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The International Comparative Legal Guide to:

# Public Investment Funds 2019

**2nd Edition**

A practical cross-border insight into public investment funds

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# EDITORIAL

Welcome to the second edition of *The International Comparative Legal Guide to: Public Investment Funds*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of the laws and regulations of public investment funds.

It is divided into two main sections:

Four general chapters. These chapters are designed to provide readers with an overview of key issues affecting public investment funds, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in public investment funds laws and regulations in 17 jurisdictions. All chapters are written by leading public investment funds lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editors Gregory S. Rowland and Sarah E. Kim of Davis Polk & Wardwell LLP for their invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.com.


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# PREFACE

Davis Polk & Wardwell LLP is honoured to serve as Contributing Editor for the second edition of *The International Comparative Legal Guide to: Public Investment Funds*, and it is my pleasure to have been invited to write this preface.

Publicly offered investment funds are subject to regulatory frameworks that, depending on the jurisdiction, impose comprehensive restrictions on how a fund is operated. The regulatory framework in the U.S., for example, imposes strict requirements on, among other things, a public investment fund's corporate governance, capital structure, portfolio investments, affiliated transactions, reporting and recordkeeping. The degree of regulation and the specifics of the requirements in each jurisdiction vary significantly, which is why a guide such as this is essential.

The second edition provides broad overviews of the general regulatory framework for public investment funds in 17 jurisdictions, as well as four general chapters on topics of particular interest.

As the regulations in the financial services industry continue to evolve in response to new developments and obstacles in financial systems globally, it will be important for legal professionals and industry participants to have up-to-date resources such as this guide for practical insight relating to different jurisdictions.

We hope that you find this guide useful in your practice, and we look forward to future editions of the guide going forward.


Gregory S. Rowland

Partner

Davis Polk & Wardwell LLP

# The Current State of U.S. Public Cryptocurrency Funds



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## I. Introduction

One of the many plotlines shaping the emerging cryptocurrency[1] story for 2019 involves the repeated attempts by fund sponsors, over the last year or so, to bring cryptocurrency-related funds ("**public cryptocurrency funds**") to the U.S. investing public. No such sponsor has succeeded to date. Proponents of such funds, on the one hand, argue that these products would (1) improve on the existing means by which retail investors obtain exposure to cryptocurrencies (for example, by simplifying asset acquisition and custody), and (2) provide structural benefits to the existing cryptocurrency markets (for example, by deepening the pool of available liquidity). The U.S. Securities and Exchange Commission ("**SEC**"), on the other hand, continues to express a number of concerns – primarily, questions involving the integrity of the cryptocurrency spot market, including the online exchanges where such assets trade. This article will describe the general features of the public cryptocurrency funds that the SEC has so far considered, along with the SEC's principal reasons for declining to approve any such funds. Finally, it will consider what 2019 may hold in store for these products, including the industry's efforts to improve the public perception of the cryptocurrency spot markets.

## II. A Tight Spot and Murky Futures

In 2018, the SEC considered rule change applications[2] that would allow for public cryptocurrency exchange-traded funds ("**ETFs**") of two different varieties: (1) funds intending to transact in the cryptocurrency spot market and to hold cryptocurrencies directly ("**spot position-based ETFs**"); and (2) funds intending to gain cryptocurrency exposure through futures ("**futures-based ETFs**"). Further, futures-based funds can be divided into long funds, which seek to mirror the performance, both daily and over time, of leading Bitcoin futures contracts listed and traded on regulated U.S. national futures exchanges, and short funds, which seek to do the inverse. Note that the currently proposed futures-based ETFs only pertain to Bitcoin for the moment, as no other cryptocurrencies are the subject of futures contracts in a regulated U.S. market. Additionally, most proposed spot position-based ETFs have also focused solely on Bitcoin, though at least one proposed spot position-based ETF intended to invest in a basket of cryptocurrencies.

The SEC and its staff, in declining to approve any such ETF – whether spot position-based or futures-based – have primarily cited concerns around the cryptocurrency spot market, including the online exchanges where such assets trade. The SEC has focused on this because the market price for the ETF shares will be heavily influenced by trading activity in the lightly regulated, underlying cryptocurrency spot markets. In particular, the arbitrage mechanism underlying all ETFs causes their share price to be particularly sensitive to changes in the price of the underlying assets. This arbitrage mechanism – effected through the in-kind creation and redemption process undertaken by authorised participants – is intended to ensure that an ETF's share price closely tracks the ETF's net asset value per share ("**NAV**"). For example, if the ETF's shares are trading at a premium to NAV, authorised participants will create new shares at NAV ("**creation units**") and sell them on the open market. If the fund's shares are trading at a discount to NAV, authorised participants will buy shares on the open market and redeem them at NAV. This mechanism generally works well to keep ETF shares in line with NAV, but makes the integrity of an ETF's share price vulnerable to issues in the markets for the underlying asset (and, in the case of a futures-based ETF, the assets underlying the futures contracts in the ETF's portfolio).

In that regard, the SEC and its staff have noted that the low liquidity of cryptocurrency exchanges could inhibit an ETF's arbitrage mechanism by limiting the ability of authorised participants to obtain sufficient quantities of the underlying asset to support creation transactions without affecting the underlying market price. The SEC also noted that less liquid markets are more susceptible to manipulation and that, moreover, much of the volume in cryptocurrency trading occurs outside the United States in venues that are suspected to experience significant manipulation. The SEC thus raised concerns that manipulation in the spot markets could ultimately adversely affect the integrity of the price of an ETF's shares or even permit the shares to themselves be manipulated. In addition, the SEC and its staff noted that cybersecurity, theft, hacking and operational issues, which have plagued cryptocurrency exchanges, could also inhibit the operation of a cryptocurrency ETF, such as by reducing liquidity or permitting price manipulation.

Unfortunately for the ETF industry, the recent history of cryptocurrency exchanges offers several examples from which the SEC can draw to support its concerns. Over the past several years, a number of cryptocurrency exchanges have been closed due to cybersecurity breaches and theft, in amounts totalling over $1 billion (USD). For instance, the now infamous Mt. Gox exchange recently filed for bankruptcy, claiming $63.6 million (USD) of outstanding debt, in connection with losing 750,000 of its customers' Bitcoins, along with 100,000 of its own.[3]

Additionally, as of the writing of this article, one of the largest Canadian exchanges is currently unable to retrieve at least $190 million (USD) worth of customer funds.[4] After the mysterious death of its founder, customers quickly learned that this individual had the sole power to authorise movement of customer funds – fiat and cryptocurrency, alike. While an investigation is currently ongoing, this episode highlights the lack of appropriate operational risk management at some cryptocurrency exchanges, even large exchanges located in countries with robust financial regulatory systems.

Furthermore, in late 2017, an anonymous blogger cited publicly available trading data to conclude that a trading bot, aptly nicknamed "Picasso" was engaging in paint-the-tape-style manipulation on one of the largest and most prominent U.S. exchanges.[5] This strategy involved the alleged buying and selling of Bitcoin and Bitcoin Cash between affiliated accounts in order to create the appearance of substantial trading activity and, ultimately, to influence the price of such assets. Other reports of manipulative practices include so-called "banging the close"[6] and "spoofing"[7] and have been the subject of a high-profile criminal investigation by the U.S. Department of Justice.

More broadly, these episodes illustrate the SEC's general observation that no cryptocurrency spot market, whether in the United States or abroad, is subject to governmental oversight on par with U.S. national securities exchanges, which are held to high cybersecurity and operations standards, and are required to take steps to detect and deter price manipulation and fraud. For example, the SEC rejected arguments that Gemini Exchange was a sufficiently regulated market simply by virtue of its New York State trust charter and supervision by New York's Department of Financial Services.

While it is too early to anticipate what effect they will have in the near term, several trends may help the industry overcome the SEC's concerns with the state of the spot markets. First, not all SEC commissioners are convinced that the market issues are so grave that they should prevent the launch of a cryptocurrency ETF. In particular, Commissioner Peirce made waves with her dissent from the SEC's order disapproving the listing of one such fund, arguing that such disapprovals effectively preclude greater institutionalisation of cryptocurrency markets, and accordingly, raise even greater investor protection concerns.[8] Consider, for example, price fragmentation – i.e., the tendency of cryptocurrencies to vary in price, from time to time, across different exchanges. Commissioner Peirce notes that authorised participants would minimise fragmentation because, in the process of composing creation units, such participants could obtain cryptocurrency from any source. Because authorised participants have an incentive to buy at the lowest prices available, such authorised participants would effectively keep prices close together by "bidding up" the price on certain exchanges where the price started to diverge downward from the market.

Second, industry participants have joined forces in an effort to allay concerns of the SEC and the broader market related to issues of market integrity. For example, in November 2018, several large cryptocurrency companies – including prominent exchanges, OTC dealers and investment and trading firms – announced the formation of the Association for Digital Asset Markets ("**ADAM**").[9] ADAM's stated goal is provide a framework for self-regulation in the cryptocurrency spot market, in the form of a Code of Conduct, which would deter market manipulation and promote market integrity, risk management and data protection, among other topics. Eventually, ADAM could take on a more active self-regulatory-type role within the industry (e.g., by resolving disputes, disciplining members and promulgating licences).

## III. Additional Core Concerns

The SEC's disapprovals in 2018 of various proposed cryptocurrency ETFs, as described above, were foreshadowed by the January 2018 letter from Dalia Blass, Director of the SEC's Division of Investment Management. This letter was addressed to industry sponsors and pertained to public cryptocurrency funds, both ETFs and public, non-exchange-traded funds, and offered a list of questions that sponsors would be expected to address when attempting to bring these products to market. In particular, in addition to the manipulation concerns cited by the SEC in its disapproval orders, the letter highlighted the apprehensions of SEC staff about valuation, liquidity, custody and arbitrage.

### A. Valuation

The letter first addressed staff concerns about valuation challenges in calculating public cryptocurrency funds' NAV. In general, public mutual funds and ETFs in the United States are required to value their assets each business day to calculate a NAV. This is important for determining fund performance and the price at which investors may purchase or redeem shares. In particular, SEC staff expressed concerns about whether public cryptocurrency funds would have the information necessary to appropriately value cryptocurrencies, given their volatility, the fragmentation and general lack of regulation of underlying cryptocurrency markets and the nascent state of and current trading volume in the cryptocurrency futures markets.[10] SEC staff also questioned how and which policies would be instituted in order to properly establish the "fair value" of a cryptocurrency fund's portfolio. For instance, SEC staff expressed concern over how funds' valuation and accounting policies might be designed to address cryptocurrency-specific risks, such as when a blockchain diverges into different paths (a "fork"), which can produce different cryptocurrencies with differing prices, and how this possibility would be recognised in the fund's NAV.

### B. Liquidity

The letter next discussed staff concerns about liquidity – specifically, the importance of funds maintaining sufficient liquidity such that daily redemptions would be possible, given that an essential feature of most U.S. ETFs and other public open-end funds is daily redeemability. The SEC staff also expressed doubt over digital currency funds' ability to adhere to fund liquidity requirements, which generally necessitate that most types of U.S. ETFs and other public open-end funds implement a liquidity risk management programme, be able to classify investments into one of four categories and limit the fund's investments in illiquid securities to 15% of the fund's total assets.

### C. Custody

The letter also raised staff concerns relating to requirements applicable to certain U.S. public funds regarding custody of their holdings, and inquired as to how funds that planned to directly hold cryptocurrencies would satisfy such custody requirements. The letter asked these questions in light of the underlying novel technical aspects of cryptocurrencies and related cybersecurity threats, as well as in connection with funds that plan to hold public cryptocurrency derivatives.

### D. Arbitrage

Next, the letter discussed SEC staff's concerns related to how well a cryptocurrency ETF's arbitrage mechanism would be able to function in light of the fragmentation, volatility and trading volume of the cryptocurrency marketplace. As discussed above, an ETF's arbitrage mechanism is the fundamental means by which the market price of the ETF's shares is kept in line with its NAV. SEC staff inquired whether cryptocurrency ETF sponsors had engaged with market makers and authorised participants in order to understand the feasibility of arbitrage in relation to public cryptocurrency ETFs.

## IV. Conclusion

Given the SEC's persisting qualms, no sponsor of either a spot position-based ETF or futures-based ETF has succeeded yet in convincing the SEC to let it offer public cryptocurrency funds to U.S. retail investors. We do not expect, however, that sponsors will be deterred from continuing to push for public cryptocurrency funds in the United States in 2019. As the underlying spot markets mature, sponsors' chances for success will improve, although whether success will be achieved this year remains to be seen. Indeed, at the end of 2018, SEC Chairman, Jay Clayton noted, "[w]hat investors expect is that the trading in that commodity that's underlying the ETF is trading that makes sense, is free from the risk or significant risk of manipulation". He continued, "[t]hose kinds of safeguards don't exist in many of the markets where digital currencies trade", making it unlikely, he said, that the SEC will approve a Bitcoin ETF in the near future.[11]

## Endnotes

1. In this paper, "cryptocurrency" is used to refer to all decentralised digital assets, whether they are intended to be used in a currency-like manner (e.g., Bitcoin), or as part of a larger platform (e.g., Ethereum). In addition to pure cryptocurrencies and privacy-focused coins, the broad range of general purpose digital assets ("platform coins") includes NEO and Ravencoin, for instance. These platform coins also enable the creation of new digital assets called "tokens", that are usually developed for a particular purpose or application.
2. Generic listing rules currently do not permit any national exchange (e.g., NYSE Arca, NASDAQ or Cboe) to allow trading in public cryptocurrency funds. Consequently, the listing exchange must submit, and the SEC must approve, a listing rule specifically allowing such a fund. Such applications are generally made pursuant to Rule 19b-4 under the Securities Exchange Act of 1934, as amended ("**Exchange Act**"), which (1) requires public notice and comment, and (2) provides that the SEC must make specific findings that the rule change would be consistent with the Exchange Act's policy goals. *See*, *e.g.*, Exchange Act Release No. 79183 (Oct. 28, 2016), 81 FR 76650 (Nov. 3, 2016) (amending, and replacing, original rule filing in its entirety); Exchange Act Release No. 34-83792, File No. SR-CboeBZX-2018-040 (Aug. 7, 2018); Exchange Act Release No. 34-83912, File No. SR-NYSEArca-2018-02 (Aug. 22, 2018).
3. Jon Southurst, Mt. Gox Files for Bankruptcy, Claims $63.6 Million Debt, CoinDesk (2014), https://www.coindesk.com/mt-gox-files-bankruptcy-claims-63-6m-debt (last visited Feb. 2, 2019).
4. *See* Nikhilesh De, QuadrigaCX Owes Customers $190 Million, Court Filing Shows, CoinDesk (2019), https://www.coindesk.com/quadriga-creditor-protection-filing (last visited Feb. 2, 2019).
5. *See* Bitfinex'ed, Meet 'Picasso', the Painter on GDAX. – Bitfinex'ed – *Medium*, medium.com (2017), https://medium.com/@bitfinexed/meet-picasso-the-painter-on-gdax-c478ff8f50e5 (last visited Jan. 4, 2019).
6. "Banging the close" is a type of Bitcoin futures manipulation strategy in which the price of Bitcoin is pushed either higher or lower when the futures contract expires and which is easiest to execute if there are small numbers of participants in an auction. *See* Alexander Osipovich, Bitcoin Futures Manipulation 101: How 'Banging the Close' Works, *The Wall Street Journal* (2017), https://www.wsj.com/articles/bitcoin-futures-manipulation-101-how-banging-the-close-works-1513425600/ (last visited Feb. 2, 2019).
7. "Spoofing" is an illicit tactic whereby a trader submits a series of orders and then cancels them as soon as prices move in the desired direction. *See* Matt Robinson & Tom Schoenberg, U.S. Launches Criminal Probe into Bitcoin Price Manipulation, Bloomberg.com (2018), https://www.bloomberg.com/news/articles/2018-05-24/bitcoin-manipulation-is-said-to-be-focus-of-u-s-criminal-probe (last visited Feb. 2, 2019).
8. *See* Dissent of Commissioner Hester M. Peirce to Release No. 34-83723; File No. SR-BatsBZX-2016-30 (2018), https://www.sec.gov/news/public-statement/peirce-dissent-34-83723 (last visited Jan. 10, 2019).
9. Association for Digital Asset Markets, ADAM: Vision and Founding Principles – Association for Digital Asset Markets – *Medium*, medium.com (2018), https://medium.com/AssociationDigitalAssetMarkets/adam-vision-and-founding-principles-be98f97aa42a (last visited Feb 2, 2019). *See also*, Cameron Winklevoss & Tyler Winklevoss, A Proposal for a Self-Regulatory Organization for the U.S. Virtual Currency Industry – *Medium*, medium.com (2018), https://medium. com/gemini/a-proposal-for-a-self-regulatory-organization-for-the-u-s-virtual-currency-industry-79e4d7891cfc (last visited Feb. 2, 2019) (describing Gemini's efforts to introduce greater oversight and self-regulatory mechanisms into the virtual currency industry through the creation of the Virtual Commodity Association, an industry-sponsored, self-regulatory organisation for the U.S. virtual currency industry pertaining specifically to virtual commodity exchanges and custodians).
10. Staff Letter: Engaging on Fund Innovation and Cryptocurrency-related Holdings (2018), https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm (last visited Feb. 2, 2019).
11. Benjamin Bain, Bitcoin ETFs Roadblocked by Lack of Safeguards, SEC's Chief Says, Bloomberg.com (2018), https://www.bloomberg.com/news/articles/2018-11-27/bitcoin-etfs-roadblocked-by-lack-of-safeguards-sec-s-chief-says (last visited Feb. 2, 2019).

### Acknowledgment

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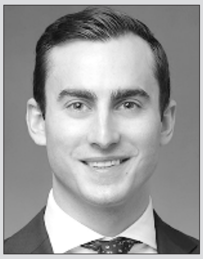

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Davis Polk has worked on many of the most significant business and legal developments of the past 160 years – from landmark court cases to the formation of major corporations and financial institutions to the development of new financial instruments. With 10 offices worldwide, Davis Polk has a broad and innovative practice representing U.S. and non-U.S. companies and financial intermediaries in a wide range of legal services.

Active for more than 50 years, Davis Polk's Investment Management Group is prominent in advising on the formation, operation and regulation of public and private funds for many of the industry's most high-profile sponsors and investors. We have a renowned practice with significant and flexible resources advising funds, investors and advisers on the structuring and documentation of pooled investment vehicles that are sold in the U.S. and abroad, as well as on a wide range of compliance and exemptive issues.

# Registered Investment Companies – Commercial Considerations for First Timers


Marc Ponchione

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## I. Introduction to the Regulatory Framework

The Investment Company Act of 1940, as amended (the **Investment Company Act**) is the principal U.S. federal regulatory regime applicable to investment funds. The Investment Company Act broadly prohibits an entity that meets the definition of "investment company" from using means of U.S. commerce to issue securities unless it registers with the U.S. Securities and Exchange Commission (the **SEC**) or qualifies for an exemption from registration. This chapter considers the commercial implications of registering as an investment company with the SEC under the Investment Company Act. As discussed elsewhere in this publication, the SEC and other U.S. agencies are considering regulatory reforms to the regimes applicable to investment companies, and managers that are interested in entering the registered funds space must be mindful of key commercial considerations as well as the evolving regulatory landscape applicable to registered funds.

In this chapter, we provide a brief overview of the types of registered funds and the key commercial and operational considerations that could affect a manager sponsoring a registered fund for the first time, with a focus on issues applicable to a non-U.S. manager that is new to registered funds.

## II. Types of Registered Funds[1]

If an investment company cannot rely on an exemption from registration under the Investment Company Act, it generally must register itself with the SEC under the Investment Company Act and it must register securities offered to the public under the Securities Act of 1933, as amended (the **Securities Act**). The staff of the SEC reviews registration statements (which may be on Form N-1A, Form N-2, or other investment company forms) to seek to ensure compliance with form requirements and related regulations. The staff of the SEC may issue comments on the filing prior to declaring the registration statement "effective". An open-end fund (discussed in more detail below), such as a mutual fund which offers its securities to the public, must maintain a current prospectus with the SEC by filing post-effective amendments to its Securities Act registration statement. A closed-end fund (discussed in more detail below) that offers securities to the public may register the securities at the time of offering or maintain a shelf registration statement that permits the fund to offer securities from time-to-time by, among other things, filing a prospectus supplement with the SEC at the time of the offering. A mutual fund and a closed-end fund respectively must provide shareholders with annual and semi-annual reports containing updated financial information and a list of the fund's portfolio securities, with closed-end funds also needing to file quarterly reports like traditional public companies.

Funds registered under the Investment Company Act generally fall into one or more of the categories below:

***(a) Open-end funds***

Open-end funds, some of which are commonly referred to as "mutual funds", offer their shares to investors continuously. Open-end funds may be actively or passively managed, but must invest in at least 85% of their net assets in liquid securities.[2] Mutual funds offer the benefit of liquidity to investors and must allow investors to redeem their interests at least once daily at the mutual fund's current net asset value. According to the Investment Company Institute, as of year-end 2017, mutual funds total net assets made up over 80% of the total net assets of all U.S. registered funds.

***(b) Exchange-traded funds***

Exchange-traded funds (**ETFs**) are typically structured as open-end funds, but differ in that they specifically provide investors with exposure to an index or a pool of assets. Prior to launch, an ETF must generally obtain an exemptive order from the SEC for conditional relief from certain provisions of the Investment Company Act, which would otherwise be inconsistent with an ETF's strategy. Instead of redeeming through the fund, most investors obtain liquidity by trading shares on an exchange at market-set prices. Only "authorised participants" (such as large broker-dealers) may buy and redeem ETF shares from the ETF, which occur through in-kind purchases and sales.

