in Luxembourg, in another EEA member state or in a third country are authorised to market AIFs they manage to retail investors in Luxembourg, provided the following conditions are met:

- the AIFs must be subject to permanent supervision in their home state, in order to ensure the protection of investors; and
- the AIFs must be subject to regulation in their home state, providing investors with guarantees of protection at least equivalent to those provided by Luxembourg laws governing AIFs authorised to be marketed to retail investors in Luxembourg. The home state supervision must also be equivalent to that provided in Luxembourg.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

The regulatory regime applicable to an AIF differs depending on the type of fund. All AIFs are indirectly subject to the provisions of the AIFM Law. The extent to which the AIFM Law is applicable depends on whether a fund is managed by a fully authorised AIFM or a registered AIFM.

The Part II UCI is subject to investment restrictions and risk diversification rules arising from the "UCI Law" and various implementing CSSF circulars. For example, a Part II UCI cannot generally:

- invest more than 10% of its assets in securities that are not listed on a stock exchange and are not traded on another regulated market that operates regularly and is recognised and open to the public;
- acquire more than 10% of the same type of securities issued by the same issuing body; and
- invest more than 20% of its net assets in securities issued by the same issuing body.

These general investment restrictions do not apply to Part II UCIs that adopt a fund of fund structure if the investment funds in which the Part II UCI shall invest are open-ended and are themselves subject to similar general investment restrictions. In addition, these general investment restrictions do not apply to Part II UCIs that are mainly investing in venture capital or real estate, or pursuing alternative investment strategies.

Part II UCIs may, in principle, borrow the equivalent of up to 25% of their net assets without restriction as to the intended use thereof.

Part II UCIs that are mainly investing in real estate may borrow the equivalent of up to an average of 50% of the valuation of all their properties.

Part II UCIs that are mainly pursuing alternative investment strategies (hedge funds) may borrow up to 400%.

There are no asset restrictions for SIFs, but they may not invest more than 30% of their assets or commitments in securities of the same type issued by the same issuer.

A RAIF that has chosen the SIF regime is subject to similar rules.

The SICAR is obliged to invest its funds in assets representing risk capital but is not subject to any diversification rules. A RAIF that has chosen the SICAR regime is subject to the same rules.

In general, the SLP is not subject to any investment restrictions or risk diversification rules.

AIFs may choose one of the EU labels, such as European Venture Capital Fund (EuVECA), European Social Entrepreneurship Fund (EUSEF) or European Long Term Investment Fund (ELTIF), in which case they will also be governed by the rules applicable to those regimes.

2.3.2 Requirements for Non-local Service Providers

Luxembourg AIFs may be managed by an AIFM based in a member state of the EEA. If an AIFM established in another member state intends to market units or shares of an EEA AIF that it manages to professional investors in Luxembourg, the competent authorities of the home member state of the AIFM must transmit the notification file to the CSSF.

For RAIFs, SIFs, SICARs and Part II UCIs, the respective depositary must either have its registered office in Luxembourg or have a branch there if its registered office is in another EU member state. The central administration of these entities must be located in the Grand Duchy of Luxembourg.

CSSF Circular 22/811 clarified that foreign investment fund managers with the appropriate licence may act as administrator for non-regulated funds in Luxembourg (eg, SLPs).

2.3.3 Local Regulatory Requirements for Non-local Managers

Part II UCIs, SIFs or RAIFs established in the form of an FCP must appoint a Luxembourg AIFM. AIFs in corporate or partnership form can appoint an AIFM established anywhere in the EEA. In order to manage a Luxembourg fund, such AIFMs must provide a notification to their home supervisory authority, which will transmit it to the CSSF.

The portfolio management of Luxembourg AIFs can be delegated to managers situated in third countries, provided that, in the case of regulated funds, prior approval is obtained from the CSSF.

AIFMs that intend to delegate the task of carrying out functions on their behalf to third parties must notify the supervisory authorities of their home member state before the delegation arrangements become effective.

2.3.4 Regulatory Approval Process

The approval process usually takes between three and six months and is dependent on several factors, including:

- the completeness of the initial application;
- the speed with which the CSSF's queries are answered;
- whether it is a first-time fund; and
- the nature of the investment policy.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

Pursuant to the AIFM Law, an AIFM that is established in another member state and is pre-marketing or intending to pre-market an AIF to professional investors in Luxembourg must notify the supervisory authority of its home country (the CSSF in the case of Luxembourg AIFMs), including:

- specifying in which countries and during which periods the pre-marketing is taking or has taken place; and
- providing a brief description of the pre-marketing, including information on the investment strategies presented and, where relevant, a list of the AIF(s) and compartments of AIF(s) that are or were subject to pre-marketing.

Information presented to potential professional investors in the context of pre-marketing cannot:

- be sufficient to allow investors to commit to acquiring units or shares of a particular AIF;
- amount to subscription forms or similar documents, whether in draft or final form; nor
- amount to constitutional documents, a prospectus or offering documents of a not-yet-established AIF in final form.

The AIFM must ensure that professional investors do not acquire units or shares in an AIF through pre-marketing, and that investors contacted as part of pre-marketing may only acquire units or shares in that AIF after the formal marketing notification.

Any subscription by professional investors, within 18 months of the AIFM having begun pre-marketing, to units or shares of an AIF referred to in the information provided in the context of pre-marketing, or of an AIF established as a result of the pre-marketing, shall be considered to be the result of marketing and shall be subject to the applicable notification procedures (see **2.3.8 Marketing Authorisation/Notification Process**).

2.3.6 Rules Concerning Marketing of Alternative Funds

AIFMs marketing AIFs in Luxembourg must comply with the provisions of the AIFMD. Where another firm is marketing in Luxembourg, it could be considered to be carrying out an activity of the financial sector and should thus be licensed or otherwise authorised to do so, pursuant to the Law of 5 April 1993 on the financial sector. Firms from other EU member states with the appropriate licence pursuant to the Markets in Financial Instruments Directive (MiFID) would be authorised to carry out distribution activities in Luxembourg.

All marketing communications will need to comply with the requirements of Article 4 of Regulation 2019/1156 on facilitating cross-border distribution of collective investment undertakings. CSSF Circular 22/795 stipulates that Luxembourg AIFMs must provide the CSSF with information regarding marketing communications, and the CSSF will conduct testing to verify their compliance with the applicable requirements under Article 4.

2.3.7 Marketing of Alternative Funds

SIFs, SICARs and RAIFs are reserved for and can only be marketed to well-informed investors in Luxembourg – ie, institutional investors, professional investors or any other investors who meet the following conditions:

- they have confirmed in writing that they adhere to the status of well-informed investor; and
- they invest a minimum of EUR100,000, or have been the subject of an assessment made by an entity such as a bank, management company or AIFM certifying their expertise, experience and knowledge in adequately apprising an investment in a fund.

Part II UCIs can be marketed to any type of investors (both retail and well-informed investors).

In addition to the above restrictions, EEA AIFs managed by an authorised AIFM can be marketed to professional investors in Luxembourg, pursuant to Article 32 of the AIFMD.

As previously discussed, in certain circumstances authorised AIFMs may market non-Luxembourg AIFs to retail investors in Luxembourg.

EuVECAs and EUSEFs governed by Regulation (EU) No 345/2013 and Regulation (EU) No 346/2013, respectively, can be marketed to professional investors and other investors, provided that each investor (noting that such funds could take one of the available forms of fund in Luxembourg like SICAR or SIF):

- commits to investing a minimum of EUR100,000; and
- states in writing that they are aware of the risks associated with the envisaged investment.

ELTIFs, which are AIFs that could take the form of one of the available funds in Luxembourg, are potentially available to be marketed to both retail and professional investors upon notification in accordance with Article 32 of the AIFMD, depending on the rules with which they comply.

2.3.8 Marketing Authorisation/Notification Process

An AIFM wishing to market to professional investors in Luxembourg must submit a notification to the competent authorities of its home member state (the CSSF for Luxembourg AIFMs) in respect of each EEA AIF that it intends to market. This does not apply to Luxembourg AIFMs marketing Luxembourg regulated funds. The notification must contain certain information, including:

- a notification letter, with a programme of operations identifying the AIFs the AIFM intends to market and information on where the AIFs are established;
- the AIF rules or instruments of incorporation;
- identification of the depositary of the AIF;
- the indication of the member state in which it intends to market the units or shares of the AIF to professional investors; and
- information about arrangements made for the marketing of AIFs and, where relevant, information on the arrangements established to prevent units or shares of the AIF from being marketed to retail investors, including in the case where the AIFM relies on activities of independent entities to provide investment services in respect of the AIF.

The competent authorities of the home member state of the AIFM should transmit the complete notification file to the CSSF, no later than 20 working days after the date of receipt. From the date of notification of such transmission, marketing can begin.

Those AIFMs wishing to market non-Luxembourg AIFs to retail investors must follow the detailed rules laid down in CSSF Regulation 15-03 on the marketing of foreign alternative investment funds to retail investors in Luxembourg. Prior to marketing its units or shares to retail investors in Luxembourg, any foreign AIF must have obtained authorisation from the CSSF for such marketing.

2.3.9 Post-marketing Ongoing Requirements

Material Changes

In the event of a material change in the information contained in its original marketing notification file, an AIFM must provide written notice of this change to its home state competent authority (the CSSF in the case of Luxembourg AIFMs), by resubmitting a marked-up version of the original notification file, indicating the proposed changes.

All material changes planned by the AIFM must be notified to the CSSF at least one month before implementing the change, or immediately after an unplanned change has occurred.

De-notification

An AIFM may de-notify arrangements made for marketing as regards units of shares of some or all of its AIFs in Luxembourg, if the following conditions are met:

- other than in respect of closed-ended funds and ELTIFs, a blanket offer is made to repurchase or redeem all such units or shares held by Luxembourg investors, free of any charges or deductions;
- the intention to terminate arrangements made for marketing such units or shares is made public by means of a publicly available medium; and
- any contractual arrangements with financial intermediaries or delegates are modified or terminated with effect from the date of de-notification in order to prevent any new or further, direct or indirect, offering or placement of such units or shares.

The de-notification procedure is carried out through the home supervisory authority of the AIFM, which then informs the CSSF.

However, if an AIFM intends to cease the marketing of its non-Luxembourg AIF to retail investors in Luxembourg, it must inform the CSSF about whether Luxembourg investors are still invested in the AIF.

2.3.10 Investor Protection Rules

SIFs, SICARs and RAIFs are intended for well-informed investors that are able to adequately assess the risks associated with an investment in such vehicles.

Part II UCIs can be marketed to retail investors, but the applicable investment restrictions add to investor protection, in addition to the fact that they are supervised by the CSSF. The fact that all AIFs bar the unregulated SLP must appoint a depositary and an auditor provides additional protection for investors.

Any AIF managed by an authorised AIFM needs to provide audited annual accounts which, in the case of regulated AIFs, need to be provided to the CSSF. The CSSF is also made aware of the content of the management letters.

In addition, such funds are required to disclose certain information to investors, pursuant to the rules of the AIFMD, and to inform investors of any changes thereto. The AIFMD imposes rules on the preferential treatment of investors and disclosure to them, and the valuation of an AIF's assets must be carried out in accordance with such rules.

AIFMs are also required to have risk management, liquidity management and conflict of interest policies in place, all of which serve to add to the protection of investors. Part II UCIs must, in addition, produce a half-yearly report for submission to the CSSF.

All of the regulated funds are subject to regular reporting to the CSSF, to enable it to carry out its supervisory function.

In the case of a dispute with a Part II UCI, a retail investor can request the CSSF to impartially intervene for an out-of-court resolution, although the CSSF's out-of-court decision is not binding on the parties.

In the case of regulated funds, CSSF Circular 02/77, relating to the protection of investors in the case of net asset value (NAV) calculation errors and correction of the consequences resulting from non-compliance with the investment rules, sets out specific rules for dealing with such circumstances in a way that does not harm investors.

2.3.11 Approach of the Regulator

The CSSF takes a practical approach. It can be approached for face-to-face meetings, particularly in relation to a new entry to the market or in relation to new projects. As regards ongoing matters, it can be reached by phone or email. The CSSF has also set up an electronic platform to facilitate the exchange of documents and information.

2.4 Operational Requirements

See **2.3 Regulatory Environment** for further discussion on investment restrictions, borrowing restrictions and risk diversification rules applicable to Luxembourg AIFs.

AIFs managed by a fully authorised AIFM and SIFs, SICARs and Part II UCIs that do not have an AIFM must appoint a depositary acting in the interests of investors and providing services as required by the respective product laws as well as the AIFM Law (ie, safekeeping of assets, cash monitoring and monitoring of compliance with the legal and regulatory framework). Depositaries must be credit institutions established in Luxembourg and must have a specific licence granted by the CSSF in order to carry out such business or be so-called depositary-lites, which may be appointed for certain types of AIFs that do not hold financial instruments and that must be held in custody.

AIFs must have an AML policy and comply with the AML Law for their business relationships (including for their investors).

The asset valuation of AIFs must be done in accordance with the laws applicable to them, and in accordance with the AIFM Law where the AIFs are managed by a fully authorised AIFM.

2.5 Fund Finance

Luxembourg AIFs frequently borrow for bridging finance, for working capital purposes or, in the case of some funds, for leverage.

While there are lenders on the Luxembourg market, lenders are often from outside Luxembourg.

There are no borrowing restrictions applicable to SIFs, SICARs, RAIFs or SLPs, although pursuant to the AIFMD there are rules around disclosing the maximum amount of leverage. Part II UCIs are subject to borrowing restrictions (generally 25% of the NAV, although this can be increased in the case of hedge funds).

The lender will generally always take security, the type of which will depend on the type of borrowing and the types of assets involved. Security over undrawn commitments and pledges over Luxembourg bank accounts are often seen.

2.6 Tax Regime

Part II UCIs, SIFs and RAIF-SIFs

Part II UCIs, SIFs and RAIF-SIFs are exempt from net wealth tax, municipal business tax and corporate income tax. Luxembourg withholding tax does not apply to distributions made by the SIF to investors. These entities also benefit from a value-added tax (VAT) exemption on management services.

SIFs and RAIF-SIFs are subject to subscription tax at an annual rate of 0.01% based on their NAV. There are, however, several categories of exemptions. Part II UCIs are subject to a subscription tax at an annual rate of 0.05% of the NAV, reduced to 0.01% or exempted in certain conditions.

In addition, the SIF, RAIF-SIF and Part II UCI in the form of a SICAV or SICAF may benefit from double tax treaties that have been concluded by Luxembourg. The SIF, RAIF-SIF or Part II UCI in the form of an FCP do not, in principle, have access to double tax treaties.

To encourage investment into ELTIFs, the Law of 21 July 2023 modernising the Luxembourg fund toolbox provides that RAIFs, Part II UCIs and SIFs (or sub-funds thereof) authorised as ELTIFs are exempt from subscription tax.

SICARs and RAIF-SICARs

The tax regime applicable to SICARs and RAIF-SICARs will depend on the legal form adopted. Those taking a corporate form are fully taxable entities (corporate income tax and municipal business tax) but benefit from an exemption for income derived from transferable securities and income from cash held for a maximum period of one year prior to its investment in risk capital. Those taking the form of a common limited partnership (SCS) or SLP are tax-transparent under Luxembourg law.

Luxembourg withholding tax does not apply to distributions made by these entities to investors. These entities also benefit from a VAT exemption on management services.

SICARs and RAIF-SICARs are not subject to an annual subscription tax, but they are subject to a minimum amount of annual net wealth tax.

SICARs and RAIF-SICARs in corporate form have full access to double tax treaties from a Luxembourg perspective; those in the form of SLPs do not, and nor do SCSs and RAIFs in the form of an FCP.

SLP

An SLP is tax-transparent and is not subject to subscription tax, net wealth tax or withholding tax. Corporate income tax is not applicable. Municipal business tax of 6.75% (for an SLP registered in Luxembourg City) may be applicable if the SLP carries out a commercial activity or is deemed to carry out a commercial activity.

SLPs do not benefit from the EU Parent-Subsidiary Directive and have no access to double tax treaties signed by Luxembourg.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

Undertakings for collective investment in transferable securities (UCITS) and undertakings for collective investment subject to Part II of the UCI Law (Part II UCIs – together with UCITS, the “retail funds”) are the two main investment funds for retail investors.

Retail funds are subject to direct supervision by the CSSF and require prior CSSF approval before they can be set up. A retail fund may be set up as a standalone fund or as an umbrella fund. However, the umbrella fund structure is used most often as it is cost-effective if several sub-funds are launched.

Each retail fund may issue classes and sub-classes of shares (or units depending on the legal form chosen – see **3.2.2 Legal Structures Used by Fund Managers**), enabling the retail fund's shares to be adapted to the needs of its investors and its sponsor.

UCITS

UCITS are highly regulated investment vehicles that can be easily marketed to retail investors in the EEA thanks to the EU passport, but also to professional and institutional investors.

Stringent diversification rules are laid down by the UCI Law. In particular, a UCITS may invest no more than 10% of its assets in transferable securities (which must be listed on a regulated market) or money market instruments issued by the same body, and specific restrictions apply to index funds, holdings of other funds, use of financial derivative instruments and deposits. Leverage is restricted, and a UCITS must be an open-ended fund – ie, investors must be able to redeem.

Part II UCIs

Although Part II UCIs always qualify as AIFs, they are open to retail investors. Part II UCIs are subject to a less stringent diversification policy than UCITS:

- they may borrow money or securities (up to 400% of the NAV for Part II UCIs following alternative investment strategies);
- they can be closed or open-ended funds; and
- they can be used to invest beyond transferable securities (private equity, real estate, etc).

However, Part II UCIs remain subject to the supervision of the CSSF. They are not entitled to the European UCITS passport for distribution to retail investors in the EEA, but they can rely on the AIFMD marketing passport if they fall within the scope of the full AIFMD regime.

3.1.2 Common Process for Setting Up Investment Funds

Retail funds must be authorised and supervised during their lifetime by the CSSF. A retail fund set up in contractual form as an FCP shall only be authorised if the CSSF has approved its management company, which must be based in Luxembourg.

A retail fund set up in corporate form and appointing a management company or AIFM shall only be authorised if the CSSF has approved the management company or AIFM (if a Luxembourg entity), or if the relevant management company or AIFM has notified pursuant to the management passport. Where the management company or AIFM delegates portfolio management, the entity to which they have delegated is subject to the approval of the CSSF.

Directors (who must be of sufficiently good repute and sufficiently experienced) and other service providers of retail funds are subject to the approval of the CSSF.

The application is carried out online on a CSSF portal and requires the provision of, inter alia, the following documents:

- application questionnaire;
- draft instruments of incorporation;

- draft prospectus;
- draft PRIIPs KID or, in the case of UCITS exclusively distributed to professional investors, a UCITS key investor information document (KIID);
- key policies (generally already in place within the investment fund manager);
- various AML documents;
- confirmation letters regarding main service provider agreements;
- information on the directors of the fund in question; and
- a business plan.

Once the application is complete, the authorisation process for a retail fund will range between three and six months. The actual length and cost depend mainly on the complexity of the investment strategy, the completeness of the application file and whether or not it is a first-time fund.

The largest set-up costs are generally legal fees, although service providers also sometimes charge a set-up or on-boarding fee. In addition, there are fees payable to the CSSF for regulated funds. The CSSF charges an examination fee and an annual fee for its supervisory activity of retail funds. The fee amount differs depending on whether the retail fund is a standalone or an umbrella fund and on whether or not it is self-managed. For example, the examination fee for a standalone retail fund is EUR4,650, whereas for an umbrella fund it is EUR9,250.

3.1.3 Limited Liability

Regardless of the legal form or structure, investors in retail funds are only liable up to the amount of their contributions.

3.1.4 Disclosure Requirements

UCITS

UCITS must publish a prospectus that includes the information necessary for investors to be able to make an informed investment decision and containing at least the information listed in Schedule A of Annex I of the UCI Law, as well as information about the remuneration policy. The prospectus must be kept up to date. In addition, a three-page PRIIPs KID (or a two-page KIID for UCITS exclusively distributed to professional investors) summarising the key elements of the prospectus must be issued and kept up to date.

The following reports must be produced:

- an annual report;
- a semi-annual report covering the first six months of the financial year;
- a semi-annual risk report (only intended for the CSSF);
- a monthly financial report (only intended for the CSSF); and
- an annual long form report (only intended for the CSSF).

Part II UCIs

As with UCITS, Part II UCIs must also publish a prospectus that includes the information necessary for investors to be able to make an informed investment decision and containing at least the information listed in Schedule A of Annex I of the UCI Law. The prospectus must be kept up to date. In addition, a three-page PRIIPs KID summarising the key elements of the prospectus must be issued if the Part II UCI is marketed to retail investors.

The following reports must be produced:

- an annual report;

- a semi-annual report covering the first six months of the financial year;
- a semi-annual risk report (only intended for the CSSF);
- a monthly financial report (only intended for the CSSF); and
- an annual long form report (only intended for the CSSF).

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

The majority of retail fund investors are located outside Luxembourg. All types of investors invest in retail funds (retail, professional and institutional investors).

3.2.2 Legal Structures Used by Fund Managers

Usually, a retail fund is set up in the contractual form of an FCP or a SICAV (ie, a corporate entity with variable capital taking the form of a public limited liability company (*société anonyme*)). The Law of 21 July 2023 modernising the Luxembourg fund toolbox (the "Modernising Law") extends the choice of legal forms for Part II UCIs to the form of an SCA, SCS, SCSp, *société coopérative* organised as an SA and Sàrl. However, in the case of a Part II UCI, it is possible to opt for a SICAF in a different corporate legal form or in the form of a partnership.

3.2.3 Restrictions on Investors

There are no restrictions – all investors (ie, retail, professional and institutional investors investing for their own account and/or on behalf of retail investors) can invest in retail funds.

Non-Luxembourg investment funds that do not qualify as UCITS can be marketed to retail investors in Luxembourg if the provisions of CSSF Regulation 15-03 are complied with and the CSSF has authorised them; if such funds qualify as ELTIFs, CSSF Regulation 15-03 does not apply but rather the rules applicable under the ELTIF regulation.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

UCITS

Eligible assets are restricted to transferable securities admitted on a regulated market, investment funds, financial derivative instruments, cash and money market instruments.

Risk diversification requirements for UCITS include the following:

- they cannot invest more than 10% of assets in transferable securities or money market instruments issued by the same issuer, and those holdings that exceed 5% cannot in aggregate exceed 40% of their assets;
- they cannot invest more than 20% of assets in deposits made with the same body; and
- global exposure relating to financial derivative instruments cannot exceed the total value of the portfolio.

A UCITS cannot borrow more than 10% of its assets on a temporary basis. Uncovered short positions are not allowed, but a UCITS can pursue a long-short investment strategy and achieve short exposure synthetically through the use of financial derivative instruments. Various liquidity monitoring requirements are provided for.

Part II UCIs

Part II UCIs are subject to investment restrictions and risk diversification rules arising from the UCI Law and various implementing CSSF circulars. For example, generally a Part II UCI cannot:

- invest more than 10% of its assets in securities that are not listed on a stock exchange

and are not traded on another regulated market that operates regularly and is recognised and open to the public;
- acquire more than 10% of the same type of securities issued by the same issuing body; and
- invest more than 20% of its net assets in securities issued by the same issuing body.

These general investment restrictions do not apply to Part II UCIs that adopt a fund of fund structure if the investment funds in which the Part II UCI shall invest are open-ended and are themselves subject to similar general investment restrictions. In addition, these general investment restrictions do not apply to Part II UCIs that are mainly investing in venture capital or real estate, or pursuing alternative investment strategies.

Part II UCIs may, in principle, borrow the equivalent of up to 25% of their net assets without restriction as to the intended use thereof.

Part II UCIs that are mainly investing in real estate may borrow the equivalent of up to an average of 50% of the valuation of all their properties.

Part II UCIs that are mainly pursuing alternative investment strategies (hedge funds) may borrow up to 400%.

3.3.2 Requirements for Non-local Service Providers

The depositary, administrative agent, registrar, transfer agent and approved statutory auditor of a retail fund must be established in Luxembourg and are all subject to regulation in Luxembourg.

The management company of a UCITS can be established in the EEA, unless the UCITS is an FCP, in which case the management company must be established in Luxembourg. The AIFM of a Part II UCI can be established in the EEA unless the Part II UCI is an FCP, in which case the AIFM must be established in Luxembourg.

Portfolio managers and investment advisers located in third countries can provide advisory or portfolio management services, but this is subject to the CSSF's authorisation of any delegated portfolio management function.

3.3.3 Local Regulatory Requirements for Non-local Managers

UCITS and Part II UCIs in the form of an FCP must have their management company established in Luxembourg. UCITS that are SICAVs and are not self-managed may have their management company established elsewhere in the EEA.

An AIFM from any jurisdiction in the EEA can be appointed to manage a Part II UCI unless the Part II UCI is an FCP. Those AIFMs established elsewhere than in Luxembourg need to notify their home supervisory authorities of their intention to manage a Luxembourg fund. Those authorities will in turn notify the CSSF.

The portfolio management of Luxembourg retail funds can be delegated to managers situated in third countries, provided that prior approval is obtained from the CSSF.

3.3.4 Regulatory Approval Process

For retail funds, the process for obtaining regulatory approval depends on the complexity of the investment policy, the completeness of the file that has been submitted and whether or not it is a first-time fund. Generally, the time ranges from three to six months.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

Pre-marketing to Luxembourg retail investors is not allowed for UCITS and AIFs.

3.3.6 Rules Concerning Marketing of Retail Funds

No notification or authorisation is required for the marketing of Luxembourg UCITS or Part II UCIs in Luxembourg.

A UCITS located in another EEA country may be marketed in Luxembourg as soon as the home supervisory authority has duly notified the CSSF of the intended marketing. Such EEA UCITS must provide facilities in Luxembourg to facilitate the processing of subscription and redemption orders, and the provision of information. They need not appoint a third party nor have a physical presence in Luxembourg (ie, facilities can be provided via the internet).

An AIF located in a country other than Luxembourg may be marketed to Luxembourg retail investors, in accordance with the provisions of CSSF Regulation 15-03, provided that, inter alia:

- it is subject to ongoing supervision by its home supervisory authority;
- it has obtained the authorisation of the CSSF for such marketing;
- its NAV is calculated at least once a month; and
- it follows certain risk diversification principles.

Retail funds and AIFs marketed in Luxembourg to retail investors must provide these investors with a PRIIPs KID.

All marketing communications will need to comply with the requirements of Article 4 of Regulation 2019/1156 on facilitating cross-border distribution of collective investment undertakings. CSSF Circular 22/795 provides that the CSSF requires investment fund managers to provide the CSSF with information regarding marketing communications, and will conduct testing to verify their compliance with the applicable requirements under Article 4.

Closed-ended funds marketed to Luxembourg retail investors must generally issue a prospectus in accordance with EU Regulation 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

3.3.7 Marketing of Retail Funds

Retail funds can be marketed to all investors located in Luxembourg, whether retail, professional or institutional.

However, a number of rules stemming from the MiFID may restrict the marketing of retail funds through MiFID-regulated firms, as the investor profile of a retail investor must be in line with the type of retail fund being marketed (eg, it is not appropriate to advise a retail investor with a conservative risk profile to invest in a fund presenting higher risk).

3.3.8 Marketing Authorisation/Notification Process

Notification or authorisation is required by the CSSF prior to the marketing of non-Luxembourg retail funds taking place.

In the case of cross-border marketing of a UCITS, the notification process described above must be complied with; in the case of marketing a foreign investment fund that is not a UCITS, there is an authorisation process to be complied with in accordance with CSSF Regulation 15-03.

3.3.9 Post-marketing Ongoing Requirements

Change in the Content of the UCITS Marketing Notification Letter

Where an amendment has an impact on the notification letter sent to the CSSF via the UCITS home supervisory authority at the time when the UCITS intended to market its units in Luxembourg or regarding a change of the share classes to be marketed in Luxembourg, the UCITS must directly inform the CSSF before implementing this amendment.

De-notification

Investment fund managers may de-notify arrangements made for marketing as regards units or shares of some or all of their UCITS and/or AIFs marketed in Luxembourg, provided that:

- a blanket offer is made to repurchase or redeem all such units or shares held by Luxembourg investors, free of any charges or deductions;
- the intention to terminate arrangements made for marketing such units or shares is made public, by means of a publicly available medium; and
- any contractual arrangements with financial intermediaries or delegates are modified or terminated with effect from the date of de-notification, in order to prevent any new or further, direct or indirect, offering or placement of such units or shares.

The de-notification procedure is carried out through the home supervisory authority, which then informs the CSSF. However, if an AIFM intends to cease the marketing of its non-Luxembourg AIF to retail investors in Luxembourg, it must inform the CSSF whether Luxembourg investors are still invested in this AIF.

Other Ongoing Requirements

Please refer to **3.3.10 Investor Protection Rules** regarding reporting and other requirements.

3.3.10 Investor Protection Rules

To ensure compliance with the regulatory framework and to detect any potential non-compliance, retail funds must produce the following reports:

- an audited annual report;
- an unaudited semi-annual report covering the first six months of the financial year;
- a report in the case of NAV calculation error or non-compliance with applicable investment rules (only intended for the CSSF);
- a monthly financial report (only intended for the CSSF); and
- an annual long form report (only intended for the CSSF).

In addition, UCITS must provide the CSSF with a semi-annual risk report, and their management companies must have a remuneration policy and procedures designed to prevent conflicts of interest and discourage risk-taking that is inconsistent with the risk profile of the managed UCITS.

Furthermore, retail funds must appoint a custodian bank acting in the interests of investors and providing services as required by the UCI Law – ie, safekeeping of assets, cash monitoring and monitoring of retail funds' compliance with the legal and regulatory framework. The appointment of a custodian bank is ultimately intended to ensure the protection of the fund's assets.

In the case of a dispute with a retail fund, a retail investor can contact the CSSF in order for the CSSF to impartially intervene for an out-of-court resolution, but the CSSF's out-of-court decision is not binding on the parties.

Finally, NAV calculation errors are highly monitored by auditors and the CSSF, and incoming and redeeming investors are compensated in the case of NAV calculation errors.

3.3.11 Approach of the Regulator

The CSSF takes a practical approach. New Luxembourg market participants can have a face-to-face meeting with CSSF officials to present their projects, better understand the CSSF's expectations and ask questions.

Formalities and filings with the CSSF are mainly done through an online platform, although the CSSF can be contacted via telephone and email during an authorisation process.

3.4 Operational Requirements

Retail Funds

Please refer to **3.1.4 Disclosure Requirements** and **3.3.1 Regulatory Regime** regarding investment restrictions for retail funds.

Retail funds must appoint a custodian bank acting in the interests of investors and providing services as required by the UCI Law – ie, safekeeping of assets, cash monitoring and monitoring of retail funds' compliance with the legal and regulatory framework. Custodian banks must be credit institutions established in Luxembourg and have a specific licence granted by the CSSF in order to carry out this business.

Retail funds admitted to trading on the Luxembourg Stock Exchange are subject to the Luxembourg Law of 11 January 2008 on transparency requirements (implementing Directive 2004/109/EC of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC), and to the Luxembourg Law of 23 December 2016 on market abuse (stemming from Regulation (EU) No 596/2014 of 16 April 2014 on market abuse).

Retail funds must have an AML policy and comply with the AML Law for their business relationships (including for their investors).

UCITS

The asset valuation of UCITS must be done in accordance with the UCI Law, which provides that listed securities should be valued at the last known stock exchange quotation, unless this is not representative. Non-listed securities or listed securities for which the market price is not representative should be valued on the basis of the probable realisation value.

Management companies must have policies in place to prevent insider dealing and the misuse of confidential information by one of their employees or service providers.

Uncovered short positions are not allowed, but a UCITS can pursue a long-short investment strategy and achieve short exposure synthetically through the use of financial derivative instruments.

Part II UCIs

The asset valuation of Part II UCIs must be done in accordance with the UCI Law, which provides that the valuation must be based on fair value, unless the constitutional documents provide otherwise. Part II UCIs also need to value assets in compliance with the AIFM Law if they are managed by an authorised AIFM.

Authorised AIFMs of Part II UCIs must have policies in place to prevent insider dealing and the misuse of confidential information by one of their employees or service providers.

Part II UCIs may have uncovered short positions.

3.5 Fund Finance

UCITS

A UCITS may borrow in the following circumstances:

- on a temporary basis, provided that such borrowing represents no more than 10% of its assets; or
- to enable the acquisition of immovable property essential for the direct pursuit of its business and representing no more than 10% of its assets.

Such borrowing shall not exceed 15% of its assets in total. Generally, borrowing is used to finance redemption requests, not to invest.

UCITS may invest in derivative financial instruments that can provide leverage, and can enter into back-to-back loans to acquire foreign currencies.

For the above transactions, a UCITS may provide security such as a pledge on securities it owns as collateral.

Securities lending transactions, as well as repurchase agreement transactions and reverse repurchase agreement transactions, can only be used by UCITS for the purpose of efficient portfolio management.

Part II UCIs

A Part II UCI may borrow money or securities up to 25% of its NAV on a permanent basis. However, this cap may increase depending on the investment strategy:

- 200% of its NAV for alternative investment strategies; and
- 400% of its NAV for alternative investment strategies with a high level of correlation between long positions and short positions.

A Part II UCI may invest in derivative financial instruments that can provide leverage, but it cannot borrow to finance margin deposits.

A Part II UCI is authorised to enter into securities lending transactions, as borrower, with first-class professionals specialised in this type of transaction.

For the above transactions, a Part II UCI may pledge its own securities as collateral.

Equity bridge financing can be used if the Part II UCI in question operates on a commitment basis.

3.6 Tax Regime

UCITS and Part II UCIs are exempt from net wealth tax, corporate income tax and municipal business tax. UCITS and Part II UCIs are subject to an annual subscription tax of 0.05% of the NAV (paid quarterly), reduced to 0.01% in certain specific cases.

The Modernising Law amended the UCI Law by regulating a full exemption for the subscription tax stated in the new Article 175 for the following.

- Those UCITS dedicated to Pan-European Personal Pension Product (PEPP), which is a long-term, individual, non-occupational personal pension product (third pillar pension), subscribed to on a voluntary basis by so-called "PEPP savers" to provide supplementary income on retirement and created per Regulation (EU) 2019/1238 on a pan-European Personal Pension Product ("PEPP Regulation"), which entered into application on 22 March 2022, and by which the Luxembourg congress on 4 March 2022 enacted the law of 25 February 2022, which lays down certain rules on, among others, the PEPP Regulation.

- Those UCITS as well as individual compartments of UCITS with multiple compartments:
  - (a) whose securities are reserved for institutional investors;
  - (b) that are authorised as short-term money market funds in accordance with Regulation (EU) 2017/1131; and
  - (c) that have obtained the highest possible rating from a recognised rating agency. Where several classes of securities exist within the UCITS or the compartment, the exemption only applies to classes whose securities are reserved for institutional investors.
- Those UCITS that are authorised as ELTIFs in accordance with Regulation (EU) 2015/760.

In addition, retail funds may benefit from reduced subscription tax rates on the portion of their net assets or compartment thereof invested in economic activities that qualify as being environmentally sustainable within the meaning of the Taxonomy Regulation ("Qualifying Activities") (Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088). For instance, the tax rate is reduced to 0.04% if the retail fund invests at least 5% of its net assets in Qualifying Activities.

Furthermore, the annual subscription tax will be reduced to zero in the case of institutional money market cash funds, special pension funds, exchange-traded funds and microfinance funds, and for retail funds investing in other Luxembourg funds that are already subject to a subscription tax. These exemptions apply to the whole retail fund, the sub-fund or the class of shares qualifying for the exemption.

Investors located outside Luxembourg are not subject to Luxembourg capital gains tax.

Luxembourg withholding tax does not apply to distributions made by these entities to investors. These entities also benefit from a VAT exemption on management services.

These entities may not benefit from the EU Parent-Subsidiary Directive, but if in corporate form may benefit from double tax treaties that have been concluded by Luxembourg.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

On 24 July 2023, the Modernising Law was published in the Luxembourg Official Gazette (*Mémorial*), bringing substantial improvements to the Luxembourg toolbox for investment funds and their managers, as well as greater consistency between the product laws, with a view to further increasing the competitiveness of the Luxembourg fund centre, including in the context of the democratisation of alternative investment funds, as evidenced by the increased interest for Part II UCIs and ELTIFs under Regulation (EU) 2023/606 amending Regulation (EU) 2015/760 as regards the requirements pertaining to the investment policies and operating conditions of European long-term investment funds and the scope of eligible investment assets, the portfolio composition and diversification requirements and the borrowing of cash and other fund rules (ELTIF 2.0).

Approximately one third of the assets managed by sustainable funds in Europe are domiciled in Luxembourg. This trend towards more sustainable investing is expected to continue.

At the European level, the ELTIF 2.0 regime and the AIFMD II framework as reflected in the final political agreement published by the European Council on 6 November 2023, especially in the context of debt funds, will have an impact on the fund regulatory environment in Luxembourg.

Trends and Developments

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Norton Rose Fulbright is a global law firm that provides a full business law service and has more than 3,500 lawyers and other legal staff based in Europe, the United States, Canada, Latin America, Asia, Australia, the Middle East and Africa. The firm's Luxembourg investment funds practice is well regarded in the market, and provides high-quality and tailored legal advice on the full spectrum of investment funds law, including the latest regulations, innovations, market practices and trends. It has deep experience in alternative investment funds, mutual funds, ETFs, hedge funds and related fund and asset management matters. The firm is a trusted counsel to international and national clients, including asset managers, institutional and professional clients, banks, non-profit organisations, venture capital firms, family offices/high net worth individuals and pension funds. Its investment funds team works closely with its global tax team, advising on the tax aspects of the structuring of funds, investment into funds and related international tax implications.

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Investment Funds in Luxembourg: Trends and Developments

Introduction

Following the turmoil of the past few years, 2023 saw increased activity pushing forward new regulatory measures in the funds industry and preparing for the future of several key regulations. Those regulations in the pipeline seek the right balance between encouraging investments in Europe on the one hand and protecting investors on the other hand.

2024 promises to be as busy as 2023 on the regulatory front, bringing the EU fund industry to a new level of sophistication.

One step closer to AIFMD 2

Following the end of their trilogue, an agreement was reached in October 2023 between the European Parliament (the Parliament), the European Commission (the Commission) and the Council of Europe (the Council) in relation to the proposed revision of two EU directives:

- Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers (AIFMs) (AIFMD) and its associated annexes (the revised AIFMD, AIFMD 2); and
- Directive 2009/65/EC of 13 July 2009 on Undertakings for Collective Investment in Transferable Securities (UCITS) (UCITS Directive).

The adoption of the final text is still pending, and the Parliament has set an initial date for a plenary sitting on 5 February 2024. Accordingly, the final text could be published in the Official Journal in February or March 2024 and the new rules should come into effect around Q1 2026 (ie, two years after adoption).

The key changes will be on the following topics.

- AIFM and management company (ManCo) governance: AIFMs and ManCos will require at least two full-time employees/executive members domiciled in the European Union (the EU) and will be encouraged to appoint one independent director when managing investment funds open to retail investors. Furthermore, ESG parameters will be integrated into the governance and risk management rules supporting investment decisions (especially when managing alternative investment funds (AIFs) or UCITS with sustainable strategies).
- Depositary: if opened at the discretion of the EU member states when transposing AIFMD 2, it will be possible to have a depositary in a different country than that of the relevant investment fund under certain conditions, notably:
  - (a) if there is a lack of relevant depositary services in the country of the investment fund;
  - (b) if the depositary assets in the country of the investment fund are under EUR50 billion; and
  - (c) on a case-by-case basis.
- Leveraged AIFs: a common definition of a leveraged AIF will be introduced – ie, "an AIF whose exposures are increased by the AIFM that manages it, whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means".
- Loan originating funds: loan originating AIFs are defined in AIFMD 2, together with accompanying rules, with flexibility for nations to enforce stricter rules. In particular, AIFMD 2 contains a prohibition of loans to certain entities (the AIFM, its delegates, depositaries, custodians, etc) and demands full disclosure as to the value of the loan. If the borrower is itself an AIF/UCITS, an investment limit of

20% will be set and a leverage cap for open/closed ended funds will be introduced (175% or 300%, respectively). All of the changes introduced by AIFMD 2 on this topic will benefit from a grandfathering clause.
- Delegation: AIFMD 2 introduces a stronger supervision of delegated functions, with requirements for the entire delegation structure to be objectively justified, and for the delegation requirement to be automatically applied mutatis mutandis to the entire chain of delegation. However, these requirements are not applicable to distributors marketing the investment funds under their own MIFID licence or through insurance-based products.
- Reporting and disclosure requirements: the new reporting and disclosure requirements will be applicable to all markets, all exposures, all instruments and all assets, risk profiles and liquidity arrangements, where marketed. For delegates, disclosures will consist in particular of identity, links to the AIFM/ManCo, authorisation (or lack thereof) and applicable supervisory authority. For AIFM/ManCo, the disclosures will consist in particular of employees, qualification, how the percentage delegation of portfolio management is made, resources, due diligence performed, and the same information outlined above on delegates.
- New requirements on costs borne by investors: there will be new requirements with regard to what is charged by the AIFM/ManCo directly/indirectly to the investment fund/investors. This will need to be provided with a report explaining the reasons of the level of costs and the differences between them. Further reporting to the national authority and the European Securities and Markets Authority (ESMA) will be due, to develop a common understanding of the costs.

EU member states will have to transpose AIFMD 2 and changes to the UCITS Directive into their national legislation, raising interest as to how they will implement it domestically (for example, with or without gold-plating) and how they will make the most of it for the fund industry.

The new EU AML Package

On 20 July 2021, the European Commission presented an ambitious package of legislation to strengthen the EU AML and CFT rules (the AML Package). The aim and content of this AML Package is to remedy the gaps of the 5th AML Directive of 2018, which was not implemented equally or in full by all member states, as well as the lack of serious consequences in the event of non-compliance. This AML Package is based on four pillars that aim to correct existing deficiencies and raise the level of global response with respect to the fight against AML/CFT; they consist of the following.

- The EU “Single Rulebook” Regulation: an EU-wide mandatory instrument applying within the scope of AML obligations, which contains provisions on conducting due diligence on customers, the transparency of beneficial owners and the use of anonymous instruments such as crypto-assets, and new entities such as crowdfunding platforms. The regulation also includes provisions on so-called “golden” passports and visas.
- The 6th AML Directive contains national provisions on supervision and Financial Intelligence Units (FIUs), as well as access for competent authorities to necessary and reliable information – eg, beneficial ownership registers and assets stored in free zones.
- The regulation establishing the European Anti-Money Laundering Authority, which will operate with an independent executive board and will have direct supervisory powers

over some financial entities, including both financial and non-financial entities within the scope of AML obligations. It will also have regulatory powers to issue guidelines, technical standards and opinions, and will furthermore support the already existing national FIUs. Following the 2022 invasion of Ukraine, it has been suggested that the role of the European Anti-Money Laundering Authority should be expanded to playing a part in the enforcement of financial sanctions adopted by the EU.

- The amendment of the EU Transfer of Funds Regulation will update the existing regulation to bring crypto-assets service providers (CASPs) within the scope of the AML/CFT framework. It is the only element of the AML Package that was adopted earlier in 2023 together with the Market in Crypto Asset Regulation (MiCA). As a result, newly obliged CASPs should urgently update their AML/CFT processes to bring them in line with the regulation and the overall AML/CFT framework. However, CASPs that are already subject to AML/CFT rules should implement adjustments, if necessary.

On 28 March 2023, the Parliament adopted its position on the AML Package and on 17 April 2023 initiated a trilogue, which concluded on 17 January 2024. The final vote on the AML Package is expected to occur during the first half of 2024.

Towards ESG compliant fund names

In November 2022, ESMA published a consultation paper about its draft guidelines on the use of ESG or sustainability-related terms in fund names. The consultation closed on 20 February 2023, after an open hearing consultation held on 23 January 2023.

The consultation seems to have been far-reaching among participants, and ESMA received (and published) a wide range of responses. Whereas consensus emerged on the overarching objective of the consultation, which sought to limit greenwashing risks, increase legal certainty and avoid misleading information for investors, many questioned the ESMA approach, both in terms of the suitability of associating specific thresholds with name-associated sustainability claims and also in consideration of this issue on a standalone basis.

This consultation preceded the publication on 2 October 2023 of an ESMA Trends, Risks and Vulnerabilities Risk Analysis on ESG names and claims in the EU funds industry, with findings relevant for its context. The ESMA announced on 14 December 2023 that it was delaying the adoption of its guidelines to fully consider the outcomes of the current review of AIFMD 2, while also taking the opportunity to fine-tune them.

Taxonomy and new technical screening criteria

Commission Delegated Regulation (EU) 2023/2485 (CDR 1) and Commission Delegated Regulation (EU) 2023/2486 (CDR 2) were published on 21 November 2023 in the Official Journal. CRD 1 amends the “Climate Delegated Regulation” (ie, Commission Delegated Regulation (EU) 2021/213 of 4 June 2021 establishing technical screening criteria in relation to the contribution to climate change mitigation or climate change adaptation). These regulations add technical screening criteria with respect to economic activities not previously included under Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment (Taxonomy) (notably manufacturing activities in relation to key components for low carbon transport and electrical equipment). In addition, CDR 2 establishes technical screening criteria for economic activities making a substantial contribution to non-climate environmental objectives of Taxonomy, namely:

- the transition to a circular economy;
- control, or protection and restoration of biodiversity;
- pollution prevention; and
- the use and protection of water and marine resources.

The measures under CRD 1 and CRD 2 apply as of 1 January 2024.

Fine-tuning the Sustainable Finance Disclosure Regulation (SFDR) regulatory technical standards (RTS)

Following a mandate received by the Commission on 11 April 2022 to review and revise the SFDR RTS, the European Supervisory Authorities (the European Insurance and Occupational Pensions Authority, the European Banking Authority and ESMA – together, the ESAs) jointly published a consultation paper on 12 April 2023, titled "Review of SFDR Delegated Regulation regarding PAI and financial product disclosures" (the Consultation Paper). The SFDR Delegated Regulation under review was Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 (the so-called SFDR RTS, which provides technical regulatory standards for the application of the SFDR). A consultation period, which opened with the expectation of a final report being submitted to the Commission by October 2023, together with draft amendments to the SFDR RTS, closed on 4 July 2023.

The ESAs took the opportunity, beyond their initial mandate, to:

- open a discussion on the "Do No Significant Harm" principle (DNSH) and extensively revisit the templates provided by the SFDR Delegated Regulation;
- propose an extension of, and enhancements to, the list of indicators for principal adverse impacts (commonly referred to as PAIs);
- introduce new mandatory decarbonisation disclosures; and
- propose adjustments to all existing disclosure templates under the SFDR Delegated Regulation.

The future of the SFDR regime

On 14 September 2023, the Commission launched a consultation on the functioning of SFDR, aimed at gathering feedback on its implementation and objectives, and questioning how it should evolve, particularly by opening the door to what is perceived as an alignment with the Sustainability Disclosure Requirements developed in the United Kingdom (the SDR), through the use of a labelling regime overlapping with the SDR regime.

This consultation was open until 15 December 2023 and involved two publications:

- one focused on how the SFDR is working in practice and the issues of its implementation; and
- one focusing on identifying the shortcomings of the SFDR and exploring options to improve the regime.

No related amendments to the SFDR or the SFDR RTS have been proposed by the Commission, the focus of which, for now, is to find solutions to perfect the SFDR regime.

ESG ratings providers

In response to the recent (over) development of ESG rating providers, and noting that "the ESG ratings market currently suffers from a lack of transparency", the Commission published a set of rules on 13 June 2023, aimed at regulating their activities by:

- improving the reliability and transparency of ESG ratings activities;
- setting out organisational principles and clear rules on the prevention of conflicts of interest; and
- enabling investors to make better informed decisions regarding sustainable investments, which the Commission will now discuss with the Parliament.

European Sustainability Reporting Standards

In November 2022, the European Financial Reporting Advisory Group (EFRAG) submitted the first set of drafts of mandatory European Sustainability Reporting Standards (ESRS), which are the rules and requirements for companies to report on sustainability-related impacts, opportunities and risks under the Directive amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU as regards corporate sustainability reporting (CSRD). These drafts are in the form of technical standards, based on the initial draft standards used in the public consultation run earlier in the year.

In June 2023, the Commission released a proposed version of the final ESRS, with a number of its own changes. The most notable proposed change was that all disclosure requirements, with the exception of a set of general disclosures, will be subject to materiality assessments. This allows companies to focus reporting on sustainability factors that they consider material to their businesses. In addition, the Commission further converted several mandatory datapoints proposed by EFRAG into voluntary datapoints. The datapoints concerned are those considered most challenging or costly for companies, such as reporting a biodiversity transition plan and certain indicators about self-employed people and agency workers in the undertaking's own workforce.

In relation to the above, on 31 July 2023 the Commission adopted a draft delegated regulation (not yet published in the Official Journal), which supplements the CSRD (the ESRS Delegated Regulation). The ESRS that are to be used by entities in scope of the CSRD for their sustainability reporting are set out in Annex I and Annex II.

Annex I contains two sets of standards:

- ESRS 1 ("General Requirements"), which set out general principles to be applied when reporting according to ESRS; and
- ESRS 2 ("General Disclosures"), which specify essential information to be disclosed irrespective of the sustainability matter under consideration, and which are mandatory for all companies within scope of the CSRD.

In addition, Annex I contains a set of specific standards on:

- environmental disclosures covering climate change, pollution, water and marine resources, biodiversity and ecosystems, and resources and the circular economy;
- social disclosures, covering an organisation's own workforce, workers in the value chain, affected communities and customers and end-users; and
- governance, covering business conduct.

These specific standards and the individual disclosure requirements and related data are subject to a materiality assessment. However, disclosure requirements subject to a materiality assessment are not optional, but subject to a disclose or explain mechanism.

The ESRS Delegated Regulation was passed along to the Parliament and the Council for a two-month scrutiny period, which ended in October 2023.

EU Retail Investment Strategy (RIS)

In continuation of the 2020 Capital Markets Union action plan (aimed at improving access for retail investors to financial markets and ensuring investor protection), the Commission published the final version of the RIS on 24 May 2023. The Commission's proposal of the RIS package includes a proposal for an Omnibus Directive amending the UCITS Directive and the AIFMD (among others), therefore requiring that it be considered and voted on by the Parliament and Council before becoming applicable.

This package sets out new requirements and enhancements to the investor protection framework in a wide range of areas, such as:

- a ban on inducements paid by manufacturers to distributors for execution-only sales, and rules to "further substantiate" the need for firms to act in their clients' best interests, while introducing new tests for advisers to consider when recommending products;
- stricter rules on marketing communications, with new obligations such as the requirement for management bodies to define, approve and oversee a policy on marketing communications and enhanced record keeping requirements;
- changes to Directive 2014/65/EU on Markets In Financial Instruments, for clients requesting to be treated as "professional", including reducing the minimum wealth criterion from EUR500,000 to EUR250,000 and adding a new criterion around professional experience or education; and
- in furtherance of ESMA's recent opinion on considering "undue" costs in UCITS and AIFs, giving a mandate to ESMA (notably) to regularly update cost and performance benchmarks against which manufacturers would need to compare their products before offering them to the market.

The Commission's RIS package is currently being discussed between the Parliament and the Council and should not enter into force before 2025.

Modernisation of the Luxembourg toolbox

On 11 July 2023 (ie, at the same time as the adoption of the revised – and more accessible – regime on the European Long Term Investment Fund label, available as of 10 January 2024), the Luxembourg legislature adopted the bill of Law No 8183 introduced by the Ministry of Finance on 27 March 2023 (the Law) and amended the following laws:

- the Law of 15 June 2004 relating to the investment company in risk capital (SICAR), as amended;
- the Law of 13 February 2007 relating to specialised investment funds (SIFs);
- the Law of 17 December 2010 on undertakings for collective investment (UCIs);
- the Law of 23 July 2016 on reserved alternative investment funds (RAIFs), as amended; and
- the AIFM Law.

The Law was published in the Official Journal on 24 July 2023 and entered into force on 28 July 2023, modernising the Luxembourg investment funds toolbox by introducing the following adjustments to the above-mentioned laws:

- the threshold to qualify as a well-informed investor has been lowered from EUR125,000 to EUR100,000;
- SICARs, SIFs and RAIFs now have 24 months to reach their applicable minimum capital, and UCIs subject to Part II of the UCI Law (the UCI Part II) now have 12 months;
- European long-term investment funds qualifying as SICARs, SIFs, RAIFs or UCIs Part II are exempt from the subscription tax;
- AIFMs now have the possibility to appoint tied agents (alignment on UCITS);
- SICARs and SIFs can be marketed in Luxembourg to retail investors that are "well-informed investors", and also to RAIFs; and
- the second notarial deed for the incorporation of RAIFs (ie, the *constat de constitution*) has been removed when the relevant RAIF has been incorporated by way of a notarial deed.

The Law irons out several inconsistencies in and between the above-mentioned laws and is a welcomed improvement for the Luxembourg investment funds industry.

Conclusion

Luxembourg is in the middle of a regulatory wave, caused partly by the current economic, political and financial environment and partly by the need to fill certain gaps and establish a complete and strong harmonised framework in this maturing industry (in particular on the alternative investment side), not to mention the overarching necessity to do business in a more sustainable and responsible manner. One of the biggest challenges for market players will be to find opportunities and gains within this framework for change.

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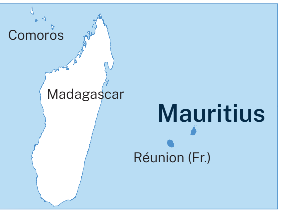

Law and Practice

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BLC Robert & Associates

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BLC Robert & Associates

BLC Robert & Associates is the leading independent business law firm in Mauritius, with the largest number of fee earners. The firm's membership of ALN strengthens its position as the leading provider of legal services both locally and into the African continent, through the presence of member law firms in 15 African jurisdictions. The firm has eight partners and four main practice areas: corporate and commercial, banking and finance, financial services and regulatory, and dispute resolution. The firm also has further specialised sub-practice groups, covering business law, M&A, employment, taxation, real estate and hospitality, insolvency, capital markets, and technology, media and telecommunications. Clients include a vast number of funds, private equity houses, managers, insurance companies, fiduciary businesses and financial advisers. Funds and funds-related work is a core area of the practice, with a dedicated team advising on all aspects of fund formation, closings, investor relationships, regulatory and tax structuring.

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1. Market Overview

1.1 State of the Market

Mauritius has established itself as a leading international financial services centre, and has made it to the pantheon of successful developing economies by adopting international norms and best practices, and promoting a business-friendly environment. The choice of Mauritius as a domicile for structuring business into Africa and Asia is well established among fund managers and institutional investors, who can benefit from the well-established and advantageous ecosystem. Mauritius has so far concluded 46 tax treaties and is a party to 29 Investment Promotion and Protection Agreements, which provide extra assurance and protection for the country's potential investors. Mauritius has always proved itself as a jurisdiction of economic substance.

Mauritius is a recognised jurisdiction for global investment funds, with 945 funds (both open-ended and closed-end), according to statistics published by the Financial Services Commission (FSC) in January 2023. Mauritius has improved its position in the Global Financial Centre Index (GFCI) by 13 places according to the 34th edition of the GFCI, and had around 956 global funds as of December 2023 as per the monthly global business data sheet issued by the FSC.

Mauritius has been at the forefront of providing innovative products and solutions to investors. The FSC is keen to develop fintech-related initiatives in Mauritius, and has recently launched its Fintech and Innovation webpage in order to meet the diverse needs of the financial services and fintech industry. This is a comprehensive resource hub and an additional feature on the FSC website so as to stay abreast of new product offerings and emerging trends in the fintech ecosystem.

As an international financial centre and growing fintech hub, Mauritius was one of the first countries in the Eastern and Southern African region to adopt comprehensive legislation on virtual assets and initial token offerings, namely the Virtual Asset and Initial Token Offering Services Act 2021 in February 2022. This statute regulates the business activities of virtual asset service providers and initial token offerings.

In addition, Mauritius is a politically stable jurisdiction with a system of law inspired by English common law and French civil law, with a final right of judicial recourse to the Judicial Committee of the Privy Council of the United Kingdom. At the same time, it is geographically and culturally close to countries in Africa and Asia, making it a preferred platform for establishing holding structures in the emerging markets of these continents. Mauritius is a member of the Southern African Development Community (SADC), the Indian Ocean Rim Association (IORA) and the Common Market for Eastern and Southern Africa (COMESA).

Mauritius' regulatory framework provides for both retail funds and AIFs, the latter of which are authorised as investment funds generally and further categorised as expert funds or professional CISs under the laws of Mauritius. They are available only to sophisticated and expert investors and high net worth individuals, and are exempted from the stricter regulations applied to retail funds. Retail funds are offered to the public and are regulated as open-ended funds (known as collective investment schemes – CISs) or closed-end funds (CEFs). Recently, the FSC has also added additional fund categories such as special purpose funds and real estate investment trusts (REITs).

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2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

Funds can be set up as companies, limited partnerships, protected cell companies (PCCs), trusts or variable capital companies (VCCs). The typical vehicle used to structure a CEF is a company or a limited partnership, whereas a CIS is commonly structured as a company, unit trust or PCC. The new VCC structure now provides an alternative for fund structuring, giving fund managers the opportunity to operate several sub-funds and special purpose vehicles (SPVs, which can include a CIS and a CEF) under an umbrella fund instead of having to set up separate structures.

Companies

Companies may be established as public or private and are incorporated under the Companies Act 2001. Participants are issued with shares of the company. A private company is limited to 50 shareholders and cannot offer shares to the public. Companies have the following features:

- they can be structured as limited life companies and/or limited by shares;
- the liability of a shareholder is limited to the extent of the amount unpaid on their shares;
- a board is subject to the doctrine of fiduciary responsibility;
- a separate legal personality is maintained; and
- statutory rules for filing and reporting ensure transparency and accountability.

Distribution to shareholders is subject to the company remaining solvent, and the company is treated as one taxable unit.

Limited Partnerships

This form of partnership is governed by the Limited Partnerships Act 2011. It can be set up with or without legal personality, and will have at least one general partner and one or more limited partners. The general partner is responsible for the management of the limited partnership and has unlimited liability for the debts and obligations of the partnership. The liability of the limited partner is limited to the maximum amount of its contribution, provided that the limited partner takes no part in the management of the partnership. Where the limited partner does become involved in the management of the partnership, they will be treated as a general partner and be liable for the debts of the partnership. Participants' interests are referred to as partnership interests.

A private equity fund structured as a partnership would offer the benefits of:

- relative flexibility;
- the mitigation of fiduciary risks;
- the ability to account for profits and losses at limited partner level; and
- tax transparency.

The partnership also offers limited liability to limited partners, but the liability of a general partner is not capped.

Protected Cell Companies

A PCC is subject to the Protected Cell Companies Act 1999 and the Companies Act 2001. Participants in a PCC are issued with "cell shares" in the cell in which they invest. The segregation of assets and liabilities can be achieved by using a PCC.

PCCs are often structured to meet the objectives of investment, such as providing for investor returns from specific cells, distinct separation of non-cellular assets and cellular assets, and restricting liability arising from one cell to that cell only. PCCs have the same advantages as companies, including limited liability for shareholders, a board that has fiduciary duties, separate legal personality and the same statutory rules for filing and reporting.

Trusts

Trusts are created under the Trusts Act 2001, and participants are issued with units therein. A trust established in Mauritius can have up to four trustees, at least one of whom should be a qualified trustee (a person who is authorised as such by the FSC).

Trusts are relatively easy to set up and are flexible vehicles, but do not have legal personality. The creation of a trust does not require any registration or incorporation, but an application to the FSC must be made in order to be authorised as a fund. Trustees are subject to fiduciary duties.

Variable Capital Companies

A VCC is incorporated under the Companies Act 2001 and carries out its activities through sub-funds and SPVs. A VCC needs to be authorised by the FSC as a "VCC Fund", pursuant to the Variable Capital Companies Act 2022.

A VCC can operate as a standalone investment fund or can be structured as an umbrella fund through its sub-funds and/or its SPVs. The assets and liabilities of one sub-fund or SPV are segregated from those of another and, as such, the liabilities of a sub-fund under an umbrella VCC can only be discharged from its assets and not out of the assets of the other sub-funds or SPVs.

Unlike a PCC, one sub-fund of a VCC Fund can be structured as a CIS, while another sub-fund of the same VCC Fund can be structured as a CEF. Therefore, a VCC Fund can accommodate both open-ended and closed-ended structures under one "umbrella" structure. In addition, the sub-fund or SPV of a VCC Fund may have separate legal personality from that of the VCC Fund (ie, separate name and legal entity), in which case it must be incorporated as a company under the Companies Act 2001. A sub-fund of a VCC Fund can also act as a feeder fund or a master fund. On the other hand, SPVs can only operate as a vehicle ancillary to the VCC or a sub-fund of the VCC, and not as a fund on their own.

2.1.2 Common Process for Setting Up Investment Funds

A fund in Mauritius is regulated as a CIS or a CEF, and requires fund authorisation from the FSC. AIFs are typically sub-classified as expert funds or professional CISs.

A fund that conducts business principally outside of Mauritius, the majority of whose shares/voting rights/legal or beneficial interests are held by non-citizens, will also be required to apply for a Global Business Licence (GBL). Any corporation holding a GBL must be administered by a management company that is duly licensed by the FSC (Administrator). Such an Administrator must also be appointed as the GBL's corporation secretary/registered agent, and will be responsible for liaising with the authorities on the setting up and licensing of the entity, and for ensuring ongoing compliance with Mauritius' laws.

Prior to application, the applicant will need to reserve the proposed names of the entities with the Mauritius Registrar of Companies/Registrar of Limited Partnerships (Registrar) and pay the relevant fee; if approved, the proposed name is valid for two months from the date of notice of reservation of the name.

In relation to the setting up of the fund in Mauritius, the application for registration is lodged with the Registrar, who will then notify the FSC of the application through the FSC One Platform (FSC One). Following receipt of this notification, the application for a GBL and authorisation to operate as a fund (open-ended or closed-end) will be lodged on the FSC One.

The following documents need to be submitted for the registration and licensing of the fund:

- a duly completed application form for the registration/incorporation and licence;
- fund documents:
  (a) a constitution and the shareholders' agreement (if adopted) for a company;
  (b) a limited partnership agreement for a limited partnership;
  (c) the trust deed for a trust; and
  (d) the subscription agreement, the investment management agreement and any advisory agreement (drafts of the fund documents may be submitted, but the FSC expects these to be in near final form);
- a draft offering memorandum or prospectus;
- a consent form for initial shareholders and directors or partners;
- know-your-customer documentation on promoters, beneficial owners and proposed directors, general partners or trustees (as applicable);
- certificates and confirmations required by law and the regulators;
- the appropriate government/licensing fees; and
- any additional documents the FSC might require.

The timeframe for the application for a fund authorisation is around 60 business days from the time the application is submitted to the authorities, assuming the application is complete and related queries are cleared on time.

The following fees are payable to the FSC for the licensing process:

- a registration fee for CISs (open-ended) and CEFs (for a single fund) of USD1,000 and an annual fee (payable in advance) of USD3,000;
- a registration fee for CISs (open-ended) and CEFs that are structured as umbrella funds or PCCs and have more than one fund/cell, of USD1,000 for the first fund/cell and USD300 for each additional fund/cell;
- an annual fee of USD3,000 for the first fund/cell and USD600 for each additional fund/cell;
- a registration fee for CISs (open-ended) and CEFs that are structured as VCCs, of USD1,000 for the first sub-fund and USD500 for each additional sub-fund or SPV;
- an annual fee of USD3,000 for the VCC (inclusive of the first sub-fund), then USD1,000 each for the second to fifth sub-funds/SPVs, and USD1,950 for each additional sub-fund or SPV;
- an annual fee of USD5,000 for a fund categorised as a Special Purpose Fund or a REIT; and
- for the GBL, a processing fee of USD500 and an annual fee of USD1,950.

In addition to FSC fees, an incorporation fee of around MUR4,600 (USD107) and an annual fee of around MUR13,000 (USD300) are payable to the Registrar of Companies in the case of a company, and a registration fee of around MUR4,600 (USD107) and an annual fee of around MUR3,600 (USD84) are payable to the Registrar of Limited Partnerships in the case of a limited partnership.

2.1.3 Limited Liability

Investors typically seek participation in a structure where their liability is limited. These investments generally take the form of shares in a company limited by shares or partnership interests in a limited partnership. The liability of investors will be limited to the amount they have contractually undertaken to pay to the fund.

To enjoy limited liability, the underlying principle in both structures is for the investor to have a passive participation. Investors risk losing their limited liability status if they participate in the management of the business of the fund. In doing so, they may be viewed as acting as the general partner or a director (depending on the structure) and thus attract the unlimited liability that generally attaches to a general partner, or they may become personally liable as a director.

Legal opinions on the limited liability of investors (and on matters such as due incorporation/registration and the power, capacity and authority of the fund to execute the fund agreements) are typically provided upon request by the shareholders/limited partners.

2.1.4 Disclosure Requirements

A fund authorised in Mauritius needs to file an offering document with the FSC. Any update to these documents must also be filed with the FSC. The type of offering document and the relevant disclosure in this document will vary depending on the category of the fund and the target investors.

The disclosure requirements for funds being offered by way of private placement or to sophisticated investors, high net worth investors or expert investors will be reduced. However, the offer document must contain the requisite disclaimers and generally sufficient information to allow investors to make an informed decision on investment in the fund.

Reporting Requirements

Non-retail funds are required to file audited financial statements with the regulator within six months of the balance sheet date, but such accounts do not need to be made public.

The annual financial statements of companies/limited partnerships (other than those holding a GBL) are available for public inspection at the Registrar of Companies/Limited Partnerships (as applicable).

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

There is a diverse range of investors in Mauritius, including institutional investors, development finance institutions, family offices and financial institutions.

2.2.2 Legal Structures Used by Fund Managers

An investment manager licensed by the FSC must:

- be incorporated or registered as a body corporate in Mauritius;
- be engaged principally in the business of managing funds;
- have directors, officers and beneficial owners who meet the fit and proper test;
- have appropriately qualified staff;
- maintain a minimum stated capital of at least MUR1 million (or an equivalent amount in a different currency) at all times;
- have proper insurance cover in place;
- establish and document its rules of internal control to ensure that it is legally compliant and sufficiently supervised;

- have a code of ethics and a code of conduct in place that are binding on its officers, advisers and employees; and
- comply with anti-money laundering laws.

Fund managers are typically set up as companies incorporated under the Companies Act 2001.

2.2.3 Restrictions on Investors
An expert fund is only available to:

- an investor making an initial investment on its own account of no less than USD100,000;
- a sophisticated investor (as defined in **2.3.10 Investor Protection Rules**); or
- any investor similarly defined in the securities legislation of another country.

A professional CIS is not available to the public but to sophisticated investors, as defined in the Securities Act 2005, or on a private placement basis in the case of an open-ended fund where the minimum subscription amount is at least USD200,000 and for a CEF where the subscription amount is generally more than USD200,000.

To qualify as a professional CIS, the following restrictions apply:

- shares acquired by the participants may not be resold to the public, and the participants are advised of this restriction at the moment of subscription; and
- the fund may not be listed for trading on a securities exchange.

A special purpose fund (which can be open-ended or closed-end) is only permitted to offer its shares by way of private placements to competent investors with significant experience and knowledge of fund investment. It can have a maximum of 50 investors and a minimum subscription of USD100,000 per investor.

2.3 Regulatory Environment
2.3.1 Regulatory Regime
There are two main categories of funds: CISs and CEFs. As defined in the Securities Act 2005, a CIS is obliged to redeem a participant's shares at their request, at a price corresponding to the net asset value (NAV) of those investments (minus fees and commissions). This obligation does not exist for CEFs, which are characterised principally by the fact that the investors do not have control on exiting the fund. A CIS or CEF is set up mainly to invest in portfolios of securities, money market instruments or debt instruments, including loans, debt obligations or similar instruments or other financial assets, real property or non-financial assets, subject to the approval of the FSC.

A fund is required to be managed by an investment manager licensed as a CIS manager by the FSC, or by a foreign investment manager with the approval of the FSC in the case of a fund holding a GBL. A fund that is constituted as a company may be self-managed (ie, managed by its board of directors), with the approval of the FSC.

AIFs are classified as expert funds (which must be open-ended) or professional CISs (which can be either open-ended and closed-end), and are entitled to exemptions from the following detailed regulations that apply to retail funds:

- the requirement to have a prospectus in the prescribed form (the offering memorandum can be customised subject to a few mandatory disclosure requirements);
- the minimum funding requirements;
- investment and borrowing restrictions;

- the requirement to prepare and file management reports and quarterly reports;
- the requirement to conduct daily valuations; and
- the requirement to publish the prices of interests in the CIS on a weekly basis.

To qualify for categorisation as a professional CIS, the restrictions set out under **2.2.3 Restrictions on Investors** would apply.

2.3.2 Requirements for Non-local Service Providers

Non-local service providers cannot provide services as administrators, custodians, director services providers, etc, in Mauritius by way of business. They will need to set up either a branch or a subsidiary in Mauritius, which will need to apply for a licence from the FSC in order to conduct business in Mauritius.

Where there is no business establishment in Mauritius and the service provider does not solicit Mauritius retail investors in respect of services related to the marketing of securities, there will be no prohibition on the service provider dealing with such persons, and usually no licensing requirement will be triggered for such non-local service provider. However, depending on the services being provided and the categorisation of the fund granted by the FSC, the fund may be limited to local service providers or may require the approval of the FSC prior to the appointment of a non-local service provider.

2.3.3 Local Regulatory Requirements for Non-local Managers

Prior FSC approval is required to appoint a foreign manager to manage a fund authorised in Mauritius, although this option is only available where the fund holds a GBL.

The FSC will assess whether the licence of the foreign investment manager is issued by a regulatory body in a jurisdiction that has comparable regulation to Mauritius for investor protection. In support of the application for prior approval, a draft of an investment management agreement between the fund and foreign investment manager and evidence of the licensed status of the manager need to be submitted to the FSC, alongside details of the management team's appropriate competence and relevant fund management experience.

2.3.4 Regulatory Approval Process

The timeframe for the application for a fund authorisation is around 60 business days from the time the application is submitted to the authorities, assuming the application is complete and related queries are cleared on time.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

The production and offering of marketing materials are regulated by the Securities Act 2005 and the regulations and rules thereunder, and by the FSC's Guidelines for Advertising and Marketing of Financial Products 2014. These Guidelines regulate the conduct of the marketing and the content of advertisements and marketing materials, and require certain specific disclosures and disclaimers on the product and the persons promoting them.

The regulatory framework does not provide specific rules on the pre-marketing of alternative funds; however, any fund-related document provided to investors should clearly disclose the status of such document (for instance, if it is still in draft form) as well as the regulatory statuses of the person marketing the document, of the fund and of the manager. Investors must be expressly informed of the above and should be warned to only rely on the final constitutive documents of the fund when making any investment decision.

2.3.6 Rules Concerning Marketing of Alternative Funds

The production and offering of marketing materials are regulated by the Securities Act 2005 and the regulations and rules thereunder, and by the FSC's Guidelines for Advertising and Marketing of Financial Products 2014.

The law limits any solicitation to invite or induce a retail investor in Mauritius to buy, sell or exchange securities to be done solely by licensed persons. The following activities may be carried out only by locally licensed intermediaries:

- seeking to meet a retail investor at their place of residence or work, or in public places;
- contacting a retail investor by telephone, letter, circular, the internet or other electronic means or telecommunication system; or
- publishing or causing an advertisement to be published or circulated by a person to induce another person to buy, sell or exchange securities or to participate in transactions involving securities, or offering such a person services, recommendations or advice for those purposes.

These Guidelines regulate the conduct of the marketing and the content of advertisements and marketing materials, and require certain specific disclosures and disclaimers on the product and the persons promoting them.

All marketing materials need to be submitted to the FSC prior to dissemination.

2.3.7 Marketing of Alternative Funds

Shares or interests in funds that are authorised as professional CISs or expert funds can only be offered to specific types of investors, as described in **2.2.3 Restrictions on Investors**.

2.3.8 Marketing Authorisation/Notification Process

All marketing materials need to be submitted to the FSC prior to dissemination.

A professional CIS (open-ended or closed-ended) must notify the FSC 15 days before the offering is made, and simultaneously file a copy of the offering document prepared for the purpose of the offering. Moreover, a professional CIS (open-ended or closed-ended) is required to inform the FSC of the conclusion of an offering, indicating the total amount and value of shares sold.

2.3.9 Post-marketing Ongoing Requirements

There are no prescribed ongoing requirements for firms that have marketed an alternative fund other than contractual obligations they have entered into and the general licensing obligations specifically applicable to them by virtue of the capacity under which they have marketed the fund.

2.3.10 Investor Protection Rules

There are specific categorisations of funds that are targeted only to specific investors and thus enjoy exemption from the regulations on the grounds that they are only offered to sophisticated, institutional or high net worth investors.

"Expert funds" can only be offered to expert investors (ie, an investor that makes an initial investment for its own account of no less than USD100,000) or sophisticated investors, as defined in the Securities Act 2005 (or any investor similarly defined in the securities legislation of another country).

Under the Securities Act 2005, sophisticated investors include the following:

- the government of Mauritius;
- a statutory authority or an agency established by an enactment for a public purpose;
- a company whose shares are wholly owned by the government of Mauritius, a statutory authority or an agency established by an enactment for a public purpose;
- the government of a foreign country, or an agency of that government;
- a bank (licensed by the Bank of Mauritius);
- a CIS;
- a fund manager (licensed by the FSC);
- a pension fund or its management company;
- a CEF;
- an insurer (licensed by the FSC);
- an investment adviser (licensed by the FSC);
- an investment dealer (licensed by the FSC);
- an investor that warrants, at the time of entering into a securities transaction, that:
  (a) its ordinary business or professional activity includes entering into securities transactions, whether as principal or agent;
  (b) for a natural person, the individual net worth or joint net worth with a spouse exceeds USD1 million or its equivalent in another currency; or
  (c) it is an institution with a minimum amount of assets under discretionary management of USD5 million or its equivalent in another currency; and
- a person declared by the FSC to be a sophisticated investor.

A professional CIS cannot be offered to the public and is only available to a sophisticated investor, as defined in the Securities Act 2005, or as a private placement in the case of an open-ended fund where the minimum subscription amount is at least USD200,000 and for a CEF where the subscription amount is generally more than USD200,000.

Investors are not protected by any statutory compensation arrangements in Mauritius in the event of the fund's failure, and it is mandatory for the offer document to include such disclosures along with other disclosures specific to the type of fund as required by the FSC.

2.3.11 Approach of the Regulator

The FSC is mandated under the Financial Services Act 2007 to, inter alia, ensure the orderly administration of financial services and global business activities, and to ensure the sound conduct of business in the financial services sector and in the global business sector. To achieve its objectives, the FSC elaborates policies that aim to ensure the fairness, efficiency, transparency and stability of the financial system in Mauritius. It also publishes monthly newsletters, FAQs and circular letters to provide regular updates and guidance. The regulator's online portal contains general information, up-to-date legislation and regulations, and statistics on licensed entities operating in Mauritius.

The FSC conducts investigations and imposes sanctions (including the revocation or suspension of licences) where it has reasonable cause to believe that a licensee is committing or has committed a breach of the relevant laws, or is carrying or has carried on an activity that may cause prejudice to the soundness, integrity and stability of the financial system of Mauritius or to the reputation of Mauritius.

Where additional information or clarifications are required by the FSC with respect to fund applications, the FSC will usually raise such queries with the administrators via email. It is also possible to request face-to-face meetings with the FSC.

2.4 Operational Requirements

There are no particular regulatory restrictions or requirements in relation to the types of investments for AIFs. Any person wishing to establish a specialised fund that invests in real estate, derivatives, commodities or any other product must apply to the FSC for a decision on whether such fund would be authorised.

An open-ended fund categorised as an expert fund or a professional CIS is required to appoint a custodian that holds a custodian licence under the Securities Act 2005 to hold and safekeep the assets of the fund. Only banks and trust companies that are subsidiaries of banks are eligible for a custodian licence. If the fund holds a GBL, it may appoint a foreign custodian with the approval of the FSC. The appointed custodian must act independently from the fund manager and the fund. However, CEFs are exempt from the requirement to appoint a custodian, with the assets being held in the name of the fund itself.

Risk

Although there are no specific rules on risks for exempted funds, the offering memorandum of such fund must disclose all material risks to potential investors, to enable them to make an informed decision on whether or not to invest in the fund.

Valuation and Pricing

AIFs are free to specify the method and frequency of their valuations.

System and Controls

AIFs are not regulated as strictly as retail funds. Because they can only be offered to sophisticated or high net worth investors, they are spared the application of the various prudential and conduct of business rules that are generally applicable to retail funds.

Insider Dealing and Market Abuse

The Securities Act 2005 contains a chapter on market abuse, which creates the offences of insider dealing, false trading, market rigging, fraud and deceptive conduct involving securities. The prohibition on insider dealing is a general prohibition applicable to any person who uses insider information to deal in the securities of a reporting issuer (directly or indirectly), or who discloses insider information unlawfully.

Transparency

AIFs have reduced filing and publication requirements, but are still required to file annual financial statements and to keep the regulator informed of any material change in the AIF.

Money Laundering

All funds must comply with:

- the Financial Intelligence and Anti-Money Laundering Act 2002 (inspired by the Financial Action Task Force principles);
- the Financial Intelligence and Anti-Money Laundering Regulations 2018; and
- the Financial Services Commission Anti-Money Laundering and Countering the Financing of Terrorism Handbook 2020 (issued by the FSC, which is the supervisory authority of funds for money laundering and related purposes).

Funds must carry out customer due diligence (CDD) in accordance with the law, including verifying the identity of investors and being satisfied that the source of funds is lawful. For corporate investors, the fund must obtain copies of incorporation documents to establish the existence of the fund and the identity of its principals. The fund must also provide CDD information on the investor(s), directors and other principals, including beneficiaries, account signatories and any person operating under a power of attorney.

Reduced or enhanced CDD may be applied, depending on the profile of the investors, whether they are regulated institutions, and their country of domicile. Moreover, funds are required to appoint a money laundering reporting officer, a deputy money laundering reporting officer and a compliance officer who are conversant with the anti-money laundering laws of Mauritius.

Funds are also required to comply with the United Nations (Financial Prohibitions, Arms Embargo and Travel Ban) Sanctions Act 2019 (the UN Sanctions Act), which prohibits dealing with funds or other assets of, or making funds or other assets available to, a party listed on a United Nations Sanctions List or a Designated Party declared as such under the UN Sanctions Act. The UN Sanctions Act also establishes several reporting obligations and authorisation mechanisms, which reporting persons (including funds) must implement.

Short Selling

There are no rules that specifically address short selling.

Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS) Regimes

FATCA

The Republic of Mauritius and the government of the United States of America have signed an Agreement for the Exchange of Information Relating to Taxes (the Agreement) and the Inter-Governmental Agreement (Model 1 IGA) to improve international tax compliance and implement FATCA. The Agreement provides for the exchange of tax information (upon request, spontaneous and automatic) between Mauritius and the USA, while the IGA provides for the automatic reporting and exchange of information in relation to accounts held with Mauritius financial institutions by US persons and the reciprocal exchange of information regarding financial accounts held by Mauritius residents in the USA. Following the IGA, Mauritius financial institutions will not be subject to the 30% withholding tax on US source income if they comply with the requirements of FATCA.

CRS

Mauritius has signed the Convention on Mutual Administrative Assistance in Tax Matters (the Convention) developed by the Organisation for Economic and Co-operation and Development (OECD), under which information can be exchanged on request, spontaneously or automatically. Thus, Mauritius will be able to exchange information automatically on a reciprocal basis with all jurisdictions that have signed the Convention. Mauritius financial institutions have to report annually to the Mauritius Revenue Authority on the financial accounts held by non-residents for eventual exchange with relevant treaty partners.

Funds in Mauritius must assess their FATCA and CRS classification to determine their reporting requirements to the Mauritius Revenue Authority.

2.5 Fund Finance

Funds in Mauritius can access fund finance for subscription financing and/or leverage.

There are no regulatory restrictions in relation to borrowings for funds categorised as expert funds or professional CISs; these requirements will be guided by the fund documentation.

Typically, a fund finance transaction related to private equity funds will be secured by security over bank accounts of the fund and the assignment of rights to make capital calls, which is accompanied by a power of attorney in favour of the lender to exercise such rights on behalf of the fund/general partner and/or manager (as the case may be), in addition to the assignment.

The main issues are the restrictions on the creation of security rights over capital commitments/calls or the use of investor contributions, which may be set out in the private equity funds' documentation and more especially the side letters between the fund and a particular investor. It is also common for investors to resist acknowledging any notice of assignment and refuse to pay the lender directly.

2.6 Tax Regime

The tax status will depend on the type of vehicle used to structure a fund. Funds are generally structured as companies or limited partnerships.

Companies

Companies are tax opaque. Where a fund is structured as a company, it is liable to pay tax on its chargeable income at the rate of 15%. However, a CEF or CIS duly authorised by the FSC may be entitled to benefit from a partial exemption of 80% on all its income if it satisfies the below conditions relating to the substance of its activities. The partial exemption is also available to a CIS manager, CIS administrator, investment adviser, investment dealer or asset manager duly authorised by the FSC.

The substance conditions are that the company:

- carries out its core income-generating activities in Mauritius;
- employs, directly or indirectly, an adequate number of suitably qualified persons to conduct its core income-generating activities; and
- incurs a minimum expenditure proportionate to its level of activities.

Alternatively, a company may be entitled to claim foreign tax paid on its foreign source income as credits against the income tax payable in Mauritius (up to a maximum of 15%) in respect of that income, where this can be evidenced (Foreign Tax Credit). The Mauritius Income Tax Act 1995 (ITA) defines "foreign source income" as income that is not derived in Mauritius.

There is no withholding tax on dividends distributed by a company to its shareholders. Furthermore, any interest paid to a non-resident not carrying on any business in Mauritius by a company holding a GBL will be exempt from withholding tax to the extent that the interest is paid out of the foreign source income of the fund. There is no tax applicable to capital gains in Mauritius.

Limited Partnership

A fund structured as a limited partnership will be tax transparent, unless it also holds a GBL, in which case it can elect to be tax opaque and the tax treatment will be similar to that of a company.

Funds structured as limited partnerships that have elected to be tax transparent will not be taxable in Mauritius if they qualify as a *resident société* under the ITA; instead, their partners are liable to income tax on their share of income. A limited partnership will meet the criteria of a *resident société* as understood under the ITA when the seat of the limited partnership is in Mauritius and the limited partnership has at least one partner resident in Mauritius.

Tax opaque entities are entitled to benefit from the various tax treaties that Mauritius has with other countries.

The above tax considerations would be applicable to a fund established as a CIS and to a CEF.

There is no withholding tax on the following payments by a fund established as a company or a limited partnership:

- distribution by the fund to its resident and non-resident investors;
- in respect of a fund holding a GBL, interest paid to non-residents out of the foreign source income of the fund; or
- interest paid to a company resident in Mauritius.

Special Purpose Fund

In line with the ITA, a special purpose fund is a tax-exempt vehicle under Mauritius law. Any interest, rents, royalties, compensation and other amounts paid to a non-resident by a special purpose fund established under the Financial Services Act 2007 will also be exempt from Mauritius income tax.

Non-resident Investors

An investor who is not tax resident in Mauritius and who does not otherwise derive any income from Mauritius is not required to pay any tax in Mauritius, whether in respect of income or gains (including distributions) received from a fund, its worldwide income or otherwise, and is not required to make any tax filing in Mauritius.

In respect of limited partnership funds, insofar as the fund derives foreign source income, the partners who are not tax resident in Mauritius will not be subject to tax by reason of being a partner in the fund. Partners who are tax resident in Mauritius will be subject to tax in Mauritius, as set out further below.

Where a non-resident investor derives Mauritian source income, the investor will be required to file an income tax return in Mauritius.

Resident Investors

An investor who is tax resident in Mauritius will be liable to income tax as follows:

- at the rate of 15% for a body corporate; or
- if the investor is an individual, the chargeable income of the investor will be subject to a progressive tax ranging from 0% to 20%.

A tax resident investor that is a body corporate will be entitled to benefit from the Foreign Tax Credit and a partial exemption of 80% in respect of the following types of income:

- foreign source dividend, provided that such dividend is not allowed as a tax-deductible item in the source country and the company satisfies the conditions relating to the substance of its activities as prescribed;
- interest derived by a company other than a bank referred to in Section 44C of the ITA, a non-bank deposit-taking institution, a money changer, a foreign exchange dealer, an insurance company, a leasing company or a company providing factoring, hire purchase facilities or credit sales facilities, provided that the company satisfies the conditions relating to the substance of its activities as prescribed;
- profit attributable to a permanent establishment held by a resident company in a foreign country;
- income derived by a CIS, CEF, CIS manager, CIS administrator, investment adviser or asset manager licensed or approved by the FSC;

- income derived by companies engaged in ship and aircraft leasing;
- income derived by a company from reinsurance and reinsurance brokering activities, subject to satisfying any conditions prescribed relating to the substance of its activities;
- income derived by a company from the leasing and provision of international fibre capacity, subject to satisfying any conditions prescribed relating to the substance of its activities;
- interest derived by a person from money lent through a peer-to-peer lending platform; and
- income derived by a company from the sale, financing arrangement, asset management of aircraft and its spare parts and the provision of aviation advisory services related thereto, subject to satisfying any prescribed conditions relating to the substance of its activities.