***(c) Closed-end funds***

Closed-end funds are permanent capital vehicles that offer various forms of interests to investors, whether debt or equity (including convertible interests and warrants, in certain cases). Unlike open-end funds, closed-end funds do not offer their interests to investors on a continuous basis and they may be publicly or privately traded. In the public markets, closed-end funds function similarly to operating companies and typically conduct an initial public offering and subsequent follow-on offerings. A publicly traded closed-end fund thus generally offers liquidity to investors through secondary market trading, whereas liquidity for an investor in a privately traded closed-end fund is somewhat limited. A closed-end fund may, however, make periodic tender offers. Closed-end funds include business development companies (**BDCs**) and interval funds.

***(d) Business development companies***

A BDC is a type of closed-end fund that must invest a significant portion of its assets in small and mid-sized U.S. privately held companies. In exchange, the Investment Company Act permits

BDCs to have a higher leverage ratio than traditional closed-end funds. Most BDCs are lending vehicles that offer investors unique exposure to the floating-rate lending market and are often referred to as a part of the "shadow banking" industry in the U.S.

***(e) Interval funds***

An interval fund is a closed-end fund that offers its investors periodic liquidity events. Interval funds offer redemptions to investors consistent with a pre-determined schedule (generally every three months, six months or 12 months) pursuant to a fundamental policy of the fund.

***(f) Unit investment trusts***

Unit investment trusts (**UITs**) share some characteristics with mutual funds and closed-end funds. UITs are not generally actively managed funds, but instead buy and hold securities in a static pool. UITs have an established termination date and investors receive dividends or interest payments from the underlying portfolio.

## III. Registered Funds Could Open Up a New Investor Base for Fund Managers

According to the Investment Company Institute (the **ICI**), assets in U.S. registered funds made up a record $22.5 trillion at year-end 2017, which represents an increase of over $3 trillion from the prior year.[3] At year-end 2017, retail investors (such as U.S. households) held approximately 90% of U.S. mutual fund total net assets and approximately 95% of long-term mutual fund total net assets.[4] Mutual fund investments alone are spread across approximately 100 million investors, a substantial portion of which invest through employer-sponsored retirement plans.[5] With such a high proportion of retail investors investing in mutual funds for varied financial goals, mutual funds continually tend to attract additional capital even in times of market uncertainty. ICI survey results have also shown that younger generations tend to start investing in mutual funds earlier than their older generation counterparts did, yet an additional factor suggesting that the market will continue to grow.[6]

Any manager seeking additional streams of assets under management would thus be wise to consider the depth and breadth of the U.S. retail market, particularly because registered funds have become the dominant investment vehicle for U.S. retirement plans. The propensity of retail investors in the registered funds space is largely due to the fact that registered funds are the only variety of U.S. securities fund permitted to offer to U.S. retail investors without regard for regulatory sophistication standards typical to hedge funds and private equity funds, such as "accredited investor" or "qualified purchaser".[7]

Registered funds are attractive to investors because they provide a transparent, efficient structure for investors to gain access to the securities markets. U.S. retail investors generally do not qualify to invest in traditional hedge funds or private equity funds due to the high-net-worth requirements and steep minimum investment amounts, and therefore must look to registered funds. From a practical standpoint, registered funds are easy to invest in; they do not require subscription documents or extensive verification procedures, making the investing process more streamlined than traditional hedge funds and private equity funds.

Regardless of whether a manager is seeking U.S. retail or institutional investors, registered funds provide transparency and can deliver a tax-efficient structure via pass-through tax treatment that can eliminate K-1 tax reporting and block certain U.S. state taxation at the fund level. Similarly, managers can raise an unlimited amount of capital subject to the Employee Retirement Income Security Act of 1974 (**ERISA**) in a registered fund without additional compliance burdens, compared to privately offered funds which typically limit ERISA investments or must comply with qualified professional asset manager (**QPAM**) and other ERISA requirements.

Registered funds are also not "covered funds" under the Volcker Rule, which generally prohibits banks and affiliated banking entities from acquiring "ownership interests" in or sponsoring covered funds. By excluding registered funds from the definition of "covered fund", the Volcker Rule has provided a competitive advantage to registered funds over private funds in attracting U.S. bank capital. Registered funds offered by traditional private fund managers alongside those managers' private funds may provide an attractive alternative to banks and bank affiliates that are considering alternatives to private fund investments.

## IV. Commercial and Operational Considerations

All registered funds are subject to numerous substantive requirements and restrictions, such as periodic public reporting to the SEC and to investors, limits on the use of leverage and derivatives, prohibitions on principal and joint transactions with insiders and affiliates, limitations on investing in other funds, and specific board governance requirements. Managers must be familiar with these issues, and, more importantly, must understand how these issues translate into a number of broader commercial and operational issues, any of which may affect a manager's core enterprise and strategy, including the following:

***(a) Any manager advising a registered fund must register with the SEC as an investment adviser***

The Investment Advisers Act of 1940, as amended (the **Advisers Act**) requires managers of registered funds – including sub-advisers to registered funds – to be registered with the SEC, regardless of their amount of assets under management, the number of U.S. investors or clients, or the location of the manager's principal place of business. Non-U.S. managers and alternative managers that currently rely on the "exempt reporting adviser" or the "foreign private fund adviser" exemption must consider the implication of a full registration with the SEC. However, the additional Advisers Act requirements alone do not materially increase the compliance obligations that the Investment Company Act imposes on a manager of a registered fund, particularly because exempt managers at all times remain subject to the Advisers Act's broad antifraud, recordkeeping and insider trading requirements.

***(b) Performance fees are generally prohibited, and investors pay close attention to fees and expense ratios***

Managers will not be able to charge performance fees unless they conduct limited offerings to certain classes of sophisticated investors, such as through the Investment Company Act's funds of hedge funds or funds of private equity funds (which would eliminate many retail investors). In a rare exception, the Investment Company permits a manager of a BDC to charge a performance fee.

Investors will scrutinise management fees and a fund's overall expense ratio, and managers willing to sacrifice some economics by setting a lower assets-under-management fee must pay close attention to the fund's all-in expense ratio that includes administrative, trading and operational costs.

Registered funds in general tend to have higher expenses than traditional privately offered hedge funds and private equity funds. Mutual funds, in turn, tend to have higher management and administrative expenses than traditional closed-end funds. Many of these expenses arise from the fact that a registered fund typically engages a number of service providers, including for example, a distributor or principal underwriter, a transfer agent, a custodian, an independent auditor, an independent valuation firm, legal counsel for the fund, independent legal counsel for the board and a proxy firm. The SEC's recently adopted liquidity management rules, pursuant to which open-end funds will be required to classify assets in six specific liquidity categories and conduct an ongoing review of the fund's liquidity, are also likely to add to an open-end fund's expenses.

***(c) Distribution of open-end fund shares, and offerings of closed-end fund shares, are each critical to success***

Somewhat different to the buyer-driven market of hedge and private equity funds, the market for registered funds is developed through proactive retail sales efforts, and registered funds must be heavily marketed to attract an investor base. This means that managers must seek out distribution partners, in the case of open-end funds, and carefully consider underwriting lead and syndicate options, in the case of a closed-end fund. Distribution partnership options for open-end funds take many forms, from traditional sub-advisory roles with multi-manager funds to series trusts sponsored by a manager with a strong distribution network. Similarly, underwriter selection for closed-end funds requires careful diligence.

***(d) Managers must ensure that their strategies can perform as expected in a registered fund wrapper, and not all performance is portable for marketing purposes***

Open-end fund strategies tend to focus on the most liquid of securities, including long/short equity, and some event-driven or credit strategies that do not rely on illiquid securities. Closed-end funds, on the other hand, are not subject to portfolio liquidity requirements, do not offer their shares continuously, and are not subject to daily redemption requests. Thus, a manager of a closed-end fund may pursue a more flexible investment strategy involving, by way of example, an illiquid portfolio that focuses on fixed income securities and borrowing through the issuance of senior securities. While a flexible investment strategy may be more attractive to certain managers, closed-end funds tend to attract a smaller portion of U.S. retail capital. Many closed-end funds also trade at a discount to net asset value per share and consequently struggle to offer interests that reflect the fund's assessed net asset value in follow-on offerings. A manager determining whether to launch a registered fund should consider a "test run" of its registered fund strategy in a model portfolio sleeve, private fund or seed-only vehicle prior to marketing a registered fund.

A manager seeking to market its registered fund by using the performance of other funds or accounts must conform to strict SEC guidelines that generally require uniformity of strategy and personnel for such performance information to be used in an offering. Moreover, managers should conduct thorough pre-testing of their strategies within the liquidity, leverage and co-investment limitations of the Investment Company Act to condition their expectations and the expectations of investors, and to establish appropriate internal procedures that seek to comply with these limitations.

Many fund managers have explored sponsoring registered funds that invest, at least in part, in cryptocurrencies and cryptocurrency-related products. The SEC continues to express concern over these investments and whether they are consistent with the requirements that apply to registered funds. For example, in the case of mutual funds, the staff of the SEC has questioned whether cryptocurrency-related products would comply with the liquidity requirements of the Investment Company Act. Consequently, managers exploring such a strategy should be cautious given the staff of the SEC's general uncertainty and the current lack of regulation.

***(e) Managers must be cautious not to cannibalise their existing product offerings***

Not all potential investors will find it optimal to invest in a registered fund, and managers should be mindful about offering products that may replace existing offerings at a lower cost, particularly given the risk that a manager could give up a performance fee on a non-registered product. Managers whose strategies already conform in material part to the Investment Company Act should consider steps to distinguish a potential registered fund offering from existing offerings.

***(f) Retail investors can be reactive and are a focus of SEC enforcement***

Retail money is not "sticky" – investors in open-end funds may make large redemptions when markets decline, which could quickly and drastically reduce assets under management for a manager of an open-end fund. Investors in closed-end funds and interval funds similarly may attempt to sell or redeem shares and lower the share trading price. While the Investment Company Act permits some use of redemption fees in the case of an open-end fund, managers cannot generally lock up investors in the fund. Managers may wish to choose an investment strategy that complements an investor's existing portfolio (such as a non-correlative strategy designed to reduce overall volatility and risk) and thoroughly educate selling brokers, advisers and investors about the specific role that the registered fund is intended to play in the manager's platform as a means to prevent large-scale redemptions.

The SEC continues to focus on protecting retail investors, given the potential lack of sophistication compared to typical hedge fund and private equity fund investors. In fact, the SEC's Office of Compliance Inspections and Examinations (**OCIE**) announced in 2018 that it would prioritise examining advisers of mutual funds with poor performance to ensure that the funds are complying with applicable regulations and disclosing risks adequately. In particular, OCIE's priorities focus on never-before-examined investment advisers. Unregistered advisers that will be required to register as a result of advising a registered product should thus be conscious of compliance pitfalls at the outset and should engage appropriate compliance advisers.

***(g) Registered funds may avoid double taxation***

Registered investment companies may elect to be treated as a "regulated investment company" (**RIC**) under the U.S. Internal Revenue Code (the **Code**) in order to avoid double taxation. If a registered fund elects to be treated as a RIC and complies with the RIC requirements under the Code (including diversification requirements and the requirement to distribute 90% of the fund's net investment income to investors), the fund will not be subject to U.S. federal income tax on its income and capital gains.

***(h) A registered fund must generally be organised in the U.S.***

Section 7(d) of the Investment Company Act prohibits a non-U.S. fund from registering under the Investment Company Act unless it has received exemptive relief to do so from the SEC. The SEC has historically only granted such relief on very rare occasions, with the result of Section 7(d) being that it is practically impossible for a non-U.S. fund to register as an investment company. Since a fund pursuing a typical open-end fund or closed-end fund strategy would be required to register to offer securities in the U.S., a manager sponsoring a registered fund must be prepared to organise the fund in the U.S. and to address related considerations of having a U.S. organised client.[8] The fact that a registered fund must be organised in the U.S. does not necessarily require a manager to have a U.S. presence.

## Endnotes

1. In this chapter, we focus on the commercial and operation considerations associated with typical open-end funds and closed-end funds. We do not specifically address in detail the commercial and operational nuances of other registered funds, such as UITs, money-market funds and business development companies.
2. At least 85% of a mutual fund's net assets must be held in "liquid securities", which are generally securities that can be disposed of within seven calendar days.
3. *2018 Investment Company Fact Book*, Investment Company Institute, *available at* http://www.icifactbook.org/.
4. *2018 Investment Company Fact Book*, Investment Company Institute, *available at* http://www.icifactbook.org/.
5. *2018 Investment Company Fact Book*, Investment Company Institute, *available at* http://www.icifactbook.org/.
6. *2017 Investment Company Fact Book*, Investment Company Institute, *available at* https://www.ici.org/pdf/2017_factbook.pdf/.
7. Of course, a commodity trading adviser or an equity real estate manager could raise U.S. retail capital through a vehicle registered under the Securities Act that avoids holding securities, such as a commodity pool or an equity REIT. Certain specific asset classes that qualify for Investment Company Act exemptions (such as mortgage pools and oil and gas funds) may also be publicly offered to U.S. retail investors.
8. Most open-end funds and some closed-end funds are organised in Delaware or Massachusetts due to favourable tax and corporate governance laws. Certain closed-end funds are incorporated in Maryland for similar reasons.

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Marc's practice focuses on the asset management industry, where he advises clients on a broad spectrum of regulatory and transactional issues. Marc is fluent in all aspects of regulation affecting money managers, funds and fund sponsors and he focuses particularly on issues under the Investment Company Act of 1940 and the Investment Advisers Act of 1940. Marc regularly advises asset managers, sponsors and issuers in structuring, documenting, and offering funds and other investment products inside and outside the U.S., including funds registered under the 1940 Act, private funds, specialty finance products such as securitisation vehicles, CLOs, REITs and other vehicles, and advises asset managers on regulatory and transactional issues under the Investment Advisers Act, including registration with the SEC and exemptions from registration. Marc also has considerable capital markets experience, having represented issuers and underwriters in creating and structuring hundreds of products and transactions to avoid 1940 Act "status" issues.

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# Credit Facilities for Registered Investment Funds


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While registered investment funds are primarily capitalised by the sale of equity securities to public investors, the liquidity afforded through use of credit facilities can provide important benefits to these funds.

Registered fund credit facilities differ for open-end and closed-end funds, given their different capitalisation, regulatory requirements and liquidity needs.

Open-end funds, which issue an unlimited number of daily redeemable shares, utilise revolving credit facilities to ensure sufficient liquidity to finance share redemptions and to meet other short term liquidity needs, and may use such facilities to support their liquidity risk management programmes under the new liquidity risk management rule and related requirements mandated by the Securities and Exchange Commission ("SEC").[1]

Closed-end funds, which issue a limited number of shares that are not redeemable by the investor, use revolving and term loan facilities to seek greater investment returns through the leverage that these facilities provide, and to help provide short-term liquidity, including to effect issuer tender offers or open market share repurchase programmes and, in the case of interval funds (which offer periodic share redemption opportunities), to fund share repurchases.

The use of credit facilities by both open-end and closed-end funds is regulated by Section 18 of the Investment Company Act of 1940 (the "'40 Act"), although the requirements differ for open-end versus closed-end funds. These regulatory requirements, coupled with the unique nature of registered '40 Act funds, make it critically important for a fund's business team and its compliance and finance legal teams to work in close concert. The purpose of this chapter is to highlight the principal issues that arise for a registered fund borrower proposing to enter into a credit facility.

## Regulation Under Section 18 of the '40 Act

### Asset Coverage Tests

One of the primary restrictions on use of a credit facility by a registered fund is the applicable asset coverage test imposed by Section 18. This test requires that a fund's total assets minus liabilities (other than "senior securities representing indebtedness") cannot be less than 300% of the fund's "senior securities representing indebtedness". "Senior securities representing indebtedness" is defined generally as any bond, debenture, note or similar obligation or instrument constituting a security and representing indebtedness. The '40 Act definition of "security" includes notes and other evidence of indebtedness that would not necessarily constitute securities under the Securities Act of 1933 or other contexts. As a result, credit facilities constitute "senior securities representing indebtedness" for purposes of the asset coverage tests.

### Differences in Regulation of Open-End and Closed-End Funds

The restrictions under Section 18 differ for open-end and closed-end funds.

Section 18(f) permits open-end funds to borrow only from a "bank" (as defined in Section 18(f)), and prohibits open-end funds from issuing preferred stock or any other type of "senior security".[2] Open-end funds are required to comply with the 300% asset coverage test at all times, although the '40 Act permits a three-business-day cure period for the fund to bring itself back into compliance.

In contrast, Section 18(a) requires compliance by a closed-end fund with the 300% asset coverage test only at the time of the incurrence of indebtedness or at the time of the declaration of a dividend or of a share repurchase. Section 18(c) prohibits any closed-end fund from issuing more than a single class of indebtedness, although, for purposes of this restriction, two or more issuances of debt which are *pari passu* with one another (i.e., having equal and ratable rights against the assets of the fund) are generally considered to be a single class, notwithstanding that the debt instruments may have different economic and other characteristics.[3]

### Other Credit-Type Obligations

Both open-end and closed-end funds may routinely incur other credit-type obligations such as currency hedging exposure, reverse repurchase and securities lending transactions (where a fund either lends or sells (subject to repurchase rights) portfolio assets to a third party or borrows or purchases (subject to repurchase rights) assets from a third party), dollar rolls (where a securities lending or repurchase financing automatically extends for subsequent terms), derivative exposure and similar credit-type devices. Under SEC Release 10666, these items are generally not considered senior securities representing indebtedness for purposes of Section 18 if such exposure is adequately covered by liquid portfolio assets or by offsetting positions. In addition, many fund groups with the same investment advisor obtain authorisation by SEC exemptive order to lend amounts to each other as a supplement to their third-party credit facilities and other credit-type arrangements. Funds utilising interfund lending must adopt policies with respect to interfund lending arrangements and observe other conditions required by their applicable SEC exemptive order.

## Fund Level Restrictions

Other important sources of restrictions on fund borrowing may be found in the governing documents and investment policies of the fund itself. These must be reviewed in connection with a contemplated credit facility to ensure compliance with their requirements.

Registered investment funds are required to adopt as part of their "Fundamental Investment Policies" (i.e., policies that cannot be altered without a shareholder vote) a Fundamental Investment Policy with respect to borrowings by the fund. Such Fundamental Investment Policies may impose specific asset percentage or other limitations on borrowings by the fund that are more restrictive than those imposed by Section 18, or could prohibit borrowing altogether. Restrictions on borrowings may also be imposed by a fund's charter, bylaws or non-fundamental investment policies. The charter can generally be modified only by shareholder action, while bylaws and non-fundamental investment policies may be modified by action of the board.

Board approval is required for the fund's entry into borrowing facilities and, where a credit facility has multiple affiliated borrowers, the boards of each applicable borrower must also approve the methodology of allocating commitment fees and borrowing opportunities. Since legal opinions of finance counsel to the fund are generally required by lenders in connection with the entry into a credit facility and may be required in connection with annual renewals or other amendments, it is important that finance counsel to the fund be involved in reviewing the relevant board materials and resolutions prior to their adoption in order to avoid the need for supplementary board action prior to the completion of the facility or amendment.

## Characteristics of Registered Fund Credit Facilities

### General Structure

Credit facilities differ for open-end and closed-end funds. Open-end funds typically borrow only to fund daily redemptions and to satisfy other liquidity requirements. In addition, open-end funds are now required to adopt liquidity risk management programmes. Such programmes categorise portfolio assets into levels of liquidity and designate a specific minimum of highly liquid investments, as applicable. The need to adopt liquidity risk management programmes provides an additional basis for open-end funds to consider having liquidity lines in place.

Given that open-end funds utilise liquidity facilities for short term liquidity and risk management, rather than to provide permanent or significant leverage, open-end fund credit facilities are typically small relative to their assets and are usually (but not always) unsecured. In many cases, these open-end fund revolving facilities are seldom drawn, and serve primarily as a backstop in case redemptions reach unusual levels. In order to save on transaction costs and unused commitment fees, multiple open-end funds (in some cases over 100 funds) with the same investment advisor may borrow separately under a single umbrella credit facility.[4]

The maturity of open-end fund credit facilities is generally limited to 364 days, so that the fund receives a lower interest rate resulting from the lower capital reserve requirements for bank commitments of less than a year.

In contrast to open-end funds, closed-end funds use leverage as a more significant part of their capital structure. Their credit facilities may be either revolving credits or term notes. The facilities are typically secured and subject to a borrowing base with differing advance rates for different categories of portfolio assets. Term notes may be part of a bank credit facility or may be issued to insurance companies and other institutional lenders, and would generally have a maturity of several years.

### Organisational Structure of Open-End Funds

Credit facilities for open-end mutual funds raise special issues because of the unusual organisational structure of such funds. Open-end funds are frequently organised as multiple series of segregated assets under a single business trust, statutory trust or corporation (closed-end funds typically do not employ the series structure). This series option is also available under certain corporate (e.g., Maryland) and limited liability company statutes. Under these series structures, the trust or other entity is the only legal entity for all its separate series (or funds) and enters into the debt agreements on behalf of its various series, which may be quite numerous (often dozens). Because a business trust is typically governed by contract with the trustees and not by corporate statute, provisions stating expressly that the borrower obligations are non-recourse to the individual trustees should be included in debt agreements with business trust borrowers.

Because open-end fund credit facilities often include many separate funds, each with its own shareholders, all borrowings must be on a several basis with respect to each individual series, and not jointly with the other borrowers. Fund counsel must take care that covenants, representations, warranties and defaults apply only to the affected fund borrower, and not to all borrowers under the facility.

Where multiple funds are co-borrowers under a common credit facility, the trustees for the various funds must adopt procedures to fairly allocate borrowing opportunities and payment of shared expenses, such as upfront fees, unused commitment fees, indemnities and obligations to reimburse lender expenses. The allocation procedures must be satisfactory to the lenders as well. Most often, these allocations are based either on the relative net asset value of the fund borrowers and/or on the anticipated relative levels of use of the facility by the different borrowers, with relative net asset value being the more common approach.

### Borrowing Base

For closed-end funds (and some open-end funds), a borrowing base governs the amount of credit available, with different "advance rates" or borrowing availability for various categories of portfolio assets. The borrowing base, which dictates how much credit will be advanced against particular types of assets, involves complicated business negotiations between the fund manager and the lender, and is one of the most important terms in a credit facility.

The advance rates applicable to different assets are based on varying measures of credit-worthiness for different types of portfolio assets, such as the nature of the investment (e.g., whether it is secured or unsecured), credit rating, jurisdiction of issuer, concentration limits, issuer eligibility requirements and other factors, such as relative liquidity. Recent proposed rules which would impact investments by mutual funds in other mutual funds by limiting redemptions by the top-tier fund have caused some lenders to restrict borrowing base credit to such "fund-to-fund" investments, though it is unclear how those rules will ultimately be formulated and then how lenders will approach fund-to-fund investments for borrowing base purposes over the long run.

### Covenants: Asset Coverage Ratio

Both open-end and closed-end fund credit agreements typically include a covenant requiring the fund to comply with an asset coverage test that is similar to the '40 Act test, but which may impose a greater asset coverage level than the 300% level required by Section 18. The credit agreement will typically require compliance with the asset coverage test at all times even though, for closed-end funds, Section 18 imposes the test only upon debt incurrence and declaration of or payment of dividends. Lenders often seek an immediate event of default if the asset coverage test is violated, while Section 18 provides a three-business-day cure period for an open-end fund to sell portfolio assets in an orderly manner to resume compliance. Borrowers prefer for the credit facility to provide for the same cure period as afforded by Section 18, though not all lenders will agree.

Finance counsel for the fund borrower should carefully check the defined terms used in the credit agreement asset coverage test to ensure that the test will work as expected. Many credit facilities specify that the amount of debt is deemed to be the greater of (a) the outstanding principal amount, or (b) the value of collateral securing such debt. This formulation works reasonably well when only specific assets are pledged to secure liabilities. But where liabilities are secured by a blanket lien on all assets, the effect of this language is to cause the amount of the liabilities for purposes of the calculation of asset coverage to be equal to the entire amount of the fund's assets. Because settlement advances, hedging obligations, overdrafts and administrative fees owing to the fund custodian, and borrowings under a secured credit facility are all by their terms typically secured by all assets of the fund, exceptions to this test will be required to avoid such liabilities being deemed to equal the value of the fund's entire portfolio.

### Covenants: Permitted Indebtedness and Liens

Credit facilities impose negative covenants restricting indebtedness and liens for both open-end and closed-end funds. These covenants should permit as "permitted indebtedness" the various credit-type obligations that the fund might incur, such as hedging exposure, custodian overdraft and settlement financing, securities lending and reverse repurchase agreement transactions, dollar rolls, derivatives and similar items and the "permitted liens" should include segregated assets that cover these obligations for purposes of Section 18. Many credit facilities limit these obligations to a certain percentage of fund assets.

### Covenants: Interfund Lending

Interfund lending programmes (referred to above) raise special issues for open-end and closed-end fund borrowers, and the investment and indebtedness covenants of the credit facility must be carefully reviewed to ensure that appropriate carveouts exist to facilitate interfund lending and borrowing. Lenders typically permit interfund lending programmes so long as asset coverage compliance is maintained, though it is common for lenders to preclude borrowings by a fund while that fund has loans outstanding to another affiliated fund. Lenders also typically restrict the proceeds of their facility from being on-lent to another fund.

Unsecured credit facilities typically require that the credit facility receives equal and ratable security in the event interfund borrowing is secured, which would require that an intercreditor agreement be put in place. Alternatively, given the complexities of putting in place intercreditor arrangements, lenders may simply preclude a fund from being a borrower under the credit facility when the applicable fund is a borrower under secured interfund loans.

As noted, credit facilities often preclude funds from making interfund loans (or having interfund loans outstanding) when those funds have outstanding borrowings under the credit facility. Less commonly, lenders may prohibit borrowers from being borrowers under a credit facility and under interfund loans at the same time.

### Covenants: Restrictions on Dividends and Share Repurchases

As with most credit agreements, lenders to a registered investment fund do not want the borrower to make "restricted payments", that is, to pay dividends on its equity or to repurchase shares of equity if an event of default exists. For open-end funds that are subject to daily redemptions and may seldom have outstanding borrowings, funds should ensure that this prohibition on making equity distributions or redemptions should apply only when the particular fund has outstanding loans – not any time that a default exists. In addition, since registered funds generally must distribute to shareholders at least 90% of their net investment income in order to maintain tax pass-through status as a "regulated investment company" pursuant to Section 851 of the Internal Revenue Code, restricted payment covenants ideally contain an override exception that permits restricted payments to the extent necessary for the fund to maintain its status under Section 851.

### Covenants: Restrictions on Creation of Non-Guarantor Subsidiaries

Lenders often prohibit registered fund borrowers from creating subsidiaries to hold portfolio assets which do not become guarantors under the credit facility. However, open-end and closed-end funds will sometimes want to transfer portfolio assets (typically bank loans or bonds) to a special purpose subsidiary which obtains independent debt financing that is non-recourse to the parent fund (though the assets and indebtedness of the subsidiary will be consolidated with the fund for Section 18 purposes). Open-end and closed-end funds may also create subsidiaries to hold futures and commodities investments to avoid excess non-qualifying income for purposes of Regulation M under Section 851 of the Internal Revenue Code that would arise if these investments were held directly by the fund itself. If credit facilities permit subsidiary drop-down structures, the covenants will impose limitations on the amount of portfolio assets that can be contributed to non-obligors and on the level of debt that can be incurred at that level given that the holders of such debt have structural priority on the assets of those entities.

### Covenants: Restrictions on Changes to Fundamental Policies, Investment Advisor and Custodian

Because the lender bases its credit analysis on a fund's fundamental investment policies (including use of leverage), credit facilities for open-end and closed-end funds restrict the ability of the fund to alter these policies. Any change to such policies that is sufficiently material to require shareholder approval under the '40 Act will likely require consent of the lenders under the credit facility.

Similarly, the identity of the fund's investment advisor and, particularly for a secured credit facility where the lender and the custodian are affiliated, the custodian, is so central to the lender's credit analysis that lender consent (or termination of the credit facility) must be obtained before either the investment advisor or custodian is changed (other than to an affiliated entity).

If a change to a fund's investment policies or to the fund's advisor or custodian is contemplated, lender consent to the change should be obtained at an early stage of the process, or arrangements should be made to refinance the facility.

### Special Issues with Collateral

Secured credit facilities for closed-end funds (and, when applicable, open-end funds) involve special issues. Section 17(f) of the '40 Act generally requires all funds to keep portfolio assets with a bank custodian. As a result, in order to have a perfected security interest in such assets, the secured lender must either be the custodian itself or enter into an account control agreement with the custodian. The custodian will mark a portion of the portfolio assets as a "memo pledge" or, particularly in the case of prime broker advances that finance specific portfolio assets, may create a separate account or subaccount for such assets, and the credit facility will impose borrowing restrictions that are tied specifically to the borrowing base afforded by pledged collateral.

The credit facility should not restrict the fund borrower's ability to withdraw assets from and deposit assets to the pledged accounts, unless and until the lenders issue a "notice of exclusive control" as a result of an event of default. The SEC created uncertainty about secured borrowing by registered funds in two no-action letters for the *Stagecoach Fund, Inc.*,[5] in which the SEC staff questioned whether a fund that pledged all its portfolio assets to secure borrowings, even where the borrowings did not result in a violation of the 300% asset coverage requirement, satisfies its duty to hold portfolio assets for the benefit of its shareholders under the '40 Act. The *Stagecoach Fund, Inc.* letters have not been cited by the SEC since their issuance, however, and the widespread use of secured borrowing in the past 45 years suggests that a credit facility with customary advance rates and collateral cushions will not result in a violation of the fund's duties to its shareholders under the '40 Act.

### Regulation U

Since borrowings by a fund that invests substantially in publicly traded equity securities will likely be directly (in the case of secured facilities) or indirectly (in the case of unsecured facilities) secured by margin stock under Regulation U of the Federal Reserve Board, fund credit facilities typically require the borrower to submit a Form FRU-1 at the initial closing. For unsecured open-end fund facilities, Regulation U contains an express exemption for temporary advances incurred for redemption or trade settlement purposes.[6]

### Hybrid Revolving Credit and Rehypothecation Facilities

In a recent market development, some credit facilities for closed-end funds combine a customary revolving credit with the ability of the lender-to-broker securities lending or repurchase transactions with the borrower's portfolio assets. These transactions are referred to as "rehypothecation" or "repo-type" financings. The borrower receives a lower interest rate for its revolving borrowings if the lender has the right to use the borrower's assets for these third-party financings. The lender may share with the borrower a percentage of its profits from the repo-type financings or provide indemnity to the borrower if the counterparty defaults on its obligations and causes a loss to the borrower.

Securities lending and repurchase transactions raise additional regulatory requirements relating to the segregation of assets for repurchase transactions, and custody requirements for securities lending transactions. For these and other considerations, the borrower may wish to restrict the lender as to the duration and type of these financings and reserve the right to exclude certain assets or counterparties from this type of programme.

These hybrid facilities often provide for long termination periods for the fund borrower, some have up to 364 days' prior notice, so that the lender has time to unwind the underlying repo-type financings at the end of their term. Care should be given by the borrower's counsel to negotiate a termination period that provides enough notice to protect the lender while allowing the fund to operate in the ordinary course and in compliance with Section 18 asset coverage and other '40 Act requirements.

Because fund borrowings, securities lending and repurchase transactions are all regulated in a different manner by the SEC, a fund should work particularly closely with its compliance counsel when considering such a hybrid credit facility.

### Potential Impacts of Liquidity Risk Management Programmes on Credit Facilities

As noted above, open-end funds were required to implement liquidity risk management programmes under the new SEC rule in December 2018. Certain other elements of the rule have a compliance deadline of June 1, 2019 for larger funds. As part of these programmes, funds that do not invest primarily in highly liquid assets must set and observe a minimum amount of the fund's net assets that will be comprised of highly liquid investments (a so-called "high liquid investment minimum"). It is unclear exactly how credit facilities may factor into liquidity risk management programmes, including with respect to meeting the fund's highly liquid investment minimum. The SEC has indicated that it does not view availability under credit facilities as the same as cash for such liquidity purposes, and has cited factors including the financial health of the institution providing the facility, the terms and conditions of the facility, and fund families often sharing credit lines, as calling for a more nuanced analysis.[7] In addition to raising concerns around whether credit facilities might not be fully available when needed, the SEC has expressed concern that credit facilities can sometimes benefit redeeming investors at the expense of non-redeeming investors since if a fund uses a credit facility to bridge redemptions, the risk of the resulting additional leverage could reside with the non-redeeming investors. The SEC has opined that this factor should be taken into consideration (along with the other overall benefits and risks) when determining how to account for leverage in a liquidity risk management programme. Each fund must make a bespoke analysis of its own credit facility and likely credit availability in determining whether and to what extent such a facility may play a role in the fund's liquidity risk management programme.

As part of the liquidity risk management programmes, the SEC is requiring additional reporting. Open-end funds must confidentially notify the SEC when the fund's illiquid investment holdings exceed 15% of its net assets or if its amount of highly liquid investments declines below its highly liquid investment minimum for more than a brief period of time. Banks will likely be interested in knowing whether any of these notifications have taken place and what is being done to remedy any breach, and it is not unlikely that similar reporting requirements may become part of fund liquidity facilities.

Additionally, the classification of assets (ex. "highly liquid") that this new SEC rule will require for open-end funds may be a convenient way for a bank to monitor their collateral and determine advance rates, and may accordingly become an element of the formulation of borrowing bases.

## Conclusion

Credit facilities are an important source of liquidity and leverage for registered investment funds. The prevalence of credit facilities among open-end funds may increase in light of the new SEC liquidity rule and the development of related programmes.

The regulatory landscape that applies to registered investment funds and their lenders continues to evolve. While this chapter provides an overview of some of the issues that are presented by registered fund credit facilities, given the highly regulated nature of open- and closed-end funds, the complicated and sophisticated nature of their investment techniques, and continuing developments in the regulatory landscape, ongoing close cooperation between the fund regulatory counsel, fund lending counsel and the fund's business team is essential.

## Endnotes

1. See Rule 22e-4 under the '40 Act. SEC Release 330192331 UC – 32315. Certain elements went into effect on December 1, 2018 and others will go into effect in June 2019.
2. Section 18(g) defines "senior security" generally as any note, bond or other evidence of indebtedness and any stock of a class having priority over any other class as to distribution of assets or payment of dividends. Similar provisions apply to preferred stock issued by a closed-end fund, although with an asset coverage test of 200% rather than 300%. The '40 Act imposes various other requirements that are not of practical relevance to credit facilities. Such restrictions include required remedy triggers for closed-end funds whose asset coverage ratios fall below 110% or 100%.
3. See SEC no-action letters *In the Matter of Israel Development Corporation* (publicly available March 16, 1961), and, following *Israel, In re Philadelphia Investment Company* (publicly available August 27, 1972).
4. Since these multi-borrower facilities contemplate each fund paying a portion of the commitment fee required under such credit facilities and bearing a share of other expenses of the facility, legal advisors to such funds have considered whether such arrangements could raise issues under Section 17(d) of the '40 Act and Rule 17d-1 thereunder. Section 17(d) and Rule 17d-1 prohibit an affiliated person of an investment company from participating in a joint enterprise or other joint arrangement without first obtaining an order from the SEC. In no-action letters issued in the late 1990s, the SEC confirmed that no enforcement action would be recommended on account of such multi-borrower credit facilities where each affiliated fund was liable only for its own borrowings under such facilities and would not provide collateral for the liabilities of another affiliated fund, and under the other terms described in the requests for such no-action letters. As such, while exemptive orders are required for intra-fund borrowing arrangements, they are not generally required for multi-fund credit facilities, so long as they are structured in a customary manner.
5. Publicly available May 12, 1973 and August 18, 1973.
6. See 12 CFR 221.6(f).
7. See note 1.

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# The Impact of Brexit on Asset Management


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I am writing this on the morning of 13 March 2019. The United Kingdom ("UK") voted to leave the European Union ("EU") just over two-and-a-half years ago. If you had asked me then, "could you write an article in March 2019 that describes with certainty what Brexit means for asset managers?", I would have said "no problem". What a fool I was!

At the moment, Brexit is less than 17 days away and it is still unclear whether the UK will leave the EU on the basis of the published withdrawal agreement, with no deal in place or whether it will leave on 29 March 2019 at all. However, in the asset management space, certain matters are now clear regardless of how and when the UK leaves the EU.

## Impacted Regulatory Regimes

The asset management industry in Europe is regulated by three primary regulatory regimes, namely the Alternative Investment Fund Managers Directive ("AIFMD"), the Undertakings for Collective Investment in Transferable Securities Directive ("UCITS") and the Markets in Financial Instruments Directive ("MiFID"). In the absence of a withdrawal agreement and the related implementation period during which EU rules would continue to apply in the UK, and unless the agreement on the future EU/UK relationship provides for a different outcome, these EU laws will cease to apply to the UK as a Member State and the UK will instead become a "third country" according to EU law, much like the United States is today.

Each of the UCITS, AIFM and MiFID regulatory frameworks regulates the provision of asset management services in the EU and each grants EU passporting rights to regulated entities. This enables them to operate (and, in most cases, allows all of their products to be sold) across the EU with minimal additional regulatory burden in the host countries. The fact that the UK will, most likely, no longer be part of those passporting regimes post-Brexit is the biggest challenge facing the asset management industry. It is worth noting that this is a two-way street – UK managers will lose passporting rights into the EU but EU managers (and EU funds) will also lose passporting rights into the UK.

UK asset management firms manage assets belonging to millions of investors in the EU – the UK is the largest centre for asset management in Europe. UK firms risk losing access to such investors but the inverse is also true; such investors risk losing access to those UK firms. It is in the interests of "both sides" to ensure that such access remains. For this reason, the various regulators and industry participants have engineered a post-Brexit landscape that represents, in the short term at least, as positive an outcome as could have been hoped for, particularly in light of the ongoing uncertainty relating to other aspects of post-Brexit EU/UK relations.

## Particular Impacts under UCITS

UCITS are the primary public fund in the EU and the UCITS regulations currently require that both the UCITS fund itself and its management company be domiciled in the EU. When the UK leaves the EU, this will have a number of knock-on effects, the most material of which are described below:

- UK UCITS – Unless it re-domiciles to the EU, a UK UCITS will automatically become a non-EU fund and lose its passporting rights. For EU investors in such a fund, this may not be acceptable and so the majority of impacted managers have offered those investors an EU-domiciled equivalent UCITS instead (generally in Ireland or Luxembourg). Where the UK UCITS has an EU management company, that management company will need to examine its licence to ensure it can manage non-UCITS (as UK UCITS will be considered to be non-UCITS or alternative investment funds ("AIFs") post-Brexit).
- UK UCITS management companies – These will not be authorised to manage and market UCITS. Where they manage a non-UK UCITS at present, that UCITS will need to either appoint an EU management company instead of the UK one or become a self-managed UCITS.
- EU UCITS – Such UCITS will lose access to the UK on a passported basis and their ability to be sold into the UK will instead be subject to local rules which the UK may impose on such funds post-Brexit. Until those rules are put in place, however, the UK has created the Temporary Permissions Regime. This will allow such UCITS to continue to be sold in the UK until the new rules are applied.
- EU UCITS management companies – A vast majority of EU UCITS management companies delegate portfolio management functions to an investment manager, a large number of which are based in the UK. For a long time, it was unclear whether (or, most accurately, when) the necessary inter-regulator cooperation agreements would be put in place to allow this delegation to continue. On 1 February 2019, the European securities regulator, the European Securities and Markets Authority ("ESMA") announced that it had entered into the necessary cooperation agreement in the form of a multilateral memorandum of understanding ("MMoU") with the UK Financial Conduct Authority ("FCA") and it is expected that all Member States will sign up to the MMoU in advance of Brexit day. A separate point arises for an EU UCITS management company that manages UK UCITS;

when those UK UCITS become AIFs, the EU UCITS management company will need to ensure it is appropriately authorised to manage AIFs.

## Particular Impacts under AIFMD

AIFMD applies to all AIFs and, unlike the UCITS regime, it already recognises the concept of a non-EU AIF and a non-EU management company, called an alternative investment fund manager ("AIFM"). Furthermore, and again unlike the UCITS regime, passporting rights under AIFMD attach to the AIFM rather than the AIF, though they are still conditional on the domicile of the AIF. As a result, the impact of Brexit on AIFs is different to UCITS. In summary:

- UK AIFMs and AIFs managed by that UK AIFM – The AIFM will continue to be able to manage EU AIFs, although they will lose access to the AIFMD management passporting regime. Similarly, any UK AIFs managed by the UK AIFM will also lose access to the marketing passport. However, where such UK AIFs are not marketed in the EU, they will fall entirely outside of the scope of AIFMD (including its most burdensome obligations).
- EU AIFMs and AIFs managed by that EU AIFM – Any UK AIFs managed by an EU AIFM will lose access to the marketing passport. EU AIFs will be unaffected including, at least in the short term, as regards being sold in the UK – the Temporary Permissions Regime noted above also applies to AIFs.

Without access to the passporting regime, AIFs are subject to the relevant national private placement regime ("NPPR") applicable in the given target Member State. The NPPR varies from Member State to Member State and indeed some Member States do not allow for any NPPR. As a result, many managers of AIFs currently sold under the passport have decided that reliance on NPPRs is not a viable marketing strategy. Such managers are, depending on their particular circumstances, establishing EU AIFMs or EU AIFs to ensure continued access to the passport.

As noted above, AIFMD already contemplates non-EU AIFs and non-EU AIFMs. In particular, it contemplates such AIFs and AIFMs being granted passporting rights in place of the NPPRs. The extension of the EU passport to non-EU AIFs and AIFMs is contingent on positive advice from the ESMA and approval from the European Commission. ESMA may only issue positive advice in relation to a non-EU country where it is satisfied that there are no significant obstacles regarding investor protection, market disruption, competition and the monitoring of systemic risk. It is expected that, provided UK AIF regulation remains similar in a post-Brexit environment, no significant obstacles would exist which might prevent the UK from being part of any future third-country extension of the EU passport.