A tax resident investor who is an individual will be entitled to:

- Foreign Tax Credit;
- deduct the applicable amount of personal reliefs and deductions from their net income in each income year; and
- any other reliefs, allowances and deductions as apply.

Any dividend income received or gains made by any Mauritian investor from a fund established as a company in Mauritius are exempt from income tax.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

Retail funds can be set up as companies, limited partnerships, PCCs, trusts or VCCs, as described in **2.1.1 Fund Structures**.

3.1.2 Common Process for Setting Up Investment Funds

A fund in Mauritius is regulated as a CIS or a CEF, and a fund authorisation is required from the FSC.

A retail fund conducting business principally outside of Mauritius, the majority of whose shares/voting rights/legal or beneficial interests are held by non-citizens, will also be required to apply for a GBL.

The process for setting up retail funds would entail making a similar name reservation and formal application to the authorities as described in **2.1.2 Common Process for Setting Up Investment Funds**, and the same timeframe and fees would apply.

3.1.3 Limited Liability

The liability of investors participating in structures such as companies limited by shares or limited partnerships will be limited to the amount they have contractually undertaken to pay to the fund, so long as their participation remains passive, as detailed in **2.1.3 Limited Liability**.

3.1.4 Disclosure Requirements

A fund authorised in Mauritius needs to file an offering document with the FSC. The type of offering document and the relevant disclosure in this document will vary depending on the category of the fund and the target investors.

The offering document should contain all the necessary information on the securities to be offered and the fund to enable investors to make an informed assessment of the investment.

A prospectus is required for funds targeting the public or retail investors, and needs to comply with the prescribed disclosure requirements, including the matters required by the Mauritius Securities Act 2005 (the Act) and the rules and regulations made thereunder, such as:

- investment objectives and restrictions;
- the details and functions of the investment manager;
- events concerning the termination of a manager's appointment;
- the types of investors targeted and recommended lock-in periods;
- the terms of subscription (including minimum initial or subsequent investment, distribution rights, entry or exit fees, method/procedure of subscription or redemption, method and frequency of NAV calculations); and
- any fees or charges to be attributed to the fund.

Reporting Requirements

Collective investment scheme (retail fund)

An open-ended retail fund must file audited financial statements and an annual management report with the regulator, containing matters prescribed by the fund regulations. The audited financial statements should be made public unless the fund holds a GBL.

Closed-end fund (retail fund)

A closed-end retail fund must file with the regulator and make public the following:

- comparative quarterly financial statements prepared in accordance with IFRS, no later than 45 days after the end of each quarter; and
- an annual report, including audited comparative financial statements prepared in accordance with IFRS and audited as per International Standards on Auditing (or such other permitted standards), no later than 90 days after the fund's balance sheet date.

The quarterly reports and annual reports of closed-end retail funds (other than those funds that hold a GBL) must also be made public.

In the case of a public offering, the retail fund must register itself as a reporting issuer and is subject to an additional disclosure requirement (to the FSC). Reporting issuers must notify the FSC of any material changes to their affairs.

REITs

A REIT must file with the regulator and distribute to participants the following:

- a half-yearly report (including financial statements prepared in accordance with IFRS), no later than 45 days from its interim period; and
- an annual report, including audited comparative financial statements prepared in accordance with IFRS and audited in accordance with the International Standards on Auditing (or such other permitted standards), no later than six months from its balance sheet date.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

There is a diverse range of investors for retail funds, from individuals and corporates to institutional investors, development finance institutions, family offices and financial institutions.

3.2.2 Legal Structures Used by Fund Managers

Fund managers are typically set up as companies incorporated under the Companies Act 2001. Please see **2.2.2 Legal Structures Used by Fund Managers**.

3.2.3 Restrictions on Investors

CISs and CEFs that are retail funds have no limitation on the type of investor or minimum investment by investors, but the prospectus can set out specific eligibility criteria for investors or any minimum investment.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

There are two main categories of funds: CISs and CEFs.

A CIS has a number of restrictions on its investment and practices, which may be lifted with the approval of the FSC if it is satisfied that the fund has justification, and provided that the fund makes adequate disclosure in its prospectus as to investment rules and risks. For instance, without the FSC's approval, a CIS cannot:

- invest more than 5% of its net assets in the security of the issuer, unless it is a debt security issued by the government of Mauritius or the government of any other country;
- purchase and hold more than 10% of a class of securities of that issuer;
- purchase real estate;
- purchase a mortgage;
- purchase a security for the purpose of exercising control or management over the issuer of that security;
- have more than 10% of its net assets in illiquid assets;
- purchase or sell derivatives or physical commodities, except within limits established by the FSC;
- subscribe to securities offered by a company in formation;
- lend money, securities or other assets;
- invest in aggregate more than 10% of its NAV in shares of another CIS;
- acquire more than 10% of the shares of any single CIS; nor
- purchase a security nor sell a security to the investment manager, the custodian, an officer of the investment manager or the custodian or any affiliate of such persons, unless the purchase or sale is carried out at arm's length.

It should also be noted that a CIS can only borrow money or create a charge over its assets when:

- the transaction is only a temporary measure to accommodate a request for the redemption of securities of that fund, and the outstanding amount of all borrowings does not exceed 5% of the fund; or
- the charge secures a claim for fees and expenses incurred for services rendered while redeeming those securities.

The investment and borrowing restrictions do not apply to CEFs.

Through its guidelines, the FSC has announced that investments in digital assets and cryptocurrency may not be suitable for retail investors, due to the high-risk nature of such asset class; however, digital assets including cryptocurrency may constitute an asset class for investment by funds that are authorised as expert funds, professional CISs or specialised CISs.

The FSC has issued the Securities (Real Estate Investment Trusts) Rules 2021, which provide a specific regime for licensing and regulating REITs. A REIT is a CIS or CEF that invests primarily in real estate assets with the aim of providing returns to holders derived from the rental income of the real estate asset.

3.3.2 Requirements for Non-local Service Providers

The position is the same as described in **2.3.2 Requirements for Non-local Service Providers**.

3.3.3 Local Regulatory Requirements for Non-local Managers

The position is the same as described in **2.3.3 Local Regulatory Requirements for Non-local Managers**.

Where a retail fund holds a GBL, it will be able to appoint a foreign manager subject to the prior approval of the FSC. The FSC will consider whether the licence of the foreign investment manager is issued by a regulatory body in a jurisdiction that has comparable regulation to Mauritius for investor protection.

3.3.4 Regulatory Approval Process

The timeframe for the application of a fund authorisation is generally around 60 business days from the time the application is submitted to the authorities, assuming the application is complete and related queries are cleared on time. However, the application for a retail fund may be lengthier.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

Please see **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**.

In addition, for a retail CEF, unless the prospectus has been approved by the FSC, no application form should accompany the prospectus, no offer for subscription should be entertained and only indications of interest without a firm commitment may be entertained.

3.3.6 Rules Concerning Marketing of Retail Funds

The production and offering of marketing materials are governed by the Securities Act 2005, the rules and regulations made under it and the Guidelines for Advertising and Marketing of Financial Products 2014, as detailed in **2.3.6 Rules Concerning Marketing of Alternative Funds**.

In addition, a retail CIS cannot issue, use or cause to be issued or used, for any purpose, any advertisement in connection with a CIS, unless a copy is forwarded to the FSC no later than five working days prior to the issue or use.

3.3.7 Marketing of Retail Funds

Once authorised, there are no restrictions on the categories of persons to whom retail funds can be marketed, which will follow any eligibility criteria set out in the fund's offer document.

3.3.8 Marketing Authorisation/Notification Process

A retail CIS cannot issue, use or cause to be issued or used, for any purpose, any advertisement in connection with the CIS, unless a copy of the advertisement is forwarded to the FSC no later than five working days prior to the issue or use.

All marketing materials need to be submitted to the FSC prior to dissemination.

3.3.9 Post-marketing Ongoing Requirements

Where any significant change occurs or any new information arises that should be stated in the offer document of a CIS after it has been filed with the FSC, the offer document may be amended by inserting an addendum and notifying the FSC by filing a copy of the addendum therewith. Investors should also be informed of the significant change.

3.3.10 Investor Protection Rules

Since retail funds target the public, extensive disclosure is required in the prospectus of such funds in order for potential investors to understand the investment and risks. Retail funds need to comply with a list of prescribed disclosure requirements, including the matters required by the Mauritius Securities Act 2005 and the rules and regulations made thereunder, such as:

- investment objectives and restrictions;
- the details and functions of the investment manager;
- events concerning the termination of a manager's appointment;
- the types of investors targeted and recommended lock-in periods,
- the terms of subscription;
- an explanation of the nature of the risks; and
- any fees or charges to be attributed to the fund.

In addition, the prospectus should specify the type of investors for whom investment in the fund is suitable.

The fund manager must also send an account statement to each investor with full information regarding investment, to ensure the investor is fully aware of the overall investment.

3.3.11 Approach of the Regulator

The approach of the regulator is as provided in **2.3.11 Approach of the Regulator**.

3.4 Operational Requirements

Retail funds have investment and borrowing restrictions, as described in **3.3.1 Regulatory Regime**.

A retail fund formed as a CIS must appoint a custodian that holds a custodian licence under the Securities Act 2005 to hold and safekeep the assets of the fund. Only banks and trust companies that are subsidiaries of banks are eligible for a custodian licence. If the fund holds a GBL, it may appoint a foreign custodian with the approval of the FSC. The appointed custodian must act independently from the fund manager and the fund.

CEFs are exempt from the requirement to appoint a custodian, with the assets being held in the name of the fund itself.

Risk

The prospectus of the retail fund must disclose all material risks to potential investors. For retail CISs in particular, the prospectus must explain the nature of the risks, including minimum exposure to stock market, sensitivity to rate of interest risk, exposure to currency risk, concentration risk, derivative risk, foreign investment risk, investment in illiquid securities risk, etc.

Valuation and Pricing

An open-ended retail fund must conduct a valuation on a daily basis or at such other intervals as agreed with the FSC. The prospectus must describe the valuation method that such fund will employ in valuing its portfolio to arrive at a NAV.

System and Controls

Various prudential and conduct of business rules apply to an open-ended retail fund, such as:

- minimum funding requirements;
- regulation of its constitutive documents and prospectus;
- regulation of its book-keeping principles;
- regulation of transactions with related parties; and
- mandatory investors' voting powers.

Insider Dealing and Market Abuse

The Securities Act 2005 makes a provision for market abuse, which creates the offences of insider dealing, false trading, market rigging, fraud and deceptive conduct involving securities. The prohibition on insider dealing is a general prohibition applicable to any person who uses insider information to deal in the securities of a reporting issuer (directly or indirectly) or who discloses insider information unlawfully.

Transparency

Retail funds have several disclosure and reporting requirements, as detailed in **3.1.4 Disclosure Requirements**. In addition, an open-ended retail fund must publish the issue, sale, repurchase and redemption prices at least once a week, or at such frequency as the FSC may approve.

Money Laundering

There is no difference in the obligations of AIFs and retail funds under the anti-money laundering laws, as detailed in **2.4 Operational Requirements**.

Short Selling

There are no rules that specifically address short selling. For retail funds, securities lent and collateral received by the fund must be disclosed in the financial statements.

FATCA and CRS Regimes

Funds in Mauritius must assess their FATCA and CRS classification to determine their reporting requirements to the Mauritius Revenue Authority; please see **2.4 Operational Requirements**.

3.5 Fund Finance

Funds in Mauritius can access fund finance for subscription financing and/or leverage.

A retail fund formed as a CIS can only borrow money or create a charge over its assets when:

- the transaction is only a temporary measure to accommodate a request for the redemption of securities of that fund, and the outstanding amount of all borrowings does not exceed 5% of the fund; or
- the charge secures a claim for fees and expenses incurred for services rendered while redeeming those securities.

CEFs are not subject to any borrowing restriction.

Retail CEFs would follow the usual lending practices and take into account the assets and receivables of the fund.

There can be issues in financing CEFs where the fund documents set out limitations on the creation of security over assets of the fund.

3.6 Tax Regime

The tax regime that applies to AIFs also applies to retail funds in the manner described in **2.6 Tax Regime**.

An investor in a retail fund is taxed in the same manner as an investor in an AIF, as described in **2.6 Tax Regime**, and there is no special or preferential tax regime for investors participating in retail funds.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

Securities Act

The definition of "collective investment schemes" and "closed-end funds" in the Securities Act 2005 has been amended to enable CISs and CEFs to invest in money market instruments and debt instruments, including loans, debt obligations or similar instruments. This expansion of eligible investment instruments is anticipated to provide some much needed certainty related to debt funds for fund managers and investors alike.

In addition, taxable funds already benefit from a partial exemption of 80% on all their income but changes in the law are envisaged such that they will be able to benefit from a 95% partial exemption on their interest income as from the year of assessment commencing 1 July 2024 and the subsequent year of assessment. These changes are aimed at clarifying and promoting the establishment and operations of debt funds in Mauritius.

Environmental, Social and Corporate Governance (ESG) for Investment Funds

In view of the growing need and interest in ESG-related investment products, the FSC released a consultation paper dated 23 October 2023 to invite stakeholders and public to provide their input on draft ESG Guidelines to enhance the approach adopted by the industry with regards to the disclosure of investment funds on their ESG strategies for investors to make informed decisions.

It is proposed that these ESG Guidelines will apply to authorised CISs and CEFs that use or include ESG factors as their key investment focus and strategy. This means that ESG factors significantly influence the scheme's selection of investment assets – ie, at least two-thirds of the scheme's NAV is ESG-focused at all times. ESG factors include those that are aligned with one or more of the ESG criteria as per the United Nations Sustainable Development Goals.

Digital Signatures

On 23 October 2023, the FSC issued a set of comprehensive guidelines that are highly contextualised and adapted, with the goal of striking a balance between the security, trust and user experience of digital signatures. The issuance is a sign of adaptability and evolution to keep up with international trends, and aims to further improve the ranking of Mauritius in the Global Financial Centre Index.

The guidelines are the minimum standards that applicants and licensees are expected to observe during the conduct of their financial business activities. The guidelines may relate to any submission of PDF documents, which are digitally signed, through the FSC One platform, in relation to an application for a licence, post-licensing requests or any such submissions as may be required by the FSC.

NETHERLANDS

Law and Practice

Contributed by:
Vilmar Feenstra, Robert Veenhoven, Roderik Boogaard and Sebastiaan Verkerk
Loyens & Loeff N.V.

Contents

Contributed by: Vilmar Feenstra, Robert Veenhoven, Roderik Boogaard and Sebastiaan Verkerk,
Loyens & Loeff N.V.

Loyens & Loeff N.V. has over 70 dedicated specialists in its investment management practice group that are based in Amsterdam, with a similar number of professionals based in Luxembourg. This makes the investment management practice one of the firm's core practices. Loyens & Loeff offers clients a unique combination of tax, legal and regulatory advice on the structuring of funds and all other investment management work, and is very skilled in combining the various detailed tax and regulatory regimes and rules in cross-border structures. An integrated approach is vital for the firm's investment management practice and makes Loyens & Loeff stand out in the market. The firm has a strong international capability in relevant jurisdictions. The Netherlands, Luxembourg, Belgium and Switzerland are its four home markets, and it has offices in New York and London with an investment management focus. The Amsterdam-based team assists the majority of the Dutch-based fund managers with their fundraisings and general legal maintenance of their funds.

Authors

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Roderik Boogaard is an Amsterdam-based attorney at law and a partner in the investment management practice group at Loyens & Loeff. He frequently advises on topics such as AIFMD, UCITS, MiFID II, the SFDR/Taxonomy Regulation, CRDIV/CRR, Solvency II, and the Fourth and Fifth AML Directives. He has deep experience on AIFMD licence applications and advising asset managers on ongoing regulatory and compliance issues related to the investment management industry. Roderik heads the fund regulatory team of Loyens & Loeff, which advises Dutch and international fund managers on all regulatory aspects relating to the managing and marketing of their funds.

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1. Market Overview

1.1 State of the Market

The Netherlands is a jurisdiction commonly used for the formation of investment funds, and has a sophisticated, clear and flexible legal and governance system. In addition to its stable business and political environment, the Netherlands has various tax advantages that also make it an attractive fund jurisdiction. Capital is raised both internationally and from domestic investors (eg, Dutch pension funds).

As a location for private equity and venture capital funds, the Netherlands is typically used by fund managers who operate in and from the Netherlands. However, the Netherlands is also frequently used as a fund structuring and platform jurisdiction by fund managers who have their head office outside the Netherlands, in which case they typically have some form of presence in the Netherlands, often for operational purposes.

Despite a slowdown in deal volume, the Dutch fundraising market continues to demonstrate resilience and growth. Although there is a trend of fundraisings taking longer, Dutch fund managers are still able to secure substantial funds from a diverse range of investors, including but not limited to Dutch pension funds, insurance companies, family offices, high net worth individuals and regional public investment institutions. Investing in private equity funds is becoming more common among individuals, with a trend known as the retailisation of private markets. This comprises offering people the chance to invest through so-called feeder vehicles.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

In the Netherlands, depending on the tax analyses performed in relation to them, alternative investment funds (AIFs) are generally structured in the form of a limited partnership (*commanditaire vennootschap*, or CV), a co-operative (*coöperatie*, or Coop), a contractual fund for joint account (*fonds voor gemene rekening*, or FGR) and/or a private limited liability company (*besloten vennootschap met beperkte aansprakelijkheid*, or BV), or a combination thereof.

Private Equity Funds

Private equity funds are generally structured in the form of a CV or a Coop.

CV

A CV is a limited partnership for the purpose of a durable co-operation between one or more managing (or general) partners (*beherend vennoten*), each with unlimited liability, and one or more limited partners (*commanditaire vennoten*), with limited liability (see **2.1.3 Limited Liability**). A CV has no legal personality and is not a separate legal entity distinct from its partners. In principle, assets cannot be held by a CV in its own name, but are held by a community of property of the partners (*gemeenschap*) or by one or more partners or a third party for the account of the community of property of the partners. Investors participate in the CV as limited partners and receive a limited partnership interest in the investment fund. Substantially all terms and conditions of an AIF can be laid down in the limited partnership agreement of the CV.

A proposed legislative reform may impose substantial changes to Dutch partnership laws (see

4.1 Recent Developments and Proposals for Reform).

Coop

A Coop is a special form of association and is a separate entity from its members (ie, it has separate legal personality), with legal title and beneficial ownership of its assets. Investors participate in a Coop as members, with corresponding membership interests. The terms and conditions of the investment fund are typically laid down in a membership agreement (in addition to the articles of association of the Coop). A Coop does not have capital divided into shares or units.

BV

A BV is the Dutch equivalent of a private company with limited liability, and is generally the preferred legal form for privately held companies in the Netherlands. The BV is a legal entity with capital divided into one or more transferable shares, and has legal personality. A BV is incorporated by the execution of a notarial deed of incorporation (including the articles of association of the BV) to that effect.

Hedge Funds, Debt Funds and Real Estate Funds

These types of funds are generally structured in the form of an FGR, which is not a legal entity. It is a contractual arrangement sui generis (often referred to as its terms and conditions) between a fund manager and each investor (ie, the participants), obliging the fund manager to invest and manage assets contributed by the participants for their joint account. Generally, the legal ownership of the FGR assets is held by a separate legal entity (ie, the title-holder). The FGR is not dealt with in Dutch corporate law. Parties are free to determine the financial and governance structure of an FGR.

The FGR is established by the execution of a notarial or private deed setting out its terms and conditions. The parties involved are the fund manager, the title-holder and each of the participants separately. The UBOs of an FGR need to be registered in the trust register from 1 February 2023, which register after a European Court of Justice ruling is no longer publicly available.

2.1.2 Common Process for Setting Up Investment Funds

Although the process for setting up an investment fund in the Netherlands shall mainly depend on the specific facts and circumstances, as a general rule, fund managers typically start discussing the structure and terms and conditions of the investment fund with their professional advisers. The fund manager will decide on the fund structure (primarily based on the attributes of the prospective investors, the fund's investment strategy and related tax considerations) and will prepare a term sheet setting forth the main terms and conditions of the investment fund.

In order to start (pre-)marketing activities, the fund manager will prepare the marketing material. Depending on the regulatory regime of the investment fund (please see below), (regulatory) approvals and/or registrations will first need to be obtained and/or made before the fund manager may approach potential investors. The fund manager typically makes available the fund agreement, management agreement (if applicable) and subscription agreement. Additional investors may be admitted at subsequent closings. During negotiations, investors may request side letters and/or legal and tax opinions.

Under Dutch law, the regulatory regime and supervision with respect to externally managed AIFs concern the alternative investment fund manager (AIFM) of an AIF, rather than the AIF itself (unless the latter is managed internally). The regulatory regimes that apply to Dutch AIFMs and non-Dutch AIFMs when setting up Dutch AIFs are discussed below.

Dutch AIFM

The fully licensed regime

Pursuant to the Dutch Act on Financial Supervision (*Wet op het financieel toezicht*, or AFS), an AIFM is prohibited from managing an AIF or marketing interests in an AIF in the Netherlands without a licence thereto from the Netherlands Authority for the Financial Markets (*Stichting Autoriteit Financiële Markten*, or AFM), unless an exemption or exception applies.

The AFM will grant a licence to a Dutch AIFM upon application if the AIFM meets the requirements under Dutch law implementing the Alternative Investment Fund Managers Directive (2011/61/EC, or AIFMD). The licence requirements relate to, inter alia, the suitability and trustworthiness of the board members, the operational and control structure of the AIFM, the management of potential conflicts of interest, the appointment of a depositary, and solvency and capital requirements. The AFM has a review period of 26 weeks and may request additional documents or information during the application process (the review period will then be suspended). In practice, therefore, the process to obtain a licence takes more time.

If a Dutch AIFM holds a licence from the AFM pursuant to the AIFMD, it is, in principle, allowed to manage AIFs and to offer the interests in the AIF it manages to professional investors within the meaning of the AFS in the Netherlands, provided that it has obtained approval thereto from the AFM, as further discussed below. If the AIFM complies with the "retail top-up regime" (as discussed in **3. Retail Funds**), the AIFM may also offer interests to non-professional investors in the Netherlands.

A licensed Dutch AIFM can manage a new AIF within the investment strategy covered by its licence and can market such AIF to professional investors if it has obtained approval thereto from the AFM. To obtain such approval, a so-called investment institution notification form should be submitted to the AFM, with, inter alia, the following attached:

- a structure chart of the AIF and all connected entities;
- the fund agreement and other contractual arrangements between the vehicle and the investors;
- the prospectus in which the information required pursuant to Article 23 of the AIFMD is contained; and
- a notification form containing information on the depositary.

The AFM has one month to decide on the application, which can be extended by one month. If the AIF is managed or marketed to professional investors outside the Netherlands, a marketing passport needs to be obtained, pursuant to the Dutch implementation of Article 32 of the AIFMD.

A Dutch-licensed AIFM can also pre-market an AIF in the Netherlands or another EU member state to professional investors, provided it made a pre-marketing notification to the AFM and the conditions set forth in Article 30a of the AIFMD, as implemented in the Netherlands, are met.

Registration regime for "small managers"

There is an exception from the above-mentioned licence obligation for Dutch AIFMs that can make use of the small managers registration regime (the "small managers regime") of Section 2:66a of the AFS. To be able to make use of this exemption, each of the following conditions has to be met by the AIFM.

- The AIFM manages directly – or through an undertaking with which it is linked through common management, common control or a qualified holding – portfolios of AIFs whose assets under management (AuM) in total do not exceed (the "AuM Thresholds"):
  - (a) EUR100 million; or
  - (b) EUR500 million if all the AIFs managed by the AIFM are unleveraged and there are no redemption or repayment rights exercisable with respect to interests in the AIFs for a period of five years following the date of the acquisition of the interests in the respective AIFs.
- Interests in each AIF managed by the AIFM may only be marketed (the "Placement Restrictions"):
  - (a) to professional investors within the meaning of Section 1:1 of the AFS;
  - (b) to fewer than 150 persons; or
  - (c) for a countervalue of at least EUR100,000 per investor.

The AFM clarified that the following conditions should be met, in order to make use of the third Placement Restriction mentioned above:

- the amount of the first capital commitment per investor is at least EUR100,000 (exclusive of costs);
- the first amount called under the commitment per investor should be at least EUR100,000; and
- the amount of committed capital may never fall below EUR100,000.

A Dutch AIFM that meets the AuM Thresholds and the Placement Restrictions and wants to make use of the small managers regime needs to register itself and the AIF it manages/intends to market with the AFM, by submitting a registration form through a digital portal (including an overview of the AuM and a description of the investment strategy). The AFM charges EUR4,400 for a registration. After review and acceptance of the registration form, the AIFM and the AIFs managed by it will be included in the public register of the AFM kept on its website. If the AIFM meets the conditions of the small managers regime, it can start managing the AIF and marketing the AIF in the Netherlands after the registration is submitted to the AFM. There is no waiting period.

If the AIFM wishes to raise a new AIF after registering itself, it should register the AIF two weeks prior to the commencement of the marketing of the AIF. This term of two weeks is a request from the AFM and is not provided for in Dutch legislation, but it is advisable to take this period into account. If the AIFM exceeds the AuM Thresholds or no longer fulfils the Placement Restrictions, the AIFM must apply for a licence from the AFM within 30 calendar days thereafter.

Non-Dutch AIFM

A non-Dutch AIFM that intends to set up a Dutch AIF should comply with the following regulatory regimes, depending on whether the non-Dutch AIFM is an EU AIFM or a non-EU AIFM.

EU non-Dutch AIFM

An EU AIFM with an AIFMD licence in another EU member state can manage a Dutch AIF pursuant to a passport obtained in accordance with Article 33 of the AIFMD.

An EU sub-threshold AIFM is, pursuant to a recent change in Dutch law, allowed to manage a Dutch AIF provided it complies with the conditions as set forth in the Registration regime for "small managers" as set out above and interests in the AIF are only marketed to professional investors.

Non-EU AIFM

A non-EU AIFM that intends to manage a Dutch AIF needs to comply with the Dutch implementation of the national private placement regime of Article 42 of the AIFMD (NPPR). A number of conditions apply in order to make use of the Dutch NPPR, such as:

- that interests in the AIF can only be marketed to professional investors;
- a memorandum of understanding is entered into between the competent supervisory authority of the non-EU AIFM and the AFM, and the third country in which the non-EU AIFM and/or non-EU AIF is established should not be listed as a noncooperative country for the purposes of the Financial Action Task Force (FATF);
- the AFM is notified by the non-EU AIFM through a notification form including an attestation of the competent supervisory authority of the non-EU AIFM; and
- certain transparency rules of the AIFMD are complied with, as set out in Articles 22, 23, 24 and 26–30 of the AIFMD.

A non-EU AIFM can also pre-market an AIF in the Netherlands to professional investors, provided it made a notification to the AFM and the conditions set forth in Article 30a of the AIFMD, as implemented in the Netherlands, are met.

2.1.3 Limited Liability

The Dutch legal forms commonly used for investment fund formations are a CV, a Coop, an FGR and/or a BV. All these forms provide for the limited liability of investors. Typically, upon the request of investors, legal opinions are given in this respect, subject to the customary assumptions and qualifications.

The Netherlands, furthermore, provides for two specific tax fund regimes that may be used for specific strategies:

- the exempted investment institution (*vrijgestelde beleggingsinstelling*, or VBI); and
- the fiscal investment institution (*fiscale beleggingsinstelling*, or FBI); note, however, that for direct real estate investments this regime is expected to be abolished in 2025.

CV

A CV is a limited partnership for the purpose of a durable co-operation between one or more managing (or general) partners, each with unlimited liability, and one or more limited partners (*commanditaire* or *stille vennoten*) who are not liable towards third parties for the obligations of the CV in excess of the amount they have contributed or have agreed to contribute to the CV, unless the names of the limited partners (or characteristic elements of their names) are used in the name of the CV, or the limited partners engage in any act of management or control (*daden van beheer*) or are involved in any activities of the CV (even by virtue of a power of attorney – *volmacht*). However, a limited partner may be held liable for obligations of the CV if:

- such limited partner has committed a tort (*onrechtmatige daad*);
- such limited partner qualifies as a policymaker (*beleidsbepaler*) or a co-policymaker

(*medebeleidsbepaler*) of the GP and there is evidently improper management of the GP;
- such limited partner voluntarily assumes liability for the obligations of the CV; or
- in certain exceptional circumstances only, a limited partner is identified with a GP.

A proposed legislative reform may impose substantial changes to Dutch partnership laws (see **4.1 Recent Developments and Proposals for Reform**).

Coop

If the articles of association of the Coop do not provide otherwise, members and former members of a Coop are liable for deficits upon liquidation or bankruptcy. However, Dutch law allows the liability of the members to be limited or excluded in the articles of association. The letters WA (*wettelijke aansprakelijkheid* – unlimited liability), BA (*beperkte aansprakelijkheid* – limited liability) or UA (*uitsluiting aansprakelijkheid* – exclusion of liability), respectively, have to be added to the name of the Coop to indicate the level of liability of the members. A member of a Coop UA is not liable for any deficit of the Coop. However, a member of a Coop UA may still be held liable for the obligations of the Coop if:

- such member has committed a tort;
- such member qualifies as a policymaker or a co-policymaker of the Coop and there is evidently improper management of the Coop; or
- such member voluntarily assumes liability for the obligations of the Coop.

BV

A BV is a legal entity with capital divided into one or more transferable shares, which has legal personality (*rechtspersoonlijkheid*). A shareholder of a BV is, in principle, not liable for acts performed in the name of the company, and does not have to contribute to the losses of the company in excess of the amount to be paid up on its shares. However, the liability of a shareholder for the obligations of the BV may arise if:

- such shareholder committed a tort;
- such shareholder qualifies as a policymaker or a co-policymaker of the company and there is evidently improper management of the company;
- such shareholder voluntarily assumes liability for the obligations of the company;
- in exceptional circumstances, where "hiding" behind separate legal identities constitutes an abuse of law, such shareholder may be identified (*vereenzelvigd*) with the company; or
- a shareholder receives a distribution in excess of the company's freely distributable reserves while being aware – or when it reasonably should have been aware – that such distribution was not permitted.

FGR

The liability of a participant of an FGR to make contributions is generally limited to the amount that such participant has agreed to pay. However, although the FGR is not a legal entity (*rechtspersoon*) or a partnership (*personenvennootschap*), but a contractual arrangement sui generis, the possibility of an FGR being requalified as a partnership (*maatschap/vennootschap onder firma*) or a limited partnership among the fund manager, the title-holder and the investors (ie, the participants) or among the participants cannot be ruled out if, as a factual matter, it meets the constitutive requirements of such a partnership. Upon such a requalification, the investors may become liable for equal amounts (*gelijke delen*) (if the FGR is requalified as a *maatschap*) or jointly and severally liable (*hoofdelijk aansprakelijk*) (if the FGR is requalified as a *vennootschap onder* *firma* or *commanditatire vennootschap*) for the liabilities of such partnership.

2.1.4 Disclosure Requirements

Dutch AIFMs

Pursuant to the Dutch implementation of Article 23 of the AIFMD, a Dutch-licensed AIFM should provide professional investors with a prospectus setting out the disclosures required pursuant to Article 23 of the AIFMD when marketing an AIF in the Netherlands. If the AIF is marketed under the retail top-up regime to non-professional investors that invest less than EUR100,000, additional disclosure requirements apply, as set out under **3. Retail Funds**. Also, if the AIF is marketed to non-professional investors, a key information document (*Essentiële-informatiedocument*, or KID) must be made available to non-professional investors pursuant to Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs), regardless of the amount invested.

Dutch AIFMs that are registered under the small managers regime should include a selling legend in the private placement memorandum and other marketing materials, in which the Placement Restrictions that will be used by the AIFM (as set out in **2.1.2 Common Process for Setting Up Investment Funds**) are explained. If the marketing is not limited to professional investors, the marketing materials and offering documentation must contain an exemption statement in the manner as provided for by the AFM, and a KID has to be prepared and made available to the non-professional investors. In addition, if an AIF is closed-ended with tradable units, the AIF should publish an approved prospectus pursuant to the Prospectus Regulation (EU 2017/1129), unless an exemption applies.

Furthermore, pursuant to the SFDR and Taxonomy Regulation (Regulation (EU) 2020/852, the "Taxonomy Regulation") that has introduced additional disclosure requirements to the existing elements of relevant sectoral legislations (AIFMD, UCITS, etc) both at the legal entity and at the financial product level, Dutch AIFMs are required to make certain disclosures in, among others, the prospectus or private placement memorandum and on the website of the AIFM.

Non-Dutch AIFMs

With respect to EU AIFMs, on the basis of their home country rules implementing the AIFMD, authorised AIFMs from other European Economic Area (EEA) member states will be required to provide a prospectus when marketing to Dutch investors, pursuant to Article 32 of the AIFMD. If the AIF is marketed under the Dutch retail top-up regime to non-professional investors that invest less than EUR100,000, additional disclosure requirements apply, as set out under **3. Retail Funds**. Also, if the AIF is marketed to non-professional investors, a KID should be provided. In addition, if an AIF is closed-ended with tradable units, the AIF should publish an approved prospectus pursuant to the Prospectus Regulation (EU 2017/1129), unless an exemption applies.

With respect to non-EU AIFMs, the non-EU AIFM that is marketing an AIF pursuant to the Dutch NPPR should provide a prospectus setting out the disclosures required pursuant to Article 23 of the AIFMD when marketing an AIF in the Netherlands to professional investors. In addition, the disclosure requirements pursuant to the SFDR and Taxonomy Regulation for Dutch AIFMs apply mutatis mutandis to non-EU AIFMs.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

The main fund investors located in the Netherlands investing in investment funds are Dutch pension funds, commercial banks and insurance companies. There are also multiple Dutch family offices and multi-family offices/asset managers, high net worth individuals and regional public investment institutions that invest in investment funds. The Dutch government (via the European Investment Fund, or EIF) frequently invests in Dutch funds targeting SMEs.

2.2.2 Legal Structures Used by Fund Managers

Dutch fund managers often adopt the legal form of a BV to carry on their risk and portfolio management activities for the benefit of the investment funds under management.

2.2.3 Restrictions on Investors

AIFMs under the small managers regime may only offer the interests in each AIF in accordance with the Placement Restrictions.

Dutch or EU-licensed AIFMs may only offer the interests in the AIFs they manage to professional investors (within the meaning of Section 1:1 of the AFS), unless they have opted for the "retail top-up". The AIFM is not required to comply with the requirements under the retail top-up regime if interests are offered for a countervalue of more than EUR100,000 per investor.

Non-EEA AIFMs making use of the Dutch NPPR may only offer interests to "qualified investors" within the meaning of the AFS.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

Under Dutch law, the regulatory regime and supervision with respect to investment funds is the concern of the fund manager of an investment fund, rather than the investment fund itself (unless the latter is managed internally). In principle, fund managers of AIFs that are active in the Netherlands fall within the scope of the AIFMD and the Dutch implementation thereof in the AFS, and the rules and regulation promulgated thereunder.

It is, in principle, prohibited in the Netherlands for an AIFM to manage an AIF or to market interests in an AIF without having obtained a licence from the AFM. This is only different if an exemption to the licence requirement is available, such as using a passport by a licensed EU AIFM, making use of the small managers regime or registration under the NPPR. In principle, there are no investment limitations, other than those included in the authorisation (licence or registration).

2.3.2 Requirements for Non-local Service Providers

Pursuant to the Dutch Trust Offices Act 2018 (*Wet toezicht trustkantoren 2018*), it is prohibited to provide the following trust services (*trustdiensten*) in the Netherlands, unless a licence to do so has been obtained from the Dutch Central Bank (*De Nederlandsche Bank NV*, or DNB):

- being a director/partner of a legal entity/company;
- providing a (postal) address for an object company and performing "additional activities" such as record-keeping or preparing and filing tax returns (domicile plus);
- selling or intermediating in the sale of legal entities;
- acting as a trustee; and
- providing a conduit company.

Non-local service providers located in another EEA member state are prohibited from providing trust services in the Netherlands, unless a trust office licence has been obtained. Non-local service providers located outside the EEA cannot apply for such a licence, and thus are prohibited from offering trust services in the Netherlands. With respect to custody services, a licence pursuant to the second Markets in Financial Instruments Directive (2014/65/EU, MiFID II) may be required.

2.3.3 Local Regulatory Requirements for Non-local Managers

An AIFM authorised in another EEA member state in accordance with Article 6 sub-paragraph 1 of the AIFMD may manage a Dutch AIF in the Netherlands on a cross-border basis with a passport, provided that the procedure of Article 33 of the AIFMD is followed, which, in summary, entails certain documentation and information being provided to the home member state regulator of the AIFM and notification to the AFM that the AIFM intends to manage a Dutch AIF.

An AIFM within the EEA that is not authorised in another EEA member state is not allowed to manage Dutch AIFs on a cross-border basis. The small managers regime as set out under **2.1.2 Common Process for Setting Up Investment Funds** is not available to "small" EU AIFMs outside the Netherlands. For the sake of completeness, the authors note that a legislative proposal is under consultation, pursuant to which, EU sub-threshold AIFMs are allowed to manage Dutch AIFs, provided that interests in the AIF are marketed to professional investors.

A non-EEA AIFM may manage a Dutch AIF on a cross-border basis if such AIFM complies with the conditions of the Dutch NPPR. These conditions entail, in summary, certain reporting, disclosure and transparency requirements relating to the annual report, disclosures to investors (both initially and on an ongoing basis), reporting obligations to regulatory authorities and, where relevant, transparency and asset-stripping requirements relating to investments in portfolio companies, and where co-operation arrangements are in place between the supervisory authority of the non-EEA country where the AIFM is established and the AFM.

In addition, a notification should be filed with the AFM, including an attestation of the home country supervisor of the non-EEA AIFM. Furthermore, the non-EEA country where the AIFM is established should not be listed as a noncooperative country for the purposes of the Financial Action Task Force (FATF). Finally, pursuant to the Dutch NPPR, units in the relevant AIFs may only be offered to "qualified investors", within the meaning of the AFS.

2.3.4 Regulatory Approval Process

Please see **2.1.2 Common Process for Setting Up Investment Funds**.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

See **2.1.2 Common Process for Setting Up Investment Funds**.

2.3.6 Rules Concerning Marketing of Alternative Funds

Please see **2.1.2 Common Process for Setting Up Investment Funds**. The regulatory regimes set out therein also apply if an AIF is marketed in the Netherlands. As a result, a Dutch AIFM should make use of the fully licensed regime or, if applicable, the small managers regime when marketing interests in AIFs in the Netherlands. A licensed AIFM in another EEA member state may market interests in EU AIFs in the Netherlands pursuant to the passporting regime set out in Article 32 of the AIFMD. Recently, Dutch law has changed to provide that sub-threshold AIFMs in other EEA member states may market interests in AIFs to professional investors in the Netherlands provided the conditions of the Dutch sub-threshold regime are met. Non-EEA AIFMs may only market interests in AIFs in the Netherlands while making use of the Dutch NPPR. If a licensed EEA AIFM intends to market a non-EEA AIF in the Netherlands, the Dutch NPPR should be complied with.

With respect to marketing communications by Dutch AIFMs, as a general rule, marketing information provided by an AIFM has to be accurate, clear and not misleading. Also, all information provided by the AIFM may not be contrary to the information that is required to be disclosed pursuant to the AFS, and it should be made clear whether documents are of a commercial nature. Marketing communications with respect to UCITS and AIFs marketed by licensed AIFMs or with respect to AIFs that apply the EuVECA or EuSEF regime should comply with the requirements of the ESMA Marketing Communication Guidelines.

Regarding the information to be made available when marketing interests in AIFs in the Netherlands, see again **2.1.2 Common Process for Setting Up Investment Funds**.

2.3.7 Marketing of Alternative Funds

Please see **2.2.3 Restrictions on Investors**.

2.3.8 Marketing Authorisation/Notification Process

See **2.1.2 Common Process for Setting Up Investment Funds**.

2.3.9 Post-marketing Ongoing Requirements

For Dutch-licensed AIFMs, post-marketing ongoing requirements include, inter alia, informing investors of material changes in the information provided to investors in the marketing phase. A licensed AIFM furthermore needs to notify the AFM of material changes in the documents submitted to the AFM to obtain the approval from the AFM for the marketing and management of the AIF. The AFM in principle has one month to decide on whether it will object to the change, to be extended by another month. In addition, investors need to be informed of certain types of conflicts of interest before conducting business on their behalf. Finally, investors need to be provided on an annual basis with an AIF annual report, which complies with the requirements of Article 22 AIFMD (please see **2.4 Operational Requirements**).

2.3.10 Investor Protection Rules

For Dutch AIFMs that are registered under the small managers regime, from a regulatory perspective, there are generally no investor protection rules that should be taken into account.

For AIFMs (including Dutch-licensed AIFMs) authorised under the fully licensed regime, the investor protection rules pursuant to the AIFMD apply. Generally speaking, no gold plating of the AIFMD has taken place in the Netherlands, which means that, inter alia, the following AIFMD investor protection rules on the following topics should be taken into account:

- operating conditions, including requirements regarding remuneration, conflict of interest and risk management;
- depositary;
- fair treatment of investors; and
- transparency requirements.

When interests are marketed to non-professional investors that invest less than EUR100,000, additional investor protection rules pursuant to the Dutch retail top-up regime need to be complied with.

2.3.11 Approach of the Regulator

The AFM may be described as a supervisor that duly considers the legal basis for its supervision and enforcement, while adopting a rather pragmatic approach if possible. This is no different when it comes to the supervision of AIFMs based on the Dutch implementation of the AIFMD.

2.4 Operational Requirements

For Dutch-licensed AIFMs, the operational requirements pursuant to the AIFMD apply. In general, provided that the offering is limited to professional investors, no gold plating of the AIFMD has taken place in the Netherlands. Generally, there are no restrictions on the types of activity or the types of investments for the AIF, provided that the envisaged activities/investments fall within the investment strategy covered by the AIFM's licence.

Licensed AIFMs must appoint a depositary for the AIF. In principle, in the Netherlands, such depositary is subject to a licence requirement, unless a specific exemption to the licence requirement is available. If the AIF has no legal personality, the legal ownership of the assets under management must be held by a separate legal entity whose sole object stated in the articles of association is holding the legal ownership of the assets of investment funds.

Certain other operational requirements are also relevant, such as customer due diligence requirements based on the Dutch implementation of the (revised) Fourth Anti-Money Laundering and Terrorist Financing Directive, which is applicable to AIFs.