## Particular Impacts under MiFID

MiFID regulates the manner in which asset managers provide investment services to clients across the EU. In the context of the investment fund industry, the primary services are portfolio management and distribution/marketing. MiFID, like AIFMD, provides for an equivalence mechanism that can allow firms from outside the EU, "third country firms", to do business in the EU without the need for authorisation in individual Member States. At first glance this is the perfect solution for UK firms providing services in the EU. However, this mechanism was only introduced in January 2019 as part of MiFID II and it is untested. In addition, the equivalence process itself would take at least several months (the European Commission would have to determine that the UK has an equivalent supervisory and enforcement regime to the EU post-Brexit and then ESMA would have to assess individual firms' applications). For this reason, the MiFID third country regime is not a viable option in the immediate aftermath of a no-deal Brexit and instead industry participants are examining the following options:

- Portfolio management – As regards portfolio management and investment funds, this is not an issue. Both UCITS and AIFMD simply require that a non-EU investment manager be appropriately regulated and that a cooperation agreement be in place between the relevant regulators. As indicated above, ESMA has agreed the necessary MMoU with the FCA and, as such, UCITS management companies and AIFMs will still be able to delegate portfolio management to a UK investment manager.
- Distribution – At present, it is common for UCITS and AIFs to be sold in the EU by sales staff living in London, working for a MiFID firm with access to an EU passport and travelling to Europe in reliance on that. When the MiFID firm loses its passport post-Brexit, it will either have to: (1) establish an EU domiciled MiFID entity; or (2) rely on local country rules which provide that the given marketing activities are unregulated in that country. In the case of option (1), how to continue to use the London-domiciled sales staff also needs to be taken into account.

## Conclusion

Brexit poses significant challenges for any asset manager with exposure to the UK, whether through having a base there or simply accessing the UK market. However, in the early days of the Brexit negotiations, a majority of managers determined (correctly, as it turned out) that they could not rely on a smooth Brexit providing similar frictionless cross-border access as enjoyed today. They critically assessed their operations and investment product offerings and took proactive steps. For many, this meant establishing a fund management presence in countries like Ireland or moving assets owned by EU investors out of existing UK funds and into equivalent Irish funds. Ireland has longstanding and close ties to the UK, going well beyond a common language and time zone and a comparable legal system. This, coupled with Ireland's existing extensive investment fund industry (€2.4 trillion worth of assets are held by Irish domiciled funds which are sold in over 90 countries), means Ireland is perfectly placed to support the global and UK asset management industry as it prepares for a post-Brexit world.

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Barry has extensive experience advising on the launch of UCITS and AIFs (stand-alone funds, umbrellas and third-party manager platforms) across the full range of strategies, including plain vanilla strategies, hedge fund strategies, structured UCITS, fund of funds, money market funds, ETFs and master-feeders, and on their ongoing servicing (including the launch and termination of sub-funds, a change of service providers and listing on the Irish Stock Exchange). He is also experienced in more complex issues arising in the course of the life of a UCITS or AIF, including obtaining Central Bank approval for innovative fund mechanics and structures.

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Matheson

Established in 1825 in Dublin, Ireland and with offices in Cork, London, New York, Palo Alto and San Francisco, more than 700 people work across Matheson's six offices, including 96 partners and tax principals and over 470 legal and tax professionals. Matheson services the legal needs of internationally focused companies and financial institutions doing business in and from Ireland. Our clients include over half of the world's 50 largest banks, six of the world's 10 largest asset managers, seven of the top 10 global technology brands and we have advised the majority of the Fortune 100.

# Andorra



Marc Ambrós Pujol


Pablo José Asensio Torres

Cases & Lacambra


## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Yes. Andorra is not a member of the European Union ("EU"). Accordingly, the freedom to provide financial services in the European Economic Area ("EEA") regime does not apply, and all financial activities carried out within the Principality of Andorra ("Andorra" or the "Jurisdiction") are subject to prior authorisation from the Andorran financial regulator "*Autoritat Financera Andorrana*" ("AFA" – previously the Andorran National Finance Institute "*Institut Nacional Andorrà de Finances*").

Under the laws of Andorra, all financial activities rendered inside the Jurisdiction can only be carried out directly, with the limitations and conditions set forth in the laws, by the local entities that compose the Andorran financial system, which are subject to exclusive supervision and to a reservation of activity regime accessible upon obtaining prior authorisation from the AFA.

The Andorran Act 10/2008, 12 June, governing collective investment schemes ("*Llei 10/2008, del 12 de juny, de regulació dels organismes d'inversió col·lectiva de dret andorrà*") (the "Funds Act") determines that all funds offered to the public, both Andorran and foreign funds, must be registered before the AFA prior to their marketing or commercialisation to investors.

The Funds Act establishes two main categories for Andorran funds: (i) OICVM ("*organismes d'inversió col·lectiva de valors mobiliaris*"), which are similar to UCITS; and (ii) other undertakings of collective investment schemes ("*Altres OIC*"), which include real estate UCIs ("*OIC immobiliaris*"), Alternative UCIs ("*OIC alternatius*") that in turn can be Common Alternative UCIs ("*OIC alternatius comuns*"), Alternative UCIs for qualified investors ("*OIC alternatius per a inversors qualificats*") and Other UCIs ("*Altres OIC*").

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

The registration process starts with a prior authorisation to be granted by the AFA. In this vein, a distinction needs to be made between Andorran funds and foreign funds.

In connection with Andorran funds, prior to their registration before the AFA, it is mandatory to carry out a procedure to obtain authorisation granted by such regulatory body. Nonetheless, the specific fund acquires the conditions of an undertaking of collective investment scheme upon its registration. The resolution of the administrative procedure for obtaining such prior authorisation must be resolved within 30 business days, either from the date of submission of its application before the AFA or the moment of completion of the required documentation. Upon obtaining prior authorisation, the registration procedure exclusively requires the submission from the fund management company, investment company and/or the fund's depositary of: (i) the deed of incorporation; and (ii) the definitive versions of the totality of the documents submitted concerning the prior authorisation procedure (overall: prospectus(es); agreement between the management company and depositary entity; technical dossier gathering specific characteristics of the fund and the investment programme; delegation and identification contracts for natural persons performing delegated functions; and distribution/sub-distribution agreements).

Concerning foreign funds, the application for registration must be submitted by a financial entity authorised to operate within the Andorran financial system ("*entitat operativa del sistema financer andorrà*") by the AFA under Act 7/2013, 9 May, on the regime for the operating entities in the Andorran financial system and other provisions which govern financial activities in Andorra (the "Financial Act"), and Act 8/2013, 9 May, on the organisational requirements and operating conditions of operating entities in the Andorran financial system, investor protection, market abuse and financial securities agreements (the "Financial Securities Act") as a local distributor of foreign funds.

Usually, such entity will be a local bank ("*entitat bancària*") acting as the distributor of units of the specific foreign fund on the basis of a distribution or sub-distribution agreement formalised with the foreign fund's management company. However, the following entities can also act as distributors of the foreign fund: (i) management companies of collective investment schemes established under Andorran laws; and (ii) other entities authorised to carry out this activity in Andorra. This last category refers to investment financial companies "*Societats Financeres d'Inversió*" ("SFI") and investment financial agencies "*Agències Financeres d'Inversió*" ("AFI") according to Andorran legislation and the criteria of the AFA. Consequently, as the aforementioned entities are authorised to perform the distribution of foreign collective investment schemes, they will also be authorised to perform marketing activities regarding the foreign fund.

The application must include the following documents, which may be submitted in Catalan, French, Spanish or English:

a) documents evidencing the authorisation of the foreign fund and evidence that it offers the same level of operational guarantees as Andorran funds to investors and, in particular, the fact that such operational guarantees are subject to an external and continuous control by a regulator (including a breakdown of the regulation to which it is subject to);
b) category of the fund;
c) prospectus(es);
d) identification of the durable medium where the net asset value of the fund can be checked;
e) documents evidencing that the local entity authorised to operate as a distributor is granted access to all the information that the managing company of the fund may apply for (e.g. annual audit, quarterly reports, etc.); and
f) description of envisaged modalities for the commercialisation of segregated account portfolios within Andorra.

The AFA will communicate its decision within 30 working days after the day of reception of the complete documentation. If approved, and after the payment of the application for registration fees (approximately €800 for Andorran funds and €2,000 plus €1,000 per sub-fund for foreign funds), the fund can be considered as registered.

The commercial documentation must comply with the Andorran general advertising principles (which is a responsibility that must be fulfilled by the entity authorised to operate as a local distributor). Specifically: advertising must be adjusted to the principles of truth, objectivity and not be misleading; services available to consumers must provide enough information about their main characteristics; advertising materials must not go against the dignity of individuals or constitutional rights/values; and advertising materials must not be disloyal (i.e. create unfair competition). The last point covers references in materials in which other products or services are undervalued or when comparisons are used and are not based on the essential characteristics of the products, or when the intention is to assimilate one product or service to the product or service of another company.

Moreover, the commercial documentation must comply with general rules on advertising arising from the fund's regulations.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

The consequences of failing to register a fund before the AFA are of a dual nature: (a) criminal sanctions, to the extent as stated in question 1.1, carrying out financial activities in Andorra requires obtaining prior authorisation from the AFA (i.e. applicable to entities other than Andorran operating entities); and (b) administrative sanctions, exclusively applicable to Andorran operating entities:

- criminal sanctions: (i) imprisonment of one to four years; and (ii) a fine of up to €150,000;
- administrative sanctions (on the relevant director or responsible individual of the entity other than an Andorran operating entity): (i) public reprimand in the Andorran official gazette ("*Butlletí Oficial del Principat d'Andorra*"); (ii) a fine of between one and five times the gross profit obtained as a result of the breach (if the breach is not measurable, a fine of €90,000 to €300,000); and (iii) the cancellation of the authorisation/licence; and
- administrative sanctions on individuals: (i) a public reprimand in the Andorran official journal; (ii) a fine of €60,000 to €90,000; and (iii) removal from their position and disqualification for up to five years from holding directorships in the entity or in other entities of the same nature.

Furthermore, other consequences of failing to register the fund would be the liability for the foreign entity and/or its directors/other individuals who knowingly participated in the offence, and that the resulting contract(s) may be held to be unenforceable.

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

In respect of a foreign fund distributed within Andorra, supervision must be carried out by the supervisory authority of the fund's home state. Such fund must at all times comply with the legislation in force within Andorra.

The Funds Act merely establishes that distribution of foreign fund shares requires: (a) prior registration before the AFA; (b) the register authorisation to be reflected in any and all document and marketing material of the foreign fund distributed in Andorra; and (c) the distribution of the foreign fund shares being carried out by a local entity authorised to operate as distributor.

Please note that Act 35/2018, 20 December, on solvency, liquidity and prudential supervision of banking entities and investment firms "*Llei 35/2018, del 20 de desembre, de solvència, liquiditat i supervisió prudencial d'entitats bancàries i empreses d'inversió*" entered into force on 25 January, 2019 (the "Prudential Supervision and Capital Requirements Act").

Overall, this piece of legislation aims to implement the legal regimes regulated by: Directive 2013/36/EU of the European Parliament and of the Council of 26 June, 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms ("CRDIV"); and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June, 2013 on prudential requirements for credit institutions and investment firms ("CRR"), and foresees and advocates for the integration of the AFA into colleges of supervisors in the interest of enhanced efficiency and soundness in carrying out the financial/prudential supervision of banking entities and investment firms.

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

Management companies, depositary entities and commercialising/distributing entities (authorised to operate within Andorra by the AFA) of the fund must comply with conduct of business rules of the financial sector in place within Andorra.

Specifically regarding governance requirements, requirements applicable to the aforementioned entities are: (i) the administration body shall adopt the form of a board of directors composed by, at least, three members; (ii) members of the board of directors, including individuals representing legal entities on such organisation, shall be persons of recognised commercial and professional honourability that must possess adequate knowledge and professional experience; (iii) the management body shall possess adequate collective knowledge, skills and experience to be able to understand the institution's activities, including the main risks involved; (iv) the elected chairman shall not be the general manager of the entity; and (v) the board of directors shall draft and approve a set of internal operating rules along with a corporate governance plan which favour compliance with legal obligations and promote responsibility of all of its members.

In short, please note that corporate governance requirements stated in CRDIV have been implemented into the Andorran regulatory framework by means of the Prudential Supervision and Capital Requirements Act, although the particulars and singularities of the Andorran financial sector/entities have been taken into account in this respect.

In addition, the fund and SICAV must reach the minimum amount stated in "iii. Capital structure" from the registration date before the AFA, as otherwise the specific fund shall be liquidated.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

The function of advising the fund can be performed by: (i) the management company of the fund incorporated under the laws of Andorra; and (ii) those Andorran financial entities authorised to carry out the financial service of provision of personal recommendations to a client, either upon its request or at the initiative of the operating entity, in respect of one or more transactions relating to financial instruments. In both scenarios, such entities must be authorised to operate within the Jurisdiction by the AFA.

**iii. Capital structure**

The initial estate of the fund cannot be less than €1.25 million. In case of a fund with legal personality and without management entity, the minimum estate of the fund is €300,000. Such amounts must be maintained during the time the fund is registered by the AFA.

On the date of incorporation, the fund and, if applicable, each of its sub-funds, shall have covered a minimum of 10% of the aforementioned minimum amounts.

Concerning real estate UCIs ("*OIC immobiliaris*"), the minimum initial estate is €6 million – which must be maintained at all times – and €2 million for each sub-fund.

**iv. Limits on portfolio investments**

Concerning Andorran funds, the Funds Act provides for generic limits on portfolio investments. Overall, such limits are:

(a) Andorran funds can neither invest more than 10% of its assets in transferable securities or money market instruments issued by the same issuer (20% at an entity group level), nor more than 20% of its assets in deposits held by the same entity. The total value of the transferable securities and money market instruments comprised in the portfolio which individually exceed 5% of its assets cannot exceed 40% of the portfolio total value;

(b) the risk exposure of the counterparty in an OTC derivatives transaction cannot be superior to 10% of its assets, when such counterparty is a banking entity whose registered address is located within the EU, Andorra or an OECD state;

(c) the first of the limits stated in (a) may be increased up to 35% or 25% when the investment is made on debentures issued by a banking entity whose registered address is located within the EU, Andorra or an OECD state, subject to special public surveillance to protect the debentures' holders. When an Andorran fund invests more than 5% of its assets on such debentures issued by a unique entity, the total value of such investment cannot exceed 80% of the total portfolio value; and

(d) Andorran funds may acquire units of an Andorran fund with a concentration limit of 20% of its total assets in units of a single fund ("*OICVM*") and 30% on other funds ("*Altres OIC*").

Moreover, there are certain restrictions to investments on Andorran funds. Overall, such prohibitions are:

(a) acquisition of precious metals and bullion certificates;

(b) acquisition of voting-right shares which allow the exercise of significant influence on an issuer's management;

(c) obtaining loans (except for back-to-back loans);

(d) granting loans, credits, guarantees, bonds or similar instruments to third parties;

(e) leveraging over 10% of its assets or its estate (for temporal loans) and 10% for investment companies (for loans granted to purchase real-estate goods essential to the continuation of their direct activities), with a cap for both percentages of 15%;

(f) acquisition of more than 10% of non-voting-right shares from an issuer;

(g) acquisition of more than 10% of debentures of the same issuer; and

(h) acquisition of more than 25% of units of an Andorran fund or other funds ("*Altres OIC*").

The limits stated in (d) to (h) above will not necessarily be met at the moment of the acquisition; it may not be possible to calculate the gross amount of the debentures, money market instruments or transferable securities at such time. Certain exemptions are available to the aforementioned limits under the Funds Act. Pursuant to Andorran funds ("*Altres OIC*"), specific limits on portfolio investments are foreseen.

In respect of foreign funds, limits on portfolio investments will be determined by the applicable home state's regulations.

**v. Conflicts of interest**

The Funds Act defines conflicts of interest ("*conflicte d'interès*") in case of misalignment between the interests of the investors in the funds and the interest of the management company and depositary entity in order to perform investment operations.

Specifically, the management company and depositary entity are subject to a duty of care in preventing the generation of conflicts of interest and, if they materialise, are obliged to offer solutions to investors to avert detrimental consequences to them.

Provisions of conflicts of interest stated in the Financial Securities Act are strengthened by the Prudential Supervision and Capital Requirements Act. Broadly, this upgraded framework states that operative entities of the Andorran financial system shall adopt adequate organisational and administrative measures to detect and avert conflicts of interest that may arise at the time of providing any investment service or ancillary service between the entity itself, its senior management, its personnel or the financial agents appointed by the entity as well as the entity's clients or between clients, which may harm the interests of one or more clients. Moreover, financial operative entities of the financial system shall: (a) establish in writing the policy and procedures as to avoid conflicts of interest; (b) pay close attention to any conflicts of interest arising in connection with members of the board of directors, which must refrain from acting in case of a potential conflict of interest; (c) carry out periodic analysis as to the suitability and effectiveness of their corporate governance plans and resolution of conflicts of interests; (d) produce an ethical code (or similar deontological code) covering conflicts of interest; and (e) make sure that their remuneration policies are in line with the business strategy, objectives, values and long-term interests of the institution and incorporates measures to avoid conflicts of interest.

**vi. Reporting and recordkeeping**

In connection with reporting, management or investment, companies must submit, for each of the Andorran funds under its management: (i) a complete prospectus; (ii) a simplified prospectus; and (iii) quarterly reports which gather aggregate information collected from the beginning of the year. The: (i) complete prospectus must be available to the investors before formalisation of the agreements; (ii) the simplified prospectus; and (iii) quarterly reports must be offered to investors in identical circumstances, and quarterly reports must also be available to the public in the locations set out in both prospectuses.

With regard to recordkeeping, there are no specific provisions in the Funds Act. Nonetheless, generic provisions provided for the Financial Securities Act are applicable. Thus, operative entities of the Andorran financial system shall establish a register that includes the document(s) which set out the agreement(s) between the specific entity and the client, and establish the rights and obligations of each of the parties as well as the other terms on which the entity provides the service to the client. The operative entities of the Andorran financial system shall keep a register of all the types of transactions and services which they undertake and, in all cases, at least a register of orders and a register of transactions. These registers shall be kept for at least five years from the date of receipt of the order or the execution of the transaction and, when the entity has made a communication of a suspicious transaction in matters of market abuse to the AFA, the corresponding registers shall be kept for at least five years from the date of that communication.

**vii. Other**

There are no other restrictions or requirements to be aware of.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

Investment advisers advising public funds must be authorised by the AFA to operate within the Jurisdiction, vesting the form of the entities provided for in the Financial Act.

Usually, such investment advisers shall be investment entities ("*entitats financeres d'inversió*") or management entities ("*societats gestores*").

The authorisation process is regulated by Act 35/2010 on the legal regime for authorising the creation of new operating entities within the Andorran financial system ("*Llei 35/2010, del 3 de juny, de règim d'autorització per a la creació de noves entitats operatives del sistema financer andorrà*") as amended by the Prudential Supervision and Capital Requirements Act.

This piece of legislation determines a common procedure for creating new Andorran operating entities. Overall, such procedure encompasses: (a) building up a deposit in favour of the AFA as proof of his adequate solvency and the seriousness of the application; and (b) submitting an application accompanied by certain documentation to obtain such authorisation. Once this documentation is submitted, the AFA will grant the definitive authorisation, which shall be published in the Official Gazette of the Principality of Andorra ("*Butlletí Oficial del Principat d'Andorra*"). After such authorisation, the specific entity has a maximum period of 12 months to initiate the activities stated in its social objectives.

The Prudential Supervision and Capital Requirements Act foresees an enhanced cooperation procedure between the AFA and other Andorran (e.g. Police departments and the Andorran Financial Intelligence Unit "*Unitat d'Intel·ligència Financera d'Andorra*") and foreign supervisory authorities.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

There are no other restrictions or requirements to be aware of.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

As of today's date, the Funds Act has not been amended to set up an express legal regime regulating investing in digital currencies. Please note that, in general terms, the Andorran FinTech sector is still at a very preliminary stage and, specifically concerning digital assets, no specific regulatory regime has been created so far.

Notwithstanding this, a Law proposal on virtual assets "*Proposició de llei dels actius virtuals*" is currently being discussed in the Andorran Parliament "*Consell Genera*". This legislative action is intended to set on foot a digital currencies regulatory architecture, to be complemented by further AFA action (i.e. Technical Communications "*Comunicats Tècnic*s" and progressive alignment with/implementation of EU regulations as stated in the Annex to the Monetary Agreement), with this authority acting as a single supervisory body.

Without prejudice to the above, please note that the requirements/restrictions placed for public funds investing in digital currencies would be those provided for other undertakings of collective investment schemes ("*Altres OIC*") under the Funds Act.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

The marketing of public Andorran and foreign funds within the Jurisdiction is regulated by the Funds Act, the Financial Act and the Financial Securities Act as amended by the Prudential Supervision and Capital Requirements Act, Technical Communication 163/05, 23 February, 2006, of the INAF in respect of rules for ethics and behaviour ("*Comunicat 163/05 del dia 23 de febrer de 2006, sobre normes ètiques i de conducta*") and Technical Communication 189/09, 27 July, 2009, of the INAF in respect of registration of foreign collective investment undertakings ("*Comunicat 189/09 de 27 de juliol de 2009, sobre inscripció dels OIC de dret estranger*").

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

All active marketing activities conducted within the Jurisdiction (by telephone, e-mail, mail or in person) in relation to Andorran or foreign funds may constitute active marketing activities and, as such, are subject to local licensing requirements (i.e. prior authorisation from the AFA).

Active marketing refers to any approach to potential clients, without their prior request, to provide them with sufficient information on the specific fund to decide whether to purchase them. According to the Funds Act, it is necessary to distinguish between: (a) the marketing of funds exclusively addressed to entities operating in the local financial market (e.g. banking entities acting for their own account); and (b) other entities which are not operating in the local financial market.

In the first case, marketing activities are not considered as a reserved activity under an express legal exemption and, therefore, its performance within the Jurisdiction shall not trigger licensing requirements. In the second case, the marketing of funds addressed to entities which are not operating in the local financial market is considered as a reserved activity and, consequently, it is necessary that these entities meet certain requirements to obtain the corresponding licence from the AFA (please see question 2.2).

The AFA defines active marketing of a collective investment scheme as attracting clients, by means of an advertising activity on the account of the collective investment scheme or any entity acting on its behalf or any of its distributor's behalf, for the contribution of assets, rights or obligations to the collective investment scheme.

Regarding commonly available exemptions (other than the express legal exemption referred to in (a) above): (i) the circulation of generic information to institutional investors (i.e. information which does not refer (directly or indirectly) to specific funds) or initial contact to gauge interest, which involves discreet one-to-one discussions with a limited number of institutional investors, is unlikely to constitute an active marketing activity; and (ii) although no express exemptions are available, approaches made to potential institutional investors based in Andorra on a genuine unsolicited basis (reverse solicitation scenario) should not trigger licensing requirements. However, any marketing materials distributed will make it more difficult to argue that the approach was genuinely unsolicited.

Since it is a reserved activity, the active marketing of funds within the Jurisdiction can only be carried out by legally authorised Andorran operating entities, authorised by the AFA to act as distributors of the funds.

The marketing prohibition does not apply if funds are distributed to investors located outside of Andorra. In this sense, marketing activities conducted in person by a foreign entity outside the Jurisdiction would be subject to the applicable law of the country where the activity is effectively performed.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

There are no regulatory restrictions nor requirements pursuant to distribution fees, which are usually agreed on a free basis between the management company of the funds and the local distributor (in case of foreign funds).

In respect of remuneration of: (a) a management entity; and (b) a depositary entity, it is worth noting that:

(a) the management entity is entitled to a management fee, subscription fee and reimbursement fee, which shall cover the costs inherent to the performance of its function. There are no specific restrictions on these fees; and

(b) the depositary entity is entitled to a depositary fee calculated on the basis of the average estate under custody or according to the sort of assets under custody.

The regulation and prospectuses of the fund must determine maximum percentages and/or amounts charged over the funds for these concepts, their calculation form and frequency of their liquidations.

**ii. Advertising**

Commercial documentation of the fund must comply with the Andorran general advertising principles, as this is a liability upon the Andorran operating entity which distributes the fund. Specifically:

- advertising must be adjusted to the principles of truth, objectivity and not be misleading;
- the services available to consumers must provide enough information about its main characteristics;
- advertising materials must not go against the dignity of individuals or constitutional rights/values; and
- advertising materials must not be disloyal (i.e. create unfair competition). This covers references in materials in which other products or services are undervalued or when comparisons are used and are not based on essential characteristics of the products, or when there is the intention to assimilate one product or service to the product or service of another company.

Moreover, the commercial documentation must comply with the general rules on advertising arising from the Funds Act.

**iii. Investor suitability**

The Monetary Agreement signed between Andorra and the EU in June 2011 (which came into effect on April 2012) establishes that MiFID regulations will apply within the Jurisdiction. Andorra has already implemented investor protection regulations aligned with MiFID. Consequently, the distinction between retail investors and professional investors under MiFID is relevant.

The Funds Act defines qualified investors as entities or individuals which have the abilities or means to evaluate rigorously and exhaustively the operating risks of financial instruments. They must have: (i) a written declaration of being a qualified investor; (ii) minimum investment of €50,000; and (iii) completed an assessment by the distributor of the fund regarding their knowledge, investment background and the acknowledgment of the risks that are present. However, a qualified investor according to the Funds Act could be considered a retail investor according to MiFID.

A retail investor according to MiFID is any individual or legal person other than a professional investor. A professional investor is a client who possesses the experience, knowledge and expertise to make its own investment decisions and to properly assess the risks that it incurs.

**iv. Custody of investor funds or securities**

Under the Funds Act, the management company and depositary entity must establish adequate mechanisms and procedures to guarantee that the disposal of assets of the fund is not made without its consent and authorisation.

Designation of the depositary entity is reflected by means of a contract entered into with the management entity. The provisions of such contract must comply with the content set out in article 68 of the Funds Act (*inter alia*, rights and obligations of both parties, functions and obligations of the depositary and depositary fees).

The management company and the depositary entity can share resources (excluding personal resources) as long as, on the one hand, the conditions for protecting investors are complied with and conflicts of interest situations are avoided and, on the other hand, an authorisation is requested from the AFA.

Sub-custody of assets of the fund may be entrusted to a third party or to a central securities depository located in Andorra or outside Andorra. The depositary entity must also ensure that the management company or the fund complies with all applicable laws, the regulation and prospectuses of the fund in connection with (a) the calculation procedures of the net value, issue price and reimbursement of units or shares of the fund, and (b) investment decisions of the fund and the outcome of the distribution of the fund. Furthermore, the depositary entity shall communicate to the AFA actions and procedures of the management company which are considered as adequate.

Under the Financial Securities Act, operative entities of the Andorran financial system, when holding the clients' assets at their disposal, shall adopt reasonable measures to protect the clients' rights over such financial instruments and funds entrusted to them, prevent their undue use and establish registers which allow each client's assets to be distinguished from their own. To do this, the clients' financial instruments and cash shall be deposited in an account or accounts apart from those in which the financial instruments and cash belonging to the entity itself are deposited, using accounts with different names in the accounting for third parties, or other measures equivalent by means of which the same level of protection for their clients' assets can be achieved.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

As stated in question 3.2, all active marketing activities conducted within the Jurisdiction (by telephone, e-mail, mail or in person) in relation to a fund may constitute active marketing activities and, as such, are subject to local licensing requirements.

Under the Funds Act, Andorran funds can be directly commercialised to the end investors in Andorra, and foreign funds that are actively commercialised under the Funds Act are commonly distributed through local licensed distributors (usually local banking entities, but also possibly investment financial companies ("*Societats Financeres d'Inversió*" ("SFI")) and investment financial agencies ("*Agències Financeres d'Inversió*" ("AFI"))) which hold the appropriate licence granted by the AFA.

If the distribution of the foreign fund does not imply active commercialisation but just intermediation or transmission of orders (including any order given in the context of a managed portfolio), although the provision of such activities will not trigger registering obligations in relation to the fund, they will also be subject to licensing requirements; thus, a local operating entity will be required.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

There are no other relevant main areas of regulation impacting on the marketing of public funds.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

Under the Funds Act, undertakings of collective investment schemes may vest the form of funds (without legal personality) or companies (SICAV – without a management entity) which are set up in accordance with Act 20/2007, 18 October, on public limited companies and limited liability companies ("*Llei 20/2007, del 18 d'octubre, de societats anònimes i de responsabilitat limitada*") in the typologies stated in question 1.1. In both cases, registration before the AFA is a validity condition for the incorporation as a fund.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

Broadly speaking, each of the entities referred to in question 4.1 is subject to corporate income tax at a rate of 0%. Allocation of profits to investors which are residents within Andorra benefits from an exemption under Andorran personal income tax legislation "*Llei 5/2014, del 24 d'abril, de l'impost sobre la renda de les persones físiques*". Moreover, allocation of profits to non-tax-resident investors is likewise covered by an exemption under Andorran non-resident income tax legislation "*Llei 94/2010, del 29 de desembre, de l'impost sobre la renda dels no-residents fiscals*".

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

The income corporate tax regime stated in the answer to question 4.2 is a special tax regime as provided for by Act 95/2010, 29 December, on corporate tax ("*Llei 95/2010, del 29 de desembre, de l'impost sobre societats*"). In general terms, the requirements to qualify for such special regime are (i) the acquisition of the conditions of the fund upon registration before the AFA, and (ii) once the fund has been incorporated, registration in the Andorran Department of Tax and Borders ("*Departament de Tributs i Fronteres*").


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Chapter 6

# Australia



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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Funds that are offered to retail clients will generally be required to be registered as a managed investment Fund under the *Corporations Act 2001* (*Cth*) (**Corporations Act**).

Most Australian Funds are trust structures, but partnerships, limited partnerships and investment contracts are also used, as well as stapled structures with combinations of trust and company structure investments held by each investor.

These structures are generally regulated as managed investment schemes (**MIS**) under the *Corporations Act and Corporations Regulations and Australian Securities and Investments Commission Act 2001* (**ASIC Act**), which are administered by the Australian Securities and Investments Commission (**ASIC**). MIS regulation includes:

- structural and operational requirements under Chapter 5C;
- advertising, market conduct, offering and issuing disclosure requirements under Chapter 7 and the ASIC Act;
- continuous disclosure requirements (Chapters 6 to 6CA and 7) and, for MIS listed on an exchange, takeovers and substantial holding regulation (Chapters 6); and
- Australian financial service licence (**AFSL**) requirements and regulation of dealers, advisers, Fund operators and market operators (Chapter 7).

A Fund will be a MIS if it is a scheme where:

- people contribute money or money's worth to acquire rights to benefits produced by the Fund;
- any of the contributions are pooled or used in common enterprise to produce financial benefits or property rights or interests for Fund members (as contributors or their transferees or assigns); and
- members do not have day-to-day control of the Fund's operation (even if they have a right to be consulted or to give directions).

Exceptions apply for Funds: (a) where all members and the operator are related bodies corporate; or (b) that have structural forms that are otherwise regulated, including bodies corporate, debentures and convertible notes, outsize partnerships (generally, professional partnerships, such as partnerships of accountants or lawyers) and Funds operated by Australian Depository Institutions (**ADIs**) (banks and other financial institutions) in the ordinary course of their banking business. ASIC also has power to grant exemptions or to modify the way that the MIS regulation applies.

If a Fund is a MIS then, unless all of the issues of interests in the Fund would not have needed a regulated product disclosure statement (**PDS**) under the Corporations Act (which is the case principally where the offers and issues are only to wholesale clients, not retail clients: see question 3.1 below), the Fund must be registered if: (a) it has more than 20 members (and when counting members there is: (i) a look through to the underlying members of trust investors where any beneficiaries of the investor trust are presently entitled to a share of the trust estate or income, or control the trustee; and (ii) aggregation across Funds as noted in (c) below); (b) it was promoted by a person or an associate of a person who, when the Fund was promoted was in the business of promoting MIS; or (c) ASIC has made a determination that the Fund is one of a group of closely related Funds that together have more than 20 members.

New regulation is proposed which would facilitate the use of corporate collective investment vehicles as an alternative to the current MIS and operate in a similar way to the regulation of MIS.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

To register a Fund, it must have:

(a) a public company responsible entity (**RE**) that is the sole operator of the Fund and an AFSL that authorises it to operate the Fund;

(b) unless at least 50% of the RE's board are external directors, a Fund Compliance Committee with at least 50% external members.

A director of the RE or member of a Compliance Committee is not external if that person is, or within the last two years has been, a senior manager or an employee of, substantially involved in a professional capacity or business dealings with, or has or is a relative or spouse of a person with a material interest in, the RE or a related body corporate;

(c) a name that is not the same as any other registered MIS;

(d) a Constitution that meets the requirements under the Corporations Act.

The Constitution must be enforceable and must contain "adequate provision" for specific matters, including:

- the consideration that is to be paid for any interest in the Fund;
- the Fund's investment and borrowing powers;

- if Fund members are to be able to withdraw from the Fund, the members' rights to withdraw. For illiquid Funds (those where at least 80% of the assets are not liquid – for instance, money, bank bills and marketable securities) a withdrawal procedure must be followed, as set out in the Corporations Act;
- the procedures the Fund's RE will have for handling complaints;
- winding up the Fund; and
- the RE's fees and indemnity payable out of the Fund property;

(e) a Compliance Plan that meets the requirements under the Corporations Act.

The Compliance Plan must set out what the RE will do to ensure that it complies with the Corporations Act and the Fund Constitution. Minimum requirements for the Compliance Plan include:

- ensuring Fund assets are separately identified and held;
- arrangements for a compliance committee, if one is needed (membership, when it meets, reports and recommendations to the RE, access to records and access to the Fund auditor);
- how often Fund property is valued;
- auditing the Plan; and
- record-keeping.

A registered company auditor must audit the RE's compliance with the Compliance Plan at least once a year. The Plan auditor and Fund auditor may not be the same person.

ASIC has power to require the RE to change and extend the Fund Compliance Plan and to call for information about the Plan.

Depending on its capital for the purposes of its AFSL requirements, the RE might also appoint a custodian to hold Fund property (see question 2.1, point (iii) below).

An application for registration of a Fund is to be made to ASIC by the RE in a prescribed form. The application is required to be lodged with: (a) a statement of compliance made by the directors of the RE; (b) the Fund's Constitution; and (c) the Fund's Compliance Plan. A Fund auditor and Compliance Plan auditor must be appointed and notified to ASIC.

ASIC must register the Fund within 14 days of the application being made, unless it appears to ASIC that the RE or lodged documents do not comply with the requirements of the Corporations Act.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

A Fund must not be operated if it is not registered when required. An application can be made by ASIC or an investor in the Fund to have it wound up if it has not been registered when required, and an investor may void their investment contract.

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

A registered Fund must be operated only by its RE.

As the RE must be a public company, it must have at least three directors and at least two of those directors must ordinarily reside in Australia.

If an offshore entity engages in Fund offerings in Australia, then the foreign operator may be conducting business in Australia. If that is the case, then it must be registered as a foreign company under the Corporations Act and a local agent must be appointed.

Certain concessional exemptions from AFSL, Fund registration and disclosure requirements apply for offering UK, US, Hong Kong, Singapore, NZ or Jersey Funds in Australia where the operator is registered as a foreign company in Australia, and makes certain required disclosures to investors and to ASIC.

The Asia Region Funds Passport provides a multilateral framework between participating countries in the Asian region to facilitate the cross-border marketing of passport Funds across participating regions. As at 1 March 2019, Japan, Thailand and Australia are ready to receive registration applications from local prospective passport Funds and entry applications from foreign passport Funds.

In order to register as a foreign passport Fund in Australia, the operator of the foreign passport Fund must:

1. register the Fund in its home economy;
2. register itself as a foreign company in Australia; and
3. notify ASIC of its intention to offer the foreign passport Fund in Australia.

Notification is made by submitting an ASIC form 5303 "Notify intention to offer interests in a foreign Passport Fund in Australia", attach a copy of the PDS and any consents required to use the proposed name.

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

Registered MIS are subject to a high degree of regulation for which ASIC is the regulatory authority and issues various regulatory guides.

As noted in section 1 above, a registered Fund must have a complying Constitution, a complying Compliance Plan, a public company operator RE, auditors of the Fund and Compliance Plan and, if at least 50% of the RE board are not external, a Fund Compliance Committee.

The Fund Constitution sets out the rules governing the operation of the Fund with which the RE must comply, and the Constitution must at least contain adequate provisions about particular matters as noted in section 1 above.

The Corporations Act regulates various actions in relation to the registered Fund, including amendment of the Fund Constitution, removal and replacement of the RE, meetings of Fund members, annual and half-year Fund accounts, winding the Fund up, withdrawal by members from the Fund and ongoing reporting and disclosure.

The Compliance Plan for the Fund must specify adequate measures that the RE is to apply to ensure that the Fund is operated in accordance with its Constitution and the Corporations Act.

The RE in exercising its powers and carrying out its duties from whatever source has several duties under the Corporations Act, including:

(a) general obligations to act honestly; exercise the degree of care and skill that a reasonable person would exercise if they were in the RE's position; act in the best interests of the members, and give priority to the members' interests if there is a conflict between the members' interests and the interests of the RE; treat members holding interests of the same class equally and those with different classes of interests fairly; and not to make use of information acquired by being the RE to gain an improper advantage for themselves or someone else or to cause detriment to the members;

(b) compliance obligations to ensure that the Fund Constitution and Compliance Plan meet the requirements of the Corporations Act; carry out its duties under the Fund Constitution; and comply with the Compliance Plan;

(c) obligations to separate, regularly value and preserve Fund property; and

(d) reporting breaches to the ASIC which had or are likely to have a materially adverse effect on the interests of Fund members. The reporting obligation also relates to breaches by the Compliance Committee, directors or employees of the RE, any auditor of the Compliance Plan or advisor and their representatives.

The RE can appoint agents and others but it is responsible to the Fund members for the appointees' acts, even if those acts are outside the scope of the appointee's authority.

The directors of the RE also have duties to the Fund members that override any conflicting duties to the members of the RE company. The directors must: act honestly; exercise the degree of care and skill that a reasonable person would exercise if they were in the officer's position; act in the best interests of the members, and give priority to the members' interests if there is a conflict between the members' interests and the interests of the RE; not make improper use of information or their position or to cause detriment to the members; and take all reasonable steps to ensure the RE complies with the Corporations Act, its licence conditions, the Fund Constitution and Compliance Plan.

If a director breaches these obligations, civil penalties apply so that the Court may order that the employee pay compensation where the contravention caused loss or damage to, or diminution in value of, the Fund property.

Employees of the RE have similar duties.

The Compliance Committee is appointed by the RE and is to monitor the extent of compliance by the RE with the Fund Compliance Plan, report to the RE about breaches of the Corporations Act or Fund Constitution, and report to ASIC if the Committee is of the view that the RE is not taking appropriate action to deal with any matter that the Committee has reported. The Committee must also assess the adequacy of the Compliance Plan at regular intervals and report to the RE any changes that the Committee considers should be made. Requested changes must also be reported to ASIC where they amount to a breach of the Corporations Act. The Committee has the authority to commission independent legal, accounting and professional advice or assistance at the reasonable expense of the RE and must also assist ASIC where ASIC conducts surveillance checks of the RE's compliance with the Constitution, the Compliance Plan and the Corporations Act.

A Compliance Plan auditor must be appointed by the RE. The auditor conducts an annual audit of compliance with the Compliance Plan, and provides a report to the RE (which the RE lodges with ASIC with its annual financial statements) and, in circumstances of continuing non-compliance, to ASIC.

Further authorisation or registration requirements may apply to certain types of Funds. For example, conditions apply under an RE's AFSL where the RE operates a primary production scheme. A Fund structured as a limited partnership must also be registered under the relevant State Partnership legislation. Moreover, Funds listed on the Australian Securities Exchange (**ASX**) must comply with the ASX Listing Rules and are under the regulation of the ASX as well as ASIC.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

There are no specified requirements for the selection of Fund investment advisers; however, general duties of the RE (see question 2.1(i) above) affect the selection, review and approval of investment advisers, and particular types of Funds (for instance, superannuation Funds and certain government Funds) have particular requirements for the appointment of advisers.

**iii. Capital structure**

There are no capital structure requirements for a Fund. However, the RE operating the Fund must meet the capital requirements of its AFSL. AFSL conditions generally require the RE to be solvent with positive net assets, project and meet at least 12 months' cash-flow requirements for Fund operation, have professional indemnity insurance and maintain a required level of net tangible assets (**NTA**). The required NTA where Fund assets are held by a custodian that meets the financial requirements is cash or cash equivalents valued at least the greater of: (a) A$150,000; (b) 0.5% of the average Funds value; or (c) 10% of average RE revenue. The required NTA where Fund assets are not held by a custodian that meets the financial requirements is at least the greater of: (a) A$10 million; or (b) 10% of the RE's average revenue.

**iv. Limits on portfolio investments**

There are no limits on Fund portfolio investments, but the holding must be permitted by the Fund's Constitution. It is typical to include broad investment powers in the Constitution.

It should be noted that certain investors may have restrictions on investment in Funds with derivative or leverage exposure, and the nature of Fund investments can affect whether the Fund is categorised as "liquid" under the Corporations Act. If a registered Fund is not liquid then: (a) investor withdrawal from the Fund is restricted to *ad hoc* withdrawal offers from identified Fund sources; and (b) it is not a "simple managed investment scheme" and therefore a short-form PDS may not be used for Fund offers.

**v. Conflicts of interest**

The RE has a duty to act in the best interests of the Fund members and not its own interest (see question 2.1, point (i) above).

Strict restrictions apply to related party dealings by a registered Fund RE. Any related party dealing either from or which may endanger Fund property is not permitted unless it is at arm's length or less favourable (to the related party) terms or has the prior approval, in a meeting, of the Fund investors. In addition, under general law, a related party dealing is not permitted unless it is clearly authorised by the Fund Constitution.

Advisers are subject to a duty to act in the best interest of their client and limits on conflicted remuneration (see question 2.3 below).

Market conduct restrictions such as short-selling restrictions, insider trading and market manipulation prohibitions also affect the operations of the Fund RE and managers.

**vi. Reporting and recordkeeping**

In addition to the offer disclosure requirements referred to in section 3 below, ongoing and periodic reporting obligations apply for registered Funds.

The RE of a registered Fund must:

(a) give an investor confirmation of transactions about their investing and withdrawals, and a balance, value and transaction report for each reporting period (of up to one year);

(b) inform members or publish a notice of any material change or significant event in relation to the Fund, and comply with the continuous disclosure obligations where the Fund is a "disclosing entity" (generally, where there are at least 100 members or the Fund is listed); and

(c) file reports with ASIC in respect of the Fund, including: reports of significant breaches; annual audit reports for the Fund, the RE, the RE's AFSL and the Fund Compliance Plan; notice of any change of officers and "responsible managers" and "key persons", if any, noted on the RE's AFSL; an "in use" and "out of use" notice in relation to a PDS (as noted in section 3 below); and any other information requested by ASIC.

REs must also file certain reports with AUSTRAC/ATO for the purpose of anti-money laundering and counter terrorism, including suspicious matter reports.

**vii. Other**

Privacy, anti-money laundering and taxation (including income and capital gains tax, goods and services tax (**GST**) and stamp duty) legislation apply.

In addition to legislation and general law, listed Funds must comply with the Listing Rules. General trust law is particularly relevant for registered Funds as the Corporations Act provides that Fund property is held on trust for the Fund members and therefore registered Funds always involve at least a statutory trust.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

Anyone who carries on a financial services business in Australia is usually required to hold an AFSL that is issued by ASIC under the Corporations Act.