Dutch AIFMs registered under the small managers regime are, in principle, not subject to any specific operational requirements.

2.5 Fund Finance

All types of investment funds in the Netherlands generally have access to subscription financing and leveraged financing. Traditional subscription financing remains the main type of financing selected by investment funds in the Netherlands, although there has been an overall increase in the use of financing by managers and investment funds, including fund-level leverage (such as hybrid credit lines and NAV financings). Traditionally, financings to Dutch investment funds are made available by (Dutch) banks; however, nowadays, foreign lenders (including alternative lenders) are also active on, or entering, the Dutch fund finance market.

An important aspect of incurring leverage at the level of a Dutch investment fund is that the relevant fund manager may be required to obtain an AIFMD licence as a consequence of breaching the AuM Thresholds. Other than that, for all practical purposes, there are no material regulatory restrictions on borrowings, provided that borrowed funds are attracted from professional market parties (eg, banks, pension funds and those persons that commit at least EUR100,000).

Typically, the security package for a subscription financing of a Dutch investment fund consists of a right of pledge over:

- bank accounts; and
- the receivables of the investment fund vis-à-vis the investors (ie, the contractual right of the investment fund to receive capital contributions).

Pursuant to Dutch law, security over receivables can be established by way of a disclosed or undisclosed right of pledge. Typically, in relation to subscription financing granted to a Dutch fund, a disclosed right of pledge over investor receivables is created. A disclosed right of pledge is created by way of a security agreement and notification of the right of pledge to the relevant debtors of the secured receivables. There is no prescribed form for notification, and no requirement to include a detailed description of the security agreement. Such notification can be made by uploading the notice to the relevant investor portal, making the process of serving notice a fairly effortless procedure. An undisclosed right of pledge is created by way of a notarial deed or by way of a security agreement that is registered with the Dutch tax authorities for date-stamping purposes.

In addition, depending on the type of financing and the structure of the investment fund, security could also be granted in respect of the assets in which an investment fund would (indirectly) invest. This will be the case for certain hybrid facilities and for NAV facilities where a debt provider is lending against the value of the underlying investments. NAV facilities are typically secured with a pledge over:

- the fund's distribution bank account;
- dividend rights; and
- the equity in the relevant bidco or a holding entity structured below the fund.

There are generally no legal issues that commonly arise in relation to fund finance in the Netherlands.

2.6 Tax Regime

Currently, a CV (and its foreign law equivalents) can be organised as a tax-transparent entity (a "closed" CV) or as a tax-opaque entity (an "open" CV). The closed character requires that any admission or substitution of a limited partner, as well as any change in relative interests among the existing limited partners, is subject to the prior unanimous consent of all partners, both general and limited. These restrictions also apply to transfers to affiliates.

The fund documentation generally provides that such consent shall be deemed to have been given if an investor has not declined its approval within four weeks of the date on which the request for approval was sent. It is expected that the consent requirements and accordingly the distinction between the closed and open CV will be abolished in 2025. Accordingly, each CV (as well as foreign law limited partnerships) is expected to become tax-transparent by default.

A Coop cannot be organised as a tax-transparent entity in the Netherlands. A Coop is subject to corporate income tax on worldwide income, provided it is fully exempt from Dutch corporate income tax on dividends and capital gains derived from the qualifying equity stakes in portfolio companies (the participation exemption). Typically, the investments made by buyout funds and venture capital funds in their portfolio companies are eligible for the participation exemption. Profit distributions made by a Coop are subject to Dutch dividend tax if the Coop qualifies as a mere holding vehicle. A Coop that is used as a principal fund vehicle by fund managers that are (substantially) based in the Netherlands may, however, be eligible for an exemption.

Open and Closed FGRs

Similar to the CV, with regard to the FGR two types of entity exist: "closed" FGRs and "open" FGRs. A closed FGR is a transparent entity for

Dutch tax purposes. An FGR is considered a closed FGR if the participations in the FGR are not transferable other than to the FGR itself by way of redemption, or if the participations are transferable only with the consent of all other participants. As from 2025, these classification criteria will change, after which only qualifying investment institutions which offer (freely) transferable participations to investors can qualify as open – tax opaque – FGR.

For example, debt funds may be structured as a closed FGR. As a consequence of its tax transparency, any income and gains realised by investing through the closed FGR are attributed to the participants as if the participants were investing directly in the investment portfolio of the FGR.

Open FGRs (ie, FGRs that do not meet the transferability criteria for the closed FGR) are subject to Dutch corporate income tax on worldwide income, and profit distributions made by an open FGR are, in principle, subject to Dutch dividend withholding tax. However, if certain conditions are met, the open FGR can opt for the status of “exempt investment institution” (*vrijgestelde beleggingsinstelling*, or VBI) or “fiscal investment institution” (*fiscale beleggingsinstelling*, or FBI).

An FGR that elects to be treated as a VBI is fully tax-exempt – ie, the VBI is not subject to Dutch corporate income tax and its profit distributions are not subject to Dutch dividend withholding tax. A VBI may only invest in financial instruments, including transferable securities.

The FBI is subject to Dutch corporate income tax at a rate of 0%. The FBI may only hold mere portfolio investments. However, unlike the VBI, the FBI may also invest in real estate. Consequently, in practice, the FBI may be referred to as the Dutch REIT regime. Note, however, that, as mentioned in **2.1.1 Fund Structures**, it is expected this regime will be abolished for direct real estate investments in 2025. The FBI is required to meet statutory requirements as to its shareholders and leverage restrictions. Furthermore, the FBI must distribute its net income within eight months of the fiscal year-end. Profit distributions made by the FBI are, in principle, subject to 15% Dutch dividend withholding tax.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

Retail funds (eg, UCITS funds) are often structured in the form of an open FGR or a public limited liability company (*naamloze vennootschap met beperkte aansprakelijkheid*, or NV) that adopts the legal status of an investment institution with variable capital (*beleggingsmaatschappij met variabel kapitaal*, or BMVK).

For more discussion on FGRs and the open FGR, please see **2.1.1 Fund Structures**.

The NV has legal personality and capital divided into shares. Shareholders of an NV are required to hold at least one physical meeting each year. The NV is incorporated by the execution of a notarial deed of incorporation (including the articles of association of the NV) to that effect. The incorporation of an NV requires a bank account to be set up in the company’s name prior to incorporation, a bank statement providing evidence of the payment of the minimum paid-in share capital (if in cash) or a description of the contribution drawn up and signed by the incorporators, and an auditor’s certificate attesting to such payment (if in kind).

Both the open FGR and the NV BMVK are suitable for the setting up of (semi) open-end and closed-end funds, as well as for umbrella funds. Both the participations in the FGR and the shares in the NV BMVK can be listed on a stock exchange.

3.1.2 Common Process for Setting Up Investment Funds

Retail investment funds (or their fund managers) have to be authorised on the basis of either the Dutch implementation of the AIFMD and the AIFMD retail top-up regime, or the Dutch implementation of UCITS.

AIFMD

Please see **2.1.2 Common Process for Setting Up Investment Funds** regarding the registration and/or approval requirements for AIFMs and AIFs pursuant to the Dutch implementation of the AIFMD. As the authorisation pursuant to the AIFMD is, in principle, limited to professional investors, managers who intend to offer interest in the AIF they manage to non-professional investors (retail) in the Netherlands should comply with the so-called Dutch retail top-up regime. The licence for these authorised AIFMs should specifically include the retail top-up.

The authorised AIFM with a retail top-up will have to meet all requirements that apply for authorised AIFMs under the fully licensed regime. In addition, the retail top-up regime, inter alia, requires the manager to comply with detailed additional compliance, information and reporting requirements. However, the manager is not required to comply with the requirements under the retail top-up regime if interests are offered to non-professional investors for a countervalue of more than EUR100,000 per investor. AIFMs have to prepare a KID (in the Dutch language) for each new AIF they are marketing, and provide this to non-professional investors prior to investing in the AIF. In this respect, please see **3.1.4 Disclosure Requirements**.

UCITS

Pursuant to Section 2:69b of the AFS, it is prohibited to manage and market UCITS funds in the Netherlands without a licence from the AFM. A licence can be obtained by the UCITS fund manager (ManCo) or by the (self-managed) UCITS. The AFM will grant a licence upon application if the ManCo meets the licence requirements under Dutch law. The licence requirements relate to, inter alia, the suitability and trustworthiness of the board members, the operational and control structure, the appointment of a depositary, solidity and minimum own funds requirements. Holders of a qualifying holding (ie, more than 10% capital or voting rights) need to obtain a declaration of no objection from the DNB.

The AFM has a review period of 13 weeks for a licence application of a ManCo, and eight weeks for a licence application of a UCITS. The AFM may request additional documents or information during the application process. The review period is suspended while additional documents are being requested.

A licensed ManCo can manage a new UCITS within the investment strategy covered by its licence, and can market such UCITS to retail investors if it has submitted the notification form to the AFM at least two weeks prior to the marketing of the respective UCITS. The following should be attached to the notification form:

- a prospectus (pursuant to Section 4:49 of the AFS); and
- a key information document (*Essentiële-informatiedocument*, or KID).

3.1.3 Limited Liability

Open FGR

Please see **2.1.3 Limited Liability** for a description of the Open FGR, and the limited liability of investors in an FGR.

NV

An NV is a legal entity with capital divided into one or more transferable shares, which has legal personality. A shareholder of an NV is, in principle, not liable for acts performed in the name of the company and does not have to contribute to the losses of the company in excess of the amount to be paid up on their shares. However, the liability of a shareholder for the obligations of the NV may arise if:

- such shareholder committed a tort;
- such shareholder qualifies as a policymaker or a co-policymaker of the company and there is evidently improper management of the company;
- such shareholder voluntarily assumes liability for the obligations of the company;
- in exceptional circumstances, where “hiding” behind separate legal identities constitutes an abuse of law, such shareholder may be identified with the company; or
- a shareholder receives a distribution in excess of the company’s freely distributable reserves while being aware – or when they should reasonably have been aware – that such distribution was not permitted.

When a shareholder supports or effects a dividend or other distribution while knowing that the NV would, as a consequence, not be able to continue paying its debts when these become due, it may qualify as acting in a tortious manner.

3.1.4 Disclosure Requirements

UCITS

The ManCo has to publish the following disclosures on its website:

- a prospectus including the information required pursuant to Article 4:49 of the AFS in conjunction with Article 118 of the Market Conduct Supervision Financial Institutions Decree (the “Decree”) and Annex I to the Decree (such as certain information about the fund, the (co-)policymakers, changes in conditions, the provision of information, the fund activities and investment strategy, costs and remuneration, participation rights, risk profile of the fund and valuation of assets);
- the fund rules or the articles of associations of the UCITS; and
- if made public, the annual accounts of the UCITS of the two preceding years (based on Article 4:50 of the AFS).

Pursuant to the PRIIPS Regulation, a key information document (*Essentiële-informatiedocument*, or KID) must be made available to retail investors before they invest in a UCITS fund and thereafter on a continuous basis. New PRIIPs regulatory technical standards entered into force on 1 January 2023, introducing certain (material) changes to the existing KID.

AIFM With Retail Top-Up

In principle, a licensed AIFM with a retail top-up will have to meet all the (disclosure) requirements that apply to licensed AIFMs under the fully licensed regime (as set out in **2.1.2 Common Process for Setting Up Investment Funds**).

With respect to an AIF that is closed-ended and with tradable units, an approved prospectus should be published pursuant to the Prospectus

Regulation (EU 2017/1129), unless an exemption applies.

With respect to an AIF whose units are not transferable and open-end AIFs, unless an exemption applies as a result of which there is no prospectus requirement, a prospectus including the information required pursuant to Article 23 of the AIFMD should be made available and published on the AIFM's website, to be supplemented with particular information deemed important for retail investors as set out in the retail top-up regime (such as certain information about the AIF, the (co-)policymakers, the procedure regarding amendment of fund terms, reporting to investors, the fund activities and investment strategy, costs and remuneration, information with respect to the participation rights, risk profile of the fund and valuation of assets). Also, semi-annual accounts with respect to the AIFs will have to be published.

As mentioned above, a KID needs to be prepared and made available to retail investors before they invent in an AIF, and thereafter on a continuous basis.

AIFM Without Retail Top-Up

AIFMs registered under the small managers regime and authorised AIFMs under the fully licensed regime that market interests to retail investors for a countervalue of more than EUR100,000 per investor have to prepare a KID and make this available to investors before they invest in the AIF.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

In general, private individuals invest in liquid funds, for the purpose of their personal wealth management.

3.2.2 Legal Structures Used by Fund Managers

Dutch fund managers often adopt the legal form of a BV to carry on their risk and portfolio management activities for the benefit of the investment funds under management.

3.2.3 Restrictions on Investors

There are no restrictions on the types of investors that can invest in a retail fund.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

Retail investment funds (or their fund managers) have to be authorised on the basis of either the Dutch implementation of the AIFMD and the Dutch retail top-up regime if investors are able to invest less than EUR100,000, or the Dutch implementation of UCITS.

With respect to authorised AIFMs with a retail top-up, in principle, no investment limitations apply. A Dutch UCITS, however, should take into account specific investment limitations as set out in the Dutch implementation of the UCITS Directive.

3.3.2 Requirements for Non-local Service Providers

Please see **2.3.2 Requirements for Non-local Service Providers**.

3.3.3 Local Regulatory Requirements for Non-local Managers

AIFMD

EEA AIFMs with a licence and that obtained a passport pursuant to Article 32 of the AIFMD can market to retail investors in the Netherlands once they have filed a retail distribution notification form with the AFM. If retail investors can invest in the AIF marketed for less than EUR100,000, the retail top-up regime needs to be complied with.

EEA sub-threshold AIFMs cannot market AIFs to retail investors in the Netherlands.

Under certain circumstances, non-EEA AIFMs located in the USA, Guernsey, Hong Kong or Jersey may market AIFs to Dutch retail investors pursuant to the so-called designated state regime. Otherwise, non-EEA AIFMs are not allowed to market AIFs to Dutch retail investors.

UCITS

A non-local EEA-authorised ManCo may manage and market authorised UCITS funds in the Netherlands on a cross-border basis, provided that the passporting procedure (Article 91 and further of the UCITS Directive) is followed. The EEA ManCo will need to obtain separate approval from the AFM for the management of a Dutch UCITS fund in the Netherlands (pursuant to the Dutch implementation of Article 5(3) of the UCITS Directive). If a non-Dutch UCITS fund is marketed in the Netherlands, a KID will have to be provided in the Dutch language.

3.3.4 Regulatory Approval Process

AIFMD

With respect to the regulatory approval process for Dutch AIFMs under the fully licensed regime and the small managers regime, please see **2.1.2 Common Process for Setting Up Investment Funds**.

UCITS

If a ManCo applies for a licence from the AFM pursuant to the AFS, the AFM has a review period of 13 weeks. With respect to a licence application for a UCITS, the AFM has a review period of eight weeks. During the application process, the AFM may request additional documents or information; the review period is suspended when the AFM is requesting additional documents. A licensed ManCo can manage a new UCITS if it has submitted the notification from the UCITS to the AFM at least two weeks prior to the marketing of the respective UCITS.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

See **3.3.6 Rules Concerning Marketing of Retail Funds.**

3.3.6 Rules Concerning Marketing of Retail Funds

As a general rule, information provided by an AIFM or ManCo has to be accurate, clear and not misleading. Also, all information provided by the AIFM or ManCo may not be detrimental to the information to be supplied or made available pursuant to the AFS, and it should be made clear whether documents are commercial. Additionally, rules regarding marketing materials apply. Please also see **3.1.4 Disclosure Requirements**.

In addition, the Unfair Commercial Practice Act (*Wet oneerlijke handelspraktijken*, or UCPA) applies to all financial institutions that market, offer or sell products or services to consumers in the Netherlands, regardless of the authorisation, registration or exemptions that may be relied upon for Dutch financial regulatory purposes. If the AFM, as competent supervisory authority of the UCPA, deems that information provided to consumers is misleading or unfair, it may, for example, impose a fine on the fund in question (or its fund managers).

The Netherlands has not introduced a pre-marketing regime with respect to non-professional investors. Consequently, there are only limited possibilities for a fund manager to pre-market an investment fund to non-professional investors.

3.3.7 Marketing of Retail Funds

There are no restrictions on the types of investors that can invest in a retail fund.

3.3.8 Marketing Authorisation/Notification Process

See **3.1.2 Common Process for Setting Up Investment Funds**.

3.3.9 Post-marketing Ongoing Requirements

For Dutch-licensed AIFMs, post-marketing ongoing requirements include, inter alia, informing investors of material changes in the information provided to investors in the marketing phase. Also, a licensed AIFM needs to notify the AFM of material changes in the documents submitted to the AFM, to obtain its approval for the marketing and management of the AIF. The AFM in principle has one month to decide on whether it will object to the change, to be extended by another month. In addition, investors need to be informed of certain types of conflicts of interest before conducting business on their behalf. Finally, investors need to be provided on an annual basis with an AIF annual report, which complies with the requirements of Article 22 AIFMD. Please see **3.4 Operational Requirements.**

AIFMs marketing AIFs under the retail top-up regime and ManCos must comply with certain additional ongoing requirements following the marketing of an investment fund aimed at protecting retail investors.

3.3.10 Investor Protection Rules

In principle, an authorised AIFM with a retail top-up will have to meet all the requirements that apply for authorised AIFMs under the fully licensed regime (see **2.3.10 Investor Protection Rules**).

Authorised AIFMs with a retail top-up and authorised ManCos have to comply with certain investor protection requirements pursuant to the AFS and the promulgated regulations thereunder, such as the requirement to have certain organisational and administrative procedures in place relating to, inter alia, conflicts of interest, complaints handling and product approval procedures. In addition, the requirement to be registered with the Dutch Financial Services Complaints Tribunal (*Klachteninstituut Financiële Dienstverlening*) applies.

3.3.11 Approach of the Regulator

The AFM may be described as a supervisor that duly considers the legal basis for its supervision and enforcement, while adopting a rather pragmatic approach if possible. Please see **2.3.11 Approach of the Regulator**.

3.4 Operational Requirements

In principle, the authorised AIFM with a retail top-up will have to meet all the requirements that apply for authorised AIFMs under the fully licensed regime and the rules set out in the retail top-up regime.

With respect to authorised Dutch UCITS funds, specific operational requirements apply, as set out in the Dutch implementation of UCITS. For instance, the legal ownership of the assets under management of the UCITS has to be held by a separate legal entity whose sole object as stated in the articles of association is holding the legal ownership of the assets of the UCITS fund.

Authorised Dutch UCITS funds have to appoint a depositary. In principle, in the Netherlands, such depositary is subject to a licence requirement, unless a specific exemption to the licence requirement is available.

Certain other operational requirements are relevant, such as customer due diligence requirements on the basis of the Dutch implementation of the (revised) Fourth Anti-Money Laundering and Terrorist Financing Directive, which is applicable to Dutch UCITS funds.

3.5 Fund Finance

Please see **2.5 Fund Finance**.

3.6 Tax Regime

Retail funds that are structured as an open FGR or NV BMVK often elect to be treated as a VBI or an FBI.

An FBI is subject to Dutch corporate income tax at a 0% rate.

Profit distributions by an FBI are, in principle, subject to 15% Dutch dividend withholding tax, with two important exceptions.

- The FBI can apply a conditional rebate for the amount of directly suffered (foreign) withholding taxes against the FBI's own obligation to remit 15% Dutch dividend tax to the Dutch tax authorities, withheld in respect of its own profit distributions. Effectively, the (foreign) withholding tax levied in connection with the investments of the FBI will be converted into Dutch withholding tax, for which the retail investors may be eligible for a credit or (partial) refund. This is considered an apparent benefit of the FBI regime compared to other investment tax regimes (including the Dutch VBI regime), where (foreign) withholding taxes suffered in connection with the investment portfolio are often neither creditable nor refundable, as a consequence of which, such withholding taxes will be a fund cost, reducing the return on investment.
- The FBI can elect to apply a so-called reinvestment reserve (*herbeleggingsreserve*) by claiming such a reserve in its Dutch corporate income tax return. This reserve is equal to the net balance of (unrealised) gains and losses reduced with a proportionate part of the running costs of the FBI. By creating a reinvestment reserve, items of a capital nature will be excluded from the FBI's taxable profits and, therefore, will not fall under the annual distribution obligation. Furthermore, subject to certain provisos, the FBI can make distributions at the expense of the reinvestment reserve free from Dutch dividend withholding tax, so that items of a capital nature realised by the FBI are effectively subject to neither Dutch corporate income tax nor Dutch dividend withholding tax.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

Legislation on Partnerships

On 10 October 2022, a second preliminary draft bill in relation to the modernisation of Dutch partnership laws was presented for consultation. One of the most remarkable amendments would be that a partnership would obtain legal personality.

POLAND

Law and Practice

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Contents

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LSW is a leading Polish law firm, having practised on the Polish market for over 20 years. LSW's investment funds practice is well recognised both locally and internationally, working closely with distinguished international and foreign investment fund/private equity practices. The team advises the whole gamut of investment funds, including venture capital, buyout, real estate, infrastructure, distressed asset, and sovereign wealth, through the course of an investment fund's existence. Our specialist teams advise on, among other things, fund formation, fundraising and M&A. LSW is renowned for advising international and foreign investment funds taking their first steps on the Polish market, as well as assisting Polish funds on creating international structures to approach foreign markets, and attracting foreign investors. The team has advised the following investment funds and/or their portfolio companies: Warburg Pincus, TPG Capital, Mid Europa Partners, Nuveen, GIC Private Limited, Paine Schwartz Partners, Pollen Street Capital, Brookfield Asset Management, Partners Group, Marlin Equity Partners, Davidson Kempner Capital Management, Abris Capital, Enterprise Investors, and many more.

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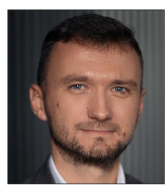

Michal Klimowicz concentrates on legal projects for commercial law firms and M&A deals, including taxation issues. He has advised on various investment processes, such as individual investors in a rapidly growing internet video company. Experienced in corporate financing, he manages bond issues. Michal oversees transformation and merger projects in TV production, advertising, PR agencies, public opinion polling, and heavy industry. His work spans diverse industries, allowing him to focus on specific legal regulations. He has also provided counsel in sports, establishing entities such as the Basketball Section of Legia Warszawa and a leading Polish e-sports team, which involved negotiations on corporate governance.

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1. Market Overview

1.1 State of the Market

Alternative Investment Funds (AIFs) conducting their activity as a collective investment institution whose object of activity, including activity as part of a separated sub-fund, is collecting assets from multiple investors in order to invest them in the interest of such investors in accordance with the specified investment policy, exist in Poland (other than a fund acting in compliance with the Community (EU) law governing the rules for collective investment in securities).

AIFs, in their current shape, have existed in Poland since 2016 – as a result of the implementation of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

The legal basis for the existence of AIFs in Poland is the Investment Funds and the Management of Alternative Investment Funds Act of 27 May 2004 (the “AIF Act”).

The Polish AIF market is well developed, including through the activity of alternative investment companies (one of a few types of AIF), often chosen by investors recently. There are clear legal requirements for the establishment of AIFs, including regulations indicated in the AIF Act. Supervision under the AIF market is exercised by the Polish Financial Supervisory Authority (PFSA), which grants permissions for AIFs and their management parties in certain cases.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

There are three types of AIFs in Poland:

- specialised open-end investment fund (SOEIF);
- closed-end investment fund (CEIF); and
- alternative investment company (AIC).

SOEIF

The sole object of activity of a SOEIF is investing cash means raised through proposing the acquisition of participation units, in securities, money-market instruments and other property rights specified in the AIF Act.

Investors take up participation units in SOEIFs. The participation units of a SOEIF may not be transferred to third parties by a participant (investor). It is possible to limit the group of investors who can become participants of a SOEIF. Participation units of a SOEIF may be redeemed at the request of the participant.

A SOEIF is managed by a society – special entity with permission granted by the PFSA. The society of a SOEIF acts in the form of a joint stock company (commercial company). The society establishes the SOEIF, manages it and represents it in relations with third parties.

Details concerning the opening, existence and liquidation of SOEIFs are regulated in the AIF Act. A SOEIF has separate legal personality and it does not act in the form of a commercial company.

CEIF

A CEIF is an AIF in which investors take up investment certificates. The sole object of activity of a CEIF is investing cash means raised through proposing the acquisition of investment certificates, in securities, money-market instruments and other property rights specified in the AIF Act.

The investment certificates of CEIFs are transferable. Moreover, they may be admitted to trading on a regulated market or alternative trading system.

There is a limited possibility of exit through the redemption of investment certificates by CEIF. Such redemption is regulated and possible only on terms and conditions specified in the statutes of CEIFs.

A CEIF is managed by a society – special entity with permission granted by the PFSA. The society of a CEIF acts in the form of a joint stock company (commercial company). The society establishes the CEIF, manages it and represents it in relations with third parties.

Details concerning the opening, existence and liquidation of CEIFs are regulated in the AIF Act. A CEIF has a separate legal personality and does not act in the form of commercial company.

AIC

The sole object of activity of an AIC is collecting assets from multiple investors in order to invest them in the interest of such investors in accordance with the specified investment policy.

Investors take up shares in an AIC. The shares of an AIC are transferable; however, limitations in this scope may be introduced on the basis of the statutes of AICs. Moreover, a new regulation (effective 29 September 2023), requires the consent in writing of the AIC's managing party for any transfer of shares in an AIC to an entity other than the investor of this AIC and the AIC's managing party. The AIC's managing party will refuse to consent if, after verification, the potential purchaser does not meet the conditions for recognition as a professional client. A transfer of an AIC's shares performed without the consent of the AIC's managing party is invalid. This limitation is not applied if at least 50% of rights to participate in the AIC are held by professional clients specified in the AIF Act (eg, AIC's managing party, society of AIF, investment firm).

An AIC conducts its activity in the form of a commercial company. An AIC may carry out its activity in the form of:

- a limited liability company, a joint stock company or a European company; or
- a limited partnership or a limited joint stock partnership in which the sole general partner is a limited liability company, joint stock company or a European company.

Details concerning the opening, existence and liquidation of the commercial companies are regulated in the Polish Commercial Companies Code.

Each AIC should have a managing party. An AIC's managing party may be exclusively:

- in the case specified in the first point above – a company being an AIC and carrying out the activity as a party managing the AIC on an internal basis; or
- in the case specified in the second point above – a company being a general partner in an AIC and carrying out the activity as a party managing the AIC on an external basis.

2.1.2 Common Process for Setting Up Investment Funds

AIC

An AIC is established by its investors and managing party. The AIC and AIC's managing party are registered in the register of entrepreneurs of the National Court Register. However, before the registration of an AIC in the National Court Register, the AIC's managing party should be entered in the register of AIC managing parties maintained by the PFSA, or the PFSA should grant permission. Before the registration, the statutes and investment policy of the AIC should be adopted too.

The activity of the AIC's managing party may be performed on the basis of an entry in the register of AIC managing parties, and therefore without the separate authorisation (licence) of the PFSA, if the total value of assets included in the investment portfolios of the AICs that the AIC's managing party intends to manage or manages does not exceed the PLN equivalent of EUR100 million, and, where the ACI's managing party manages only companies that do not use AIF financial leverage and in which participation rights can be redeemed after at least five years from the date of their acquisition, the equivalent of EUR500 million. Exceeding the above limits results in an obligation to obtain a licence granted by the PFSA. In order to obtain the licence, the AIC's managing party should submit to the PFSA an application for authorisation to perform the activities of an AIC's managing party.

The majority of managing parties in Poland use a simplified procedure, ie, the obligation of entry to the register but without a separate licence from the PFSA.

The whole process of registration of the AIC and its managing party usually takes several months.

SOEIF and CEIF

SOEIFs and CEIFs may be established exclusively by a society. The society is a management body of SOEIF and CEIF and conducts its activity in the form of a joint stock company. SOEIFs and CEIFs may be established exclusively by the society which obtained a permit to pursue the activity. Permission is granted by the PFSA.

SOEIFs and CEIFs should be registered in the register of investment funds. The register of investment funds is kept by the Circuit Court in Warsaw.

2.1.3 Limited Liability

Investors of AIFs are not liable for the obligations of AIFs. This liability is borne by the AIF and the managing party of the AIF in certain cases.

2.1.4 Disclosure Requirements

AIFs have several obligations in the field of reporting. Each AIF should prepare its financial statement for each fiscal year pursuant to the Polish Accounting Act of 29 September 2004.

Moreover, SOEIFs should publish an information prospectus and annual and semi-annual financial statements on their websites. The information prospectus should especially contain: the fund's articles; declaration of the audit firm on the compliance of the methods and rules for appraising the fund's assets described in the information prospectus with the provisions on accounting of investment funds; and also on the completeness of such rules and their compliance with the investment policy adopted by the fund.

A CEIF which is not a public CEIF should make available to the fund's participants, upon their demand, annual and semi-annual financial statements.

When transferring the participation units of a SOEIF, issuing investment certificates of a CEIF and marketing an AIC in the territory of Poland, the society, the AIC's managing party pursuing activity on the basis of a permit should make the information available to the client of the AIF, enabling it to review the same before acquiring participation units, taking up investment certificates or acquiring or taking up participation rights of an AIC. Details of the information available to the client of the AIF are specified in the AIF Act, which covers especially:

- business name (name), seat and address of the AIF;
- business name (name), seat and address of the party that manages the AIF;
- description of the object of activity of the AIF, including a description of its investment objectives and investment policy and investment strategy, in particular a description of the types of assets in which it may invest, the techniques it may employ, types of risk involved in the investment, and any investment restrictions;
- description of the procedures by which the AIF may change its investment strategy or investment policy; and
- description of the methods and rules of valuation of assets.

Another disclosure requirement is imposed on the society of the SOEIF and CEIF. The society shall, within four months from the end of the financial year, submit to the PFSA and funds participants, upon their request, the AIF's annual statements drawn up separately for each SOEIF and CEIF in which it is a body. The AIF's annual statement should contain especially:

- balance sheet for a given financial year;
- profits and loss account for a given financial year;
- report on the alternative investment fund's activity for a given financial year;
- description of material changes in the information listed in the information for the client of an alternative investment fund that took place during the financial year; and
- report from the audit of the annual financial statements of the AIF.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Various types of investors join AIFs; however, Polish regulations establish some limitations in the scope of access for retail investors. In recent times, the AIC has been considered the most popular type of AIF in Poland, particularly due to the more simplified procedure for opening this type of AIF and its continued existence, which is mostly regulated by the Polish Commercial Companies Code.

2.2.2 Legal Structures Used by Fund Managers

Legal structures used by alternative fund managers in Poland are regulated and indicated in the AIF Act and the Polish Commercial Companies Code.

As mentioned previously, SOEIFs and CEIFs may be established and managed exclusively by a society. The society conducts its activity in the form of a joint stock company.

An AIC is managed by the AIC's managing party, which acts as a commercial company. The AIC's managing party may act as a party managing the AIC on an internal basis (AIC is its own managing party) or as a party managing the AIC on an external basis (a separate company is the managing party of the AIC).

2.2.3 Restrictions on Investors

There are some limitations for retail investors in the scope of access to investment in AIFs. Pursuant to the new regulations (with effect from 29 September 2023), an investor in an AIC is an entity that has the right to participate (shares) in an AIC and meets the criteria of a professional client (with some exceptions). A natural person may be considered a professional client if the value of their contribution to the AIC is not less than the PLN equivalent of EUR60,000. This limitation is not applied if at least 50% of rights to participate in the AIC consist of professional clients specified in the AIF Act (eg, AIC's managing party, society of AIF, investment firm).

2.3 Regulatory Environment

2.3.1 Regulatory Regime

Regulatory Regime for AIC and AIC'S Managing Party

The AIC'S managing party should obtain a licence from the PFSA or entry to the register kept by the PFSA. Entry to the register is sufficient (without a licence) if the total value of assets included in the investment portfolios of AICs that the AIC's managing party intends to manage or manages does not exceed the PLN equivalent of EUR100 million, and, where the AIC's managing party manages only companies that do not use AIF financial leverage and in which participation rights can be redeemed after at least five years from the date of their acquisition, the equivalent of EUR500 million.

The starting capital for pursuing the activity of:

- the AIC's managing party on an external basis shall amount to at least the equivalent of EUR125,000 denominated in PLN; and
- the AIC's managing party on an internal basis shall amount to at least the equivalent of EUR300,000 denominated in PLN.

Moreover, the AIC's managing party shall notify the PFSA of any material changes to the shareholder structure.

Requirements in the scope of starting capital of an AIC's managing party and notification about changes to the shareholder structure are not applied in reference to the AIC's managing party, which is obliged only to obtain entry to the register (without separate permission from the PFSA).

The AIC's managing party is obliged to notify the PFSA in written form of the intention to market the ASI on the territory of Poland.

Regulatory Regime for CEIF, SOEIF and Society (Managing Party of CEIF/SOEIF)

The following activities are required in order to establish a CEIF and SOEIF:

- a society providing the investment fund with statutes;
- conclusion by the society of a contract with a depositary for performing the function of an investment fund's depository;
- issue of a permit by the PFSA;
- collection of payments to the investment fund in the amount specified in its statutes; and
- entry of the investment fund in the register of investment funds.

There are some exceptions according to which a permit of the PSFA is not required in reference to establishment of the CEIF – especially in the case of offering an investment certificate within non-public offer.

Moreover, a society of CEIF and SOEIF is a licensed entity and should obtain its licence from the PFSA.

The starting capital of the society for carrying on activity shall be at least the equivalent of EUR125,000 denominated in PLN. If the society carries on the activity of managing portfolios including one or more financial instruments, the starting capital shall be increased to the equivalent of EUR730,000 denominated in PLN.

The initial capital of the society may come exclusively out of documented sources. The means for covering initial capital or acquiring shares may not come from a loan or credit.

The PFSA has some rights in the scope of control changes to the shareholder structure of the society. For example, a subject intending to acquire or take up shares or rights attached to shares in a society, directly or indirectly, in a number which ensures reaching or exceeding respectively 10%, 20%, one third or 50% of the total number of votes at a general meeting or a share in the initial capital, shall be obliged, on each occasion, to notify the PFSA of its intention to acquire or take up shares.

Investment Limitations

A CEIF may invest in certain types of assets specified in the law, including the following:

- securities;
- receivable debts, except for debts to natural persons;
- shares in limited liability companies, including in companies with their seats abroad;
- derivative instruments, including non-standardised derivative instruments;
- property rights whose price depends directly or indirectly on things designated as to their kind, specific types of energy, meters and limits of the volume of production or emission of pollutants, admitted to trading on commodity exchanges; and
- money-market instruments.

Indicated assets should be transferable. The CEIF may also invest in:

- ownership or co-ownership of:
  - (a) land and immovable property within the meaning of the provisions on immovable property management;
  - (b) buildings and premises constituting separate immovable property;
  - (c) sea-going vessels; and
- perpetual usufruct.

There are some limitations according to which a CEIF may not invest in certain assets amounting to more than a certain percentage of total value of the CEIF's assets (rules of diversification). For example, the CEIF may invest only up to 50% of the value of its assets in participation units or investment certificates of one investment fund or in participation titles issued by one collective investment institution having its seat abroad.

Limitations in the scope of the list of assets which are subject to investment as well as rules of diversification are also established in reference to a SOEIF.

There are no specific investment limitations in reference to AICs; however, each AIC should have its own investment policy which determines the manner of investing its assets.

2.3.2 Requirements for Non-local Service Providers

Foreign investment funds and their managing parties may conduct their activity in Poland as a rule. Specific requirements and limitations are described in the AIF Act.

For example, an AIF from the territory of the European Union (EU AIF) may be marketed in the territory of Poland if the PFSA receives from the competent supervisory authority from the other EU member state (appropriate to the managing party of the EU AIF) a notification on the intention to market such an EU AIF in the territory of Poland.

2.3.3 Local Regulatory Requirements for Non-local Managers
The rules of conduct of activity in the territory of Poland by foreign funds and management companies are specified in detail in the AIF Act.

2.3.4 Regulatory Approval Process
If permission or entry to the register (as the case may be) is required in relation to an AIF or its managing party, this process typically lasts several months.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds
There are some regulations which apply to firms pre-marketing and marketing alternative funds in Poland, particularly:

- the AIF Act;
- the Polish Commercial Companies Code of 15 September 2000; and
- the Act on public offering and conditions for introducing financial instruments to organised trading and on public companies of 29 July 2005.

These legal acts specify in detail the requirements to be met regarding pre-marketing and marketing alternative funds in Poland, including reporting requirements, the list of documentation to be prepared and supervisory powers of the PFSA.

2.3.6 Rules Concerning Marketing of Alternative Funds
These are described at **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**.

2.3.7 Marketing of Alternative Funds
AIFs may be marketed to investors subject to the regulations that establish limitations to access to investment in AIF (including limited access for retail investors to investment in AICs).

2.3.8 Marketing Authorisation/Notification Process
There are some cases in which an AIF or its managing party should notify or obtain approval of the national regulator (PFSA) prior to the marketing of the AIF taking place. For example, the AIC's managing party shall be obliged to notify the PFSA in written form of the intention to market an AIC on the territory of Poland.

Where a SOEIF intends to transfer participation units, a CEIF intends to offer investment certificates or an AIC's managing party pursuing activity on the basis of a permit intends to market on the territory of a member state of the European Union an alternative investment company or an EU AIF which it manages, the society of AIF or the AIC's managing party shall inform the PFSA about such intention in writing.

Moreover, if participation units of an AIF (eg, shares of an AIC) are offered in the form of public offer, then notification or approval of the PFSA may be required (especially in the case of a public offer with the obligation of the preparation of an issue prospectus or an information memorandum).

2.3.9 Post-marketing Ongoing Requirements
Firms which have marketed an alternative fund in Poland have several ongoing requirements

including reporting requirements (specified in detail in **2.1.4 Disclosure Requirements**).

If an AIC conducts its activity in the form of joint stock company or limited joint stock partnership and offers its shares within a public offer, then the AIC should notify the PFSA about this offer and the number of shares taken up by the investors (notification to the Share Registration System maintained by the PFSA).

2.3.10 Investor Protection Rules

Regulations regarding AIF put an emphasis on the protection of retail investors. Therefore, limited access to investment in AIC for retail investors is established (including the minimal amount of investment which would allow recognition of a retail investor as a professional client).

2.3.11 Approach of the Regulator

The processes applicable to AIFs (conducted by the PFSA – including entry to the register and granting a licence) are mostly written procedures which require preparation and submission of documents indicated in regulations. However, the PFSA openly allows face-to-face meetings in order to discuss various aspects of the procedure, for example concerning requirements remaining to be met.

2.4 Operational Requirements

The general and acceptable activity of an AIF is the collection of assets from multiple investors in order to invest them in the interest of such investors in accordance with a specified investment policy. Each AIF should invest taking into account a principle of diversification of assets. The specific requirements in the scope of diversification of assets result from provisions of law and internal regulations of the AIF, including the investment policy of the AIF.

The Depositary

An AIF should have a depositary holding the assets of AIF and keeping a register of all its assets, and also acting as a con – monitoring the activities performed by the AIF and its management in order to ensure that they carry out regulated activities in accordance with the law and internal regulations of the AIF. A depositary is not required in relation to an AIC whose managing party is only subject to entry in the register maintained by the PFSA.

A contract for fulfilling the function of an investment fund's depository may be concluded exclusively with:

- a domestic bank whose own funds amount to at least PLN100 million;
- a branch of a credit institution with its seat in the territory of Poland, if the funds allocated for the disposal of that branch amount to at least PLN100 million; or
- the National Depository of Securities.

This contract may also be concluded with an investment firm authorised to perform the acts in the scope of storing or recording financial instruments, provided that its founding capital amounts to at least the PLN equivalent of EUR750,000.

Register of the Fund's Participants and Registration of Investment Certificates

A SOEIF should keep a register of the fund's participants. Moreover, investment certificates of a CEIF should be registered in a depository for securities maintained in accordance with appropriate provisions.

Register of Shareholders

An AIC which conducts its activity in the form of a joint stock company or a limited joint stock partnership should have a register of shareholders in which all shareholders and shares held by them are recorded. The list of entities authorised to maintain a register of shareholders is limited to the specific professional institutions, including investment firms.

2.5 Fund Finance

There are some limitations in the scope of accessibility to borrow funds as an established AIF. An AIC may not conclude a loan agreement or other agreement of a similar nature, or issue bonds or other securities that do not constitute participation rights of an AIC, if the person granting the loan or concluding another agreement of a similar nature or covering or purchasing the bonds or other security is a natural person. This limitation does not apply to a natural person considered a professional client pursuant to the regulations regarding AICs (this is a new regulation valid from 29 September 2023).

A CEIF may take out, only from domestic banks, credit institutions or foreign banks, loans and credits with a total amount not exceeding 75% of the value of the fund's net assets at the time of concluding the loan or credit agreement. Granting loans by a CEIF is also limited – to a certain percentage value of the fund's net assets. CEIF may also grant loans in securities to other entities.

A SOEIF may take out loans and credit, only from domestic banks or credit institutions, with a repayment period of up to one year, in a total amount not exceeding 10% of the value of the fund's net assets at the time of concluding the loan or credit agreement.

2.6 Tax Regime

As a general rule, income (revenue) of CEIFs and SEIFs, when applying investment rules and restrictions laid down for CEIFs, is exempt from corporate taxation, with certain exceptions. In particular, income from a share in foreign tax-transparent entities is subject to corporate tax, as well as income from certain transactions with such entities.

An AIC is generally subject to corporate tax with certain exemptions. Specifically, income (revenue) of an AIC obtained from the disposal of shares is exempt, provided that the AIC that disposes of shares has held directly, continuously for two years before the date of the disposal, not less than 5% of the shares in the capital of the company whose shares are being disposed of. An AIC may also apply a participation exemption for received dividends and interest on general terms provided in the law for all capital companies.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

There is no response for this jurisdiction.

3.1.2 Common Process for Setting Up Investment Funds

There is no response for this jurisdiction.

3.1.3 Limited Liability

There is no response for this jurisdiction.

3.1.4 Disclosure Requirements

There is no response for this jurisdiction.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

There is no response for this jurisdiction.

3.2.2 Legal Structures Used by Fund Managers
There is no response for this jurisdiction.

3.2.3 Restrictions on Investors
There is no response for this jurisdiction.

3.3 Regulatory Environment
3.3.1 Regulatory Regime
There is no response for this jurisdiction.

3.3.2 Requirements for Non-local Service Providers
There is no response for this jurisdiction.

3.3.3 Local Regulatory Requirements for Non-local Managers
There is no response for this jurisdiction.

3.3.4 Regulatory Approval Process
There is no response for this jurisdiction.

3.3.5 Rules Concerning Pre-marketing of Retail Funds
There is no response for this jurisdiction.

3.3.6 Rules Concerning Marketing of Retail Funds
There is no response for this jurisdiction.

3.3.7 Marketing of Retail Funds
There is no response for this jurisdiction.

3.3.8 Marketing Authorisation/Notification Process
There is no response for this jurisdiction.

3.3.9 Post-marketing Ongoing Requirements
There is no response for this jurisdiction.

3.3.10 Investor Protection Rules
There is no response for this jurisdiction.

3.3.11 Approach of the Regulator
There is no response for this jurisdiction.

3.4 Operational Requirements
There is no response for this jurisdiction.

3.5 Fund Finance
There is no response for this jurisdiction.

3.6 Tax Regime
There is no response for this jurisdiction.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform
As mentioned previously, there are some new regulations within the scope of AICs which limit the accessibility to invest in AIC by retail investors. These regulations have entered in force in 2023 and cover especially the following.

- An investor in an AIC is an entity that has the right to participate (shares) in an AIC and meets the criteria of a professional client (with some exceptions). A natural person may be considered a professional client if the value of their contribution to the AIC is not less than the PLN equivalent of EUR60,000. This limitation is not applied if at least 50% of rights to participate in the AIC consist of professional clients specified in the AIF Act (eg, AIC's managing party, society of AIF, investment firm).
- A investor in an AIC should obtain consent in writing from the AIC's managing party for any transfer of shares in an AIC to an entity other than the investor of this AIC and the AIC's managing party. The AIC's managing party will refuse to consent if, after verification,

the potential purchaser does not meet the conditions for recognition as a professional client. This limitation is not applied if at least 50% of rights to participate in the AIC consist of professional clients specified in the AIF Act (eg, AIC's managing party, society of AIF, investment firm).
- An AIC may not conclude a loan agreement or other agreement of a similar nature, or issue bonds or other securities that do not constitute participation rights of an AIC, if the person granting the loan or concluding another agreement of a similar nature or covering or purchasing the bonds or other security is a natural person. This limitation does not apply to a natural person considered to be a professional client pursuant to the regulations regarding AICs.

Trends and Developments

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LSW is a leading Polish law firm, having practised on the Polish market for over 20 years. LSW's investment funds practice is well recognised both locally and internationally, working closely with distinguished international and foreign investment fund/private equity practices. The team advises the whole gamut of investment funds, including venture capital, buyout, real estate, infrastructure, distressed asset, and sovereign wealth, through the course of an investment fund's existence. Our specialist teams advise on, among other things, fund formation, fundraising and M&A. LSW is renowned for advising international and foreign investment funds taking their first steps on the Polish market, as well as assisting Polish funds on creating international structures to approach foreign markets, and attracting foreign investors. The team has advised the following investment funds and/or their portfolio companies: Warburg Pincus, TPG Capital, Mid Europa Partners, Nuveen, GIC Private Limited, Paine Schwartz Partners, Pollen Street Capital, Brookfield Asset Management, Partners Group, Marlin Equity Partners, Davidson Kempner Capital Management, Abris Capital, Enterprise Investors, and many more.

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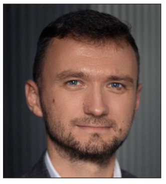

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Krzysztof Marzyński is a leading expert in real estate and construction law with over 16 years of experience, regularly advising international investors entering the Polish market. Specialising in property transactions, asset management and real estate development, he has handled diverse real estate assets, including office buildings, logistics, commercial and hotel properties, as well as alternative assets such as student housing, rental apartments, co-living projects, and agricultural and forest properties. His clients include investment and asset management entities, private equity real estate funds, family offices, and developers from Europe, America, the Middle East, and Africa. Krzysztof gained professional experience at PwC, Clifford Chance, and Dentons, and was a Partner at Crido Legal.

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Introduction

The current main highlights of the Polish investment funds market include a growing number of alternatives to AIF structures, the popularity of international structures, and a noticeable shift towards ESG and sustainable investing.

International Angle of PE and VC Market

Many prominent PE and VC funds operating in the Polish market, often perceived as Polish funds, are actually structured abroad, mainly in Luxembourg. These funds typically have non-Polish limited partners (LPs) and were established to focus on Poland and the CEE region. Despite being structured abroad, they are considered part of the Polish ecosystem because their managers and decision-makers are based in Poland, and they primarily invest in targets based in Poland.

Foreign Expansion

A growing trend among successful Polish managers, with a strong track record in the Polish market (usually under AIF structures), is to establish their next fund in Luxembourg. They seek financing from the Polish sovereign wealth fund, as well as the European Investment Fund and other non-Polish investors. These funds aim to invest across the entire EU, not just in Poland or the CEE region.

Role of the Sovereign Wealth Fund

The Polish sovereign wealth fund of funds, PFR (Polish: *Polski Fundusz Rozwoju*), continues to play a significant role in boosting the start-up ecosystem and investing in innovative technologies and infrastructure. Start-up financing is expected to rebound and flourish in 2024 with PFR's involvement, as Poland is set to receive funds from the EU recovery fund.

PFR's funds are regulated by the Investment Funds and the Management of Alternative Investment Funds Act of 27 May 2004 (the "AIF Act").

PFR integrates ESG risks into its investment decision-making process. Given PFR's commitment to sustainable investment and its major role in the VC market, a significant shift in the approach of previously ESG-restrained VCs is predicted.

ESG Obligations Start to Take Effect

Managers of alternative investment funds are now obligated to comply with European Union ESG legislation, including the following.

- Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (SFRD).
- Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 with regard to regulatory technical standards specifying the details of the content and presentation of information related to the principle of "do no significant harm", sustainability indicators, adverse sustainability impacts, and the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites, and in periodic reports (RTS).
- Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, amending Regulation (EU) 2019/2088 (the "EU Taxonomy").
- Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 by establishing

the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or adaptation and for determining whether that activity causes no significant harm to other environmental objectives (the "Climate Regulation").

Obligatory Disclosures on ESG Risks and ESG Alignment of Investment Strategy

The Polish Financial Supervision Authority is actively monitoring compliance with ESG legislation by Alternative Investment Fund Managers (AIFM). In 2023, all AIFMs were required to disclose information regarding their consideration of ESG factors in investment decisions, covering aspects such as the following.

- Policies on the integration of sustainability risks.
- Consideration of principal adverse impacts on sustainability factors.
- Consistency of remuneration policies with the integration of sustainability risks.
- Integration of sustainability risks into investment decisions.
- Assessment of the likely impacts of sustainability risks on financial product returns.
- Explanation of whether and how a financial product considers principal adverse impacts on sustainability factors.
- Information on characteristics promoting environmental or social factors.
- Description of environmental or social characteristics or sustainable investment objectives.
- Methodologies used to assess, measure and monitor environmental or social characteristics or the impact of sustainable investments in financial products.

Funds Ahead of the ESG Curve

In recent years, the Polish investment funds sector has seen a divide between enthusiastic ESG adopters and more cautious players. Mature funds and those with substantial assets under management quickly embraced ESG, implementing investment policies, due diligence procedures, exclusion lists, ESG scoring criteria, and appointing ESG officers. Smaller funds, while not outright rejecting ESG, were often hesitant, citing their role as minority investors in early-stage companies as a limiting factor.

ESG obligations are now becoming more apparent, with smaller funds realising the necessity of aligning with ESG principles. There are a few factors behind the growing ESG importance.

- ESG-alignment is a must to co-invest with ESG-focused funds and secure exits to such funds or strategic investors.
- The growing use of venture debt in the past three years in Poland has also prompted venture debt funds to scrutinise portfolio companies through an ESG lens.
- Start-ups collaborating with blue-chip companies are increasingly obligated to meet ESG supply chain requirements, prompting VC funds to recognise the ESG transformation within their portfolio companies.

In 2023, the Polish Financial Supervision Authority mandated AIFMs to disclose their ESG stance. Still, some funds revealed a lack of consideration for sustainability factors. The market's response to these non-ESG alignment statements in 2024 will likely determine whether such funds need to re-evaluate their ESG approach to attract Limited Partners (LPs) and co-investors, and to secure exits.

REITS Law

Approximately 98% of investments in real estate in Poland is undertaken by foreign investors; domestic capital investing in real estate is almost non-existent. This is particularly painful in down phases of real estate market cycles. When foreign investors are struggling to invest abroad, real estate transaction volumes in Poland significantly reduce as there is no domestic capital which, to some extent, could fill the gap after foreign investors.

The real estate market consensus is that one of the reasons for lack of domestic capital on the Polish real estate market is non-existent regulations on Real Estate Investment Trusts (REITs). These vehicles are adopted in a number of other worldwide jurisdictions and they allow for effective (legally and tax wise) investments in real estate by retail and institutional investors.

There were several attempts to implement REITs regulations in Poland. In the latest attempt, in 2021, LSW real estate partner Krzysztof Marzyński was part of the Advisory Committee to the Ministry of Development, Labour and Technology that was working on a draft REIT regulation. Unfortunately, there was no political consensus to finalise the work and REIT regulations were not introduced to the Polish legal system.

The real estate market is hoping that the new Polish government will, at some point, return to working on the REIT law.

Alternative Structures

Many VC funds opt not to adopt the AIF structure, choosing instead to operate as limited liability companies or partnerships. This decision is primarily influenced by their smaller size and a limited number of investors, typically consisting of Polish angel investors. These alternative structures are often preferred for their ease of management and cost-effectiveness.

However, even the alternative structure is now encountering emerging competition from a rising trend known as crowdinvesting. This trend is promoted as the fastest and least formalised method of raising funds, posing a new challenge to the traditional structures in place.

Crowdinvesting ramping up as an alternative to form of financing

Crowdinvesting is an alternative method of financing of joint stock companies. The company issues shares in the increased share capital, which are taken up by investors in exchange for payment of the issue price of the shares – in this way, the investors become co-owners of the company (usually minority shareholders).

Crowdinvesting projects are implemented via crowdfunding platforms. The platform's intermediation between the company and the investor consists in publishing a public offering of the company's shares on an online platform through which investors subscribe for the company's shares.

The most important services of the crowdfunding platform provided to the companies and investors include:

- providing the company with an online platform where the company publishes a public offering of shares and investors subscribe for these shares;
- preparation and implementation of a crowdfunding campaign page on the platform;
- accepting subscriptions for shares from investors; and

- advisory services related to the crowdfunding campaign – in particular in the field of advertising and promotion of the crowdfunding campaign, strategy and organisation of the campaign.

New legal regime for crowdinvesting platforms

Currently, there is a new legal regime for crowdinvesting platforms in the European Union – established pursuant to the Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business. In consequence, from 11 November 2023, only entities authorised by the Polish Financial Supervision Authority may continue to operate crowdfunding platforms in Poland.

As of 12 December 2023, there is only one active crowd investing platform in Poland with permission granted by the Polish Financial Supervision Authority.

New opportunities for companies to obtain financing through crowdinvesting

From 11 November 2023, it is now possible for joint stock companies to obtain financing of up to EUR5 million over a period of 12 consecutive months, as part of a public offering of shares, through crowdinvesting. The previous limit was EUR1 million over a period of 12 consecutive months. The condition is to obtain this financing via a crowdfunding platform authorised by the Polish Financial Supervision Authority.

Obtaining financing through crowdinvesting takes place with simplified requirements, ie, without the need to prepare and publish a prospectus and have it approved by the Polish Financial Supervision Authority and without the intermediation of an investment company (brokerage house).

Instead of the prospectus, it is necessary to prepare a key investment information sheet containing the most important information about the public offering of the company's shares. The key investment information sheet is not subject to approval by the Polish Financial Supervision Authority and its content is very simplified compared to a standard prospectus.

Additional investor protection measures

From 11 November 2023, platforms are also obliged to implement new functionalities aimed at protecting investors:

- platforms should classify investors as sophisticated investors or non- sophisticated investors;
- platforms should allow non-sophisticated investors to take an entry knowledge test and simulation of the ability to bear loss (done when registering an investor account on the platform); and
- each non-sophisticated investor will also be able to withdraw from investing in shares within four days (reflection period).

These solutions are intended to strengthen investor confidence in investing through crowdfunding platforms.

Secondary market of shares – bulletin board

Crowdinvesting platforms that have permission from the Polish Financial Supervision Authority may conduct a bulletin board, which is a kind of secondary market of the shares (until now this was not possible). Investors can post announcements on the board regarding their intention to buy or sell shares of companies that were initially offered on the platform. This will make it easier to find a buyer for the shares and improve the liquidity of these shares.

Prohibition on investment crowdfunding for limited liability companies by offering shares

From 10 November 2023, it is no longer possible to obtain financing for limited liability companies through crowdinvesting, ie, by an offer to subscribe for new shares. New provisions have been introduced into the Polish Commercial Companies Code that prohibit offering the take up and purchase of shares in a limited liability company to an unspecified recipient. Advertising and any other form of promotion of the subscription and purchase of company shares directed to an unspecified recipient is also prohibited. Violation of these provisions is subject to criminal liability.

Crowdlending platforms

As a side note, it should be mentioned that new regulations have also been introduced in the area of crowdlending (ie, granting loans through the crowdlending platforms). From 11 November 2023, only entities with permission issued by the Polish Financial Supervision Authority may continue to operate crowdlending platforms.

SINGAPORE

Law and Practice

Contributed by:
Woon Hum Tan
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Contents

Shook Lin & Bok LLP is a leading, full-service law firm in Singapore with a strong Asian presence and global reach. It has more than a century of rich legal heritage, and among its 150 lawyers are numerous partners who are eminent lawyers in their respective areas of expertise. The firm believes that its success lies in its team of well-trained and experienced lawyers who deploy innovative and effective solutions to solve complex and difficult legal issues, and who provide customised and value-added legal services to clients. Over the years, the firm has built a strong base of clients comprising both local and international financial institutions and large multinational corporations. It has a leading specialised asset and wealth management practice led by a veteran specialist funds lawyer who has been ranked band 1 in Investment Funds by Chambers Asia-Pacific since 2014.

Author

Woon Hum Tan is a senior partner and heads the trust, asset and wealth management practice at Shook Lin & Bok LLP. He has practised law since 1996 and is widely regarded as one of the rare market leaders specialising in investment funds, wealth management and family offices. For more than two decades, he has advised on and established approximately 30 listed REITs, numerous retail funds, Cayman funds and Singapore funds of various strategies and sizes, including more than 100 variable capital company (VCC) funds. He is conversant in English and Mandarin and holds a law degree and an MBA (Finance).

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1. Market Overview

1.1 State of the Market

Regulations and the Regulator

In Singapore, the management, offering and distribution of funds and related issues are regulated and primarily governed by the Securities and Futures Act 2001 (SFA) and its subsidiary regulations. The regulatory authority in Singapore that has supervisory responsibility for administering the SFA and its subsidiary regulations is the Monetary Authority of Singapore (MAS).

The funds market can be broadly divided into retail and non-retail. Any investor which does not qualify as an accredited investor (AI) or institutional investor (II), as defined in the SFA, will be considered a retail investor. Any funds that are not offered exclusively to AIs and/or IIs are considered retail funds.

Retail Funds

Retail funds are generally called collective investment schemes (CIS) and comprise:

- listed real estate investment trusts (REITs);
- listed exchange-traded funds (ETFs);
- listed business trusts (BTs); and
- non-listed retail unit trust funds.

The management, offering and distribution of retail funds entails stricter licensing requirements, regulatory compliance, disclosures, regulatory approvals and filings. Any fund manager that manages retail funds and any entity that offers and distributes retail funds requires a capital markets services (CMS) licence for retail products, unless otherwise statutorily exempted.

Any offering of retail funds in Singapore must be accompanied by a registered prospectus which must first be submitted to the MAS for review and approval. The prospectus must comply with the disclosure standards set out in:

- the SFA;
- the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 (SFR); and
- the Code on Collective Investment Schemes (the “Code on CIS”).

The retail fund must also be authorised (for Singapore funds) and recognised (for non-Singapore funds) by the MAS. In addition, the prospectus must be accompanied by a product highlights sheet in respect of the offer.

Alternative Funds

Non-retail funds are commonly known as private funds or alternative funds.

Alternative funds remained active throughout the past year (2023), especially due to the increasing acceptance and popularity of variable capital company (VCC) funds, family offices setting up alternative funds, and the preference for using fund managers and funds based in an international financial centre instead of using offshore centres.

Further, the VCC Grant Scheme (on reduced terms) has been extended for two years from 16 January 2023 to 15 January 2025.

Listing of REITs and ETFs and capital raising remained challenging in 2023 due to high interest rates, poor capital market conditions, geopolitical risks and market uncertainty.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

Alternative funds may take any of four legal structures, namely:

- unit trust;
- limited partnership (LP);
- company; and
- VCC.

The most common structure was the LP prior to the launch of the VCC framework on 15 January 2020. Since then, a significant shift towards VCCs has been seen.

Unit Trust Fund

The unit trust fund is not a separate legal entity. The unit trust fund is organised as a trust pursuant to a trust deed where the legal ownership of the unit trust fund's assets is vested in a trustee that holds such assets on trust for the benefit of the investors. The trust does not need to be registered with the Accounting and Corporate Regulatory Authority (ACRA) and there is no public register for private trusts. The trustee must hold a trust business licence pursuant to the Trust Companies Act 2005 (TCA).

Investors are known as unitholders and own units. There are no management units or general partnership units. There is no board of directors as in a normal company. As such, the day-to-day control, management and decision-making powers of the unit trust fund vest with the trustee but are delegated to the fund manager. The investment mandate and terms of such delegation are normally found in the trust deed.

Unit trust funds are more commonly used for open-end funds, hedge funds and private property income funds.

A unit trust fund can be organised as an umbrella fund with sub-funds created under the umbrella structure. The umbrella structure itself is not a fund that investors may invest into but is merely an overarching structure to house the sub-funds. Investors select and invest into the sub-funds and the investment assets are held by the sub-funds. The sub-funds are not separate legal entities. Although the performances, assets and liabilities of each sub-fund may be contractually segregated from those of other sub-funds, there is no statutory or legal segregation.

LP Fund

The LP fund is not a separate legal entity. The LP fund is organised as a limited partnership pursuant to the Limited Partnerships Act 2008 and pursuant to an LP agreement where the legal ownership of the LP fund's assets is vested in the general partner (GP), who holds such assets on behalf of the LP fund. The LP fund must be registered with the ACRA.

Investors are known as LPs and own LP units. GP units are usually owned by the fund manager or a GP entity. There is no board of directors as in a normal company. As such, the day-to-day control, management and decision-making powers of the LP fund vest with the GP but are often delegated to the fund manager. The investment mandate and terms of such delegation are normally found in the investment management agreement.

LP funds are more commonly used for closed-end private equity, real estate, venture capital and other exotic assets funds.

Company Fund

The company fund is a separate legal entity. The company fund is organised as a private limited company pursuant to the Companies Act 1967 and pursuant to its constitution, where the legal ownership of the company fund's assets is vested in the company. The company fund must be registered with the ACRA.

Investors are known as shareholders who typically own preference shares or redeemable preference shares. The ordinary shares are usually owned by the fund manager or a GP entity. There is a board of directors. As such, the day-to-day control, management and decision-making powers of the company fund vest with the board of directors but are often delegated to the fund manager. The investment mandate and terms of such delegation are normally found in the investment management agreement.

Company funds are seldom used and have certain disclosure and reporting requirements under the Companies Act 1967. Company funds are also subject to capital maintenance requirements.

VCC Fund

The VCC framework was introduced in Singapore on 15 January 2020 pursuant to the Variable Capital Companies Act 2018 (the "VCC Act"). The VCC Act stipulates that the VCC can only be used as a fund and must appoint a regulated fund management company (a "Regulated FMC", as defined in **2.3.1 Regulatory Regime**) or certain types of financial institutions licensed in Singapore to manage the VCC.

There is ongoing discussion with the MAS to amend the VCC Act and its regulations to allow a single-family office to manage the VCC under certain conditions.

The VCC fund is a separate legal entity and is organised as a VCC pursuant to the VCC Act and pursuant to the constitution where the legal ownership of the company fund's assets is vested in the VCC. The VCC fund must be registered with the ACRA.

Investors are known as shareholders who own participating shares. The management shares are usually owned by the fund manager or a GP entity. There is a board of directors. As such, the day-to-day control, management and decision-making powers of the VCC fund vest with the board of directors but are often delegated to the fund manager. The investment mandate and terms of such delegation are normally found in the investment management agreement.

VCC funds have certain disclosure and reporting requirements under the VCC Act, but capital maintenance requirements are not applicable and the register of shareholders is not available to the public. The VCC must also comply with the requirements for prevention of money laundering and terrorism financing prescribed by the VCC Act.

VCC funds can be used for open-end and closed-end funds. VCC funds can be used for hedge, private equity, real estate, venture capital and exotic assets funds. It is the most flexible of all the Singapore funds structures.

A VCC fund can be organised as an umbrella VCC fund with sub-funds created under the umbrella VCC. The umbrella structure itself is not a fund that investors can invest into but is merely an overarching structure to house the sub-funds. Investors select and invest into the sub-funds and the investment assets are held by the sub-funds. The sub-funds are not separate legal entities but have their own unique sub-fund registration number issued by the ACRA.

The performances, assets and liabilities of each sub-fund must be segregated from those of other sub-funds as required by the VCC Act. Hence, there is statutory and legal segregation, unlike in the case of sub-funds of an umbrella unit trust. In fact, the VCC Act stipulates that the sub-funds must be segregated from each other and that the directors of the VCC must ensure that sub-funds are segregated from each other.

2.1.2 Common Process for Setting Up Investment Funds

Unit Trust Fund

The unit trust fund is constituted when the trust deed is executed by the trustee and the fund manager, and no registration is required.

The constitutive document for a unit trust fund is the trust deed, and the main contracts are the trust deed and subscription agreement.

There is usually an offering memorandum called the private placement memorandum (PPM).

The time taken to set up a unit trust fund can range from a few days to a few weeks, and this is largely dependent on the negotiation of the terms of the trust deed between the parties. There is no registration fee and the professional fees for setting up are considered reasonable.

LP Fund, Company Fund and VCC Fund

The LP fund, company fund and VCC fund are constituted when they are registered or incorporated by the ACRA. Prior to establishment or incorporation, reservation of names is required, and the registration or incorporation forms must be lodged with the ACRA, together with relevant supporting documents.

The constitutive document for the LP fund is the LP agreement, and the main contracts are the LP agreement, investment management agreement and subscription agreement.

The constitutive document for the company fund and VCC fund is the constitution, and the main contracts are the constitution, investment management agreement and subscription agreement.

There is a PPM for LP funds, company funds and VCC funds.

The time taken to set up an LP fund, company fund or VCC fund can range from a few days to a few weeks, and this is largely dependent on the negotiation of the terms of the LP agreement, investment agreement and subscription agreement (as may be applicable) between the parties. The incorporation/registration fee for a VCC is SGD8,000. The professional fees for setting up LP funds, company funds and VCC funds are considered reasonable.

2.1.3 Limited Liability

Generally, fund investors have limited liability and are only liable for their respective capital contributions or capital commitments based on the subscription agreement.

Where the fund is constituted as a private limited company or a VCC under Singapore law, the fund is a separate legal entity. The investors, which are its shareholders, are not liable for the obligations of the fund. The corporate veil of the company or the VCC can be lifted if there are abuses of the limited liability status of the company or the VCC.

Where the fund is constituted as a unit trust or a limited partnership under Singapore law, the fund is not a separate legal entity. The investors, which are its unitholders or limited partners, are usually not liable for the obligations of the fund, which are usually expressly stated in the trust deed and limited partnership agreement, respectively, as well as in the PPM.

If there are specific atypical terms and conditions set out in the constitution (or trust deed in the case of a unit trust fund), subscription agreement and/or PPM, the investors may be liable. If the investors participate in the management of the funds in any manner, they may be liable. For example, an investor may be liable as a director of the fund established as a company or VCC, or an investment committee member of the fund (regardless of the structure).

2.1.4 Disclosure Requirements

Fund managers are required to provide adequate disclosures to the investors and prospective investors in the funds.

Disclosures are usually made in the PPM and should cover all material and up-to-date information that will assist the investors and prospective investors to make informed decisions about investing in the funds. The information should include:

- names of the funds and sub-funds;
- a description of the funds and sub-funds;
- names of the fund managers, and other professionals and main service providers;
- legal structures of the funds;
- investment strategies, theses, approaches, restrictions and limitations of the funds;
- risks associated with the funds;
- fees and charges applicable to the funds;
- conflicts of interests;
- how the funds are offered in Singapore and which statutory exemptions are invoked for the offers;
- subscriptions, redemptions, exits, suspensions, valuations terms and conditions;
- gatings and lock-ups;
- restrictions on transfers and redemptions;
- distributions, if any;
- leverage, if any;
- the charter life of the funds; and
- termination.

If there are material changes to the terms and conditions of the funds, or to any sections of the PPM, it is likely that an amendment or supplement to the PPM will need to be issued with a notice to the investors who have invested with the funds.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Singapore alternative funds have been popular and widely accepted by investors from both within and outside Singapore (especially Asian and European investors).

Investors include high net worth individuals, large corporations, institutional investors, family offices, sovereign wealth funds and foreign funds of funds.

2.2.2 Legal Structures Used by Fund Managers

All four Singapore fund structures have been used by fund managers, although the most common structures are the LP fund and (in the last three to four years) the VCC fund.

2.2.3 Restrictions on Investors

Non-retail funds can only be offered to AIs and IIs as defined in the SFA.

There are no restrictions on nationality or domicile of investors for non-retail funds.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

See **1.1 State of the Market**.

Any entity that manages alternative funds in Singapore must hold one of the three licences or be registered as set out below, unless otherwise statutorily exempted:

- a CMS licence for fund management for retail investors (a "Retail LFMC");
- a CMS licence for fund management for AIs and IIs only (AIFMC);
- a CMS licence for venture capital fund management for AIs and IIs only (VCFMC); or
- a registered fund management company for AIs and IIs only (RFMC – collectively "Regulated FMCs"), although the MAS has announced that the RFMC regime will be phased out.

Any entity that distributes or markets any alternative funds requires a CMS licence for dealing in capital markets products (CMS-DCMP), unless otherwise statutorily exempted. Applications for the CMS licence and registrations of RFMCs must be submitted to the MAS. The MAS will only grant its approval if the application terms and conditions are met and after substantial due diligence on the applicants, its shareholders, directors and key employees.

The MAS launched a public consultation paper on 24 October 2023 in which it proposed repealing the regulatory regime for RFMCs as part of continual enhancements to the regulatory regime for fund management companies in Singapore. The consultation paper sets out the MAS's proposed transitional arrangements for existing RFMCs. The MAS has said it will no longer accept new applications for RFMCs from 1 January 2024. Existing RFMCs that wish to carry on fund management after the RFMC regime is repealed must apply to the MAS for a CMS licence for fund management. The application must be made in a prescribed form during a prescribed application window. RFMCs that transition to AIFMCs will be subject to licence conditions to restrict their managed assets to SGD250 million and if there is an intention to manage more than this amount such AIFMCs may engage the MAS to review the licence conditions. RFMCs that do not apply for a CMS licence by the stipulated deadline will have to cease their fund management business upon the repeal of the RFMC regime.

Statutory Exemptions

Where the alternative funds are offered to non-retail investors, there are statutory exemptions from the requirements of authorisation for the alternative funds and registering a compliant prospectus, provided certain conditions are met. These statutory exemptions are discussed below.

Small offers

This exemption applies to personal offers of units in the fund where the total amount raised from such offers within any period of 12 months does not exceed SGD5 million.

Private placements

This exemption applies to offers of units in the fund where the offers are made to no more than 50 persons within any period of 12 months.

Offers to institutional investors

This exemption applies to offers of units in the fund where the offers are made solely to IIs.

Offers to accredited investors and certain other persons

This exemption applies to offers of units in the fund where the offers are made solely to:

- AIs or certain relevant persons who are related to the offeror; or
- a person who acquires the units as principal if the offer is on terms that the units may only be acquired at a consideration of not less than SGD200,000 for each transaction.

To invoke this exemption, a notification must be lodged with the MAS before the fund can be offered pursuant to Section 305 of the SFA.

For an exempt offering of alternative funds to non-retail investors, the following applies:

- the offer must be accompanied by the PPM;
- the PPM must state the statutory exemption that is invoked for the exempt offer;
- there must be no advertising or promotion of the funds; and
- there must not be a prospectus registered with the MAS.

For non-retail funds, there are no investment restrictions or limitations. Non-retail funds can adopt any investment strategy, apply any investment thesis or approach, invest in any asset class or jurisdiction, raise any amount of capital and invest any amount of committed capital for any length of investment period, subject to legal limitations, sanctions and any other specific legal regulatory restrictions.

Non-retail funds can also invest directly or indirectly through special purpose vehicles.

The critical requirement is that the investment terms and conditions, and risks, are adequately disclosed in the PPM.

2.3.2 Requirements for Non-local Service Providers

Generally, non-local service providers that do not conduct any regulated activities in Singapore are not subject to Singapore licensing regulations or registration requirements.

For non-local service providers that carry out business activities in Singapore that are regulated under the SFA (eg, sub-management, sub-advisory or securities custody), requirements would depend on whether the relevant activities are deemed to be conducted in Singapore pursuant to the SFA, which has certain extraterritorial provisions (namely Section 339). Where such relevant activities are deemed to be conducted in Singapore, the parties must apply to the MAS for the requisite CMS licence, unless statutorily exempted.

2.3.3 Local Regulatory Requirements for Non-local Managers

See **2.3.2 Requirements for Non-local Service Providers**.

Non-local managers may launch and manage alternative Singapore funds, except VCCs. Alternative Singapore funds that are managed by non-local managers will not enjoy the tax incentives available to alternative funds (eg, under Sections 13O and 13U of the Income Tax Act 1947 (ITA), see **2.6 Tax Regime** for further discussion).

For non-local managers that manage alternative Singapore funds but do not otherwise carry out business activities or have a physical presence in Singapore, the requirements would depend on whether the relevant activities are deemed to be conducted in Singapore pursuant to the SFA, which has certain extraterritorial provisions (namely Section 339). Where such relevant activities are deemed to be conducted in Singapore, the non-local managers must apply to the MAS to be a Regulated FMC, unless other statutory exemptions are available.

2.3.4 Regulatory Approval Process

Alternative funds are not regulated in Singapore. There is no regulatory approval or registration required, except for the notification that must be lodged with the MAS before the fund can be offered to AIs and certain other persons pursuant to Section 305 of the SFA.

See **2.3.1 Regulatory Regime** for further details.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

For the statutory exemptions for small offers, private placements and offers to accredited investors and certain other persons (see **2.3.1 Regulatory Regime**), none of the offers may be accompanied by an advertisement making an offer or calling attention to the offer or intended offer, and there must be no selling or promotional expenses paid or incurred in connection with each offer other than those incurred for administrative or professional services, or by way of commission or fee for services rendered by certain prescribed persons.

Apart from this, there are no express legal requirements or prohibitions against pre-marketing of alternative funds in Singapore. However, any regulated activities in Singapore may require the requisite CMS licence or statutory exemptions, and any offer of units in alternative funds must be made pursuant to the statutory exemptions of the SFA and comply with the conditions applicable to the exempt offering.

In the absence of any other formal offering documents, a presentation, flipbook or teaser document (in print or other form) containing the key terms of the investment in the alternative fund such that it practically forms the basis of the offer might be considered a form of offering document. Much depends on the actual facts, and the details and substance found in such documents.

2.3.6 Rules Concerning Marketing of Alternative Funds

Any entity that distributes or markets any alternative funds in Singapore would likely be seen as conducting the regulated activity of dealing in capital markets products as defined in the SFA and would be required to hold a CMS-DCMP, unless otherwise statutorily exempted.

The entity that distributes or markets any alternative funds in Singapore is also likely to be seen as conducting the regulated activity of advising others, either directly or through publications or writings, whether in electronic, print or other form, concerning any investment product. This is a regulated activity that requires a financial adviser's licence pursuant to the Financial Advisers Act 2001, unless otherwise statutorily exempted.

A Regulated FMC can market in Singapore the alternative funds that it manages or sub-manages, as well as the funds that such manager's related corporations (as defined in the SFA) manage without a CMS-DCMP.

2.3.7 Marketing of Alternative Funds

See **2.2.3 Restrictions on Investors**.

2.3.8 Marketing Authorisation/Notification Process

See **2.3.1 Regulatory Regime** and **2.3.4 Regulatory Approval Process**.

2.3.9 Post-marketing Ongoing Requirements

There are no specific ongoing legal requirements applicable to firms that have marketed alternative funds in Singapore, except for ongoing anti-money laundering, countering of financing of terrorism and suspicious transactions monitoring requirements that are generally applicable to Regulated FMCs.

2.3.10 Investor Protection Rules

Aside from what has been discussed throughout **2. Alternative Investment Funds** and elsewhere in this chapter, there are no specific investor-protection regulations in relation to investing in alternative funds.

2.3.11 Approach of the Regulator

The MAS is generally considered to be proactive, forward-looking, approachable and business-friendly. The regulatory teams in the MAS are known to be willing to engage with the industry to understand the market, trends, challenges and needs. They are also willing to meet face-to-face or attend audio or virtual calls, where appropriate.

The development team which promotes Singapore as an international financial centre and asset and wealth management hub is also willing to engage with the industry and prospective licence applicants and is willing to support credible applicants by providing useful connections, information and guidance.

The MAS also engages with groups of fund managers, professionals, service providers and associations in the asset and wealth management space to seek feedback, provide high-level guidance and directions, or conduct pre-consultations before implementing or amending relevant laws and regulations that will have a substantial impact on funds or fund managers.

The MAS takes a strong view on legal and regulatory compliance, especially for professional breaches, professional misconduct, fraud, know-your-customer checks, money laundering and financing of terrorism. On its website, the MAS publishes formal regulatory and enforcement actions taken by it against any entities for breaches of laws and regulations under its jurisdiction, including breaches by fund managers and their personnel.

2.4 Operational Requirements

See **2.1.1 Fund Structures**.

Where funds invest in securities (as defined in the SFA), a securities-based derivatives contract that is not a futures contract, or units in a CIS, the funds must appoint a custodian. The custodian must have a CMS licence for providing custodial services pursuant to the SFA.

The PPM must disclose information that is true, accurate and not misleading to enable the reasonable investors or prospective investors to make an informed decision on whether to invest in the fund. The PPM should include sufficient disclosure of the risks of the investment in the fund.

Alternative funds have no borrowing restrictions. If the intention is for the funds to borrow, this must be disclosed in the PPM.

Private equity, real estate, venture capital and exotic funds are typically audited and valued annually.

Insider trading and market manipulation rules pursuant to the SFA are applicable to funds.

Ongoing anti-money laundering, countering of financing of terrorism and suspicious transactions monitoring requirements are applicable to Regulated FMCs. Regulated FMCs and the entities that provide services to the funds, such as the custodians, banks and brokers, must comply with these ongoing obligations. VCC funds and their directors must also comply with these ongoing obligations.

2.5 Fund Finance

Alternative funds may avail themselves of financing from the banks in Singapore. There are no restrictions on fund financing.

It is common for banks in Singapore to obtain sufficient security as collateral for fund financing. This could take the form of charges or pledges of the securities owned by the fund, mortgages over real estate owned by the fund, assignments of income or receivables, assignments of insurances, and debentures, including corporate guarantees and personal guarantees. Banks may also secure financing against the uncalled capital of the investors in the funds.

Where banks finance the funds, the banks would typically conduct due diligence and know-your-customer checks on the funds, the fund managers and even the investors in the funds, especially if the funds are not considered to be widely held. The due diligence and know-your-customer checks could be extensive, requiring considerable time and a fair amount of information and supporting documents.

2.6 Tax Regime

Taxes in General

In Singapore, income tax is imposed on any income that is accrued in or derived from Singapore and on any foreign-sourced income received in Singapore, unless otherwise statutorily exempted. Currently, the corporate income tax rate in Singapore is 17%.

At present, the Singapore government does not impose tax on capital gains unless the investment gains of any entity are considered to be income in nature, which will depend on a number of factors. This is subject to scrutiny by the Inland Revenue Authority of Singapore (IRAS).

For the purposes of funds, the investment decisions and control and management are typically delegated to the fund manager. If the fund manager is incorporated in Singapore, or has its control and management in Singapore, it is highly likely that the fund will be considered to have tax residence in Singapore and would therefore be subject to Singapore income tax.

On 6 June 2023, the Ministry of Finance released various proposed legislative amendments to the ITA for public consultation. The Ministry proposed the introduction of Section 10L to tax gains from the sale or disposal of any immovable or movable property situated outside Singapore that are received in Singapore by a relevant entity without economic substance in Singapore. Fund managers operating in Singapore should pay attention to future developments in this area and the specific details since investment entities availing themselves of the Singapore fund tax incentives are not specifically carved out from section 10L provisions.

Specific Taxes

Unit trust

The unit trust fund is not a separate legal entity. However, the unit trust fund requires a trustee to hold a licence pursuant to the TCA. Such trustee must be a company incorporated under Singapore law. Thus, the unit trust fund is subject to 17% corporate income tax by virtue of the trustee being a Singapore tax resident.

LP fund

The LP fund is not a separate legal entity and will not be subject to corporate income tax. Instead, the limited partners will be subject to tax on the income derived from the LP fund in accordance with their own tax incidence and liability.

Company fund

The company fund is a separate legal entity and is subject to 17% corporate income tax.

VCC fund

The VCC is a separate legal entity and is subject to 17% corporate income tax.

Fund managers

Regulated FMCs are subject to 17% corporate income tax. The income of the Regulated FMC typically includes management or base fees, performance fees and carried interest, including any other income derived from the fund.

Tax Incentives

There are certain tax incentives available to funds and fund managers, provided certain conditions are fulfilled.

Sections 13O and 13U tax incentives

A fund managed by a Regulated FMC can apply to the MAS for tax incentives pursuant to Section 13O or Section 13U of the ITA, allowing the fund to be taxed at a lower rate. If the incentives' conditions are met, the MAS will grant the incentives in writing to the fund. The key conditions for the incentives are as follows:

- the fund must be managed by a Regulated FMC;
- for Section 13O, the fund must be a Singapore company or VCC;
- for Section 13U, the fund must have minimum assets under management of SGD50 million at the time of the application;
- the Regulated FMC must have at least two (for Section 13O) or three (for Section 13U) full-time investment professionals with minimum salary qualifications;
- the fund must be administered in Singapore;
- the fund must have a minimum annual local expenditure of SGD200,000;
- the fund must not alter its investment strategy or objective after the tax incentives are approved unless it obtains the prior approval of the MAS; and
- there are other specific requirements and restrictions for Section 13O.

There are also specific requirements and restrictions regarding the investment assets and investment income of the fund.

Where the fund is managed by a single-family office (SFO) that is exempt from a CMS licence for fund management under the SFA, additional requirements are applicable for the purposes of Section 13O and Section 13U tax incentives with effect from 5 July 2023. They key changes in conditions from the previous conditions issued by MAS on 18 April 2022 are that:

- there is no longer a grace period for applicants to meet the minimum conditions of the Section 13O and 13U tax incentive schemes at the point of application (including minimum

assets under management, minimum number of investment professionals, and minimum number of investment professionals who are not family members of the beneficial owners);
- only local business spending will be recognised under the minimum business spending requirement, subject to the tiered spending requirement framework;
- eligible donations to Singapore charities as well as grants to qualifying blended finance structures may now be recognised under the minimum business spending requirement;
- more categories of eligible investments have been added under the capital deployment requirement (CDR); and
- the amount invested in certain eligible investment categories will be scaled by a multiplier of 1.5 (or 2 for CDR computation).

Financial Sector Incentive – Fund Management Award

A Regulated FMC can apply to the MAS for incentives under the Financial Sector Incentive – Fund Management Award. This incentive allows the Regulated FMC to be taxed at a lower rate of 10%. The key conditions are:

- the fund manager must be a Regulated FMC;
- the Regulated FMC must have at least three full-time investment professionals with minimum salary qualifications; and
- the Regulated FMC must have minimum assets under management of SGD250 million.

Philanthropy tax incentive for SFOs (PTIS)

A qualifying donor approved under the PTIS scheme will be able to claim a 100% tax deduction for their overseas donations made through qualifying local intermediaries for a period of five years starting from an approved incentive commencement of 1 January 2024. The tax deduction is capped at 40% of the approved qualifying donor's statutory income. The unutilised deductions cannot be carried forward to be offset against income from any subsequent year of assessment. The deduction also cannot be transferred to another company of the same group under group relief arrangements.

To qualify, donors must have an incentivised fund under the Section 13O or 13U schemes and meet the eligibility conditions.

Investors

Investors in alternative funds will be subject to tax incidence on any income or any distributions they received from the funds according to the relevant tax laws and regulations applicable to them based on their tax residence. Singapore investors who are individuals are currently not subject to income tax for the income or distributions they receive from funds.

Stamp Duty

Stamp duty is applicable in Singapore when investors transfer their shares in company funds or VCC funds. This is chargeable at 0.2% of the transfer consideration or the value of the shares being transferred, whichever is higher. Where there is no open market value of shares available, the Comptroller of Stamp Duties is willing to accept the net asset value as the value of such shares.

Double Tax Agreements

Singapore has entered into more than 90 double tax agreements. Alternative funds that are structured as a company or a VCC established under Singapore law can utilise the relevant double tax agreements.

FATCA and CRS

Singapore has signed a reciprocal Model 1 Intergovernmental Agreement with the USA on 13

November 2018. This came into force on 1 January 2021 and supersedes the previous Model 1 Intergovernmental Agreement (IGA) signed between Singapore and the USA on 9 December 2014.

In short, effect is given to the automatic tax information exchange requirements of the US Foreign Account Tax Compliance Act (FATCA). The relevant Singapore regulations and framework for dealing with FATCA requirements have been put in place, and there are also local guidelines published by the IRAS. All financial institutions including Regulated FMCs are required to comply with these regulations.

In addition to the FATCA, the Standard for Automatic Exchange of Financial Account Information in Tax Matters (AEOI), more commonly known as the Common Reporting Standard (CRS) – a framework and set of regulations developed by the Organisation for Economic Co-operation and Development – are also applicable. The relevant Singapore regulations and framework for dealing with AEOI and CRS requirements have been put in place, and there are also local guidelines published by the IRAS. All financial institutions including Regulated FMCs are required to comply with these regulations.

It is important to note that the fund and/or Regulated FMC may be compelled by law to disclose or hand over certain information or documentation to the IRAS pursuant to the rules and regulations concerning the FATCA, AEOI and/or CRS. The IRAS may under certain conditions be required to automatically exchange information with the relevant foreign tax authorities or agencies in accordance with the relevant FATCA and/or CRS regulations.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

Retail funds are generally called collective investment schemes (CIS). Retail funds can take the form of a unit trust or a VCC. There is no limit on the number of investors for such structures. By far the most common structure is the unit trust for both listed and non-listed retail funds. Most listed retail funds are REITs, ETFs and BTs, all of which are structured as unit trusts.