A "financial services business" is a business of any of the following in relation to financial products:

(a) dealing – issuing, applying for, acquiring, varying or disposing of a financial product or arranging for such conduct. Self-dealing exceptions apply for some types of products;

(b) providing financial product advice – making a recommendation or statement of opinion or a report that is, or could reasonably be regarded as, intended to influence a person's decision about a financial product. Providing purely factual information is not advice. Advice is separated into general advice and personal advice. Personal advice is given when the recipient's objectives, financial situation or needs have been taken into account or a reasonable person might expect that to have been the case. All other advice is general advice. If personal advice is given to retail clients, then advisers must meet additional requirements;

(c) making a market – through a facility or at a place or otherwise, the person regularly states prices at which they propose to acquire or dispose of products on their own behalf and a person has a reasonable expectation that they will be able to regularly effect transactions at the stated prices. This is distinguished from operating a market (for which an authority is required) by the person accepting on their own behalf or on behalf of only one party to the transaction;

(d) operating a registered MIS; or

(e) providing a custodial or depositary service – an arrangement under which a product is held in trust for or on behalf of the client or the client's nominee.

Various exceptions from the requirement to hold an AFSL apply. For instance, conditional exemptions apply to some advisers and dealers (referred to as foreign financial service providers or FFSPs) with certain UK, US, Singapore, Hong Kong, German or Luxembourg local licences where their activities in Australia are confined to wholesale clients and they lodge various complying documents with ASIC and meet ongoing disclosure requirements both to their Australian wholesale clients and to ASIC. However, these exceptions have been under review and are due to expire in their current form, possibly as early as September 2019. It is unclear whether, or in what form, they may continue. It is possible that the current exemption will be replaced with a requirement for the FFSP to apply for a limited AFSL.

To obtain a regular AFSL, the proposed holder must meet capital adequacy, operational, education and experience requirements. An application must be made to ASIC, nominating responsible managers with required education and practical skills. The application must be lodged with a police check and bankruptcy check for nominated responsible managers and various proofs that establish the operational competencies of the applicant to provide the financial services sought to be authorised.

If an AFSL is granted, the holder has obligations, under the Corporations Act, requiring them to: operate their business efficiently, honestly and fairly; maintain the organisational competence; ensure their representatives comply, are competent and adequately trained; have adequate financial, technological and human resources to provide the financial services; maintain risk, conflict management, dispute resolution and compensation systems and arrangements for retail clients; and comply with the financial services laws and their AFSL.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

In addition to the restrictions associated with an AFSL holder's licence, restrictions apply to the conduct of advisers in marketing Funds as mentioned in section 3 below.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

There are no statutory or regulatory requirements or restrictions for Funds to invest in digital currencies.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

Marketing materials for Funds are regulated by the Corporations Act and the ASIC Act. In addition, requirements and restrictions under general law may also apply.

A PDS is required to be given to a retail client before they can be offered or issued an interest in a Fund that is a financial product, such as a MIS interest.

An investor is a retail client if they are not a wholesale client. Whether an investor is a wholesale client for this purpose depends on the amount that they invest in the Fund, the amount of money that the investor controls or the type of investor body. For instance, an entity is a wholesale client, and therefore not a retail client, if:

(a) the price or value of the Fund interests to be acquired is at least A$500,000 (excluding amounts borrowed from the Fund offeror or the offeror's associate);

(b) the Fund investment is provided for use in conjunction with a business that is not a small business (less than 100 employees for a goods manufacturing business, and otherwise, 20 employees);

(c) the investor provides a qualified accountant's certificate given within the preceding 24 months that the person had net assets of at least A$2.5 million or gross income for each of the last two years of at least A$250,000;

(d) the investor holds an AFSL, is a body regulated by the Australian Prudential Regulation Authority (**APRA**) (for instance, a bank), is registered under the Financial Corporations Act, is an exempt public authority or is a listed entity or one of the listed entity's related bodies corporate;

(e) the investor controls A$10 million or more or is the trustee of certain superannuation Funds where the Fund has net assets of at least A$10 million; or

(f) the investor is a body that carries on the business of investing in financial products, interests in land or other investments, and invests Funds raised from the public on terms which provide for use of the Funds raised for that purpose.

A PDS must be up to date and "clear, concise and effective" and must contain prescribed statements and disclose the following about the Fund: significant benefits and risks; costs, fees and charges; details about dispute resolution; significant taxation implications; details of payments that may affect returns; in some cases, information about the availability of accounts; and whether ethical considerations are taken into account in investing.

Elements of these requirements contain prescriptive details of the information to be disclosed and how it is to be disclosed.

A short-form PDS may be used if the Fund is both, a "simple managed investment scheme", i.e. one where the RE can reasonably expect to realise 80% of the Fund assets for market value within 10 days – and not classified as a hedge Fund in accordance with ASIC regulatory Guide 240 (or otherwise subject to particular benchmark disclosure by ASIC). A short-form PDS for a simple MIS must be no longer than eight pages and contain specified information about the RE, how the Fund works, benefits and risks, the Fund investments, fees and costs, tax and how to apply.

The application form for investment must be in, or accompany, the PDS.

A PDS is only lodged with ASIC if the Fund interests are to be tradeable on a financial market (such as the ASX). Otherwise, ASIC must be given an "in use" notice in a prescribed form within five business days after a PDS is first given and an "out of use" notice within five business days after the PDS ceases to be used.

For PDSs that are lodged with ASIC, there is an exposure period (of seven days after lodgement, subject to an extension by ASIC of up to 14 days) during which investments cannot be issued or sold.

In addition to the regulated disclosure document requirements referred to above, all financial products are subject to prohibitions under the Corporations Act, ASIC Act and general law against dishonest, misleading, deceptive and unconscionable conduct.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

An AFSL is generally required to be held by an entity that engages in marketing of Fund interests and thereby provides financial advice or deals in the financial product (see question 2.2 above). There are numerous exceptions to licensing requirements for particular circumstances – for instance, where advice is only provided to a related body or for certain offshore licensees who lodge various deeds and documents with ASIC and whose Australian clients are all wholesale clients, or where a Fund issues interests under an arrangement with an AFSL holding intermediary which offers to arrange for the issue on the terms of the offers.

A person providing services on behalf of an AFSL holder does not need their own AFSL, but must be appointed in writing as an authorised representative by the AFSL holder and the appointment notified to ASIC.

AFSL holders must comply with the financial and other conditions under their AFSL and general conduct conditions in the Corporations Act (see question 2.2 above).

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

Investment advisers may not be given or receive certain types of conflicted remuneration for retail client investments. Conflicted remuneration is any benefit, whether monetary or non-monetary, that, because of the nature of the benefit or the circumstances in which it is given: (a) could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients; or (b) could reasonably be expected to influence the financial product advice given to retail clients.

**ii. Advertising**

Advertising restrictions apply so the potential investors are aware of the Fund PDS and that they should consider the PDS before deciding whether to invest. Cold calling and anti-hawking restrictions regulate the way in which advertising and PDS material can be distributed.

Further, there are limited circumstances in which a Fund that needs to be registered as a MIS can be referred to prior to such registration.

**iii. Investor suitability**

There are currently no prescriptive investor suitability requirements for types of Funds that may be offered. However, care must be taken to ensure that there is no unconscionable or misleading or deceptive conduct in marketing Funds and that disclosure is clear, concise and effective for investors.

There is currently draft legislation being considered by the Australian government to introduce new rules that apply to the design and distribution of certain financial products: *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* (**DDO and PIP Proposals**).

Under the DDO and PIP Proposals, product issuers (or sellers) would be required to prepare a written "target market determination" that, among other things, describes the class of retail clients that comprises the target market for the product (the target market) and specifies any conditions and restrictions on retail product distribution conduct. The DDO and PIP Proposals also gives ASIC new powers to ban certain products being marketed to retail clients.

**iv. Custody of investor funds or securities**

A custodian separate to the Fund RE is not required, but because capital adequacy requirements apply under the RE's AFSL if it holds certain Fund assets, it is usual to appoint a custodian of registered Fund assets (see question 2.1, point (iii) above).

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

Unregistered Funds may not be marketed to retail clients. They can only be marketed or sold to wholesale clients. Otherwise, there are currently no restrictions on to whom a Fund may be marketed or sold. The DDO and PIP Proposals (noted above at question 3.3, point (iii)) would impose additional requirements and restrictions on Funds being marketed to retail clients.

Care must also be taken to ensure that there is no unconscionable or misleading or deceptive conduct in marketing Funds and that disclosure is clear, concise and effective for investors.

Advisers providing personal advice must take care to ensure that the selection of the Fund for investment takes into account the financial circumstances, needs and objectives of the client and whether a Fund could meet those circumstances, needs and objectives.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

ASIC imposes requirements in respect of some Funds through conditions in the RE's AFSL. For instance, conditions are imposed pertaining to registration of real property interests that form the basis of primary production schemes.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

As mentioned in section 1 above, in Australia, most retail Funds are trusts. Trusts are defined as entities for tax purposes but are generally established and managed so that tax is paid by the investors, not the trust. This requires care in drafting the Fund Constitution and in managing the Fund accounts and distributions.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

**Fund**

Unit trusts are generally taxable on a flow-through basis, provided that the trustee (i.e. RE) distributes all trust income for each tax year. This treatment is not available if the RE carries on active business activities such that the trust is a trading trust as defined in the taxation legislation. Trading trusts are taxed as companies and taxed at the trading trust level.

Trusts whose activities constitute an "eligible investment business" are not trading trusts and may be taxed on a flow-through basis with the investors paying the tax. Activities such as investing in land for the purpose of deriving rent and investing or trading in various debt and equity securities and derivatives are generally considered to be eligible investment business.

Unlisted trusts which have less than 50 members are generally not considered to be public trusts and may be taxed on a flow-through basis even though they carry on a business other than an eligible investment business. The legislation also looks to the type of member so, for example, a trust in which one or more of certain types of tax-exempt entities hold more than 20% of the units would not pass this test, even if it had less than 50 members.

In some cases, securities in different entities are stapled; for example, with one entity carrying on an eligible investment business, such as holding land and leasing it to the other entity which carries on an active trading business (such as managing a toll road or a hotel). The entity carrying on the active business will be taxed as a company, either because it is a public trading trust or because it is a company. It is necessary to ensure an adequate split of profit between the entities, and in many cases, a tax ruling is obtained to confirm that the arrangements are acceptable to the Commissioner of Taxation. In March 2017, the Commonwealth Treasury released a consultation paper as part of its current review of the taxation treatment of stapled structures. Legislation was introduced on 20 September 2018 to deal with a number of issues relating to foreign investors including investors in MITs. It is proposed to tax certain MIT distributions at 30% where the underlying income is non-concessional MIT income as defined. This would include income received from a cross-stapled entity to the extent it includes trading income of that entity. The legislation is intended to be effective from 1 July 2019. However, it is subject to grandfathering provisions designed to extend the effective date for investments acquired before 27 March 2018 to 1 July 2026 (or later in some cases).

If the trust qualifies as a Managed Investment Trust (**MIT**), it may be able to make a capital account election and have its gains and losses treated on capital account.

MIT status requires satisfaction of a number of conditions, including conditions relating to the Australian residence of the trust and management of the trust's activities, its status under the Corporations Act provisions dealing with MIS and the spread of ownership of direct and indirect interests in the trust.

Certain MITs may elect to be treated as "Attribution MITs" or "AMITs" for Australian income tax purposes and if so, a separate taxation regime will apply. Under this regime (known as the **AMIT regime**), receipts and the character of those receipts are attributed to the members of the MIT and thereby aligning the commercial and tax consequences of the activities of the MIT and providing flow-through of income and tax offset amounts with particular characteristics to the members of the MIT.

Australia has an Investment Manager regime which seeks to ensure foreign Funds and their members are not disadvantaged by engaging Australian-based service providers and managers. Under these provisions, certain returns, gains, losses and deductions of widely held foreign Funds are disregarded where: (a) the returns or gains would otherwise be assessable income of the Fund only because they are attributable to a permanent establishment in Australia; and (b) that permanent establishment arises solely from the use of an Australian-based agent, manager or service provider. The main types of gains covered by these rules are Australian-sourced capital gains (other than gains related to interests in land and other limited cases) and foreign-sourced income and gains. There are proposals to extend this concession.

The Commonwealth Government has recently released exposure draft legislation as part of a consultation process for the introduction of two new collective investment vehicles (**CIV**) which are intended to be more internationally recognisable to foreign investors. These vehicles are: (1) a company (or corporate collective investment vehicle (**CCIV**)); and (2) a limited partnership, which in both instances meet certain legal and regulatory requirements.

The taxation treatment proposed for CIVs and CCIVs will broadly align with the AMIT regime which is a "character-flow through" model of taxation. Further exposure draft CCIV legislation was introduced on 17 January 2019 and consultations continued until 28 February 2019.

Australia has various systems of accruals rules. The Taxation of Financial Arrangements (**TOFA**) regime is mandatory for financial arrangements where the value of trust assets exceeds A$100 million. In addition, an election may be made for these rules to apply where the assets are valued at less than A$100 million. Transactions which are not covered by the TOFA regime may be taxed on an accruals basis where they have an eligible return; for example, a zero coupon bond where the income is deferred until the repayment date. Also, accruals rules may apply to some foreign investments made by Funds.

**Goods and Services Tax**

There are rules concerning the treatment of financial supplies which mean that Funds cannot fully recoup GST paid in relation to some financial supplies. Under regulations which commenced on 1 July 2012, trusts making financial supplies will receive reduced input tax credits (**RITC**) of 55%; in the case of supplies and in certain specified cases (for example, custodial services), an RITC of 75% of the GST paid.

**Position of Resident Investors**

The taxable income of the Fund is usually taxed to the investors in proportion to the distributions they receive. If the Fund has deductions or allowances that reduce its taxable income below its accounting income, then in some cases the amount distributed may exceed the amount of taxable income. This excess is commonly called a "tax-free" or "tax-deferred" distribution. Any such distribution will reduce the cost base of the units in the unit trust in the hands of the investors for capital gains tax purposes. Once the cost base in their units reaches zero, further tax-free distributions are taxed as capital gains in the hands of the investor.

It is also possible that the amount of taxable income attributable to an investor will exceed the actual cash distribution, although Funds usually seek to avoid this outcome.

Capital gains made by the trust may be passed through to investors and will retain that character in the hands of the investor and (if the trust has held the relevant asset for at least 12 months) may be eligible for discount capital gains tax treatment, depending on the type of entity the investor is (i.e. a 50% capital gains tax discount applies to an investor who is an individual, while a discount of 33.33% applies to a complying superannuation entity). The capital gains tax discount applies only to residents.

Resident investors are usually taxable on capital gains and capital losses made on disposal of their units. Such capital gains usually qualify for discount capital gains treatment for the units held by a natural person, superannuation Fund or trust for a period of 12 months or more.

**Position of Non-Resident Investors**

If the Fund qualifies as an MIT, non-resident investors will generally be taxed on distributions to them by way of a final withholding tax of 15%, provided they are resident in a country with a tax information exchange agreement with Australia. Distributions of non-concessional MIT income attract 30% withholding. Non-concessional MIT income includes income from residential property, from trading businesses, from agriculture and from cross-stapled entities.

Distributions of interest, royalties and dividends will be not be taxed at 15% but at their normal withholding rates – 10% in the case of interest and 0% in the case of franked dividends. If dividends are not franked under the dividend imputation rules, then normal dividend withholding tax rates will apply. These rates vary from 0% to 30% depending on the terms of any applicable treaty. Royalties are generally taxed at between 10% and 30%.

The tax position of gains and losses made by non-resident investors on disposal of their units varies depending on the nature of their investment.

If the non-resident investor holds their units on capital account, they are generally not taxed. However, if the Fund is land-rich (i.e. real property, including mining leases, exceeds 50% of the value of the Fund) and the investor holds more than 10% of the Fund, then they may be subject to Australian capital gains tax on any gains made on disposal of their units. Also, units held by a non-resident investor that are used in carrying on a business through a permanent establishment of the investor in Australia will be subject to capital gains tax on any gain made on their disposal.

Investments on revenue account, for example, investments made by a Fund for the purposes of short-term gain or as part of business activities, will be taxable in Australia, but subject to the operation of relevant tax treaties.

**4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?**

See question 4.2 above regarding MITs, AMITs and CIVs (subject to them being legislated).


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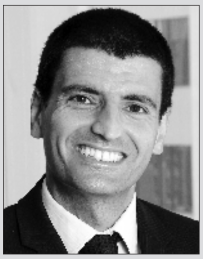


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# Brazil

Sérgio Machado

André Mileski

Lefosse Advogados

## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Yes. As a rule, Brazilian-formed investment funds are required to be registered with the local securities commission (Comissão de Valores Mobiliários – CVM), regardless of their quotas being subject to a private or public offering. The rules and requirements for registration of investment funds are set forth by the CVM and are generally determined based on the type of investment funds, target investors and type of public offerings.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

The registration of public funds in Brazil requires the prior registration with the CVM through the filing of a minimum set of documents, which is made by the fiduciary administrator through the CVM's website, such as the: (i) fund's bylaws and evidence of its registration with the registry of deeds and documents; (ii) enrolment of the fund with the Federal Revenue Office taxpayer's register; (iii) statements of the fund's fiduciary administrator attesting the compliance of the fund's bylaws with the applicable regulations, as well as the execution of certain required agreements (i.e., portfolio management agreement, bookkeeping of quotas, distribution and custody, etc.); and (iv) name of the independent accounting firm responsible for auditing the fund's financial statements, among others.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

Under the applicable laws, the distribution of quotas of investment funds not registered with the CVM is classified as a serious infraction (*infração grave*), being subject to the following penalties:

(i) warning;

(ii) financial penalty;

(iii) temporary disqualification, up to a maximum period of 20 years, for exercising duties of director or member of the audit committee of listed companies, entities which are part of the securities distribution system, or other entities that depend on authorisation or registration with the CVM;

(iv) suspension of the authorisation or registration to perform activities related to capital markets;

(v) temporary disqualification, for a maximum period of 20 years, to perform activities related to capital markets;

(vi) temporary prohibition, for a maximum of 20 years, from performing certain activities or transactions for entities that are part of the securities distribution system or other entities that depend on authorisation or registration with the CVM; and/or

(vii) temporary prohibition, for a maximum period of 10 years, to directly or indirectly perform in one or more types of transactions in the securities market.

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

Foreign-formed investment funds are not admitted to registration in Brazil, nor their interests may be publicly offered in Brazil.

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

Investment funds in Brazil are structured as unincorporated pool of assets (*condomínios*), with the investors participating in the fund through the acquisition of quotas, each of which corresponds to a notional fraction of all assets held by the relevant fund. Brazilian-formed funds do not have corporate veil protection and are not incorporated as legal entities (i.e., companies, partnerships or trusts), but can assume duties and obligations towards third parties, as well as sue and be sued. As a consequence of not having corporate veil protection, and of being an unincorporated pool of assets, local investment funds are not considered separate and independent legal entities from their investors and therefore do not confer limited liability to them.

Brazilian investment funds may be formed as closed-ended or open-ended funds. In closed-ended funds the quotas cannot be redeemed prior to its liquidation, with distributions to quota holders being made through the amortisation of quotas, generally approved by the fiduciary administrator or the investment manager. Quotas of closed-ended funds may be subject to secondary negotiation among the quota holders. On the other hand, open-ended funds allow their investors to redeem their quotas at any time, regardless of the fund's liquidation, but prohibit the secondary transfer of quotas (except in case of judicial order, universal succession, collateral foreclosure, fiduciary assignment, etc.)

The principal document of an investment fund is the bylaws, registered by the fiduciary administrator, which contains the description of the investment policy, term, target investors, service providers, characteristics of the quotas and distributions to quota holders, fees, governance and quota holders meetings, among others. The fiduciary administrator is the primary responsible for the fund and is subject to the terms and conditions set forth in the bylaws, also being responsible for the engagement and supervision of any of the fund's service providers, such as the investment manager, custodian and distributor, as applicable.

The investment decisions in public funds are generally taken by the investment manager, subject to the investment policy set forth in the bylaws.

The investors participate in local formed funds through the quota holders meetings, responsible, under the terms of the regulations, for resolving on certain matters, such as: (i) approval of the fund's financial statements; (ii) replacement of the fiduciary administrator, investment manager and/or custodian; (iii) merger, spin-off or transformation of the fund; (iv) increase of the fund's fees; (v) changes to the fund's investment policy; (vi) for closed-ended funds, issuance of new quotas; (vii) amortisation or redemption of quotas in the absence of specific language in the bylaws; and (viii) amendment to the bylaws. Additional matters subject to resolution by the quota holders meetings may be included in the bylaws.

Local investment funds may also have investment or technical committees or boards, formed by members appointed by the administrator, investment manager or quota holders, pursuant to the terms of the fund's bylaws. The existence of committees or boards does not exempt the fiduciary administrator and the investment manager of their obligations in respect to the operations and management of the fund's portfolio.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

The fiduciary administrator is responsible for selecting and engaging the fund's service providers, including the investment manager, which shall be duly authorised by the CVM for the exercising of investment management activities (see question 2.2). The engagement of the investment manager is formalised through an investment management agreement, privately negotiated and executed by the parties (fiduciary administrator, investment manager and the fund). Such agreement is not filed with the CVM nor made available to the public in general, but may be at any time requested for analysis and consultation by the CVM.