See **2.1.1 Fund Structures**.

3.1.2 Common Process for Setting Up Investment Funds

Unit Trust Fund

See **2.1.2 Common Process for Setting Up Investment Funds**.

VCC Fund

See **2.1.2 Common Process for Setting Up Investment Funds**.

For retail VCC funds, at least one of the VCC directors must be independent. The VCC must appoint a custodian that has received approval from the MAS to act as a trustee for authorised CIS pursuant to the SFA.

Additional Requirements

Registration and licensing

Managers of retail funds must be a Retail LFMC. The requirements here are the most stringent amongst the Regulated FMCs, including having at least three full-time investment professionals that meet the MAS' requirements and that the CEO must have at least ten years of relevant experience.

The manager of a REIT requires a CMS licence for real estate investment trust management. The requirements for the REIT manager are similar as for the Retail LFMC. A REIT manager can manage only one REIT.

Where the retail fund is a unit trust including a REIT, the trustee of the fund must be licensed as a trust company under the TCA and be approved by the MAS to act as a trustee for authorised CIS pursuant to the SFA.

The retail unit trust fund must be authorised (for Singapore funds) or recognised (for non-Singapore funds) by the MAS prior to an offer being made.

The offer for any retail unit trust fund must also be accompanied by a prospectus that complies with the disclosure requirements of the SFA, the SFR and the Code on CIS. The prospectus must be reviewed and approved by the MAS, and upon receiving approval the prospectus will be registered with the MAS. Compared to a PPM, the prospectus is a lengthier, more detailed and more complex document, with more disclosures and information.

The provisions of the SFA, the SFR and the Code on CIS prescribe certain terms of the trust deed and certain rights, duties and obligations of the fund manager, the trustee and investors under the trust deed. Appendix 6 of the Code on CIS also imposes certain restrictions on REITs in Singapore, including a restriction on the types of investments which REITs in Singapore may hold, a general limit on a REIT's level of borrowings, and certain restrictions with respect to interested party transactions that a REIT enters into.

Listed funds

Where the retail fund is listed on the Singapore Exchange (SGX), a new listing application for the units of the retail fund must be made to the SGX pursuant to the SGX Listing Manual. The prospectus must also be submitted to the SGX for review and approval. Upon approval, the final prospectus must be registered and made available to the public.

The retail fund must also be properly authorised or recognised before the units will be listed on the SGX for trading.

Subsequent to listing of the units in the retail fund on the SGX, there are continuous reporting requirements and obligations pursuant to the SGX Listing Manual and the SFA.

Insider trading and market manipulation rules pursuant to the SFA are applicable to listed retail funds.

Length and expense of the application process

The licence application process for the CMS licence (whether for a Regulated FMC or REIT manager) typically takes a few weeks to a few months. The authorisation/recognition process typically takes a few weeks. The prospectus drafting, review by the MAS and final approval typically takes a few months. The application for new listing of the units in the retail fund on the SGX, the review by the SGX and final approval for listing typically takes a few months.

The total cost of applications, licence fees, authorisations/registrations, filings/lodgements, listing applications and professional fees (ie, for lawyers, auditors, tax advisers, trustees, issue managers, bankers and other services providers) is considered expensive for listed retail funds as it is a large and complex transaction involving many parties, and the process is long. More importantly, it entails greater risks because it is offered to many investors including retail investors, especially if the retail fund is listed on the SGX.

3.1.3 Limited Liability
See **2.1.3 Limited Liability**.

The Code on CIS stipulates that the liability of investors in retail funds should be limited to their investment in the fund. For this purpose, the constituent document of the fund should contain a provision limiting the liability of investors to their investments in the fund.

3.1.4 Disclosure Requirements
See **2.1.4 Disclosure Requirements**.

The form and content of the prospectus and the product highlights sheet that accompany the offer of the units in the retail fund must contain all relevant and material information to be disclosed to investors and prospective investors, in accordance with the requirements of the SFA, the SFR (in particular, the Third Schedule) and the Code on CIS.

3.2 Fund Investment
3.2.1 Types of Investors in Retail Funds
Singapore non-listed retail funds are popular and widely accepted by investors from Singapore. These include retail investors as well as AIs.

Singapore REITs, BTs and ETFs are popular and widely accepted by investors from Singapore and outside Singapore, especially Asian investors. In particular, Singapore REITs have enjoyed prominence and success over the last two decades and are popular with Asian, European and US investors. The investor base includes large corporations, institutional investors, family offices, sovereign wealth funds and foreign funds of funds.

3.2.2 Legal Structures Used by Fund Managers
By far the most common structure is the unit trust for both listed and non-listed retail funds. The large majority of the listed retail funds are REITs, ETFs and BTs, all of which are structured as unit trusts.

3.2.3 Restrictions on Investors
Retail funds can be offered to any types of investors.

There are no restrictions on nationality or domicile of investors for retail funds.

3.3 Regulatory Environment
3.3.1 Regulatory Regime
See **3.1.2 Common Process for Setting Up Investment Funds**.

Retail funds must comply with the SFA and the Code on CIS. In particular, the retail funds must be classified according to the types of retail funds. These are:

- traditional funds;
- money market funds;
- hedge funds;
- capital guaranteed funds;
- index funds;
- property funds; and
- precious metals funds.

There are specific restrictions and requirements imposed on the various types of retail funds.

The Code on CIS stipulates the core investment guidelines, concentration limits, limits on use of derivatives other than for efficient portfolio management, borrowing limits and valuation requirements. There are also specific guidelines, requirements and limits applicable to non-traditional funds and these are set out in the Appendixes of the Code on CIS. Where the fund contains a novel or new structure, risk or investment policy, the fund manager (or the VCC, in the case of a fund constituted as a VCC or sub-fund thereof) should consult the MAS prior to application for authorisation of the fund.

Similar to non-retail funds, the critical requirement is that the investment terms and conditions, as well as risks, are adequately disclosed in the prospectus of the retail fund.

Where the retail fund is listed on the SGX, there are requirements and obligations pursuant to the SGX Listing Manual and the SFA. Insider trading and market manipulation rules pursuant to the SFA are applicable to listed retail funds.

3.3.2 Requirements for Non-local Service Providers

See **2.3.2 Requirements for Non-local Service Providers**.

3.3.3 Local Regulatory Requirements for Non-local Managers

Non-Singapore retail funds are usually established under non-Singapore laws and are managed by non-Singapore fund managers.

An application must be made to the MAS to recognise the non-Singapore retail fund before the non-Singapore prospectus can be registered with the MAS and before the fund can be offered. Prior to this, the fund and the non-Singapore fund manager must fulfil a number of criteria, demonstrating that:

- the fund is constituted and regulated in a jurisdiction where the laws and practices afford protection to investors in Singapore at least equivalent to that afforded to investors in funds that are wholly managed in Singapore;
- the fund adheres to investment guidelines and borrowing limits which are substantially similar to those set out in the Code on CIS and the relevant Appendixes; and
- the fund has a non-Singapore fund manager that is reputable and supervised by an acceptable financial supervisory authority.

In addition, the non-Singapore fund manager must be licensed or regulated in the jurisdiction of its principal place of business, must be a fit and proper person in the opinion of the MAS, and there must be a representative in Singapore for the non-Singapore retail fund. The non-Singapore retail fund, the non-Singapore fund manager and the non-Singapore trustee must comply with the SFA and the Code on CIS.

3.3.4 Regulatory Approval Process

See **3.1.2 Common Process for Setting Up Investment Funds**.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

No one is permitted to publish or disseminate, in Singapore or elsewhere, any document relating to any offer or intended offer of units in a retail fund or proposed retail fund, being an offer that is, or an intended offer that will be, made in or accompanied by a prospectus or profile statement that complies with Section 296 of the SFA, if the document resembles or may otherwise be confused with a product highlights sheet.

If a prospectus is required for the offer, or intended offer, of units in a retail or proposed retail fund, a person must not advertise the offer or intended offer nor publish a statement that directly or indirectly refers to the offer or intended offer, or is reasonably likely to induce people to subscribe for or purchase the units in the retail fund, unless the advertisement or publication is authorised by Section 300 of the SFA.

3.3.6 Rules Concerning Marketing of Retail Funds

See **2.3.6 Rules Concerning Marketing of Alternative Funds** and **3.3.5 Rules Concerning Premarketing of Retail Funds**.

The Retail LFMC can market in Singapore the retail funds that it manages, as well as the funds that its related corporations (as defined in the SFA) manage without a CMS-DCMP.

3.3.7 Marketing of Retail Funds

Retail funds can be offered to all types of investor.

3.3.8 Marketing Authorisation/Notification Process

See **3.1.2 Common Process for Setting Up Investment Funds**.

3.3.9 Post-marketing Ongoing Requirements

There are no specific ongoing legal requirements applicable to firms which have marketed retail funds in Singapore except for ongoing anti-money laundering, countering of financing of terrorism and suspicious transactions monitoring requirements that are generally applicable to all Regulated FMCs.

3.3.10 Investor Protection Rules

Aside from what has been discussed in **3. Retail Funds** and elsewhere in this chapter, there are no specific investor protection regulations in relation to investing in retail funds.

3.3.11 Approach of the Regulator

See **2.3.11 Approach of the Regulator**.

The Singapore Exchange Regulation Pte. Ltd. (the “SGX RegCo”) is a wholly owned subsidiary of the SGX that undertakes all frontline regulatory functions on behalf of the SGX and its regulated subsidiaries.

For retail funds that are listed on the SGX, the SGX RegCo and the SGX take a strong view on legal and regulatory compliance, especially for professional breaches, professional misconduct and any breach of the SFA and listing rules.

3.4 Operational Requirements

See **3.1.2 Common Process for Setting Up Investment Funds** and **3.3.1 Regulatory Regime**.

The provisions of the SFA and the Code on CIS prescribe certain terms of a trust deed and certain rights, duties and obligations of the fund manager, the trustee and investors under the trust deed.

The Code on CIS requires the trustee of a retail unit trust fund to be independent of the fund manager, to conduct all transactions with or for a scheme at arm’s length, to send financial statements to the investors, and to inform the MAS of any breach of Section 289(3) of the SFA within three business days after the trustee becomes aware of the breach.

Specifically, the funds, trustees and fund managers for retail property funds must also comply with the requirements of Appendix 6 of the Code on CIS. The trustee of such funds should exercise due care and diligence in discharging its functions and duties, including safeguarding the rights and interests of investors. The trustee should exercise reasonable care in ensuring that the fund has proper legal and good marketable titles to the real estate assets owned by the fund, that material contracts entered into on behalf of the fund are legal, valid, binding and enforceable by or on behalf of the fund in accordance with its terms, and that the fund manager arranges adequate insurance coverage in relation to the real estate assets of the fund.

Appendix 6 also stipulates the requirements and limitations on:

- interested party transactions;
- permissible investments of the retail property funds;
- investments and activities of the funds;
- valuations of the funds' real estate investments; and
- the aggregate leverage limit of the funds.

Insider trading and market manipulation rules pursuant to the SFA are applicable to funds.

3.5 Fund Finance

See **2.5 Fund Finance**.

REITs must comply with the Code on CIS (in particular, Appendix 6 of the Code on CIS), amongst others.

The total borrowings and deferred payments (collectively, the "aggregate leverage") of a REIT:

- should not, before 1 January 2022, exceed 50% of its deposited property; and
- should not, on or after 1 January 2022, exceed 45% of its deposited property.

The aggregate leverage of the REIT may exceed 45% of its deposited property (up to a maximum of 50%) only if it has a minimum adjusted interest coverage ratio of 2.5 times after taking into account the interest payment obligations arising from the new borrowings.

3.6 Tax Regime

See **2.6 Tax Regime**.

A REIT (being a listed property fund) will usually apply to the IRAS for "tax transparency treatment" subject to various conditions. This treatment applies to only certain income of a REIT, including rental income or income from the management or holding of immovable property. Whether distributions are taxed in the hands of the unit holder will depend on the type of income from which the distribution is made by the REIT and the type of unit holder.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

See **1.1 State of the Market** regarding VCC funds.

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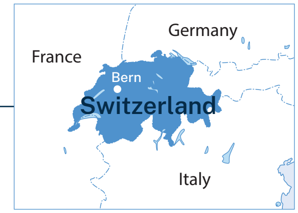

Law and Practice

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Contents

Pestalozzi Attorneys at Law Ltd is a multicultural Swiss business law firm that has focused on high-end work for domestic and international clients since 1911. Pestalozzi lawyers are strong and empathetic, and are known for their truly independent approach to advising and representing their clients. The firm guides and supports its clients in their strategic business decisions, anticipates their future challenges and helps them solve their critical issues. Being fully integrated, Pestalozzi encounters no internal limits in shaping the most competent and efficient teams for clients' needs. With more than 100 professionals in Zurich and Geneva, the firm is at home in Switzerland's two main commercial hubs, and has developed a wealth of experience in its key industries of banking, life sciences, commodity trading and insurance. While being locally embedded, Pestalozzi has also developed sought-after expertise in dealing with multi-jurisdictional transactions and disputes.

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1. Market Overview

1.1 State of the Market

Switzerland as an Asset Management Hub

Switzerland has a high level of political stability combined with a reasonable legal and regulatory framework, moderate corporate tax rates and a highly skilled labour force. Among European asset management hubs, Switzerland takes a leading position with respect to offering favourable conditions for the asset management industry. However, fund structures domiciled in Switzerland that are available for alternative investments are often not a suitable alternative to well-established non-Swiss alternative investment fund (AIF) offshore locations such as Jersey, Guernsey or the Cayman Islands, or onshore locations such as Luxembourg and Ireland.

With a long banking and finance tradition, Switzerland is also a leading light in the international asset management industry, which constitutes one of the main pillars of the country's financial centre. One survey of asset managers conducted in 2023 found again that a competitive regulatory framework and non-discriminating access to international markets are important requirements for future growth. Asset managers see the integration of ESG into the investment process as part of their fiduciary duty to their clients.

Swiss Fund Market in 2023

In the third quarter of 2023, the stock markets suffered from depressed market sentiment, which manifested itself in the Swiss fund market in performance losses and money outflows. This put the brakes on the growth momentum that had emerged in the Swiss fund market at the beginning of the year. At the end of September 2023, the volume in the Swiss fund market was CHF1,360,75 million, representing a decline of CHF18,467 million or 1.3% since the end of June. Since the beginning of the year, the Swiss fund market has still gained CHF36,727 million or 2.8%; of this increase, CHF25,417 million or 1.9% is attributable to performance and CHF11,310 million or 0.9% to new money inflows.

The development of the various asset classes was uneven: over the entire nine months, only equity and money market funds achieved a positive inflow of new money. For equity funds, this amounted to CHF3.9 billion, while for money market funds it amounted to CHF15.6 billion. This asset class was the only one in which the positive development continued in the past third quarter. Investment strategy funds suffered outflows of CH 2.5 billion, bond funds CHF2 billion and alternative investments CHF1.4 billion. Commodity funds (CHF1.3 billion) and real estate funds (CHF548 million) also lost volume.

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

Legal Framework

The key statutes and implementing ordinances governing the establishment and operation of AIFs and their managers are as follows:

- the Swiss Collective Investment Schemes Act (CISA);
- the Swiss Collective Investment Schemes Ordinance (CISO);
- the Swiss Collective Investment Schemes Ordinance of the Swiss Financial Market Supervisory Authority (CISO-FINMA); and
- the Swiss Ordinance of FINMA on Bankruptcy of Collective Investment Schemes (CISBO-FINMA).

In addition, the following legislation sets out the legal framework for financial institutions acting as fund management companies and investment managers of AIFs and their assets:

- the Swiss Financial Institutions Act (FinIA);
- the Swiss Financial Institutions Ordinance (FinIO); and
- the FINMA Swiss Financial Institution Ordinance (FinIO-FINMA).

Finally, sales of financial instruments including AIFs to clients in Switzerland are governed by:

- the Swiss Financial Services Act (FinSA); and
- the Swiss Financial Services Ordinance (FinSO).

Open-Ended Funds

There are two forms of regulated Swiss open-ended collective investment schemes. Swiss-domiciled AIFs are typically structured as fund of funds in the form of open-ended funds, as either:

- contractual investment funds (FCPs) with no legal personality; or
- corporate funds in the form of an investment company with variable capital (SICAV) in the category of “other funds for alternative investments”.

“Other funds for alternative investments” include open-ended collective investment schemes whose investments, structure, investment techniques (short selling, borrowing of funds, etc) and investment restrictions exhibit a risk profile that is typical for alternative investments. FCPs and SICAVs are subject to the same investment rules.

Reference to the special risks involved in AIFs must be made in the fund name, and in the prospectus and marketing material. The prospectus must be offered free of charge to interested persons prior to an agreement being concluded or prior to subscription. FINMA may allow transaction-related settlement services of a directly investing other fund for alternative investments to be provided by a regulated institution specialising in such transactions (prime broker). It may specify which monitoring functions must be undertaken by the fund management company and the SICAV.

Swiss investment fund regulation does not provide for additional vehicles specifically designed for AIFs. In practice, however, the Swiss fund structures available for alternative investments are often not suitable alternatives to well-established non-Swiss AIF offshore locations such as Jersey, Guernsey or the Cayman Islands, which provide for more flexibility as to the possible investments, leveraging and customisation.

Popular European onshore locations for AIFs include Luxembourg and Ireland.

Open-ended collective investment schemes can be set up in the form of L-QIFs in accordance with CISA as of 1 March 2024. Such L-QIFs (as either FCPs or SICAVs) are only available to qualified investors, and are subject to indirect supervision.

Closed-Ended Funds

As provided by CISA, Swiss-domiciled AIFs can also be structured as a limited partnership for collective investment schemes (Swiss LP) or a company with fixed capital (SICAF).

SICAF

A regulated SICAF is a Swiss company limited by shares whose corporate purpose is limited to the investment and management of its own assets, with no entrepreneurial activity. However, as the regulatory framework provided by CISA is rather limited, the SICAF is substantially governed by the Swiss Code of Obligations. SICAFs have no practical relevance in Switzerland as Swiss limited companies are not subject to CISA and are therefore not regulated by FINMA if their shares are listed on a stock exchange or if their shareholders are exclusively qualified investors as defined by CISA and only registered shares are issued.

Investment companies benefit from this safe harbour (see **Unregulated Investment Companies** below). As a result, no SICAF is currently registered with FINMA and subject to prudential supervision by it.

Swiss LP

The Swiss LP has been introduced not only for alternative investments but also for private equity investments, real estate, construction and infrastructure projects. The sole purpose of a Swiss LP is collective investment, and it conducts investments in risk capital under rather flexible investment guidelines. A Swiss LP requires a partnership agreement, with at least one member being the general partner and therefore subject to unlimited liability for the commitments of the Swiss LP. This general partner must be a Swiss company limited by shares and can be appointed as a general partner of one Swiss LP only.

The minimum share capital requirement for the general partner is CHF100,000. However, no capital requirements apply to the Swiss LP. The investors in the Swiss LP are the limited partners, and they are only liable for a specific amount. Only qualified investors as defined in CISA are eligible to invest in the Swiss LP. The Swiss LP is a structure regulated by FINMA, so must obtain a FINMA licence and is subject to ongoing prudential supervision by FINMA. There are currently approximately 20 Swiss LPs registered with FINMA.

Closed-ended collective investment schemes can be set up in the form of L-QIFs in accordance with CISA as of 1 March 2024. Such L-QIFs (only in the form of Swiss LPs) are only only available to qualified investors and are subject to indirect supervision.

Unregulated Investment Companies

Unregulated investment companies are very popular as they are suitable for investments in alternative asset classes. Specifically, these companies are subject to the Swiss Code of Obligations only and are not within the scope of CISA if the shares of the investment company are listed on a Swiss stock exchange, or if only registered shares are issued and the investment is restricted to qualified investors.

If these conditions are not met, the investment company falls within the scope of the (regulated) SICAF, as described above. Unregulated investment companies domiciled in Switzerland are popular for investments in private equity, hedge funds, venture capital and real estate vehicles.

2.1.2 Common Process for Setting Up Investment Funds

Licensing Requirements

All Swiss AIFs require a licence from FINMA, regardless of their organisational structure or the type of investors. Subject to limited de minimis exemptions provided in FinIA for asset managers of collective investment schemes, asset managers of AIFs must obtain a FINMA licence as the manager of collective assets prior to engaging in asset management activities for AIFs.

The length of the FINMA authorisation and approval process largely depends on the complexity of the fund, including its investment policy, investment techniques, etc, as well as the current workload of FINMA. As a rule of thumb, FINMA seeks to approve AIFs that are open to all investors within two months and AIFs that are only open to qualified investors within one month from the date it receives a complete filing. However, it is not unusual for FINMA approval processes to take up to six months in practice.

Open-Ended Funds

FCPs

FCPs are established by a tri-party fund contract between the investors, the fund management company and the custodian bank. The fund management company and the custodian bank must be authorised by FINMA, and the fund contract – with the consent of the custodian bank – requires FINMA approval. Under the fund contract, the fund management company undertakes to manage the assets of the fund independently and in its own name, in accordance with the fund contract. It is further obliged to ensure that the investors participate in the investments proportionally to their assets.

SICAVs

FINMA must authorise all SICAVs and approve their articles of incorporation and investment regulations.

For the most part, the establishment of a SICAV takes place according to company law rules under the Swiss Code of Obligations. The only exception relates to corporation formation rules pertaining to contributions in kind, acquisitions in kind and particular advantages, as CISA governs those situations specifically.

To establish a SICAV, an act of incorporation in the form of a public deed is required. The deed must include the articles of incorporation and the investment guidelines. In addition, the officers of the SICAV must be appointed upon the incorporation of the SICAV. SICAVs may delegate management to a third party, which must be a fund management company subject to prudential supervision by FINMA.

Closed-Ended Funds

Both the Swiss LP and the SICAF require FINMA authorisation, and FINMA approval is required for the limited partnership agreement for LPs, and for the articles of incorporation and investment regulations for SICAFs.

SICAF

The rules of the Swiss Code of Obligations apply to the establishment of a SICAF, which itself must obtain a FINMA licence confirming that its international organisation is appropriate according to CISA. In addition, the articles of incorporation and the investment guidelines are subject to review regarding their compliance with the applicable law, and must be approved by FINMA. Currently, there are no SICAFs registered with FINMA.

Swiss LP

The establishment of a Swiss LP, for the most part, takes place according to the company law rules on ordinary limited partnerships as provided in the Swiss Code of Obligations. The general partner must be a Swiss corporation and can only act in such capacity for one Swiss LP, unless it holds a FINMA licence as a manager of collective assets. Only qualified investors are eligible to invest in a Swiss LP.

Unregulated Investment Companies

CISA provides that an investment company organised as a company limited by shares is not within the scope of CISA, provided that it has qualified investors and registered shares only, or that its shares are listed on a Swiss stock exchange. To establish an unregulated investment company, the ordinary process to form and register a corporation pursuant to the rules of the Swiss Code of Obligations is followed. The articles of incorporation must provide that only qualified investors can become shareholders. No regulatory licensing process or approval will be required in connection with setting up an unregulated investment company.

2.1.3 Limited Liability

Investors are only liable for their investment in a Swiss open-ended AIF. Funds and SICAVs may be structured as umbrella funds with various sub-funds. In such cases, investors are only entitled to the income and assets of the sub-fund in which they are invested, and each sub-fund is only liable for its own liabilities.

With respect to a closed-ended Swiss LP, the general partner's liability is not limited, while the limited partners are only liable for their investment. With respect to a SICAF, the shares are those of a typical corporation, so investors are only liable for full payment of their investment.

2.1.4 Disclosure Requirements

Prospectus Requirements

Open-ended funds

Open-ended AIFs including FCPs and SICAVs must issue a prospectus with information on the investment policy, the investment techniques including leverage and short selling, and the maximum level of management fees. Furthermore, the prospectus must include the fund regulations.

Any fund that may be offered to retail investors requires a key information document (KID) for investors. The minimum information to be included is set out in FinSO.

Closed-ended funds

Swiss LPs must issue a prospectus including the partnership agreement, which is subject to FINMA approval. The SICAF must issue a prospectus as well, including the articles of incorporation and the fund regulations. Currently, there are no SICAFs registered with FINMA.

Foreign funds

Foreign AIFs not approved by FINMA for marketing to retail investors can only be marketed to qualified investors in Switzerland. For further details, please see **2.3.6 Rules Concerning Marketing of Alternative Funds**.

Reporting Requirements

Open-ended collective investment schemes and Swiss LPs must maintain accounts and publish an annual and semi-annual report. The annual report must be published within four months after the end of the financial year and must include the following:

- financial statements;
- information on the number of shares/units issued and redeemed during the financial year, as well as the total number of shares/units outstanding;
- an inventory of the fund's assets at market value;
- valuation principles;
- a breakdown of buy and sell transactions; and
- the performance of the open-ended collective investment scheme (possibly benchmarked against comparable investments).

The report should also include information on matters of particular economic or legal importance, such as amendments to regulations, change of manager, custodian bank, directors or officers, and legal disputes.

The semi-annual report must be published within two months after the end of the first half of the financial year. Among other things, it must include unaudited financial statements, information on shares/units issued and redeemed during that period and the number of shares/units outstanding, the inventory of the fund's asset at market value and a breakdown of buy and sell transactions.

Upon request, open-ended AIFs or their managers must provide information regarding the basis of the calculation of the net asset value per unit. Investors may also require further information on a specific transaction, including the exercise of voting rights, creditors' rights or risk management.

Investment companies not subject to CISA must observe the general rules on financial reporting.

Foreign AIFs have no specific reporting obligations in Switzerland as they do not need to be approved by FINMA for marketing in Switzerland. This is different for foreign retail funds.

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Due to the high number of sophisticated investors, there is significant appetite for AIFs in Switzerland. The market consists mainly of institutional investors, including private and public pension funds, insurance companies, family offices and financial intermediaries, which invest on behalf of their clients in Switzerland and abroad. There is also a significant number of high net worth individuals who invest into AIFs directly, or through their family office.

2.2.2 Legal Structures Used by Fund Managers

Please see **2.1.1 Fund Structures** for details on Swiss-domiciled fund structures.

2.2.3 Restrictions on Investors

There are no restrictions on local investors investing in Swiss AIFs per se, but 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 can invest directly in AIFs if they are specifically mentioned by the investment regulations and if they comply with the general principles for safe and diversified asset management.

2.3 Regulatory Environment

2.3.1 Regulatory Regime

Among open-ended collective investment schemes, open-ended AIFs offer the broadest range of investments and strategies. In particular, they are specifically designed to carry out investments that have only limited marketability, are subject to strong price fluctuations, exhibit limited risk diversifications or may be difficult to value. They may engage in short selling and borrow funds.

Specifically, open-ended AIFs may invest in the following:

- securities;
- units in collective investment schemes;
- money market instruments;
- sight and time deposits with a maturity of up to 12 months;
- precious metals;
- derivative financial instruments whose underlying assets 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
- structured products.

FINMA can also authorise other investments, including commodities and commodity certificates, if mentioned by the investment regulations. AIFs are subject to lower restrictions than funds for traditional investments, which means that:

- loans can be raised for an amount up to 50% of the fund's net assets;
- up to 100% of the fund's net assets can serve as collateral;
- overall exposure can be up to 600% of the fund's net assets; and
- they can engage in short selling.

Swiss LPs 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 in general. They can take control of companies and have a board seat with these companies to safeguard the interests of the limited partners.

Swiss AIFs must comply with the general investment restrictions set out for the pertinent type of collective investment scheme. They can enter into derivative transactions if the economic effects of using derivatives do not result in a breach of the investment objectives as outlined in the fund regulations and the prospectus.

Restrictions to certain assets – including residential real estate in Switzerland, banks, financial institutions and other industries – may apply but are not driven by fund regulation.

2.3.2 Requirements for Non-local Service Providers

The fund management company, SICAV, Swiss LP, SICAF and investment manager of a fund domiciled in Switzerland must be subject to prudential supervision by FINMA and hold the pertinent licence. Only a Swiss-domiciled bank subject to prudential supervision by FINMA can act as the custodian bank of a Swiss-domiciled fund.

While Switzerland needs to be the effective place of management for Swiss funds, certain functions can be delegated to third parties, both in Switzerland and abroad, if they have the required capability, knowledge, experience and licences. Compared to FINMA's Risk Monitor for 2022, the risks associated with liquidity and funding, and with the outsourcing of business activities, are considered to be more significant, with the result that they are now included in the Risk Monitor that was published in November 2023.

2.3.3 Local Regulatory Requirements for Non-local Managers

Non-Swiss domiciled managers cannot manage funds domiciled in Switzerland because the effective place of management needs to be in Switzerland (please see **2.3.2 Requirements for Non-local Service Providers**).

2.3.4 Regulatory Approval Process

Please see **2.1.2 Common Process for Setting Up Investment Funds**.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

Unlike the EU, Switzerland does not have a legally defined concept of "pre-marketing" – ie, general information that falls short of marketing a specific fund. In general, any activity addressed directly at certain clients that is specifically aimed at eliciting the acquisition or disposal of units in the fund qualifies as a financial service, triggering the respective requirements under FinSA. Separately, marketing activities may constitute an offer for the purposes of CISA, but even mere advertising below such threshold may already trigger certain requirements thereunder.

While pre-marketing is not an activity defined by law, for a sales activity to be considered as a financial service pursuant to FinSA, the fund in question must in principle exist or its key terms should at least be defined. This is the case if it is already established or, at the least, if the key characteristics have been established, such as the name of the fund, the main parties, the investment policy, fees, and issuing and redemption terms that will enable investors to make an informed decision.

On this basis, exploratory discussions with potential 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 service or an offer/advertising for a fund. This is the case, for example, if information is provided on certain strategies or composites without reference being made to an actual specific product.

2.3.6 Rules Concerning Marketing of Alternative Funds

New Regulatory Regime – Duties Under FinSA

FinSA and its implementing ordinance FinSO entered into force on 1 January 2020. Under FinSA, regulatory duties in connection with the marketing of AIFs to clients in Switzerland include the following:

- a duty to register the individuals who actually perform financial services on behalf of the (foreign) financial service provider in a new register of client advisers (although client advisers of foreign financial service providers are exempt from the duty to register under the condition that the foreign financial service provider is subject to prudential supervision and limits its financial services to per se professional and/or institutional clients in Switzerland);
- all financial service providers active in Switzerland, including those marketing funds, must join an ombudsman office, unless they are targeting professional and/or institutional clients only in Switzerland;
- a duty to categorise clients into private clients, professional clients and institutional clients (see **2.3.10 Investor Protection Rules** for the investor categories);

- a duty to comply with expanded conduct rules; and
- a duty to comply with certain organisational requirements, including by disclosing or passing on fees, commissions and other remuneration or financial benefits received by financial service providers from third parties in connection with the provision of financial services, except where waived.

Furthermore, the entry into force of FinSA and the revised CISA necessitated changes to the self-regulation material published by the Asset Management Association Switzerland (AMAS). For example, AMAS has updated the code of conduct, the guidelines for real estate funds and the model distribution agreement, with the changes or revisions having entered into force on 1 January 2022.

Fund Distribution as a Financial Service

From a fund perspective, many circumstances of a former fund distribution under CISA are deemed to be a “financial service” pursuant to FinSA. The terms “purchase” and “sale” of financial instruments pursuant to FinSA go beyond circumstances in which there is an effective purchase or sale of a financial instrument. The new regulatory concept has a broad definition and also includes any related activity, such as any other action that specifically targets the purchase or sale of a financial instrument.

To be characterised as a financial service, contact with an “end investor” is a prerequisite. The provision of information on financial instruments to supervised financial intermediaries is generally not regarded as a financial service under the new law.

Whether roadshows are considered as a financial service depends on the specific circumstances. Given that an activity is only deemed to constitute a financial service if potential end investors are addressed directly (ie, specifically targeting the acquisition or disposal of a specific financial instrument by a client), in many cases roadshows will not be characterised as a financial service in the sense of FinSA and its implementing ordinance FinSO. In certain cases, however, it cannot be excluded that roadshows will constitute an offer or at least an advertisement in the sense of FinSA/FinSO.

Consequences

If the offer of units in a collective investment scheme is made to professional and/or institutional clients only, the foreign collective investment scheme no longer needs to appoint a Swiss representative and paying agent. However, this exemption does not cover high net worth retail clients and private investment structures created for them that have declared that they wish to be treated as professional clients in the sense of FinSA, as clients that opt out do not qualify as qualified investors per se. If they are being approached as part of the offering, it is still necessary to appoint a Swiss representative and paying agent.

Offer Versus Financial Service

Pursuant to FinSA, an offer is “any invitation to acquire a financial instrument that contains sufficient information on the terms of the offer and the financial instrument itself”. According to FinSO, it must be “customarily intended to draw attention to a certain financial instrument and to sell it”.

Certain scenarios do not constitute an offer in the sense of FinSA. Besides the clarification with respect to making factual information available and the mention by name of certain financial instruments, the most important clarification is the new specification in FinSO that making information available at the specific request or initiative of the client without prior advertisement does not constitute an offer.

Unlike the term "financial service", which triggers point-of-sale-related duties including conduct and organisational rules and the requirement for registration in the register for advisers, the characterisation as an offer is mainly relevant for the requirement to publish a prospectus and a KID, and with respect to fund-specific duties. Most importantly, a foreign collective investment scheme only needs approval if it is offered to non-qualified investors in the meaning of CISA. The same applies essentially with respect to the requirement for a representative and paying agent when a financial product is to be offered to investors other than qualified investors per se.

2.3.7 Marketing of Alternative Funds

Open-ended Swiss AIFs can generally be marketed to all types of investors, but it is permitted to restrict them to qualified investors only.

Closed-ended Swiss LPs and unregulated investment companies can only be marketed to qualified investors, regardless of their investment strategy. However, the shares of an investment company that are listed on a Swiss exchange can be made available to non-qualified investors without triggering a licence obligation.

For further details, see **2.3.6 Rules Concerning Marketing of Alternative Funds**.

2.3.8 Marketing Authorisation/Notification Process

No authorisation or notification is required by FINMA prior to the marketing of alternative funds taking place.

2.3.9 Post-marketing Ongoing Requirements

There are no ongoing requirements for firms that have marketed an alternative fund in Switzerland.

2.3.10 Investor Protection Rules

In order to protect unsophisticated investors, many Swiss and foreign funds are limited to qualified investors. Pursuant to CISA, qualified investors include professional and institutional clients pursuant to FinSA. Qualified investors in the sense of CISA also include retail clients for whom a financial intermediary in accordance with FinSA or a foreign financial intermediary that is subject to equivalent prudential supervision provides portfolio management or investment advice in accordance with FinSA within the scope of a permanent portfolio management or investment advisory relationship, provided they have not declared that they do not wish to be treated as such (together, QI CISA).

Specifically, QI CISA include the following:

- financial intermediaries as defined in the Banking Act, FinIA and CISA;
- insurance companies as defined in the Insurance Act;
- foreign clients subject to prudential supervision as per the two preceding points;
- central banks;
- public entities with professional treasury operations;
- occupational pension schemes with professional treasury operations and other occupational pension institutions providing professional treasury operations;
- companies with professional treasury operations;
- private investment structures with professional treasury operations created for high net worth retail clients;

- national and supranational public entities with professional treasury operations;
- large companies exceeding two of the following parameters:
  (a) a balance sheet total of CHF20 million;
  (b) a turnover of CHF40 million; or
  (c) equity of CHF2 million;
- high net worth retail clients and private investment structures created for them that have declared that they wish to be treated as professional clients in the sense of FinSA (opting out); and
- Swiss and foreign collective investment schemes and their management companies that are not already deemed to be institutional clients within the meaning of Article 4 paragraph 3 lit. a or c of FinSA in conjunction with Article 4 paragraph 4 of FinSA that have declared that they wish to be treated as institutional clients.

QI CISA under the first four categories above and national and supranational public entities with professional treasury operations qualify as “institutional clients” in the sense of FinSA.

2.3.11 Approach of the Regulator

Collaboration with FINMA is considered to be positive and helpful, including in connection with new technologies. The authority is also generally willing to discuss regulatory questions and projects on an informal basis. In addition, licensing proceedings now take less time than in the past.

2.4 Operational Requirements

The restrictions on AIFs mostly concern the eligible investor type, as well as the investments and investment technique limitations provided for each of the categories. For more information, please see **2.3.1 Regulatory Regime**.

The protection of assets is addressed separately by the requirement to appoint a custodian bank, which must be a licensed Swiss bank for open-ended AIFs and SICAFs. In addition to the banking licence, the organisation must be adapted to the purpose of acting as a custodian bank. Its role is not limited to the custody of assets: it is also responsible for the payment flows as well as the issuance and redemption of fund interests, and it is further entrusted with control functions pertaining to the compliance of the fund management company with its legal obligations.

2.5 Fund Finance

In contrast to other jurisdictions such as the USA or the UK, the Swiss fund finance market is still immature and in its infancy. However, borrowings by AIFs from non-bank lenders and bank lenders are permissible, and demand for fund financing is on the rise in Switzerland. Subject to certain regulatory restrictions, regulated AIFs may take out loans under different types of credit facilities agreements (be it a subscription line facility, an asset-backed fund finance facility or a hybrid facility form) to finance their investment purposes or strategy.

Limits on Financing Transactions

(Regulated) AIFs must observe the regulatory limitation on leverage set by the Federal Council, particularly when negotiating and entering into facility agreements and financing-related security and pledge agreements. The law only permits leverage up to a certain percentage ratio of the fund’s net assets. Currently, the limits for financing transactions related to the main types of regulated investment funds with an alternative investment strategy include the following.

- “Alternative investment funds as such” may take out loans for an amount not exceeding 50% of the fund’s net assets; they may pledge or transfer as collateral up to a maximum of 100% of the fund's net assets, and may commit to an overall exposure of up to 600% of the fund's net assets.

- "Alternative investment funds specialising in real estate investments" may take out loans; however, to secure their liabilities, they must maintain an adequate proportion of the fund's assets in short-term fixed-interest securities or in funds available at short notice. For example, funds available at short notice are cash positions or bank account deposits at sight and on demand with maturities of up to 12 months, as well as guaranteed credit facilities with a bank for up to 10% of the fund's net assets. The credit facilities must be included in the maximum level of encumbrance permitted by law – ie, the encumbrance may not exceed on average one-third of the market value of all real estate assets of the investment fund.
- "Other funds for traditional investments" may take out loans for an amount not exceeding 25% of the fund's net assets. They may only pledge or transfer as collateral up to 60% of the fund's net assets, and commit to an overall exposure of up to 225% of the fund's net assets.

FINMA may regulate any details, allow the transaction-related services to be provided by a regulated institution specialising in such transactions (prime broker) and/or grant exemptions on a case-by-case basis in relation to the restrictions (but also the permitted investments, the investment techniques and the risk diversification).

Structure of Securities

The structuring of the security package depends on the type of financing transactions in which an AIF is involved. For example, there have been transactions in which the fund management pledged its compensation claims vis-à-vis the fund in favour of the lender, the compensation of which had to be paid into a bank account opened with the lending bank.

Provided that the fund documentation allows for subscription line facilities, the security package may also include a pledge over the claims and rights against the investors related to their unfunded capital commitments as well as the pledge over the respective bank account. Nevertheless, the latter seems to be not as common as in other jurisdictions, since there seem to be more regulatory hurdles in Switzerland that need to be assessed and addressed on a case-by-case basis if a regulated alternative investment fund intends to enter into a financing transaction.

2.6 Tax Regime

Cross-Border Offering of Financial Services into Switzerland

As long as they do not involve maintaining a physical presence in Switzerland, the activities performed by a non-resident service provider from abroad should not create liability for Swiss income tax on the part of the service provider. The same holds true for Swiss securities transfer tax and Swiss VAT, provided, in the case of the latter, that the service does not qualify as a (taxable) "electronic service" to a customer in Switzerland who does not hold a Swiss VAT number. If employees of the service provider constantly travel to Switzerland for business (eg, meetings with prospects or customers) or if the service provider has employees living in Switzerland, a Swiss tax (and regulatory) exposure may result.

Fund Taxation: General

Swiss tax law does not distinguish between alternative and retail or non-retail funds but looks at whether the fund is closed-ended or open-ended and what the legal form of the fund is. Special tax rules apply to funds that directly hold real estate investments.

Application of Swiss Fund Tax Rules to Foreign Investment Funds

The Swiss tax treatment of foreign collective investment schemes follows the tax treatment (as described below) of the Swiss scheme with the closest resemblance in terms of legal form and supervision. For an investment vehicle to be recognised as a "collective investment fund" for Swiss tax purposes, one of the following tests must be met:

- FINMA has granted a licence for the distribution of units of the fund in Switzerland;
- the investment fund is under the supervision of a recognised financial regulator; or
- the investment fund's purpose of offering opportunities for collective investment (see below) holds true.

If an investment vehicle's purpose is to offer opportunities for collective investment, the Swiss tax authorities examine the following in particular:

- whether the investment vehicle has been created for a limited period of time;
- if there is "third-party management" in place – ie, the investor has no or very limited rights to exercise power over the entity's investment management;
- whether an offering memorandum exists;
- if reporting is carried out in a way similar to reporting for regulated collective investment schemes; and
- whether the investment vehicle has/uses bodies typical for collective investment schemes, such as an investment manager, a custodian bank, etc.

Swiss Income Taxation of Funds

Depending on the type of collective investment scheme (eg, whether the fund is open-ended or closed-ended, and depending on its legal form), a (foreign) collective investment scheme is treated as being either transparent or opaque for Swiss corporate income tax purposes. If the collective investment scheme is transparent for Swiss tax purposes, then it cannot constitute a taxable entity for Swiss corporate income tax.

Swiss FCPs, SICAVs and LPs are fiscally transparent, and their income is directly attributed to the investors, so the fund is not taxed on the income. By way of exception, funds that directly hold real estate are liable to income tax for the income from such real estate, while under Swiss tax law that income is exempt from tax in the hands of the fund investor.

SICAFs are always fiscally opaque entities (ie, subject to corporate income tax like corporations), and income distributed to the fund investor is taxable in the hands of the fund investor (if the fund investor is liable to taxation in Switzerland).

Swiss Income Taxation of Investors

Swiss tax law distinguishes between private assets and business assets.

For individual investors liable to income taxation in Switzerland and holding the fund units as private assets, the income earned by transparent funds, whether distributed or not, is generally subject to ordinary income tax at the level of the investors. To the extent the fund income is derived from qualifying capital gains, it is tax-exempt if it is disclosed separately in the fund accounts or distributed by a separate coupon. The profits from direct (Swiss or foreign) real estate investments by the funds are also tax-exempt in the hands of the investor. Qualifying capital gains realised upon the sale of units in a collective investment scheme are tax-exempt.

If liable to income taxation in Switzerland, individuals holding the fund units as business assets and legal entities are subject to income tax for any attributable income realised from an investment in a transparent fund, excluding direct (Swiss or foreign) real estate income realised by the fund.

Distributions from a SICAF to investors liable for income taxation in Switzerland are subject to income taxes in the same way as for dividends paid by any corporation. For qualifying participations, income tax relief may apply for individual investors, or participation relief may apply for corporate investors.

Swiss Fund Reporting for Investor Income Taxation

In order for an investor to be able to benefit from the Swiss income tax exemptions for qualifying fund income items, it must be possible for the Swiss tax authorities to distinguish taxable income items from tax-exempt income items. Financial products that do not enable a distinction between taxable income and tax-exempt items might be more difficult to sell, assuming an investor is mindful of the after-tax position. Without the necessary documentation, the investor is subject to a discretionary tax assessment based on a market rate of return (in a worst-case scenario, any return is treated as taxable income).

The Swiss Federal Tax Administration (FTA) maintains a publicly accessible product list (course listing) summarising the relevant Swiss tax values for various kinds of financial products currently available on the market. Issuers of financial products may directly approach the FTA to have a product registered in the course listing. For more frequent issues, it would be more common for issuers to register their financial products with SIX Financial Information, which offers a service feeding the data relevant for Swiss tax purposes into the FTA's list.

Swiss Tax Withholding Obligations of Funds

Regardless of whether a (foreign) collective investment scheme would be considered transparent or opaque for Swiss income tax purposes, the net income (except qualifying capital gains and income from directly held real estate) earned by a transparent Swiss fund is generally subject to Swiss withholding tax at 35%, whether distributed or retained. In the case of a SICAF, only actual distributions are subject to withholding tax.

In order for a foreign (ie, "non-Swiss") investment fund not to become subject to Swiss tax withholding obligations, the following three criteria must be met:

- the majority of the board members must be resident outside of Switzerland, whereby the board in its entirety actually assumes a true control function (regarding management and legal compliance), which it actually exercises at the meetings;
- all board meetings must be held outside of Switzerland; and
- for open-ended collective investment schemes, the custodian bank in the regulatory sense must be located outside of Switzerland.

The function of the custodian bank is divided into control tasks and technical tasks. While the control tasks relate to legal compliance (applicable laws and articles of incorporation, etc), the technical tasks primarily cover the safekeeping of the fund assets, the issue and redemption of fund units, and payment transactions. While the technical tasks may be delegated to a provider in Switzerland, the control tasks must be performed by a custodian bank, administrator or trustee located outside of Switzerland.

Withholding Tax Relief for Investors

Investors liable for income taxation in Switzerland may generally claim back the Swiss withholding tax in full. Other investors may qualify for an exemption from Swiss withholding tax under the affidavit procedure (applicable to Swiss funds that generate at least 80% of income from foreign sources), or may reclaim Swiss withholding tax based on an applicable double tax treaty.

Swiss Securities Transfer Tax

Switzerland levies a tax on transfers for a consideration of certain domestic securities or similar foreign instruments. The Swiss securities transfer tax is triggered if:

- taxable securities are transferred;
- the transfer is made against consideration;
- a Swiss "securities dealer" (as defined in Swiss tax law) is involved as a party or intermediary; and
- no tax exemption applies.

"Taxable securities" include but are not limited to investment fund units, whether the issuer of the securities is in Switzerland or overseas.

The term "Swiss securities dealer" includes but is not limited to:

- banks in Switzerland;
- brokers and professional securities dealers in Switzerland;
- asset and wealth managers in Switzerland; and
- Swiss companies with balance sheet assets of more than CHF10 million in taxable securities.

A business established outside Switzerland and not acting through a Swiss branch office is not a "Swiss" securities dealer; the same is true for a Swiss securities dealer's branch office outside Switzerland.

The tax is levied on the consideration owed for the transfer of the securities. For securities issued by a Swiss issuer, the tax rate is 0.15%. For securities issued by a non-Swiss issuer, the tax rate is 0.3%. The Swiss securities dealer owes the tax. If the Swiss securities dealer acts as an agent or on behalf of a customer, market practice is that the Swiss securities dealer charges the tax to the customer.

Exemptions from Swiss Securities Transfer Tax can be available for specific transactions or securities, or for specific parties ("exempt investors"). If the tax exemption applies because of the nature of the transaction or security, no Swiss securities transfer tax is levied at all. If the tax exemption applies because of the nature of a party involved, then 50% of the tax will fall away while another 50% charge continues to apply, unless the other party is also an exempt investor.

Exemptions available because of the nature of the transaction or the nature of the security include issuing securities, with some exceptions: for example, the issue of rights in non-Swiss collective investment funds is not an exempt transaction.

Exemptions available because of the nature of a party involved include, for example, collective investment funds.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

The majority of Swiss retail funds are open-ended and can take the form of either FCPs or SICAVs. The following asset classes are suitable for retail investors:

- securities funds (Swiss equivalent to the European UCITS);
- real estate funds; and
- other funds for traditional investments.

Although closed-ended structures such as SICAFs can be used for retail funds, no such vehicle has been registered in Switzerland since CISA was introduced in 2007.

For further information on the fund structures available in Switzerland, please see **2.1.1 Fund Structures**.

Different market participants can act as investment managers for these funds. The fund manager for an FCP must be a FINMA-licensed Swiss fund management company in order to obtain FINMA approval. Nevertheless, the fund management company can delegate the investment management to a licensed investment manager of collective assets if this is deemed to be in the interest of the investors.

3.1.2 Common Process for Setting Up Investment Funds

Please see **2.1.2 Common Process for Setting Up Investment Funds** for all types of funds except the Swiss LP, which is not available to retail investors.

3.1.3 Limited Liability

Investors are only liable for their investment in a Swiss open-ended fund, including FCPs and SICAVs.

The Swiss LP is not available to retail investors. The shares of a SICAF are those of a typical corporation, so investors are only liable for full payment of their investment.

3.1.4 Disclosure Requirements

Prospectus Requirements

Please see **2.1.4 Disclosure Requirements**, which applies to both AIFs and retail funds.

Reporting Requirements

Further to the reporting requirements outlined under **2.1.4 Disclosure Requirements**, foreign retail funds (UCITS) approved by FINMA are subject to a number of reporting obligations, which are the responsibility of the Swiss representative. Ordinary amendments to the fund's documents must be reported to FINMA and, if material, must be published in Switzerland within 30 days of the relevant changes becoming effective in the home jurisdiction. For certain corporate actions, specific reporting obligations must be met prior to the effective action.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

Swiss retail funds are mainly established for and purchased by local investors.

3.2.2 Legal Structures Used by Fund Managers

Please see **2.1.1 Fund Structures** for Swiss-domiciled fund structures.

There are two forms of regulated Swiss open-ended collective investment schemes: FCPs and SICAVs. Both are subject to the same investment rules, and are divided into categories based on their investment strategy.

The category typically used for retail investors is securities funds (the Swiss equivalent to UCITS funds), which offer a conservative investment strategy. Real estate funds can also be structured as FCPs and SICAVs, which are open to retail investors. Finally, open-ended funds in the category of "other funds for traditional investments" are considered to follow strategies that present risks comparable to those of the other retail funds.

3.2.3 Restrictions on Investors

Anyone can invest in retail funds in Switzerland; there are no restrictions.

3.3 Regulatory Environment

3.3.1 Regulatory Regime

Securities funds are open-ended collective schemes that invest their assets in securities and comply with the laws of the European Union. They may invest in transferable securities issued on a large scale and in non-securitised rights with the same purpose traded on a stock exchange or on another regulated market. Permissible investments include securities, derivatives, shares of collective investment schemes, money market instruments and short-term deposits. However, precious metals, precious metal certificates, commodities or commodity certificates are prohibited. Short selling is not permitted. Admissible investment techniques include, with limitations, securities lending, repurchase agreements, credit up to 10% of the net assets, and the pledging and transferring as security of up to 25% of net assets.

Real estate funds may invest, in particular, in real estate, real estate companies, interests in real estate funds and real estate assets abroad. The use of derivatives is permissible, subject to limitations. As security for loans, real estate funds may not encumber their real assets on average for an amount exceeding one-third of their market value.

3.3.2 Requirements for Non-local Service Providers

Please see **2.3.2 Requirements for Non-local Service Providers**.

3.3.3 Local Regulatory Requirements for Non-local Managers

Swiss funds can only be managed by a Swiss fund management company or an authorised Swiss fund in corporate form.

3.3.4 Regulatory Approval Process

Please see **2.3.4 Regulatory Approval Process**.

3.3.5 Rules Concerning Pre-marketing of Retail Funds

See **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**.

3.3.6 Rules Concerning Marketing of Retail Funds

Registration as a client adviser and affiliation with an ombudsman may be required for the marketing of retail funds. Please see **2.3.6 Rules Concerning Marketing of Alternative Funds** for further details.

3.3.7 Marketing of Retail Funds

All Swiss funds (except Swiss LPs) and investment companies can be marketed to anyone, unless they are specifically restricted to qualified investors in the fund documentation. Foreign UCITS funds approved by FINMA may also be offered to all investors.

3.3.8 Marketing Authorisation/Notification Process

For Swiss retail FCPs and SICAVs, advertising does not trigger any authorisation or specific obligation under CISA, nor does it trigger prospectus requirements (as long as the offering threshold is not reached) or any other regulatory obligation under FinSA. Persons responsible for the advertising must therefore only:

- clearly indicate that the marketing material is for advertising purposes; and
- mention the prospectus and KID and the place where these documents can be obtained by the retail investors, if they are already available.

Unlike advertising Swiss retail FCPs and SICAVs, advertising foreign retail funds triggers the marketing authorisation obligations under CISA. Those marketing foreign open-ended retail funds must publish a KID for retail investors under FinSA. If the offering of fund units also constitutes the provision of a financial service, the responsible person(s) or entity will qualify as a (foreign) financial service provider and, as such, can only provide the services towards Swiss-based investors subject to FinSA and the relevant regulatory obligations.

3.3.9 Post-marketing Ongoing Requirements

There are no ongoing requirements for firms that have marketed a retail fund in Switzerland.

3.3.10 Investor Protection Rules

Swiss retail investors can only invest in Swiss open-ended products that are not restricted to qualified investors; they may not invest in Swiss LPs. They may only invest in foreign funds established as UCITS and approved by FINMA for marketing in Switzerland.

An open-ended Swiss fund structured as an "other fund for alternative investments" must include a written warning regarding the risks involved in the investment on the front page of the prospectus.

3.3.11 Approach of the Regulator

Please see **2.3.11 Approach of the Regulator**.

3.4 Operational Requirements

Please see **3.3.1 Regulatory Regime** regarding investment and borrowing limitations.

For information on the protection of assets, conduct rules and best practices, please see **2.4 Operational Requirements**.

3.5 Fund Finance

In principle, retail investment funds may take out loans in Switzerland for the purpose of efficient portfolio management. However, such borrowings are subject to certain regulatory restrictions, which depend on the type or category of the respective retail investment fund. Currently, the following restrictions apply to retail investment funds that can be classified as follows, due to their holdings of investments (portfolio).

- Securities funds may take out loans for an amount not exceeding 10% of the fund's net assets, but only on a temporary basis. Furthermore, such retail investment funds may only pledge or transfer (securities) as collateral up to a maximum of 25% of the fund's net assets.
- Real estate funds may take out loans but, to secure their liabilities, they must maintain an adequate proportion of the fund's assets in short-term fixed-interest securities or in funds available at short notice. For example, funds available at short notice are cash positions or bank account deposits at sight and on

demand with maturities of up to 12 months, as well as guaranteed credit facilities with a bank for up to 10% of the fund's net assets. The credit facilities must be included in the maximum level of encumbrance permitted by law – ie, the encumbrance may not exceed on average one-third of the market value of all real estate assets of the investment fund.
- Other funds for traditional investments may take out loans for an amount not exceeding 25% of the fund's net assets. Furthermore, such retail investment funds may only pledge or transfer as collateral up to 60% of the fund's net assets and commit to an overall exposure of up to 225% of the fund's net assets.

FINMA may regulate any details and/or grant exemptions on a case-by-case basis in relation to the restrictions (but also the permitted investments, the investment techniques and the risk diversification). Please also see **2.5 Fund Finance** with respect to possible security packages.

3.6 Tax Regime

Swiss tax law does not distinguish between sorts of funds (alternative, retail or non-retail) but rather between the type of legal structure of the fund.

Please see **2.6 Tax Regime** for further comments.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

Limited Qualified Investor Fund (L-QIF)

A new type of investment fund is being introduced in Switzerland as of 1 March 2024: the L-QIF, which is neither subject to approval nor supervised by FINMA. However, it is only open to qualified investors and must be managed by an institution that is approved and supervised by FINMA, typically a fund management company (administration and portfolio management). Therefore, there will only be indirect supervision by FINMA. It will be quicker and more cost-efficient to set up an L-QIF compared to the currently available Swiss fund structures.

On the investor side, pension funds and insurance companies in particular have expressed their interest in the new structure. The L-QIF offers qualified investors a Swiss alternative to similar foreign fund structures, and is most comparable to Luxembourg's reserved alternative investment fund (RAIF). L-QIFs are open exclusively to qualified investors.

The launch of the new fund structure does not include the introduction of a new legal structure. Instead, it is possible to launch an L-QIF in the form of an existing Swiss fund structure, namely a contractual fund, a SICAV or a Swiss LP. Only financial institutions subject to prudential supervision by FINMA can manage an L-QIF.

On 31 January 2024, the Swiss Federal Council decided to put the revised CISA and the amended CISO into force with effect from 1 March 2024. The amendment to the CISA sets out the implementation provisions for L-QIFs. In addition, the revision provides an opportunity to amend various other points in the CISO and other ordinances, especially the FinIO. These amendments serve to implement international standards, keep abreast of market developments and increase legal certainty.

Sustainable Finance

As part of its mission to further strengthen the Swiss asset management industry's core role in sustainable finance, AMAS is taking the lead by laying down the framework conditions for manufacturing and managing sustainable collective investments. With this in mind, AMAS has developed a principle-based self-regulation for sustainable asset management. For the first time, institutions that produce and manage sustainable financial products are subject to binding organisational, reporting and disclosure obligations. AMAS has taken a principle-based approach to develop this self-regulation for its members, which entered into force on 30 September 2023. With its explicit references to both institutional and product levels, it dovetails with the self-regulation process of client advisory introduced by the Swiss Bankers Association.

Trends and Developments

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BianchiSchwald has established and highly reputable lawyers with many years of experience and passionate enthusiasm for their work. From offices in Geneva, Zurich, Lausanne and Bern, the firm puts together expert teams tailored to meet specific individual requirements. Private investors, venture capitalists, investors' clubs and private equity firms can rely on BianchiSchwald to help them navigate their way through the legal, tax and regulatory environments, whatever the transaction or the project at stake. Work spans all cycles of financing, from seed to late-stage financing and exits. Investments are mainly in medtech, biotech, cleantech, telecoms, media, entertainment and leisure, advertising, IT and web companies, and clients include founders, investment funds and investors, both Swiss and international.

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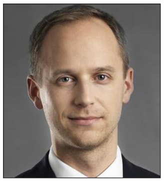

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Investment Funds in Switzerland: an Introduction

In the current macroeconomic setting, the simultaneous challenges posed by inflation and rising interest rates are undeniably impacting the global economy. However, amidst this period of uncertainty, some countries, such as Switzerland, stand out for their resilience in weathering these economic headwinds.

While acknowledging the broad implications of this economic landscape, this analysis will take a distinctive approach by abstaining from exploring the already well-documented adverse effects of the above-mentioned factors on entire economic sectors. Instead, it will focus on the venture capital and private equity market, aiming to shed light on the positive elements stemming from recent legislative developments in Switzerland and topics that are relatively unfamiliar, which hold promise for the sector amid the prevailing uncertainties.

This analysis will cover the existing regulatory environment and the introduction of a new investment fund vehicle slated to take effect in 2024, before moving on to a comprehensive review of the tax environment, including a short description of the tax treatment of carried interests under Swiss tax law and the issue of withholding tax at the fund's level and at the level of the acquisition vehicle used to hold Swiss target companies.

Regulatory environment

The Financial Services Act (FinSA)

FinSA and the Financial Institutions Act (FinIA) are part of the new financial market architecture that came into force in 2020. The aim of this legislation is to create a level playing field, enhance the competitiveness of the financial centre and improve customer protection.

On one hand, FinSA lays down rules for all providers of financial services concerning both the provision of these services and the offering of financial instruments, while also simplifying the way in which customers can exercise their rights. On the other hand, FinIA introduces differentiated supervisory rules for some regulated financial institutions (asset managers and trustees, collective asset managers, fund management companies and securities firms).

A good comprehension of the rules stipulated by FinSA is particularly relevant for investment advisers based in Switzerland or proactively offering financial services to Swiss-based residents. From a regulatory standpoint, the activities of investment advisers should be carefully distinguished from those of managers of collective assets. An investment adviser's function is purely advisory, lacking discretionary authority over client assets and control over the decision to invest. Unlike asset managers, they provide non-binding recommendations for or against transactions, leaving the decision-making power solely with the customer (ie, the General Partner if the investment fund is structured as a Limited Partnership).

Investment advisers need to comply with FinSA requirements if they are based in Switzerland or are providing financial services to Swiss clients, but they are spared the licensing requirements faced by asset managers. The term "financial services" is defined broadly, because FinSA's implementing ordinance stipulates that it covers any activity addressed directly at certain clients that is specifically aimed at the acquisition or disposal of a financial instrument.

The main requirements for financial services providers under FinSA are as follows.

- To register the people providing financial services in one of the "client adviser registers" overseen by FINMA-authorised registration offices. To be registered, an investment adviser must meet certain criteria, including demonstrating adequate knowledge of FinSA's conduct rules, possessing required specialist knowledge for investment advice, securing professional indemnity insurance or equivalent financial security, affiliating with an ombudsman service, having a clean financial market law record, and not being subject to a professional ban by FINMA.
- To classify their clients according to the three categories defined by FinSA. Requirements are very strict with respect to providing financial services to clients considered as "private clients" under FinSA, the category which deserves the most protection and information rights, while professional and institutional clients need less protection, and their relationship management therefore requires less burdensome administrative tasks.
- To provide information to clients, to ensure that their internal organisation and records are adequate, and to behave in accordance with the rules. The degree of protection and information to be given to the client depends on the classification.

In conclusion, while the registration obligation for investment advisers falls short of the stringent licensing requirements for asset managers, the requirements should not be underestimated. Companies that proactively prepare for registration before they start their activity are recommended to formalise internal processes and ensure compliance with the legal requirements.

Limited Qualified Investor Fund (LQIF)

Switzerland is recognised as a global financial hub with respect to wealth management, and faces challenges in establishing itself as an international fund domicile. Existing limitations related to regulatory approvals by FINMA, coupled with perceptions of Swiss funds as being less competitive, have led both Swiss and non-Swiss private clients to prefer foreign investment funds.

To address this and strengthen the Swiss investment fund market, the Swiss government has proposed a new fund type, called the "Limited Qualified Investor Fund" (LQIF). The LQIF is subject to a simplified regulatory framework and targets qualified investors, both institutional and private. In contrast to traditional Swiss funds, the LQIF is exempt from FINMA authorisation or approval.

This new investment fund is often cited as a challenger for the Luxembourg Reserved Alternative Investment Fund (RAIF), a comparable investment vehicle introduced in 2016. Both vehicles target qualified investors and offer flexibility in investment policies. However, the LQIF's distinctive feature is its exemption from direct FINMA supervision. The key features of the LQIF can be summarised as follows.

- Structure and legal forms: the LQIF is not a new legal vehicle, but a new regulatory envelope. Therefore, the LQIF must adopt one of the authorised legal forms under the Collective Investment Schemes Act (CISA), including a contractual investment fund, an investment company with variable capital (*Société d'investissement à capital variable* – SICAV) or a limited partnership for collective investment (*Société en commandite de placement collectif* – SCPC). Notably, an investment company with fixed capital (*Société d'investissement à capital fixe* – SICAF) is ineligible.
- Eligible investors are qualified investors only – ie, those who are professionally qualified, receive professional advice or do not need special protection due to their financial situation
- Limited regulatory supervision: the main feature of the LQIF is its exemption from FINMA licensing, approval and direct supervision. This facilitates a swift and efficient fund launch, improving time-to-market and overall efficiency. Although exempt from direct FINMA supervision, the LQIF must be managed by a FINMA-regulated entity, ensuring compliance with applicable regulations and fund documentation. To comply with this requirement, service providers and banks offer white-labelling solutions.
- Investment flexibility: the LQIF provides flexibility in terms of investment products, techniques, strategies and risk diversification, making it suitable for alternative investments, particularly private equity and venture capital investment funds.
- Tax considerations: the LQIF does not introduce a new tax regime but aligns with existing Swiss collective investment vehicle tax treatment. Notably, distributions from this new fund are subject to Swiss withholding tax of 35%, which can be viewed as a limitation, particularly compared to neighbouring jurisdictions such as Luxembourg, which does not levy withholding tax on foreign investors. However, this view can be nuanced, and will be expanded upon under the **Taxation** heading, below.

In Switzerland, the intersection of legal innovations and tax considerations often shapes the fate of new financial vehicles. A recent illustration of this dynamic is the abandonment of the Swiss trust project by the Federal Council. This decision resulted from the perceived inadequacy of the proposed tax treatment, rendering it incompatible with contemporary standards. Similarly, historical instances such as the experience with the SCPC underscore the impact of tax considerations on the success of financial initiatives, with withholding tax issues hindering the full realisation of the SCPC's potential.

The forthcoming LQIF in Switzerland is poised to address these challenges, particularly for Swiss clients. For this demographic, which is not burdened by definitive withholding tax obligations, the LQIF holds promise as a favourable investment option. However, its success will be contingent on its competitiveness against foreign counterparts, notably Luxembourg's RAIF.

Beyond the domestic landscape, the reception and adoption of the LQIF will be closely monitored, particularly in comparison to Luxembourg's RAIF, a well-established alternative. The effectiveness of the LQIF, especially in attracting investors beyond Switzerland, hinges on its ability to offer advantages that outweigh any tax-related reservations. As such, the strength with which the LQIF is embraced on the international stage, relative to its foreign counterparts like the RAIF, will be a critical metric for evaluating its impact and success in the evolving financial landscape.

The Federal Assembly adopted the bill in a final vote on 17 December 2021, and the consultation procedure on the implementing provisions ended in December 2022. The revised CISA and its implementing provisions are expected to come into force on 1 March 2024.

Taxation

This analysis will span three critical aspects of the venture capital world, starting with the taxation of carried interests and extending to withholding tax on funds distributions and issues that may arise with respect to withholding tax refunds for acquisition vehicle, approaching the matter from a top-down perspective.

Carried interests

A major point of interest for investment fund managers that are active in venture capital is the tax treatment of their potential carried interests. This is a very controversial subject, with widely differing approaches in most jurisdictions. Switzerland is no exception to these controversies, and the federalist tax system adds further complexity to the issue.

Nevertheless, it is possible to summarise the main principles governing taxation, by remembering that the aim of a venture capital fund is to invest in target companies in order to resell their investment at a later date. Most funds therefore make capital gains and, where they can be considered tax transparent, this qualification remains valid for their investors. However, there are some exceptions, and carried interests will often be treated as taxable income if the structuring is not properly planned. This will largely depend on the specifics of the fund's structure and the Canton of residence of the managers.

For these reasons, efficient taxation can be achieved in Switzerland, but the structure and characteristics of the fund must be carefully planned and analysed in advance. Furthermore, the adviser and the managers should ideally be domiciled in the same Canton.

Withholding tax – fund level

The levying of withholding tax on Swiss investment funds is often perceived as a limitation on the development of the financial centre in terms of investment fund management. It is true that a potential 35% non-refundable withholding tax on returns can be a real deterrent and greatly impact an investment fund's performance.

It is less well known that the law stipulates that withholding tax is not levied on the distribution of capital gains by the fund to the investors, provided that these capital gains are clearly distinguishable in accounting terms and are distributed via a separate coupon. The problem does not arise for venture capital funds, which by their very nature should only generate capital gains.

In addition, for distributions that are subject to withholding tax (income from dividends, interest, etc), Switzerland provides an affidavit mechanism applicable to foreign investors if 80% of the funds' income derives from foreign sources. For Swiss investors, the withholding tax is not a definitive charge, as it is deducted from their ordinary taxes.

Switzerland therefore offers real solutions, in terms of both the taxation of managers' fund investments and withholding tax management, to be considered as an attractive place to set up an investment fund.

Withholding tax – Swiss target level

When a foreign fund invests in a Swiss company, the stumbling block may lie one level below, because the dividends paid by Swiss targets are also subject to withholding tax. For operational and financial reasons, the fund often invests through an acquisition company (AcquiCo), which in theory enables it to use the withholding tax relief rules contained in the applicable double taxation treaty between Switzerland and the AcquiCo's country of incorporation. However, the validation of this relief is subject to a situation of treaty abuse, generally referred to as treaty shopping. The relief can take the form of a refund of the tax or its declaration in lieu of payment.

According to the practice of the Federal Tax Administration (FTA), entitlement to relief depends on the substance of the company claiming it. There are three substance criteria.

- Personal (physical) substance: this criterion is met if the company has an office and employees in its country of residence. The FTA adopts a consolidated approach – ie, the offices and employees of another group company in the same country may be taken into account under certain conditions.
- Functional substance: this criterion is met if, in addition to the holding in the Swiss target, the company claiming the relief has at least one other substantial holding in a company abroad. The percentage holding and the value of this other holding are considered by the FTA when assessing this criterion.
- Balance sheet substance: this criterion is met if the company has at least 30% equity calculated on the book value of its assets.

The combination of these criteria depends on the circumstances of the case and the shareholding structure. To assess the substance of an acquisition company held by an investment fund, the tax authorities generally require that two of the three criteria be met and are extremely strict in applying the personal and functional substance criteria. Typically, back-office functions located in the same jurisdiction as the AcquiCo are not sufficient to meet the personal substance requirements.

In all cases, an extremely thorough analysis of the Swiss target's ownership structure must be carried out, to avoid any unpleasant surprises related to the absence of relief from withholding tax. If the strategy implies the company will be held over a long period and if the timing allows it, a request for a binding ruling on the existence of a right to tax relief can also be filed with the tax authorities.

It is also useful to add that withholding tax issues only occur when the portfolio company has reserves on the liability side of its balance sheet that are not considered as paid-in capital.

Conclusion

Switzerland's position is sometimes overlooked in global fund incorporation jurisdictions. In addition to the incorporation of funds as such, which should be less burdensome under the new LQIF, the presence of investment advisory firms in Switzerland and the fact that some fund managers take up residence in Switzerland could be attractive options to consider from a regulatory and tax point of view.

Finally, it is regrettable that the FTA is adopting a stricter approach to the entitlement of foreign acquisition companies to tax relief in certain cases, which could ultimately have a negative impact on the Swiss start-up ecosystem and its financing.

UK

Law and Practice

Contributed by:
Sam Kay, Richard Frase, Mark Stapleton and Nicolas Kokkinos
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Contents

Dechert LLP is a global law firm with 21 locations across the US, Europe, the Middle East and Asia. It has one of the largest investment fund practices in the world, with a record of innovation stretching back 40 years. It advises across the full range of mainstream and alternative asset classes and strategies, representing some of the world's largest fund complexes. The asset management practice has dedicated lawyers across 17 offices and operates as a single practice group across the globe with no internal barriers to collaboration. Clients look to the team for support across the entire fund lifecycle, from development and formation to marketing, operations and transactions. It provides advice related to fund management and governance, and assists with the full range of regulatory and compliance issues, as well as investigations and litigation involving regulatory entities around the world.

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1. Market Overview

1.1 State of the Market

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. Due to having considerable experience and infrastructure, the UK is one of the most prominent jurisdictions for fund formations and has developed a sophisticated market, offering a range of both closed-ended and open-ended types of funds. The asset management industry is of vital importance to the UK's economy.

Within the UK market, alternative investment funds (AIFs) – as defined in the EU Alternative Investment Fund Managers Directive (AIFMD) and replicated in the UK's post-Brexit alternative investment fund manager (AIFM) legislation (UK AIFM Regime) – include private closed-ended funds, often structured as English or Scottish limited partnerships, which are commonly used for funds that focus on illiquid asset strategies (eg, private equity, venture capital, real estate, alternative credit and infrastructure funds). Listed closed-ended funds available for sale to the general public are also common, and are used for both liquid and illiquid asset strategies. The vehicles most often used are investment trust companies (ITCs) and, in the case of funds that intend to invest in real estate, real estate investment trusts (REITs).

Retail funds tend to be open-ended vehicles, which can be – from a regulatory perspective – either an undertaking for collective investment in transferable securities (UCITS) fund or a non-UCITS retail scheme (NURS). One of the key advantages of a UCITS fund is that it can be marketed to investors throughout the EU without the need for additional, local authorisation in each country, known as the UCITS marketing passport. Following Brexit, UK UCITS can no longer make use of this passport. A NURS provides a similar level of investor protection to that of a UCITS and allows the manager more flexibility in terms of the investments the fund can make.

In addition to the UCITS and NURS, there is also a more lightly regulated regime for institutional and certain other qualified investors: the qualified investor scheme (QIS).

The UK provides for a large number of open-ended vehicles that fall within these two categories, including authorised unit trusts (AUTs), open-ended investment companies (OEICs) and authorised contractual schemes (ACSs). Different authorisations apply, depending on the investments to be made. For example, OEICs that invest in real estate may be structured as property authorised investment funds (PAIFs), provided the relevant conditions are met, and OEICs that invest in unauthorised funds need to be authorised as funds of alternative investment funds (FAIFs).

2. Alternative Investment Funds

2.1 Fund Formation

2.1.1 Fund Structures

Private Funds

The typical structure of a UK private equity or venture capital fund is most commonly an English limited partnership, which is a form of partnership governed by the Limited Partnerships Act 1907 (LP Act 1907). Under the LP Act 1907, English limited partnerships must have at least one general partner (GP), who is responsible for the management of the limited partnership, and one or more limited partners. Thus, investors in such funds are limited partners in the partnership. 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.

In recognition of the importance of the private closed-ended funds business to the UK finance sector, the government introduced important reforms to the UK limited partnership law applicable to private funds, which took effect in 2017. The reforms introduced the concept of a "private fund limited partnership" (PFLP) – an English limited partnership with certain modifications, so as to simplify the regime, making it a more attractive and competitive choice of vehicle. Most private equity and venture capital funds (and related vehicles, such as co-investment vehicles and feeder funds) will fulfil the relevant PFLP conditions and can therefore choose to be designated as a PFLP (although it is not mandatory to do so).

It is also possible for a private closed-ended fund in the UK to be structured as a unit trust scheme. 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 strict fiduciary duties are owed by the trustee as a matter of law. A trust does not have a separate legal personality; all legal relationships are entered into by or on behalf of the trustee. These vehicles have historically most commonly been used for certain UK real estate fund structures.

In November 2021, rules came into effect for a new UK fund structure: the Long-Term Assets Fund (LTAF). The LTAF is a UK-authorised fund that is designed to be focused on long-term, illiquid assets and is particularly targeted at increasing defined contribution pension scheme investment into alternative assets.

The LTAF is an authorised fund so can be structured as an open-ended investment company (investment company with variable capital – ICVC), unit trust or contractual scheme. At the time of writing, the use of LTAFs remains limited, with only seven registered (three umbrella funds and four sub-funds), but there is continued hope that the LTAF will play a significant role in attracting long-term capital to the market in the future.

It would also be common for a UK-based private fund manager to establish its private closed-ended fund as an offshore vehicle (whether a partnership, a unit trust or a corporate entity). However, for the purposes of the description of closed-ended private funds in this chapter, the focus will be on English limited partnerships.

Listed Funds

The vehicles used most often are ITCs and REITs, which are typically structured as public limited companies under UK companies legislation and listed on a recognised stock exchange, most commonly the Premium Segment or the Specialist Funds Segment of the Main Market of the London Stock Exchange, although certain other stock exchanges both in and outside of the UK are possible.

As public limited companies, ITCs and REITs have a board of directors who are responsible for managing their affairs, and typically delegate the day-to-day operation of the investment trust. For example, investment management functions are usually delegated to a fund management company, a depositary/custodian will be appointed to be responsible for the safekeeping of the company's assets, a registrar will be responsible for the share register, and a broker will advise on the listing of the company's shares. The fund manager, depositary/custodian and broker will usually be authorised and regulated by the Financial Conduct Authority (FCA).

2.1.2 Common Process for Setting Up Investment Funds

Private Funds

The statutory framework in the UK requires an English limited partnership to be registered as such. This entails providing an application for registration to the (public) Registrar for Limited Partnerships (held at Companies House), providing certain details including the name of each limited partner and the amount of capital contributed by each limited partner. This will be conclusive evidence that an English limited partnership came into existence on the date of registration. Any changes to these details during the continuance of the English limited partnership must be similarly registered within seven days of the relevant change.

The key document for private closed-ended funds is the limited partnership agreement, which is a freely negotiated contract, with very few provisions prescribed by law, and is not available publicly. All parties will heavily negotiate the agreement prior to its execution.

Other frequently used key fund documentation includes side letters (providing certain investors with specific terms required for their specific circumstances), the subscription agreement for investors to subscribe for a commitment and be admitted as a partner in the limited partnership, and the investment management agreement for the fund to appoint the manager.

Listed Funds

An ITC is typically a UK public limited company that has been approved by His Majesty's Revenue & Customs (HMRC) as an ITC for the purposes of the relevant tax legislation. ITCs are subject to special tax rules (discussed below). Similarly, a REIT is typically a UK public limited company that has been approved by HMRC as a REIT for the purposes of the relevant tax legislation. REITs are also subject to special tax rules (discussed below). Since April 2022, it has been possible to have an unlisted REIT where, broadly, it is at least 70% owned by institutional investors. This makes the REIT a potentially attractive private fund vehicle for the right investor base.

A key consideration when setting up an ITC or REIT is that the eligibility conditions (and, post-launch, the ongoing requirements) set out in the relevant tax legislation need to be met in order to gain the tax advantages enjoyed by such vehicles. Tax lawyers should be engaged early in the process to provide advice on the steps necessary for a company to meet these requirements. Offers in respect of ITCs and REITs are subject to the obligation to publish a prospectus under the domestic legislation deriving from the EU Prospectus Regulation. Where a prospectus is required, this will need to be approved in an EEA member state for use in the EEA, in addition to being approved by the FCA for use in the UK. The other key document produced will be the investment management agreement for the fund to appoint the manager.

2.1.3 Limited Liability

Private Funds

The liability of a general partner for the debts and obligations of a partnership is unlimited, whereas the liability of the limited partner is limited to the amount of capital it contributes to that partnership. Also, unless the partnership is a PFLP, there is a restriction on the ability of limited partners to withdraw capital during the life of the partnership. To keep the capital element as small as possible, limited partners will typically split their commitments into a loan element (typically 99.99% of total commitments) and a capital contribution element (typically 0.01% of total commitments).

Listed Funds

In respect of ITCs and REITs, UK companies legislation limits the liability of the shareholders for company debts to the capital originally invested in the fund.

2.1.4 Disclosure Requirements

Private Funds

Although not required by UK law, the key marketing document that is usually used for a closed-ended private fund is a private placement memorandum (PPM). UK law generally requires that any marketing material, including a PPM, is "clear, fair and not misleading". Depending on the intended recipient, the PPM may also need to be approved by an FCA-authorised person. Under the UK AIFM Regime, there are also specific requirements to make set disclosures to investors prior to their investment into the fund. These disclosures are usually included in the PPM.

Listed Funds

In addition to the UK AIFM Regime disclosure requirements, ITCs and REITs must also comply with the disclosure requirements set out in the FCA's listing, prospectus, disclosure guidance and transparency rules.

Under UK companies legislation and the FCA's listing, disclosure guidance and transparency rules, UK incorporated ITCs must also publish annual and semi-annual reports and accounts. The annual report and accounts must be prepared in accordance with the applicable accounting standards, and must give a true and fair view of the assets, liabilities, financial position and profit and loss of the company. The semi-annual financial reports do not need to be audited, but it is common practice to ask the auditor to cast an eye over them, and the audit committee of the fund should certainly review them.

Under the UK's Packaged Retail and Insurance-based Investment Products (PRIIPs) Regime, derived from the EU PRIIPs Regulation, a short, standardised disclosure document containing the key information about the product being offered – a key information document (KID) – must also be produced and published for investment products marketed to retail investors in the UK. If an investment product will also be marketed to retail investors in the EU, a separate KID prepared in accordance with the EU PRIIPs Regulation must also be produced and published. Since 1 January 2023, changes to both the UK and EU regimes have led to divergence and the UK's PRIIPs Regime was replaced on 1 January 2024 by the Consumer Composite Investments Regime (see **4.1 Recent Developments and Proposals for Reform**).

2.2 Fund Investment

2.2.1 Types of Investors in Alternative Funds

Private Funds

Investors typically seen investing in private closed-ended funds in the current market include pension funds, sovereign wealth funds, endowments, insurance companies, fund of funds and high net worth individuals.

Listed Funds
Closed-ended listed funds can be marketed broadly and attract both institutional and individual investors.

2.2.2 Legal Structures Used by Fund Managers
Private Funds
Limited liability partnerships (LLPs) tend be the most commonly used legal entity for the management entities of private equity and venture capital funds, who are attracted by some of the benefits of the LLP structure, such as flexibility and the fact they are transparent for direct tax purposes and can benefit from national insurance contribution savings.

Listed Funds
The legal structure used for the management entity of listed alternative funds will depend on the jurisdiction in which the manager is based. The most common structure seen is a corporate vehicle.

2.2.3 Restrictions on Investors
Other than general marketing/financial promotion rules in the UK, there are no restrictions under UK legislation on the type of parties that can invest in a fund. However, in practice, REITs seek to prevent certain corporate investors from holding interests of 10% or more due to the adverse tax consequences that would otherwise arise.

2.3 Regulatory Environment
2.3.1 Regulatory Regime
Both open and closed-ended funds in the UK will almost certainly be AIFs for the purposes of the UK AIFM Regime. As such, the AIF's manager will be an AIFM and will need to be authorised to carry out AIF management in respect of that vehicle. Any person who carries on the activity of managing an AIF in the UK without being duly authorised, and in the absence of an exemption, commits an offence. In addition, if they have entered into an agreement with another person (eg, an investor) in the course of that activity, this agreement is unenforceable against that other party, who is entitled to receive their money back, and to compensation for any loss.

An ITC or REIT could be self-managed or managed by an external manager. The board of an externally managed ITC/REIT will generally consist of non-executive directors, the majority of whom must be independent of the investment manager. In many cases, ITCs and REITs now have no manager representative on the board, due to the unpopularity of such arrangement with investors.

2.3.2 Requirements for Non-local Service Providers
The UK AIFM Regime sets out various provisions relating to service providers, such as depositaries and valuers. Neither the UK AIFM Regime nor any other UK legislation restricts the use of non-UK service providers to provide these services.

However, one restriction does apply in the UK in respect of external valuers: UK legislation prohibits an external valuer from delegating valuation to a third party.

Under the AIFMD, the depositary of an AIF must be established in the home member state of that AIF. Therefore, EU AIFs are no longer able to use UK banks as depositories post-Brexit, and UK AIFs are no longer able to use EU banks as depositaries.

2.3.3 Local Regulatory Requirements for Non-local Managers

FCA authorisation is always required to manage a UK AIF, irrespective of the location of the manager.

2.3.4 Regulatory Approval Process

Any firm applying for authorisation or registration by the FCA must have its head office 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.

Three types of licence are available to an AIFM that has its head office in the UK:

- authorisation under the Financial Services and Markets Act 2000 (FSMA) as a full-scope UK AIFM;
- authorisation under the FSMA as a small authorised UK AIFM; and
- registration as a small registered UK AIFM.

The type of licence that is available to the manager will depend on the total amount of assets it has under management and the nature of the AIFs managed.

2.3.5 Rules Concerning Pre-marketing of Alternative Funds

The UK has not introduced equivalent legislation to that set out in the EU's Directive and Regulation on the cross-border distribution of collective investment undertakings. Although there is no formal concept of pre-marketing, any invitation or inducement to engage in investment activity will constitute a financial promotion for the purposes of the UK domestic regime. Any activity that would involve pre-marketing will therefore involve the issuance of a financial promotion in the UK and will accordingly be restricted by the UK's financial promotion regime.

A number of useful exemptions to the restrictions on making a financial promotion are available under the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the FPO), including the following in particular:

- the "investment professionals" exemption, which permits financial promotions to be made to, inter alia, firms authorised by the FCA and any person whose ordinary activities involve carrying out the activity to which the communication relates; and
- the "high net worth entities" exemption, which permits marketing to certain categories of high net worth institutions.

Between them, these exemptions generally allow financial promotions to be made in the institutional markets.

2.3.6 Rules Concerning Marketing of Alternative Funds

The activity of marketing or promoting securities or other investments is not in itself a regulated activity requiring any form of licence in the UK. However, there are circumstances where someone whose main aim is to make promotions either for their own purposes or on behalf of others (or to help others to make promotions) may, in conjunction with the marketing or promotion, be engaged in regulated activities. In this regard, the most likely regulated activities under the Regulated Activities Order are those of "arranging deals in investments" or "advising on investments". A firm will require authorisation, with specific permission for the relevant activity, to the extent that it is deemed to carry on such activities in the UK.

2.3.7 Marketing of Alternative Funds

In practice, marketing activities in relation to a fund will also often involve the regulated activities of making arrangements with a view to another person buying or subscribing for interests in the fund. In view of this, fund marketing activities in the UK are generally conducted only by authorised persons. Any person conducting marketing activities in relation to a fund should consider whether authorisation is required and, if it is authorised, whether it has the appropriate permissions from the FCA to undertake these activities.

The promotion of an interest in an unregulated collective investment scheme (such as a limited partnership interest) is restricted in the UK. Such a scheme cannot be promoted to the general public and, even for a private placement, there are broad restrictions on its promotion to different categories of recipients. The persons to which a limited partnership interest can be promoted include:

- investment professional organisations;
- high net worth organisations; and
- in limited circumstances, some certified high net worth individuals and sophisticated individuals.

In the UK, the FCA permits the marketing of a private fund to a wider group of recipients than the category of “professional investors” referred to in the AIFMD if the financial promotion rules referred to above are complied with throughout the entire marketing process.

2.3.8 Marketing Authorisation/Notification Process

Under the UK’s national private placement regime (NPPR) for AIFs, the following notification requirements need to be satisfied:

- the AIFM must submit a notification to the FCA using the FCA’s online system, Connect; and
- appropriate pre-investment disclosures need to be made in accordance with the provisions of the UK AIFM Regime.