**iii. Capital structure**

Brazilian law does not provide for capital structure rules to public funds in Brazil. The general rule is that all the quota holders, participating in the fund with a fraction of its assets, must be treated equally, holding the same rights and obligations.

**iv. Limits on portfolio investments**

In general, the limits on portfolio investments made by public funds in Brazil are determined by two main factors: (i) the type of public investment fund (if an equity fund, fixed-income fund, foreign exchange fund, or multimarket fund, among other additional classifications); and (ii) the level of sophistication of the fund's investors.

The CVM regulations establish certain rules in respect to the types of assets that may be purchased and traded by public funds, as well as concentration limits in respect of (a) the issuer of each of the assets, (b) type of financial assets, and (c) offshore investments.

The rational is that, subject to the limitations imposed to each of the specific types of public funds, the more sophisticated the investor, the more flexible the public fund's investment policy in relation to the types of assets and concentration limits. Thus, public funds targeted to qualified and/or professional investors (see question 2.1 (vii) below) require higher investment standards from such investors (and entail higher risk exposure) than those targeted to retail investors.

**v. Conflicts of interest**

The CVM regulations contain certain rules applicable to the fiduciary administrator, investment manager and distributors in relation to conflict of interest. As a general rule, service providers (and any members of the fund's committee or advisory board, if applicable) must disclose situations involving potential conflict of interest, as well as the policies and procedures for mitigating such situations.

The fiduciary administrator and investment manager are required to prepare and adopt rules and policies in relation to compliance, risk management, internal controls, and ethics code, among others.

The fiduciary administrator and the investment manager are also subject to specific segregation rules imposed by the CVM regulations, which usually involve physical and information segregations, as well as the appointment of different officers responsible for the investment management, risk management and compliance.

**vi. Reporting and recordkeeping**

The fiduciary administrator has the primary responsibility for reporting and recordkeeping the fund's information, including information about the value of the fund's quotas, fund's portfolio, performance and material facts, among other information. Most of the information is made available not only to the quota holders, but to the CVM and the public in general (available in the CVM's website).

The local regulations determine that the fiduciary administrator keeps certain documents for a minimum period of five years, such as accession instruments executed by the quota holders, any communications exchanged by the fiduciary administrator and the quota holders, executed agreements and auditing reports, among others.

**vii. Other**

The CVM regulations classify the investors into three categories, as follows: (i) retail (non-sophisticated investors); (ii) qualified investors; and (iii) professional investors. This classification is relevant for purposes of determining the public funds' investment policies (see question 2.1 (iv) above).

There is no specific definition for retail investors, meaning that retail investors are those that do not fall under the categories of qualified or professional investors.

The definition of professional investors comprises financial institutions, insurance companies, pension funds, individuals and corporations, that hold financial investments in an amount of, at least, R$10 million, investment funds, investment clubs managed by authorised investment managers, fiduciary administrators, investment managers, securities advisors and non-resident investors.

On the other hand, qualified investors are those individuals or companies that hold financial investments in an amount of, at least, R$1 million, investment clubs managed by quota holders classified as qualified investors, as well as natural persons certified by entities accredited by the CVM.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

Yes. The administration and investment management of investment funds in Brazil are regulated activities, being subject to registration with the CVM. The registration request can be required in one or both of the following categories:

(i) Fiduciary administrator (*administrador fiduciário*), responsible for the operation and maintenance of the securities portfolio, which are responsible for, among others: (a) legally forming investment funds under its administration and registering them with the Federal Revenue Office and CVM; (b) hiring investment providers which are legally required for the operation of securities portfolios and/or investment funds (i.e., portfolio managers, custodians, bookkeeping agents, etc.); and (c) treasury, accounting, custody of assets and other back-office activities.

(ii) Investment manager (*gestor*), responsible for the investment decisions (including purchase and sale) of the securities portfolios and/or investment funds, and/or for securities consulting services in respect to investments and divestments in securities.

Note that both the fiduciary administrator and the investment manager must be necessarily headquartered in Brazil and are subject to minimum infrastructure and disclosure requirements (filing and annual update of a reference form with information on asset under management, infrastructure, remuneration, internal policies, etc.). Additionally, both the fiduciary administrator and the investment manager are required to, at least, appoint an officer responsible for the asset management activities (who is also required to be registered with the CVM as an individual asset manager), and an officer responsible for compliance and risk management and anti-money laundering.

In addition to the registration with the CVM, it is a local market standard that an asset manager is also registered with the Brazilian Financial and Capital Markets Entities Association (Associação Brasileira das Entidades dos Mercados Financeiros e de Capitais – ANBIMA) in order to perform asset management activities. Broadly speaking, the registration with ANBIMA may be formalised through two different approaches: (i) becoming a member of ANBIMA – enjoying associative rights, with mandatory adherence to the ANBIMA's self-regulatory codes; or (ii) adherence to the applicable ANBIMA's self-regulatory codes.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

In addition to the requirements above, fiduciary administrators and investment managers are subject to self-regulatory rules set forth by ANBIMA, and anti-money laundering rules and reporting obligations. Fiduciary administrators and investment managers may be also subject to additional regulatory restrictions and requirements in case they are registered as financial institutions and/or manage funds invested by certain types of investors, such as pension funds and insurance companies.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

Brazilian-formed public funds cannot invest directly in digital currencies, as such type of asset does not fall under the definition of financial assets admitted for acquisition and negotiation by local public funds. However, the CVM regulations allow that public funds make indirect investments in digital currencies through the acquisition of interests in offshore vehicles and/or derivatives negotiated abroad, provided that such offshore vehicles and/or derivatives are regulated in the offshore markets where they are traded. Additionally, the Brazilian regulations require that the local fiduciary administrator and the investment manager make the appropriate disclosure to investors, conduct due diligence of such assets and offshore vehicles, and adopt monitoring practices to oversee the offshore administrator and/or investment manager of the offshore vehicles.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

The marketing and distribution of quotas of public funds in Brazil shall be made by members of the securities distribution system (in general, financial institutions, brokerage entities, fiduciary administrators, among others), following certain requirements and disclosure of information and documents as required by the CVM regulations, and also by the ANBIMA codes and guidance.

As a rule, the distribution of quotas of open-ended public funds are not subject to registration with the CVM. The distribution of quotas of closed-ended investment funds requires prior registration with the CVM, except if made through an exempted public offering, with certain limitations on the type and number of investors that may be accessed by the distributors.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

Yes. Quotas of investment funds are classified as securities under the applicable law, and their distributions require the participation of duly authorised members of the Brazilian securities distribution system, which is comprised by: (i) financial institutions and other entities with the purpose of underwriting securities (subject to registration and supervision of the Brazilian Central Bank); (ii) entities with the purpose of purchasing securities in the market and resale using their proprietary accounts; (iii) companies and individuals who intermediate the trading of securities in stock exchanges and over-the-counter ("OTC") markets; (iv) stock exchanges; (v) OTC entities; (vi) brokerage of goods, special operators and the stock exchanges of goods and futures; and (vii) securities settlement and clearing houses.

Under the applicable laws, asset managers may act as distributors of quotas of investment funds under their administration or investment management, provided that they adopt specific policies and procedures in relation to the registration, of investors' suitability and exchange of information, and appoint an officer responsible for the distribution activity.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

Distribution fees are usually deducted from the fund's management fee (received by the investment manager), usually calculated considering the fund's net worth. Note that the CVM regulations prohibit the asset managers to receive any indirect remuneration or benefit paid by related parties that would hinder or limit the asset managers' independence in their asset management activities, requiring that any indirect payment or benefit must be transferred to the fund and consequently to its quota holders.

**ii. Advertising**

Any marketing material involving public investment funds must, among other requirements, contain specific disclaimers and information consistent with the bylaws and the fund's factsheet (if applicable), and be drafted with simple, clear, moderate and concise language, alerting the investors about the risks involved in investments in funds. ANBIMA's code for asset management also provides for certain rules for disclosure of the funds' performances and other norms applicable for advertising of public funds.

**iii. Investor suitability**

The distributors of quotas of investment funds are responsible for carrying out suitability of the investors, which is made in accordance with the target investors of each of the investment funds.

**iv. Custody of investor funds or securities**

Custody fees are usually charged as one of the fund's expenses and must be duly disclosed in the fund's bylaws, with an indication about the maximum custody fee subject to payment by the fund, expressed as an annual percentage of the fund's net worth.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

Yes. The restrictions on to whom public funds may be marketed or sold are determined in accordance with the level of sophistication of the investors (i.e., retail investors, qualified investors and professional investors). The general concept, in line with one of the CVM's fundaments (conferring protection to investors) is that the more sophisticated the investor is, the more risk an investor might be exposed to and, therefore, less protection may be granted to such investors.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

No. The rules and guidance for marketing of public investment in Brazil are provided for the CVM, as the regulatory body responsible for the registration and supervision of investment funds, and the ANBIMA, as a self-regulatory entity.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

As mentioned in question 2.1 (i) above, investment funds are structured in Brazil as unincorporated pool of assets (*condomínios*) and do not have corporate veil protection.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

As a general rule, investment funds are not subject to taxation on revenues and capital gains deriving from their own transactions (at portfolio level). However, there are certain exceptions to that rule such as financial revenues earned by real estate funds.

Therefore, Brazilian taxation will apply when income or gains are distributed from the investment fund to its investors.

In such case the applicable taxation will vary taking into consideration certain aspects related to the fund (the fund's nature and portfolio maturity) and the investor (type of investor, investment term and tax residency).

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

As mentioned above, public investment funds are generally not subject to taxes. Taxation applies at the level of the investor when income or gains are distributed.

There are certain tax benefits for non-Brazilian investors of public investment funds and a lower general tax rate.

Special tax regimes can also apply taking into consideration the type of investment fund (the fund's nature and portfolio) and the investor.


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We represent local and international sponsors and sophisticated investors in the structuring of local public funds, private equity and venture capital funds, real estate funds, credit funds, including vehicles for special situations investments, fund-of-funds, and other types of funds pursuing "alternative investment" strategies. We have an experienced and skilled team of lawyers with the necessary capabilities for working across the whole deal spectrum of private funds, including structuring, formation and offering of interests, purchase and sale of assets, financing, and advice on regulatory matters.

# Canada


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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

For Canadian securities regulatory purposes, an investment fund is either an open-end fund (referred to in Canada as a "mutual fund") or closed-end fund (referred to in Canada as a "non-redeemable investment fund") that offers liquidity, takes passive positions in securities, and does not try to exercise control or otherwise influence the day-to-day business of the investee issuer. Publicly offered non-redeemable investment funds and publicly offered mutual funds that are exchange traded funds ("ETFs") typically have their securities listed on a Canadian stock exchange.

The offering of securities of an investment fund to retail investors is subject to much more numerous regulatory filing and approval requirements than is the case of investment fund offerings that are restricted to accredited investors.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

In general terms, the conduct of a retail investment fund business in Canada gives rise to four fundamental securities regulatory filing and approval requirements:

1. The requirement to prepare and file with the securities regulatory authorities in Canada (the "Securities Regulator") a prospectus and annual information form describing the material facts relating to the offering of investment fund securities (the "Prospectus Requirement"). The type of prospectus that is used in the offering of a retail investment fund is subject to National Instrument 81-101 Mutual Fund Prospectus Disclosure ("NI 81-101") which mandates the preparation of a simplified prospectus, an annual information form ("AIF"), and a fund facts document "Fund Facts").

   The simplified prospectus is divided into two parts: Part A which contains general information about mutual funds and introductory information about all mutual funds in a fund family; and Part B which contains specific information about each fund within a family. The simplified prospectus format permits several mutual funds under common management to be offered together in a single document. Until recently, the simplified prospectus was required to be delivered to investors but is now only filed with, and reviewed by, the Securities Regulator and available for inspection by the public on SEDAR (the Canadian version of EDGAR).

   The AIF contains more detailed disclosure about the mutual fund, and although filed with, and reviewed by, the Securities Regulator, it is not required to be delivered to investors. Like the simplified prospectus, the AIF is available on SEDAR.

   The Fund Facts document highlights key information that is important to investors, in a "plain language" format they can easily understand, and must be no more than two double sided pages. The Fund Facts document content requirements are set out in NI 81-101 and include basic information about the fund followed by a concise explanation of mutual fund performance, expenses and fees, advisor compensation and the investor's cancellation rights. This document must be filed and posted on the website of the mutual fund or the mutual fund manager. The Fund Facts document must be delivered to the investor prior to the dealer accepting an order to purchase from the investor.

   ETFs re-offered by way of long form prospectus and ETF Facts document, in prescribed form. The ETF Facts document is similar to the Fund Facts document and must be delivered to the ETF investor within two days of the dealer accepting an order to purchase from the investor.

   For publicly offered investment funds that are non-redeemable investment funds, a long form prospectus is delivered to investors at the time of initial offering *in lieu* of the "simplified" prospectus and Fund Facts.
2. The requirement to have the fund's investment manager registered under applicable securities laws (the "Investment Fund Manager Registration Requirement"). This requirement involves the filing of a Form 33-109 F6 on behalf of the firm and the filing of Form 33-109 F4 on behalf of registered individuals.
3. The requirement to have the investment fund's portfolio managed by an adviser registered under applicable securities laws (the "Adviser Registration Requirement"). This requirement involves the filing of a Form 33-109 F6 on behalf of the firm and the filing of Form 33-109 F4 on behalf of registered individuals.
4. The requirement to distribute the investment fund securities through dealers registered under applicable securities laws (the "Dealer Registration Requirement"). This requirement involves the filing of a Form 33-109 F6 on behalf of the firm and the filing of Form 33-109 F4 on behalf of registered individuals.

   Each of these filings and registrations must be obtained prior to the commencement of the offering of any investment fund securities to the public in a Canadian province or territory.

**1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?**

Failure to comply with the requirements described in question 1.2 above would constitute a breach of Canadian securities laws, the consequences of which include fines and other significant sanctions.

**1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?**

While the investment fund itself and its custodian must be domiciled and resident in Canada, the investment fund manager and portfolio adviser may be located outside of Canada. An investment fund established and custodied in a foreign jurisdiction may not be offered on a retail basis in Canada but may be offered to institutional investors through registered dealers or by foreign broker dealers that qualify for the international dealer exemption.

## 2 Regulatory Framework

**2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?**

**i. Governance**

The Canadian securities markets are currently regulated solely by the provincial and territorial governments. As a result, each of Canada's 10 provinces and three territories has its own legislative scheme for regulating the securities market within its own provincial or territorial jurisdiction and its own Securities Regulator for administering and enforcing such legislation. Securities regulatory requirements in Canada can therefore vary from jurisdiction to jurisdiction.

In an effort to harmonise Canadian securities laws, each of the 13 Securities Regulators in Canada have, under rule-making authority granted by the provincial and territorial governments, established numerous rules, referred to as national instruments, that operate in a substantially identical manner in each province and territory.

Notwithstanding the potential for inconsistent regulatory requirements between the provinces, there is significant harmonisation of securities market regulation in Canada and this recognition has resulted in the Securities Regulators collaborating in the development of a number of key national instruments or policies including:

- National Policy 11-202 ("NP 11-102") Process for Prospectus Reviews in Multiple Jurisdictions – which describes procedures for the filing and review of a preliminary prospectus, prospectus and related materials in more than one Canadian jurisdiction;
- National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Obligations ("NI 31-103") – which imposes registration categories and requirements for individuals and firms, registration exemptions, internal controls and systems, capital and insurance requirements and client relationship principles;
- National Instrument 33-109 Registration Information ("NI 33-109") – which sets out the required information for registration and allows regulators to assess a filer's fitness for registration or for permitted individual status, with regard to their solvency, integrity and proficiency;
- OSC Rule 31-505 Conditions of Registration ("OSC Rule 31-505") – which imposes positive duties on registrants with respect to duty and standard of care to clients;
- National Instrument 62-103 The Early Warning System and Related Take-over Bid and Insider Reporting Issues ("NI 62-103") – which prescribes securities reporting rules relating to circumstances when a portfolio adviser acquires, on behalf of one or more investment funds or accounts managed by it, control or direction over 10% or more of a class of voting securities of a Canadian reporting issuer;
- National Instrument 81-101 Mutual Fund Prospectus Disclosure ("NI 81-101") – which is meant to ensure that the offering disclosure regime for mutual funds provides investors with disclosure documents that clearly and concisely state information that investors should consider in connection with an investment decision about the mutual fund, while recognising that different investors have differing needs in receiving disclosure;
- National Instrument 81-102 Investment Funds ("NI 81-102") – which imposes a uniform code of regulatory requirements upon all those involved in the management and distribution of retail investment funds throughout Canada;
- National Instrument 81-105 Investment Fund Sales Practices ("NI 81-105") – which imposes a code on cash payments and non-monetary benefits that may be paid or provided by a member of an investment fund organisation to a dealer;
- National Instrument 81-106 Investment Fund Continuous Disclosure ("NI 81-106") – which imposes continuous disclosure requirements for investment funds across Canada; and
- National Instrument 81-107 Independent Review Committee for Investment Funds ("NI 81-107") – which imposes a minimum, consistent standard of independent oversight for all publicly offered investment funds to ensure that the interests of the investment fund (and ultimately, the investors) are at the forefront when an investment fund manager is faced with a conflict of interest.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

The investment fund manager is responsible for the selection and oversight of the portfolio adviser. The portfolio adviser may retain sub-advisers.

**iii. Capital structure**

There are no restrictions regarding an investment fund's legal form and capital structure. Tax, legal liability and market practice will often determine the appropriate structure for a fund's specific purposes. Typically, investment funds are structured as one of the following:

- Trusts – Publicly offered investment funds in Canada are most often structured as investment trusts, also frequently referred to as unit trusts. Investors are issued units and become unitholders of the fund and are the beneficiaries of the trust.
- Corporations – While most publicly offered investment funds in Canada are structured as trusts, investment funds can also be structured as corporations or as classes of shares of a corporation. Investors are issued shares and become shareholders of the fund.
- Limited Partnerships – Investment funds can also be structured as a limited partnership. This legal form is more common for hedge funds and other non-publicly offered investment funds. Investors are issued units and become

limited partners of the limited partnership. It would be unusual to see a publicly offered investment fund in the form of a limited partnership.

**iv. Limits on portfolio investments**

NI 81-102 and certain other laws and regulatory instruments impose restrictions on portfolio investment activity. These restrictions pertain to prohibiting investments in parties related to the investment fund manager and portfolio adviser, control and concentration of portfolio positions, short selling, investment in other investment funds, illiquid investments, derivatives and securities lending.

**v. Conflicts of interest**

There are numerous rules pertaining to conflicts of interest. The principal rule is NI 81-107 which prescribes the establishment of an independent review committee to review matters that present a conflict of interest for the investment fund manager in respect of its fiduciary duty to the investment fund.

**vi. Reporting and recordkeeping**

NI 81-106 sets out the continuous disclosure requirements applicable to all investment funds, including publicly offered investment funds. Such continuous disclosure requirements include requirements to prepare, file with the Securities Regulator and/or deliver to investors:

(i) annual and interim management reports of fund performance ("MRFPs");

(ii) annual and interim financial statements; and

(iii) other continuous disclosure obligations such as disclosure of the proxy voting record and material change reports.

The continuous disclosure rules also provide details with respect to the calculation of the net asset value and management expense ratio of a mutual fund.

Investment fund managers are required to maintain investment fund records for at least seven years.

**vii. Other**

In addition to the abovementioned rules, publicly offered investment funds will usually also be subject to regulation in the areas of trading (e.g., best execution, short selling, institutional trade matching, insider trading, soft dollars), privacy and anti-spam laws. In addition, if the investment fund is publicly offered in the Province of Quebec, Quebec's Charter of the French Language establishes French as the official language of the province of Quebec and prescribes French-language requirements with respect to certain documents. Canadian anti-money laundering and terrorist-financing legislation also applies to investment fund managers doing business in Canada.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

Investment Fund Manager

The manager of an investment fund or group of investment funds is the entity responsible for administering the day-to-day operations of the investment fund or investment fund group and is generally considered to be "operating mind" of the investment fund complex. In Canada, the investment fund manager of a publicly offered investment fund is subject to the Investment Fund Manager Registration Requirement. A registered investment fund manager is subject to a standard and duty of care of a fiduciary nature. The registration requirement involves a number of conditions of registration including capital requirements, insurance, audited financial statements and proficiency for the chief compliance officer.

Portfolio Advisor

The entity responsible for the investment advice that is provided to publicly offered investment funds is subject to the Adviser Registration Requirement and must be registered as a portfolio manager with the Securities Regulator within the jurisdiction in which the publicly offered investment fund is established. Like the investment fund manager category of registration, registration as a portfolio manager involves a number of conditions of registration including capital requirements, audited financial statements and proficiency for advising representatives and the chief compliance officer. A registered portfolio manager is authorised to provide advice in respect of securities to any retail investment fund. If the advice would include advice in respect of exchange traded commodity futures contracts and options, registration as an adviser under commodity futures legislation would also be required depending upon the Canadian jurisdiction in which the investment fund was established.