There is a fee for AIFMs making a notification. Marketing can commence once the FCA has received the notification.

2.3.9 Post-marketing Ongoing Requirements

Non-UK AIFMs marketing in the UK under the NPPR must report transparency information to the FCA using the Gabriel system.

2.3.10 Investor Protection Rules

The two main investor categories in relation to the distribution of funds in the UK are “professional investors” and “retail investors”. A “professional investor” is one who is considered to be a “professional client” (ie, a “per se professional client” or an “elective professional client”, in each case within the meaning of MiFID).

An investor will be a “per se professional client” if it fulfils one of a number of objective criteria listed in MiFID. Such entities include regulated financial entities, large undertakings, governments and public bodies, and investors whose main activity is to invest in financial instruments.

Any investor that does not satisfy any of the “per se” criteria in MiFID will be categorised as a “retail client”, unless it can be treated as an “elective professional client”. To be able to do this, the manager must assess the expertise, experience and knowledge of the investor and whether this makes them capable of making their own investment decisions and understanding the risks involved (the “qualitative test”). The investor must further pass the “quantitative test", meaning that they have satisfied two out of the three following requirements:

- having carried out transactions of a significant size on the relevant market at an average frequency of ten per quarter over the previous four quarters;
- having a financial instrument portfolio exceeding EUR500,000; and
- working or having worked in the financial sector for at least one year in a professional position.

An investor satisfying the relevant qualitative and quantitative tests and wishing to opt-up must be given a clear written warning of the protections and investor compensation rights they may lose, and they must state in writing that they are aware of the consequences of losing these protections and wish to be treated as a "professional client".

Private open and closed-ended funds tend only to be marketed to non-retail investors. Listed closed-ended funds are available to both professional and retail investors.

2.3.11 Approach of the Regulator

The FCA is regarded as being co-operative, and regularly publishes guidance on relevant regulatory matters.

2.4 Operational Requirements

An FCA-authorised manager must comply with the applicable FCA rules, which have been supplemented by the requirements of the UK AIFM Regime. A key requirement is that the manager must maintain a minimum amount of capital. The amount of capital is likely to be greater if the manager operates under the UK AIFM Regime or the EU MiFID. Other requirements applicable to the typical manager in this structure include:

- prudential requirements, including relating to its governance, the remuneration of key staff, and internal systems and controls;
- FCA approvals of personnel in key positions;
- requirements relating to the conduct of the manager's business, including relating to disclosures to investors and the regulator; and
- anti-money laundering checks, including due diligence checks on new investors.

The FCA-authorised manager must comply with the rules set out above and, to the extent that the UK AIFM Regime applies, must also ensure that certain requirements are met by the fund, such as:

- the appointment of a depositary to have custody of certain assets and/or verify title to privately held assets;
- adherence to organisational controls (relating to risk management, compliance and valuation, for example) and conduct of business rules (relating to due diligence, execution of orders and reporting, for example); and
- compliance with rules relating to companies in which the fund has a substantial stake.

2.5 Fund Finance

The fund finance market in the UK is sophisticated and well developed, particularly for closed-ended private funds. The market includes a range of lenders, from banks to specialist debt funds, which offer finance solutions to funds and their GPs/managers. The most common product is a capital call facility, allowing the fund to draw money from the lender in anticipation of making a capital call from the fund's investors. The main advantage of this type of facility is that it will allow quick and efficient access to capital.

The fund documents (eg, the limited partnership agreement) will normally require at least ten business days' notice to be given to the investors prior to the date of any capital call, whereas the lender under a capital call facility will allow the money to be drawn on shorter notice. This type of arrangement therefore gives the GP/manager greater certainty of funding, particularly when the fund needs capital for investment purposes. It also allows the GP/manager to smooth out when capital calls are made to investors because the fund is able to make use of the facility for irregular cash requirements, such as fees and expenses.

Other types of fund finance have been developed in addition to capital call facilities, including:

- net asset value (NAV) facilities secured on the underlying assets of the fund;
- fund finance arrangements to unlock liquidity for investors; and
- facilities targeted at GPs/managers to assist team members to participate in any "GP commitment" requirements.

Despite the developments in the market, the general principle for closed-ended private funds in the UK is that investors will not want the fund to be leveraged. This is particularly the case for a private equity fund because the investment strategy of the fund itself normally includes leveraged buyouts, so investors will not want a double layer of leverage (ie, at both the fund level and the investment level). Therefore, the limited partnership agreement in a closed-ended private fund will normally impose restrictions on the amount of leverage that may be incurred by the fund (for example, the lower of 20% of commitments made by investors and the amount of uncalled commitments), and any borrowing incurred must be on a "short-term" basis.

Furthermore, under the AIFMD, any fund that incurs leverage (short-term borrowing is excluded for these purposes) is subject to additional disclosure requirements, and the AIFM is required to observe a higher degree of regulation. As a consequence, it is important for common forms of fund finance (eg, capital call facilities) to adhere to both the investor-imposed and regulatory-imposed requirements.

It would be usual for the lender of a capital call facility to take some form of security. A common approach would be for the lender to have the right to require the GP/manager to drawdown from investors to pay any outstanding indebtedness under the facility. It is even possible for the lender to step into the shoes of the GP/manager and issue drawdown notices directly to the investors. For this to be possible, the lender must be assigned the right to issue these drawdown notices under the limited partnership agreement of the closed-ended private fund. This can give rise to negotiation with investors as to whether they are required to counter-sign security documents. A possible compromise is that the investor signs an acknowledgment that the right to drawdown has been assigned to the lender without the investor being a direct party to the security arrangements. An additional issue is whether the fund or investors are required to provide information to lenders. As a general rule, investors will not want to provide non-public information.

2.6 Tax Regime

General

Different tax regimes apply to the different forms of UK investment fund. These are complex, and a detailed summary of them is beyond the scope of this chapter, but a high-level overview of some of the key direct tax features of common UK fund structures (at both fund and investor level) is set out here for AIFs and under **3.6 Tax Regime**. Please note that the features described are necessarily general and may not apply in certain cases – eg, depending on the assets held by the fund or the circumstances of particular investors.

As a general point, the tax structuring preference of an investor will depend on its particular identity and the asset class or classes in which the fund invests. Many funds will have a wide mix of different types of investors (eg, UK resident corporates – such as life assurance companies – and individuals, sovereign wealth funds and pension funds). Fund managers will then usually look to structure the fund so as to be tax efficient for the investor base as a whole rather than a particular investor or class of investor (unless, of course, a particular investor or class is especially important or has been specifically targeted).

A key issue for all investors will typically be tax neutrality when investing through a fund (wherever that fund is established) – ie, they will not want that investment to leave them in a worse tax position than they would be in if they directly held the underlying assets instead. Investors will also commonly not want to be subject to tax filing obligations in new jurisdictions solely because of their investment in the fund, or, if that is not possible, they will commonly want to be made aware of the relevant filing obligations by the fund manager. Another factor for investors when investing in funds (wherever the funds are located) is a wish to minimise withholding taxes on their returns from the fund, due, if nothing else, to the administrative and cashflow cost.

From a UK tax perspective, a further important issue will be whether the fund would be considered to be trading. This can be relevant at both fund and investor level, as the tax privileges for certain UK fund types and investor classes do not extend to trading profits (eg, UK-registered pension schemes are generally exempt from tax on their investment income and capital profits but this exemption does not apply to trading profits). This can have an impact on the chosen structure. Similar concerns can arise for investors in other jurisdictions.

Private Closed-Ended Funds Structured as English Limited Partnerships

Tax position of the fund and investors

As mentioned in **2.1.1 Fund Structures**, the typical structure of a UK private equity or venture capital fund is the English limited partnership. These are transparent for UK direct tax purposes, which means that each limited partner is subject to tax on the income and gains allocated to it under the limited partnership agreement (whether they are distributed or not), rather than the limited partnership itself being taxable on its income and gains.

The taxation of investors on their share of the limited partnership's income and gains depends on the nature of the underlying return that the partnership has received (eg, capital gain, interest, rent or dividend) and the investor's own tax status.

English limited partnerships typically make payments to limited partners in the form of repayment of the loan element of the limited partners' partnership contribution and distribution of partnership profits. No UK withholding taxes should apply to such payments.

Listed Closed-Ended Funds – ITCs

Tax position of the fund

Companies with ITC status are subject to UK corporation tax, but (if certain conditions are met) are exempt from tax on capital gains and on profits of a capital nature from their derivative contracts and their creditor loan relationships. ITCs are also able to benefit from an elective interest streaming regime, which allows them to treat certain dividends to investors as interest distributions, enabling the ITC to claim a corporation tax deduction in respect of the interest distribution (if certain conditions are met). As a UK company, an ITC can also potentially benefit from the general UK company exemption from tax on dividends and other distributions received.

No withholding tax should apply to dividends paid to investors by ITCs, including interest distributions if the ITC enters into the elective interest streaming regime mentioned above.

Tax position of the investor

Investors in an ITC will be taxed on distributions (other than interest distributions) from an ITC in the same way as dividends from normal companies. Therefore, UK tax resident individuals will be subject to income tax, at rates of up to 39.35%, and corporation taxpayers can potentially benefit from the general UK company exemption from tax on dividends.

Interest distributions are, broadly, treated as interest receipts, so UK resident individuals will be subject to income tax (at rates of up to 45%), and corporation taxpayers will treat such distributions as if they were interest receipts under a loan relationship under the corporate loan relationship rules.

Listed Closed-Ended Funds – REITs

Tax position of the fund

A REIT is tax opaque but, if certain conditions are met, benefits from an exemption from UK tax on profits and gains from its property rental business (PRB). Conditions with which a REIT must comply include that, broadly, at least 75% of its profits must come from its PRB, at least 75% of the total value of its assets must relate to its PRB, and it must distribute at least 90% of its PRB income within 12 months of the end of the accounting period in which it arose. There is no requirement for a REIT to distribute capital gains. Other detailed REIT conditions apply in the tax legislation, which also need to be considered.

Distributions by REITs in respect of the profits and gains of their PRB are known as property income distributions (PIDs) and should be paid subject to withholding tax at the basic rate (20%), unless an exemption applies (eg, if the REIT has a reasonable belief that the person beneficially entitled to the payment is a company that is resident in the UK for corporation tax purposes).

REITs are subject to corporation tax in the usual way on any non-PRB profits (eg, trading profits). These can be paid out as dividends, without withholding tax.

Tax position of the investor

For corporation tax and income taxpayers, PIDs are generally treated as UK property income (ie, they are not treated as normal company distributions), so UK resident individuals are subject to income tax on them (at rates of up to 45%), and credit should be given for any tax withheld on payment of the PID by the REIT. Corporation taxpayers will treat them as taxable income. Depending on its particular circumstances, a non-resident investor may be able to reclaim under a double tax treaty all or part of any tax withheld from PIDs paid to it.

Other distributions of profits by REITs are taxed as dividends in the normal way. Therefore, UK tax resident individuals will be subject to income tax at rates of up to 39.35%, and corporation taxpayers can potentially benefit from the general UK company exemption from tax on dividends.

3. Retail Funds

3.1 Fund Formation

3.1.1 Fund Structures

An OEIC can be used for an open-ended retail fund, which is a collective investment scheme structured as a corporate vehicle. Different authorisations apply, depending upon the investments to be made. For example, OEICs that invest in real estate may be structured as PAIFs, provided the relevant conditions are met. For an open-ended structure, an AUT can also be used. This is a type of unit trust authorised by the FCA, which is constituted by a trust deed made between the trustee and the manager of the fund. The property of the AUT is legally held by the trustee but managed by the manager. The investors have beneficial ownership of the property of the fund. Many PAIFs have an AUT as a feeder vehicle to enable corporate investors wishing to hold 10% or more indirectly to invest without infringing regulatory requirements.

In 2013, two new types of tax transparent funds (ACSs) were introduced in the UK. These new types of authorised funds can take the form of a partnership or a co-ownership scheme. In practice, the co-ownership scheme has proved more popular, particularly from a tax perspective. However, ACSs are only suitable for use by institutional investors, with investment restricted either to investments of a minimum of GBP1 million or to professional institutional investors.

3.1.2 Common Process for Setting Up Investment Funds

Compared to AIFs (which fall within the scope of the UK AIFM Regime), retail funds structured as open-ended funds can be easier and cheaper to set up, notwithstanding the fact that the fund itself requires prior regulatory authorisation. Open-ended funds have their own constitutional documentation, depending on which type of vehicle is being set up, as follows:

- a trust deed in the case of an AUT;
- an instrument of incorporation in the case of an OEIC; and
- a co-ownership or partnership deed in the case of an ACS.

In each case, the documents set out the features, powers and rules governing each authorised fund. For both UCITS and NURS funds, however structured, there are very detailed operational requirements. Day-to-day operations are detailed in the fund's prospectus.

3.1.3 Limited Liability

OEICs in the UK can be structured as a single fund or as an umbrella company with multiple sub-funds, each of which would have its own investment aims and objectives. The legal framework in the UK provides for the ring-fencing of the assets and liabilities of each sub-fund.

An AUT can have a single fund or an umbrella fund structure. In the latter case, each sub-fund is constituted under a separate trust, and the assets and liabilities of each sub-fund are ring-fenced under UK law.

3.1.4 Disclosure Requirements

Certain pre-investment disclosures must be made to investors. Under UK regulation, every manager is required to provide comprehensive information to help investors make a balanced and informed decision about any retail fund prior to investing. In most cases, this information is contained within the prospectus. Investors in open-ended funds must have access to an up-to-date prospectus at all times.

In addition, a KID must be prepared and made available to potential investors under the UCITS Directive (the UCITS KID). The UCITS KID requirements differ from those for the document that has to be produced under the PRIIPs Regulation. For example, the UCITS KID must be provided to all potential investors, not just those in the EEA; it must also be provided to both potential retail and professional investors, whereas the PRIIPs KID is only required to be made available to retail investors.

3.2 Fund Investment

3.2.1 Types of Investors in Retail Funds

Open-ended funds, particularly OEICs, are popular with individual investors, insurance companies and pension funds. ACSs are increasingly popular for institutional investments and pension funds.

The new open-ended fund vehicle introduced in the UK in 2021 – the LTAF (see **2.1.1 Fund Structures**) – is primarily aimed at defined contribution pension schemes, but is also available to retail clients if they are sophisticated investors or certified high net worth individuals. As a result of an FCA consultation in 2022, the LTAF is now considered as a Restricted Mass Market Instrument and may be distributed to a wider market, including retail investors.

3.2.2 Legal Structures Used by Fund Managers

The legal structure used for the management entity of retail funds varies and will depend on a number of factors, such as tax considerations. The most common structure used is a corporate vehicle.

3.2.3 Restrictions on Investors

Other than general marketing/financial promotion rules in the UK, there are generally no restrictions under UK legislation on the type of parties that can invest in a retail fund. However, PAIFs cannot have a corporate investor with an interest of 10% or more (but see **3.1.1 Fund Structures** in relation to the use of feeder vehicles to address this issue).

3.3 Regulatory Environment

3.3.1 Regulatory Regime

The manager of a UCITS or other authorised fund must be authorised by the FCA to carry out this role.

3.3.2 Requirements for Non-local Service Providers

Each open-ended fund must also have a depositary. In the UK, this is a regulated activity for which the depositary must hold the appropriate FCA permissions.

The UK's authorised fund governance regime goes further than is required under the UCITS Directive in that it places a number of additional responsibilities upon depositaries and requires them to be independent (so as to avoid and manage any potential conflicts of interest).

Depositaries in the UK are also required to undertake a wide variety of oversight activities, and are subject to extensive conduct of business rules and other regulatory requirements.

3.3.3 Local Regulatory Requirements for Non-local Managers

FCA authorisation is always required to manage a UK authorised fund, irrespective of the location of the manager. UK rules permit a UK authorised fund manager to delegate to an overseas sub-manager, subject to certain requirements being met.

3.3.4 Regulatory Approval Process

Investment funds must be authorised or recognised by the FCA in order to be promoted to retail investors in the UK. Authorised funds must be established in the UK and take one of the following legal forms:

- ACS;
- AUT; or
- ICVC.

A fund must also be classified, based on a marketing strategy, as either a UCITS, NURS, QIS or LTAF. The application must include the requisite application form, certain relevant supporting documents and information, and an application fee. Application processing times depend on whether the application relates to a NURS or QIS (six months, although the FCA aims to process such applications within two months), a UK UCITS (two months) or an LTAF (six months).

3.3.5 Rules Concerning Pre-marketing of Retail Funds

The pre-marketing of retail funds is subject to the financial promotion regime (see **2.3.5 Rules Concerning Pre-marketing of Alternative Funds**), which requires financial promotions to be approved by an authorised firm.

3.3.6 Rules Concerning Marketing of Retail Funds

A "retail investor" is defined as any investor that does not meet the necessary criteria in MiFID, unless it can be treated as an "elective professional client" (see **2.3.10 Investor Protection Rules**).

UCITS and NURS funds can be marketed generally to retail investors in the UK. UK UCITS and NURS funds cannot be marketed to investors living in EU countries, unless the fund is approved by the regulators in each country and complies with the terms for regulated funds in each country.

Although QISs also fall within the UK AIFMD Regime, they may only be marketed to experienced investors who meet certain qualifying conditions.

The ability for EU UCITS to passport into and out of the UK was revoked when the UK withdrew from the EU. The Temporary Marketing Permissions Regime (TMPR) was created to allow EU UCITS that were using their marketing passport in relation to the UK to continue to market to UK retail investors for a limited period.

Schemes domiciled overseas that are not in the TMPR, including those in non-EU countries, can be recognised in the UK under the process set out in Section 272 of the FSMA. This recognition route requires the FCA to undertake an in-depth assessment of the individual scheme and its country's legislative regime. The FCA must be satisfied that a scheme meets several tests in legislation and affords adequate protection to investors (including an assessment of the suitability of both the operator and depositary). This is a lengthy and time-consuming process.

The Section 272 recognition process has been in place for some time, but given the number of schemes previously passported and already available in the UK, the government determined that a faster recognition route was required than under Section 272 and is in the process of introducing a new Overseas Funds Regime (OFR). This will follow a similar process to Section 272 but with generic equivalence assessments for different overseas fund jurisdictions streamlining the approval process. The FCA anticipates that the OFR should be ready to become operational in 2024.

3.3.7 Marketing of Retail Funds

Authorisation of a UK fund by the FCA as a UCITS or NURS entitles it to be marketed to UK retail investors.

3.3.8 Marketing Authorisation/Notification Process

Investment funds must be authorised or recognised by the FCA in order to be promoted to retail investors in the UK (see **3.3.4 Regulatory Approval Process**).

3.3.9 Post-marketing Ongoing Requirements

Before a fund is made available to retail investors, a KID will need to be drawn up (in English) in the UK in accordance with the UK PRIIPs Regulation (see **3.1.4 Disclosure Requirements**). The UK PRIIPs Regulation requires the KID to be updated regularly, and to be updated when the review indicates that changes need to be made.

The FCA introduced a new consumer duty in 2023, designed to provide a higher level of consumer protection in retail financial markets, which includes ongoing requirements in respect of the firm-consumer relationship.

3.3.10 Investor Protection Rules

In the UK, there are both legal and regulatory requirements for retail funds to produce periodic reports every six months. Managers must prepare and publish annual and semi-annual reports, and make them available upon request and free of charge.

The FCA has the power to require a manager and/or depositary to compensate an authorised fund in the event of a finding against the manager and/or depositary. It also has the power to fine those entities and to fine or ban individuals in those companies.

In addition, authorised fund management is covered by the Financial Ombudsman Service and the Financial Services Compensation Scheme, which each deal with investor complaints and can require managers to compensate investors in certain circumstances.

3.3.11 Approach of the Regulator

See **2.3.11 Approach of the Regulator**.

3.4 Operational Requirements

The FCA Handbook sets out stringent requirements as to the operation of authorised retail funds, including that a depositary must be appointed. The fund must also establish and apply remuneration practices and policies, and publish its remuneration policy.

There are also restrictions on authorised retail funds in relation to borrowing and the types of investments such funds can make. NURS have greater flexibility, with differing borrowing and investment restrictions, and are popular for real estate investment through the PAIF structure.

3.5 Fund Finance

UCITS funds are subject to prescriptive rules on borrowings, as prescribed under the UCITS Directive.

A UCITS is permitted to borrow money for use by the fund, provided it will be repaid out of the scheme property and does not conflict with any restrictions on borrowing that may have been included in the fund's Instrument of Incorporation. This borrowing is permitted purely on a temporary and infrequent basis, and must not exceed 10% of the total value of the fund's assets on any day. Prior consent for any borrowing must be obtained from the depositary, or for periods of borrowing that may exceed three months.

The same 10% borrowing limit applies for NURS, but there is no restriction on the length of time for which a NURS may borrow. QISs have the ability to borrow up to 100% of the fund's NAV. Where derivatives are used, a QIS must ensure that its total exposure to derivatives does not exceed its NAV.

3.6 Tax Regime

General

See **2.6 Tax Regime** (General).

OEICs (Other than PAIFs) and AUTs

Tax position of the fund

OEICs and AUTs are subject to UK corporation tax, but are exempt from tax on chargeable gains from the disposal of assets (provided that the gains do not represent profit on trading transactions). Furthermore, if these funds satisfy the "genuine diversity of ownership" condition (GDO), then certain capital profits from investment transactions should be treated as exempt capital gains. For the GDO to be met, the fund must be sufficiently widely marketed. An LTAF can also be treated as meeting the GDO if at least 70% of its shares or units are held by certain institutional investors (or by the manager of the fund in its capacity as manager). Failure to meet the GDO has wider consequences for QISs and LTAFs, such that, broadly, they are taxed under normal corporation tax rules rather than the (more generous) ones that typically apply to authorised funds.

OEICs and AUTs can also potentially benefit from the general exemption from corporation tax on dividends.

OEICs and AUTs must allocate for distribution as dividends or interest the total amount available for income allocation. An OEIC or AUT can only show an amount as available for distribution as interest if it meets the qualifying investments test (such funds are often called "bond funds"). It meets this test, broadly, if the market value of investments that produce interest (or a return similar to interest) exceeds 60% of the market value of the fund's total investments. If this test is met, the distribution is generally allowable as a deductible expense for the fund for corporation tax purposes.

The net effect of the tax deduction is that bond funds should typically have little to no tax leakage at the level of the OEIC/AUT. If the qualifying investments test is not met, then all of the income available for distribution must be classed as dividends (and there would be no corresponding deduction for such payments by the fund to the extent interest is included in such distribution). Whether or not any corporation tax will be payable for a fund that does not meet the definition of a bond fund therefore depends on the level of interest income and deductible management expenses. Any corporation tax paid by an OEIC or AUT is not creditable for investors.

No withholding tax should apply to distributions paid to investors by OEICs or AUTs.

Because their income profits are taxable at the basic rate of income tax, OEICs and AUTs are "subject to tax" for double tax treaty purposes. As such, they can benefit from the UK's extensive network of double tax treaties, which can help reduce withholding taxes in other jurisdictions and assist in claiming credit for foreign taxes incurred on foreign sources of income.

It is possible for OEICs and AUTs to elect to be treated as "tax elected funds", which would modify the tax treatment relating to OEICs and AUTs from that discussed above. However, in practice, the uptake of this regime has been low, so it is not discussed further here. The regime is most appropriate for funds with a mis of debt and equity investments that do not qualify for bond fund treatment.

Tax position of the investor

UK tax resident individuals will be taxed on dividend distributions in the same way as for dividends they receive from normal companies. Therefore, UK tax resident individuals will be subject to income tax, at rates of up to 39.35%.

However, for UK corporation taxpayers, the normal dividend distribution rules do not apply (ie, that dividends received from a UK corporate are usually tax exempt in the hands of a UK corporate taxpayer). Instead, special anti-avoidance rules need to be considered (called the corporate streaming rules), which are designed to prevent corporate investors using OEIC or AUT structures to convert interest-type income into exempt dividend income. The rules are complicated, but in general terms dividend distributions are streamed into franked and unfranked parts following a formula set out in the legislation. In effect, the aim is to tax corporate investors as if they had invested in the underlying assets of the OEIC or AUT directly.

Interest distributions are, broadly, treated as interest receipts, so UK resident individuals will be subject to income tax (at rates of up to 45%).

Corporation taxpayers are required to treat their units in bond funds as creditor loan relationships for the purposes of the corporation tax rules relating to corporate debt.

PAIFs

Tax position of the fund

As mentioned above, OEICs that invest in real estate can be structured as PAIFs (provided the necessary conditions are met). PAIFs are subject to a significantly modified version of the OEIC tax regime described above. An important extra benefit of the PAIF status is that, broadly, a PAIF (unlike a normal OEIC) is exempt from corporation tax on the net income of its property investment business.

Special streaming rules apply to PAIFs. Broadly, the total amount available for income allocation by a PAIF must be split into three pools comprising property income distributions, interest distributions and dividend distributions. Interest distributions should be deductible expenses for the PAIF when calculating the net income of the non-tax exempt part of its business.

Payments of property income distributions are subject to withholding tax (currently at 20%), unless an exemption applies (for example, if the PAIF has a reasonable belief that the person beneficially entitled to the payment is a UK tax resident company). Depending on its particular circumstances, a non-UK resident investor may be able to reclaim under a double tax treaty all or part of any tax withheld from property income distributions paid to it. No withholding tax should apply to payments of interest or dividend distributions.

Tax position of the investor

In relation to PAIFs, broadly, for recipients, property income distributions are taxed as profits of a UK property business, so UK resident individuals are subject to income tax on them (at rates of up to 45%), and credit should be given for tax withheld on payment of the PID. Corporation taxpayers will treat them as taxable income.

Interest distributions are, broadly, treated as interest receipts, so UK resident individuals will be subject to income tax (at rates of up to 45%), and corporation taxpayers will treat them as taxable income under the loan relationship rules.

Dividend distributions are taxed as dividends on shares in the normal way. Therefore, UK tax resident individuals will be subject to income tax, at rates of up to 39.35%, and corporation taxpayers can potentially benefit from the general UK company exemption from tax on dividends.

ACSs

Tax position of the fund

ACSs can take the form of either co-ownership schemes (CoACSs) or limited partnerships. However, the tax discussion in this chapter is confined to CoACSs, which is the more common ACS structure.

A CoACS is not subject to tax in the UK as it is not a body corporate and has no legal personality.

Distributions to investors from CoACSs should generally not be subject to withholding tax (although withholding may be required if a CoACS has UK property income and non-UK resident investors).

Tax position of the investor

From the perspective of a UK investor, CoACSs are transparent with respect to income from a tax perspective but are treated as opaque with respect to the taxation of capital gains.

For the purposes of tax on income, investors in a CoACS are therefore treated as if they directly received the income arising from its assets. Accordingly, the tax treatment of an investor in relation to such income will depend on the investor's own tax position.

For capital gains purposes, an investor's interest in the underlying assets of the CoACS is disregarded and instead its holding of units in the scheme is treated as an asset. This simplifies the computation of the participant's chargeable gains or losses as they are regarded as having a single asset rather than many separate assets, and they can only incur a chargeable gain or loss on a disposal of their interest in the fund. The rules for computing chargeable gains and losses generally operate in the normal way, as they would for shares and securities.

4. Legal, Regulatory or Tax Changes

4.1 Recent Developments and Proposals for Reform

Following the end of the Brexit transition period, the UK government has placed considerable emphasis on the potential opportunities it sees to create what it hopes will be a more competitive financial services sector post-Brexit, while preserving high regulatory standards tailored to the UK's needs. There were substantive developments in this area in 2022 and 2023.

In April 2022, the UK introduced a competitive new tax regime for qualifying asset holding companies (the UK QAHC Regime). The QAHC Regime is an elective tax-privileged regime available to certain UK resident asset holding companies that are owned by funds or institutional investment structures in order to hold investment assets. The main focus of the regime is on alternative fund structures, which are typically closed-ended, non-retail funds that hold assets across a range of private market investment strategies – chiefly credit, private equity and real estate investments. The QAHC Regime is designed to improve the competitiveness of the UK as a location for asset holding companies by better enabling the tax-efficient flow of income and gains from the underlying investments back through the fund structure to investors so that, for UK tax purposes, investors are broadly taxed as if they had directly invested in the underlying assets with the QAHC paying tax only on a small transfer-priced margin to reflect the activities that it performs. For non-UK fund structures, a UK QAHC has the advantage that substance (which is becoming increasingly important) can easily be achieved where the investment management team is in the UK.

In broad terms, in order to qualify as a QAHC a company needs to be at least 70% owned by:

- qualifying investment funds – ie, funds that:
  - (a) are widely held;
  - (b) are closely held but held by certain categories of institutional investors (such as most pension funds); or
  - (c) meet a diversity of ownership condition; or
- certain institutional investors directly.

There is also a requirement that the QAHC does not carry out trading activities.

On 27 April 2023, the UK government published a consultation seeking views on the potential introduction, scope and design of a tax regime for a new type of unauthorised contractual scheme fund structure, referred to as a reserved investor fund (contractual scheme) (RIF). As an unauthorised contractual scheme, the RIF would be a collective investment scheme under the FSMA. Under the UK's regulatory regime, the manager of an AIF – in this instance a RIF – must be authorised by the FCA as a full-scope UK AIFM or a small-authorised UK AIFM, or must be registered with the FCA as a small-registered UK AIFM. The consultation closed on 9 June 2023.

On 29 June 2023, the Financial Services and Markets Act 2023 (FSMA 2023) was enacted. Among other things, the FSMA 2023 is intended to implement the findings of HM Treasury's Future Regulatory Framework (FRF) Review. Launched in light of Brexit, the FRF Review was described by UK Finance as "a once in a generation assessment of the legislative framework in which the financial services regulators operate". The changes implemented by the FSMA 2023 will involve the revocation of the huge body of EU law that the UK essentially inherited when it left the EU, to be replaced by domestic rules. The provisions will come into force over several years on dates appointed by HM Treasury in statutory instruments.

Reform proposals designed to re-energise capital markets were also published in 2022. In July 2022, HM Treasury published the outcome of the UK Secondary Capital Raising Review, which followed on from the 2021 Lord Hill review recommendations and subsequent call for evidence and looked at ways in which to improve the secondary fundraising process for UK listed companies so that it is cheaper, quicker and more efficient. As of November 2023, the government has accepted all the recommendations addressed to it and is considering how to take the proposals forward.

In December 2022, the UK Chancellor of the Exchequer announced a series of wide-ranging reforms to the financial services sector in the UK, to take effect over the next few years (referred to as the Edinburgh Reforms), which include the legislation and regulation relevant to alternative funds, retail funds and their managers. Key measures announced include the repeal of the UK PRIIPs Regime; draft legislation was proposed on 22 November 2023.

Finally, on 26 October 2023, certain proposed amendments to the LP Act 1907 were published, by way of the Economic Crime and Corporate Transparency Act 2023 (ECCTA 2023). ECCTA 2023 implements a number of changes to the legislation on limited partnerships and creates new offences and penalties, including criminal sanctions, against the partners of limited partnerships in certain circumstances. The key changes include:

- requiring more information about the partners to be filed, including on individual limited partners (although it will not all be publicly available), and controls on who can file the information by requiring certain filings to be made by an authorised corporate service provider (which is subject to anti-money laundering regulations);
- requiring limited partnerships, both new and existing, to have a firmer connection to the part of the UK in which they are registered (by having to maintain its registered office there, as distinct from its principal place of business);
- requiring all UK limited partnerships (not just Scottish limited partnerships) to file confirmation statements confirming that the information held about them on the register is correct; and
- enabling the deregistration of a limited partnership in certain circumstances.

USA

Trends and Developments

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Katten has decades-long relationships with many of the world's largest and most successful financial market participants, including investment managers and institutional investors. The firm's sell-side and buy-side knowledge allows its business-minded attorneys to use their market insight to provide customised, tax-efficient advice that is also commercial in nature. Katten offers clients legal counsel both in the USA and globally. The UK practice and the US team work seamlessly together to help open global market opportunities for clients. The firm helps investment management clients structure their management companies and navigate the myriad of operational and legal decisions they must make as they build their businesses. The team handles anything clients require in connection with the establishment and ongoing operation of their businesses, including regulatory compliance. With unparalleled experience representing quantitative managers using algorithmic strategies, Katten is uniquely positioned to help clients navigate the complexities of this highly technical arena.

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Introduction

The regulation of investment advisers by the US Securities and Exchange Commission (SEC), pursuant to the Investment Advisers Act 1940 (the "Advisers Act"), has largely been a principles-based regime – ie, regulations that create a framework for compliance, helping to ensure that investment advisers act appropriately in meeting their fiduciary duty to clients. For decades, when applied to the operations of private funds (and their managers) that are offered to limited numbers of investors and/or sophisticated investors, the SEC has generally taken a hands-off approach. More recently, however, the SEC has signalled a much more prescriptive approach in its rule-making, including a focus on the private fund industry (eg, listing private funds and advisers to private funds as a 2024 examination priority for the SEC's Division of Examinations).

This article focuses on significant changes to the regulatory regime for private fund operations. However, it is noteworthy to consider that a number of other recent SEC rule-makings take a similarly more prescriptive approach – for example, rules focused on the safeguarding/custody of client assets, the oversight of third-party service providers, and cybersecurity.

The Commodity Futures Trading Commission (CFTC) also recently proposed certain significant amendments to its "registration lite" regime under CFTC Rule 4.7. Many commodity pool operators (CPOs) and commodity trading advisors (CTAs), including private fund managers and other advisers, rely on this exemption from certain substantial disclosure, reporting, and record-keeping requirements. These proposed amendments, if adopted, have the potential to affect many industry participants, as outlined here.

Trends in SEC Regulation

The most recent and, arguably, most significant set of SEC rules relate to private fund investment advisers. Private funds are funds that limit the number of investors in the fund and/or require a certain level of investor qualification (ie, "qualified purchaser" status). Hedge funds, private equity funds, and venture capital funds typically are private funds.

Adopted on 23 August 2023, by a 3-2 split vote of the SEC's five commissioners, the private fund adviser reforms are designed specifically to address three common risk factors in an adviser's relationship with private funds and their investors:

- lack of transparency;
- conflicts of interest; and
- lack of effective governance mechanisms for client disclosure, consent, and oversight.

Different aspects of the final rules impact SEC-registered private fund advisers and/or all private fund advisers (including "exempt reporting advisers"). Also noteworthy is the fact that the SEC has confirmed these rules do not apply to a private fund adviser with a principal place of business outside of the USA (ie, an offshore adviser) with regard to any non-US private fund, even if the non-US private fund has US investors.

Rules applicable to SEC-registered private fund advisers

Quarterly statements

Registered private fund advisers will be required to distribute to all private fund investors a quarterly statement that discloses information regarding:

- compensation, fees, and expenses paid to the adviser by the fund;
- similar fees and expenses paid by the fund; and
- portfolio investment compensation allocated or paid to the adviser (or any of its related persons) for each covered portfolio investment.

The quarterly statement must include prominent disclosure regarding the manner in which compensation, fees, and expenses are calculated and include cross-references to the applicable sections of the private fund's organisational and offering documents. The adviser must also include specified fund-level historical performance information, the content of which varies depending upon whether the private fund meets the definition of a liquid fund or an illiquid fund (and present such information for the time periods prescribed in the rule). Generally, liquid funds will report various net total return figures, whereas illiquid funds will report gross and net internal rates of return and multiple on investment capital metrics along with a statement of contributions and distributions. The quarterly statement must also include prominent disclosure of the criteria used and assumptions made in calculating the performance.

The quarterly statement must be delivered within 45 days of the end of each of the first three quarters of each fiscal year of the fund and within 90 days following the end of each fiscal year of the fund (and for private fund of funds, within 75 days and 120 days following the end of each of the first three quarters and end of the fiscal year, respectively).

Private fund audits

Registered private fund advisers will be required to cause each private fund they advise to undergo a financial statement audit. This audit must meet the requirements of the existing audit provision that many private funds currently rely on in order to comply with the Advisers Act's "custody rule".

Adviser-led secondaries

Registered private fund advisers, when conducting an "adviser-led secondary transaction" in relation to any private fund they advise, will be required to obtain a fairness opinion or valuation opinion from an independent opinion provider and distribute this to investors in the private fund. The adviser will also be required to prepare and distribute to investors a summary of any material business relationships the adviser has (or has had within the prior two years) with the independent opinion provider.

Adviser-led secondary transaction is defined to mean "any transaction initiated by the investment adviser or any of its related persons that offers private fund investors the choice between selling all or a portion of their interests in the private fund and converting or exchanging all or a portion of their interest in the private fund for interests in another vehicle advised by the adviser or any of its related persons".

Rules applicable to all private fund advisers (including exempt reporting advisers)

Certain rules (discussed below) would apply not only to SEC-registered investment advisers but also to exempt reporting advisers (ERAs). ERAs generally include investment advisers who advise:

- solely private funds that have less than USD150 million in aggregate assets under management in the USA; or
- solely one more "venture capital funds" (as defined by SEC rules).

ERAs file certain basic information with the SEC and are typically subject to far fewer substantive rules than SEC-registered investment advisers.

Restricted activities

Under the final rule, all private fund advisers (including ERAs) will be subject to additional obligations when engaging in certain restricted activities.

Investigations

The adviser may not charge a private fund for fees or expenses associated with an examination or investigation of the adviser or its related persons by any governmental or regulatory authority, unless the adviser requests and obtains written consent from at least a majority in interest of the private fund's investors that are not related persons of the adviser. The adviser may not, however, charge the fund such fees where related to an investigation that results in a court or governmental authority imposing a sanction for violating the Advisers Act or rules thereunder.

Regulatory/compliance fees

The adviser may not charge a private fund for any regulatory or compliance fees or expenses, or fees associated with an examination of the adviser or its related persons, unless the fees and expenses are disclosed in writing to investors within 45 days following the end of the fiscal quarter in which the charge occurs.

Adviser claw-backs

The adviser may not reduce the amount of any adviser claw-back by actual, potential or hypothetical taxes applicable to the adviser, its related persons, or their respective owners or interest holders, unless the adviser distributes – within 45 days following the end of the fiscal quarter in which the adviser claw-back occurs – a written notice to investors that discloses the aggregate dollar amounts of the adviser claw-back both before and after any reduction in such taxes.

Non-pro rata fee allocations

The adviser may not charge or allocate fees or expenses related to a portfolio investment on a non-pro rata basis when multiple private funds and other clients advised by the adviser or its related persons have invested (or propose to invest) in the same portfolio investment, unless the allocation approach is fair and equitable and the adviser distributes to investors (prior to charging or allocating such fees) advance written notice of such charge and a description of how the allocation approach is fair and equitable under the circumstances.

Borrowings

The adviser may not generally borrow or receive an extension of credit from a private fund client unless the adviser distributes to each investor a written description of the material terms of – and requests each investor to consent to – such borrowing or extension of credit and obtains written consent from at least a majority in interest of the private fund's investors that are not related persons of the adviser.

Preferential treatment

Subject to enumerated exceptions, advisers will be prohibited from providing preferential terms to investors regarding:

- certain redemptions from the fund; and
- certain preferential information about portfolio holdings or exposures.

Redemption preference

The adviser may not grant an investor in the private fund (or in a similar pool of assets) the ability to redeem its interest on terms that the adviser reasonably expects to have a material negative effect on other investors in that private fund (or in a similar pool of assets), unless:

- the ability to redeem is required by applicable law or regulation to which the investor, the private fund or any similar pool of assets is subject; or
- the adviser has offered the same redemption ability to all other existing investors and will continue to offer such redemption ability to future investors.

Portfolio transparency preference

The adviser may not provide information regarding the portfolio holdings or exposures of a private fund (or a similar pool of assets) to any investor in the fund if the adviser reasonably expects that providing the information would have a material negative effect on other investors in that private fund (or in a similar pool of assets). The exception would be if the adviser has offered the same information to all other existing investors at the same time or substantially the same time.

General disclosure obligations

More generally, the rules will also prohibit advisers from providing any preferential treatment to investors, unless certain terms are disclosed to prospective investors (in advance of an investor's investment in the private fund) and all terms are disclosed to current investors (after the investor's investment).

Trends in CFTC Regulation

For the past three decades, CFTC Rule 4.7 has provided registered CPOs and CTAs with exemptions from certain compliance requirements under Part 4 of the Commodity Exchange Act in their dealings with investors and clients that are "qualified eligible persons" (QEPs) under that rule. The widespread reliance upon Rule 4.7 has led the CFTC to reassess whether the provisions of the rule continue to align with the purposes motivating its adoption, thereby culminating in a proposal to implement substantial amendments to the rule.

The CFTC proposal outlines changes in four categories:

- disclosure requirements;
- QEP eligibility thresholds;
- periodic pool reporting relief for funds of funds; and
- technical changes to the rule text.

The proposed amendments to the disclosure requirements would dramatically change the information that Rule 4.7-exempt CPOs and CTAs are required to furnish to pool investors and clients. As proposed, the amendments effectively reinstate certain affirmative disclosure obligations applicable to Part 4-compliant pools – for example, the requirement to prepare and furnish a current "disclosure document" that includes prescribed information regarding a pool's principal risk factors, investment programme, use of proceeds, custodians, conflicts of interest, and past performance. Among other things, this would obligate Rule 4.7-exempt CPOs to prepare "performance capsules" and a break-even analysis for each of their Rule 4.7 pools, which is not required under the current iteration of the rule. The proposed amendments would implement similar changes to the disclosure requirements for those CTAs who rely upon Rule 4.7 when managing accounts for QEPs.

The proposed amendments would also double the eligibility threshold for those categories of QEPs relying on the "portfolio requirement". In addition, the revisions would codify frequently granted relief that permits CPOs of funds-of-funds to distribute monthly account statements within 45 days of month-end (as opposed to the timeframe set out in the current rule, which requires that such statements be distributed within 30 days of quarter-end). The CFTC also plans to adopt minor technical revisions and reorganise in order to improve the general efficiency of the rule.

Conclusion

Although the SEC's final set of rules for private fund advisers is more permissive than the initially proposed rules in many ways (eg, replacing flat prohibitions with disclosure-based exceptions), the rules continue to demonstrate a current theme – namely, a shift away from historically principles-based regulation towards more prescriptive rules. In the case of the private funds discussed here, the rules will undoubtedly have a meaningful impact on the contractual and business relationships between private funds and investors, and may impact such funds' efforts to raise capital. While the compliance dates vary to some extent (ranging from 14 September 2024 to 14 March 2025), the final rules are also currently the subject of litigation seeking to invalidate them on grounds that – among other things – challenge the SEC's statutory authority to adopt them.

As regards the proposed amendments to CFTC Rule 4.7, the comment period closed on 28 November 2023 and the substance of such proposed amendments remains subject to change. If adopted, such amendments would impose substantial additional obligations on CPOs and CTAs relying on the "registration lite" regime.

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