Portfolio managers that are retained by other Canadian registered portfolio managers to act as "sub-advisers" to a publicly offered investment are often able to take advantage of an exemption from the Adviser Registration Requirement. In addition, non-resident portfolio managers to an investment fund that restrict their investment advice to non-Canadian securities may qualify for an exemption from the Adviser Registration Requirement.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

In most cases, a publicly offered investment fund would be precluded by law from owning 10% or more of a class of voting or equity securities of an issuer. However, the portfolio adviser to a publicly offered investment fund could nonetheless exercise control or direction over more than 10% of a class of voting or equity securities of a Canadian reporting issuer on aggregate basis across all of its client accounts. Accordingly, a portfolio adviser needs to be aware that under Canadian securities law, a portfolio adviser to a publicly offered investment fund that invests in Canadian public company securities is subject to a shareholder position reporting requirement and is required to make regulatory filings with the Securities Regulator in the following circumstances:

- 10% Report Threshold – When the portfolio adviser acquires control or direction over voting or equity securities of any class of a Canadian reporting issuer (or securities convertible into voting or equity securities of any class of a Canadian reporting issuer), that, together with the purchaser's securities of that class, constitute 10% or more of the outstanding securities of that class. This report must be filed within 10 days of the end of the month in which the threshold was reached.
- Subsequent Increases and Decreases in Control or Direction – A portfolio adviser who has met the 10% reporting threshold is required to report both increases and decreases above and below the 12.5%, 15% and 17.5% thresholds in control or direction. In addition, a portfolio adviser is required to report when their control or direction position has fallen below the 10% reporting threshold. This report must be filed within 10 days of the end of the month in which the threshold was reached.
- Change in Material Fact – When there has been a change in a material fact in the portfolio adviser's most recent report required to be filed.

Canadian take-over bid laws would be engaged if a portfolio adviser were to exercise control or direction over 20% or more of a class of voting or equity securities of a Canadian reporting issuer.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

While there is no express prohibition in Canada against public funds investing in digital currencies, such investments would likely not be currently compliant with the restriction in NI 81-102 against investment funds holding illiquid assets, and may also have difficulty meeting regulatory requirements regarding the custody of fund assets. No publicly offered investment funds exist in Canada that invest substantially all of their assets in digital currency. A recent proposal by a Canadian fund manager to launch such a public fund was rejected by a Canadian regulator in part due to the illiquid nature of the digital currency in question.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

All sales of the securities of mutual funds are subject to the Dealer Registration Requirement and must therefore be made by a person or company that is registered in an appropriate category of dealer registration. The dealer registration categories that can accommodate the retail sale of mutual fund securities are the mutual fund dealer and investment dealer categories of dealer registration. A mutual fund dealer is authorised to trade mutual fund securities only. An investment dealer is authorised to sell any securities. Most investment fund managers elect to sell the securities of their mutual funds through persons or companies registered in either of these categories of dealer registration.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

Marketing of investment fund securities is considered an act in furtherance of a trade of securities and must therefore be undertaken by a registered dealer. Investment Fund Managers qualify for an exemption from the dealer registration requirement to the extent their marketing activities are restricted to wholesaling their own investment funds to registered dealers. Marketing activities that promote the investment fund manager's "brand" as opposed to a specific security generally do not trigger a dealer registration.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

In addition to fixed filing fees applied by each Securities Regulators at the time of filing of initial Disclosure Documents or the annual renewal thereof, certain Securities Regulators also levy an annual fee equal to 0.04% of the dollar value of securities sold in the jurisdiction in the prior year.

**ii. Advertising**

NI 81-102 prescribes numerous rules pertaining to the advertising of public investment funds, including advertising of the fund's performance.

**iii. Investor suitability**

Investor suitability must be conducted by the registered dealer that sells the public investment fund to the investor. The key factors of the suitability assessment are the client's financial position, age, dependents, lifestyle, investment knowledge, investment objectives, risk tolerance and time horizon.

**iv. Custody of investor funds or securities**

The portfolio assets of a public investment fund must be held by a Canadian custodian that meets certain regulatory requirements. The Canadian custodian may retain foreign sub-custodians.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

A public investment fund may be sold to any resident of Canada that has obtained the age of majority.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

NI 81-105 applies restrictions in respect of sales practices on all investment fund managers and of publicly offered investment funds in Canada in respect of their arrangements with dealers that sell the investment funds to investors. Except as specifically permitted by NI 81-105, both monetary payments and the provision of non-monetary benefits by an investment fund manager to a dealer related to the sale of publicly offered investment funds are prohibited.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

Public funds may be structured as partnerships (usually limited partnerships), trusts and corporations. Co-ownership structures are rarely used.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

A partnership is not itself liable to tax. Income (or loss) and capital gains (capital losses) are calculated at the partnership level as if the partnership were a separate person resident in Canada and are allocated to the partners in accordance with the partnership agreement. The partners take into account their share of such amounts in computing their own income or loss, whether or not they receive a distribution in respect thereof. Amounts included in income increase the adjusted cost base ("ACB") of the partner's partnership interest. Distributions to a partner are not subject to tax but reduce the partner's ACB of its interest. A partner may realise a capital gain (capital loss) on the disposition of a partnership interest to the extent that the proceeds of disposition exceed (are exceeded by) the ACB of the partnership interest. In Canada, only 50% of capital gains ("taxable capital gains") are included in income and only 50% of capital losses ("allowable capital losses") are deductible and only against taxable capital gains. If the ACB of a limited partner's interest is negative at the end of a year, a deemed capital gain will arise.

A trust is liable to tax on its income (including taxable capital gains) but is generally entitled to deduct the amount of its income paid or payable in the taxation year to beneficiaries. A beneficiary must include in income its share of the trust's income paid or payable to it. So-called "ancillary conduit" provisions permit the character of certain types of income which receive preferential tax treatment (such as dividends from taxable Canadian corporations) to retain their character in the hands of beneficiaries. Distributions to a beneficiary reduce the ACB of the beneficiary's interest except to the extent that it is included in income or is the non-taxable portion of capital gains. A beneficiary may realise a capital gain (capital loss) on the disposition of its interest or if its ACB becomes negative.

A corporation without special status (see below) is rarely used. Such a corporation is liable to tax on its income (other than dividends from other taxable Canadian corporations). A corporation is not entitled to claim a deduction for dividends or other distributions paid to shareholders. Shareholders must include dividends in income. In the case of a shareholder that is an individual, there is a partial credit given for tax paid at the corporate level and, in the case of a Canadian corporation, the recipient corporation is generally entitled to deduct the amount of the dividend in computing taxable income. A shareholder may realise a capital gain (capital loss) on the disposition of its shares.

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

A trust that is a "mutual fund trust" ("MFT") qualifies for a special tax regime. To be an MFT, a trust must generally:

- Be a "unit trust", which requires that interest of each beneficiary be described by reference to units and either at least 95% of the units (based on fair market value) are redeemable at the demand of the holder or the trust satisfies certain conditions with respect to the nature of its investments including a concentration restriction.
- Limit its activities to investing its funds in property (other than real property or interests therein) and/or acquiring, holding, maintaining, improving, leasing or managing real property or interests therein that are capital property.
- Be considered to have distributed a class of its units to the public, generally in accordance with a prospectus or offering memorandum, and in respect of a class of units so distributed, there must be 150 or more unitholders each holding not less than (1) one block of units of the class, and (2) units of the class having a total fair market value of at least $500.

An MFT may be entitled to a "capital gains refund", determined on a formula basis, which reduces the amount of capital gains the MFT has to distribute to its unitholders and consequently the amount they must include in income. An MFT, by making appropriate distributions, should be able to avoid tax at the fund level on all sources of income.

Units of an MFT are "qualified investments" for a "registered retirement savings plan" and similar tax-deferred plans.

A corporation that is a "mutual fund corporation" ("MFC") also qualifies for a special tax regime. This generally requires that:

- The corporation is a "public corporation" which requires either that (1) a class of its shares is listed on a designated stock exchange in Canada, or (2) it has elected to be a public corporation by distributing a class of its shares to the public, generally in accordance with a prospectus or offering memorandum, and depending on the attributes of the shares distributed, having 150 or more (or 300 or more) shareholders each holding not less than (1) one block of shares of the class, and (2) shares of the class having aggregate fair market value of at least $500.
- The corporation limits its activities to investing its funds in the same way as an MFT.
- At least 95% (based on fair market value) of its issued shares are redeemable at the demand of the holder.

An MFC may elect to pay "capital gains dividends" out of realised capital gains which are treated as realised capital gains in the hands of shareholders and entitle the MFC to a refund of tax payable on such capital gains ("capital gains refund"). Like an MFT, an MFC may also be entitled to a capital gains refund based on a formula taking into account redemptions of its shares which reduces the amount of capital gains dividends to be paid to shareholders. An MFC is an efficient vehicle for investments that give rise to capital gains or taxable dividends from Canadian corporations. However, corporate level tax may be paid on income from other sources (e.g., interest and foreign income) unless the corporation has sufficient deductible expenses (such as management fees).

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Chapter 9

# Denmark


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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Funds offered to the public either qualify as undertakings for the collective investment of transferable securities ("**UCITS**") or alternative investment funds ("**AIFs**").

UCITS

A Danish UCITS can be organised as:

- an investment association;
- an investment company with variable capital ("**SICAV**"); or
- a securities fund (not a separate legal entity but a contractual structure).

Any marketing of a Danish UCITS requires the prior authorisation of the UCITS by the Danish Financial Supervisory Authority (the "**Danish FSA**").

Any marketing of an EEA authorised UCITS requires the prior passporting of the UCITS' authorisation into Denmark in accordance with the UCITS Directive (Directive 2009/65/EC, as amended) and the UCITS Regulation (Regulation (EU) No. 584/2010).

AIFs

Any marketing of AIFs managed by a Danish alternative investment fund manager ("**AIFM**") to professional investors in Denmark requires either: (i) registration of the AIFM, provided the AIFM's assets under management do not exceed the thresholds in the AIFM Directive (Directive 2011/61/EU, as amended, the "**AIFMD**"), i.e. EUR 100 million if the managed AIFs use gearing or alternatively EUR 500 million; or (ii) if any of the thresholds are exceeded, authorisation of the AIFM by the Danish FSA. The AIFM is required to notify the Danish FSA of the AIFs that it manages, which will be registered with the Danish FSA.

Any marketing of an AIF managed by an EEA authorised AIFM requires the prior passporting of the AIFM's authorisation into Denmark in accordance with the AIFMD. A "top-up" authorisation by the Danish FSA is required in order to market an AIF to retail investors in Denmark.

Any marketing of an AIF managed by a non-EEA AIFM to professional investors in Denmark requires the prior authorisation of the AIFM's contemplated marketing of the AIF by the Danish FSA (such authorisation is specific to the AIF intended to be marketed). A "top-up" authorisation by the Danish FSA is required in order to market an AIF to retail investors in Denmark.

Prospectus Requirements

Please note that offering of units or shares in an AIF/UCITS may be subject to a prospectus requirement pursuant to the rules in the Danish Capital Markets Act (Act No. 12/2018, as amended), the executive orders issued pursuant thereto and the Prospectus Regulation (Regulation 2017/1129). The Prospectus Regulation will enter into force in full as of 21 July 2019.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

UCITS

A Danish UCITS is required to apply for authorisation from the Danish FSA using an application form available on the Danish FSA's website. Generally, authorisation will be granted if the following requirements are satisfied:

- The UCITS is validly established.
- Fulfilment of the requirements of Section 3(1)–(5) of Danish Investment Association Act (Act No. 1154/2018, as amended) (the "**DIA**") transposing the UCITS Directive into Danish law.
- Members of the UCITS' board of directors and management board are "fit and proper". If the UCITS does not have a management board, the investment management company must have been approved by the Danish FSA.
- The Danish FSA has approved the UCITS' articles of association and the depositary.
- The UCITS' activity plan, organisation, risk management, business procedures and administrative conditions are appropriate.
- There are no "close links" between the UCITS and other natural or legal persons that may complicate the Danish FSA's work.
- Legislation in a non-EEA Member State regarding an undertaking or person with whom the applicant has close links will not complicate performance of the tasks of the Danish FSA.
- The capital of the UCITS is at least EUR 300,000 (not including intangible assets), if the UCITS has not delegated the day-to-day management to an investment management company.
- The minimum capital is subscribed for at the first general meeting and deposited in a blocked account with the depositary, or an unconditional guarantee is provided by a

bank or insurance company for subscription of units in the UCITS for a minimum amount of EUR 300,000.

- The UCITS has its registered office in Denmark.

Finally, in order to offer units in a UCITS in Denmark, the UCITS is required to publish (i) a prospectus prepared in accordance with the Danish Executive Order on Information in Prospectuses for Danish UCITS (Executive Order No. 138/2016), and (ii) a key investor information document prepared in accordance with the Key Investor Information Document Regulation (Regulation (EU) No. 583/2010).

AIFs

A Danish sub-threshold AIFM is required to register with the Danish FSA using a registration form available on the Danish FSA's website. When registering, the sub-threshold AIFM is required to state its name and company registration number, identify the AIFs that it manages and describe the investment strategies of these AIFs. A Danish registered sub-threshold AIFM may market:

- Danish AIFs towards professional investors in Denmark.
- Danish or non-EEA AIFs in non-EEA Member States, provided this is permitted pursuant to the laws of such non-EEA Member State.
- Danish or non-EEA AIFs in other EEA Member States, provided this is permitted pursuant to the laws of such EEA Member States.

A Danish non-sub-threshold AIFM is required to apply for authorisation from the Danish FSA using an application form available on the Danish FSA's website.

Generally, authorisation will be granted if the following requirements are satisfied:

- The AIFM has sufficient initial capital and an adequate capital base in accordance with Section 16 of the Danish AIFM Act (Act No. 1166/2018, as amended) (the "**DAIFMA**").
- Members of the AIFM's management are of sufficiently good repute and sufficiently experienced in exercising their duties and responsibilities or carrying out their position (i.e. "fit and proper").
- The AIFM's business conduct is being decided by at least two persons from its management.
- Owners of "qualifying interests" in the AIFM are suitable, taking into account the need to ensure the sound and prudent management of the AIFM.
- The AIFM's head office and registered office are located in Denmark.
- The AIFM is a limited liability company.
- There are no "close links" between the AIFM and other natural or legal persons that may complicate the Danish FSA's work.
- The Danish FSA is not prevented from carrying out its supervisory functions due to laws and administrative provisions in a third country applicable to natural or legal persons with which the undertaking has close links, or due to difficulties in enforcing such laws and administrative provisions.

A Danish authorised AIFM may market:

- Danish AIFs towards professional investors in Denmark.
- EEA AIFs towards professional investors in Denmark, provided that the AIF has been passported into Denmark by way of the AIFM notifying the Danish FSA about the contemplated marketing and the Danish FSA authorising such marketing (such authorisation is not to be given more than 20 business days after the Danish FSA receiving the notification). The notification to the Danish FSA shall include:
  - a programme of operations identifying the AIF, including its home EEA Member State;
  - the AIF's articles of association;
  - information on the AIF's depositary;
  - information that is available to the AIF's investors;
  - information on where the master fund is established (if applicable);
  - information required pursuant to Article 23 of the AIFMD; and
  - information on the measures adopted to ensure that the AIF will not be marketed towards retail investors.
- EEA AIFs towards professional investors in other EEA Member States, provided that the AIF has been passported into such other EEA Member States by way of the AIFM notifying the Danish FSA about the contemplated marketing and the Danish FSA forwarding the notification to the competent authorities in the relevant EEA Member States (such forwarding is not to be done more than 20 business days after the Danish FSA receiving the notification). The notification to the Danish FSA shall include:
  - a programme of operations identifying the AIF, including its home EEA Member State;
  - the AIF's articles of association;
  - information on the AIF's depositary;
  - information that is available to the AIF's investors, including information required pursuant to Article 23 of the AIFMD;
  - information on where the master fund is established (if applicable);
  - information on the EEA Member States in which the AIFM intends to market the AIF; and
  - information on the measures adopted to ensure that the AIF will not be marketed towards retail investors.

In order to manage Danish AIFs or market EEA AIFs towards professional investors in Denmark, an authorised EEA AIFM is required to passport its authorisation into Denmark by way of requesting the competent authorities in its home EEA Member State to notify the Danish FSA about the contemplated management or marketing (as the case may be).

In order for a Danish authorised AIFM, an EEA authorised AIFM or a non-EEA AIFM to market non-EEA AIFs towards professional investors in Denmark, the following requirements must be satisfied:

- The AIFM must, if it is a Danish authorised AIFM or an EEA authorised AIFM, comply with all provisions of the DAIFMA (except Chapter 8) and all executive orders issued pursuant thereto, or, if it is a non-EEA AIFM, comply with Sections 61–68 and 70–75 (if applicable) of the DAIFMA.
- The Danish FSA must have entered into appropriate cooperation arrangements with the competent authorities in the non-EEA AIF's home country, enabling the Danish FSA to supervise the AIFM, and if the AIFM is a non-EEA AIFM with the competent authorities of the AIFM's home country.
- The non-EEA AIF's home country (and if the AIFM is a non-EEA AIFM the home country of the AIFM) may not be registered as a non-cooperative country by the Financial Action Task Force.
- The AIFM shall ensure that one or more "depo-lite" entities be appointed to perform the custody, cash-flow monitoring and other functions in respect of the non-EEA AIF set out in Sections 50, 51(1) and 52 of the DAIFMA.

- The AIFM shall apply to the Danish FSA for authorisation using an application form available on the Danish FSA's website, attaching:
  - in the case of a Danish authorised AIFM or an EEA authorised AIFM, documentation for authorisation pursuant to rules implementing the AIFMD;
  - a programme of operations identifying the non-EEA AIF, including the non-EEA AIF's home country;
  - the non-EEA AIF's articles of association;
  - information that is available to the non-EEA AIF's investors, including information required pursuant to Article 23 of the AIFMD;
  - the non-EEA AIF's latest annual report (if available);
  - a statement from the competent authorities in the non-EEA AIF's home country stating that they are prepared to grant similar Danish funds access to market themselves in the non-EEA country. If the non-EEA AIF is not under supervision in its home country, a statement to the same effect shall be issued by a qualified attorney in its home country; and
  - information (i) on whether and, if so, the extent to which the non-EEA AIF may be marketed to the public in the AIFM's and/or the non-EEA AIF's home country, (ii) that the non-EEA AIF is required to provide to its investors according to the laws of its home country, and (iii) other than the information described in (i) and (ii) that the non-EEA AIF is required to publish under the laws of its home country.

A "top-up" authorisation is required by the Danish FSA in order to market an AIF towards retail investors in Denmark.

Finally, a depositary and, if the AIF does not have its registered office in Denmark, a representative, having its registered office in Denmark and holding authorisation as a securities dealer or as a Danish authorised AIFM, shall have been appointed in respect of the AIF.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

Failure to comply with the registration, notification or authorisation requirements is sanctioned by a fine. In practice, there is often no sanction the first time an offence is made. Such an offence will often be met by a request/order from the Danish FSA to rectify the activity or behaviour.

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

Subject to compliance with the registration, notification or authorisation requirements, a foreign AIF/UCITS may be marketed in Denmark.

Generally, no local residency or local qualification requirements apply. However, (i) an EEA authorised AIFM with a presence in Denmark (e.g. a Danish office with Danish employees) will typically be required to establish a Danish branch, (ii) an EEA authorised AIFM or a non-EEA AIFM wishing to market a AIF to retail investors in Denmark is required to contract with a Danish representative assisting Danish investors in obtaining information and redeeming their units in the AIF, and (iii) an EEA authorised UCITS that intends to market in Denmark to retail investors must appoint a Danish representative assisting Danish investors in obtaining information and redeeming their units in the UCITS.

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

UCITS

Danish UCITS are required to comply with the rules on governance of a Danish UCITS in the DIA.

The strategic and overall management of a Danish UCITS is undertaken by a board of directors responsible for resolving on matters of an unusual nature or significant importance, whereas the day-to-day management of the Danish UCITS must be carried out by a management board appointed by the board of directors or an investment management company appointed by way of delegation by the board of directors, provided that the day-to-day management of a SICAV must be carried out by an investment management company.

Any decision by the board of directors of a Danish UCITS to delegate material functions to a third party must comply with the outsourcing requirements outlined in the DIA.

Members of the management of a UCITS are subject to, *inter alia*, (i) quantitative and qualitative restrictions on variable remuneration (some gold-plating is in place pursuant to the DIA compared to the UCITS Directive), and (ii) "fit and proper" requirements.

The DIA includes detailed rules on governance of a Danish UCITS. Whereas some of the detailed rules on governance in the DIA apply to all Danish UCITS (including rules on conflict of interest, target numbers for the underrepresented gender, a prohibition on speculation, non-disclosure restrictions, etc.), the DIA also includes rules particular to each of an investment association, a SICAV or a securities fund.

AIFs

Danish authorised AIFMs are required to comply with the rules on governance of a Danish authorised AIFM in the DAIFMA.

A Danish AIFM either has (i) a board of directors and a management board appointed by the board of directors, (ii) a supervisory board and a management board, or (iii) a management board alone. In case the AIFM has a board of directors and a management board, the board of directors is responsible for resolving on matters of an unusual nature or significant importance, whereas the day-to-day management is carried out by the management board. In case the AIFM has a supervisory board and a management board, the management is responsible for resolving matters of an unusual nature or significant importance and the day-to-day management, whereas the supervisory board will only supervise the management board.

An AIFM intending to delegate to a third party the task of carrying out significant functions shall notify the Danish FSA. The AIFM shall supervise the services provided by the delegate on an ongoing basis.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

As a general rule, the appointment of an investment adviser by an AIFM or a UCITS will not qualify as delegation under Danish law, provided that (i) the investment adviser only provides investment advice, (ii) the AIFM or the UCITS (as the case may be) does not base its investment decision-making solely on the rendered investment advice (i.e. the AIFM or the UCITS (as the case may be) shall carry out its own qualified analysis before concluding a transaction), and (iii) assessments made by the AIFM or the UCITS (as the case may be) may not only be of a formal character (e.g. checking whether the advice would breach investment restrictions).

**iii. Capital structure**

UCITS

A Danish UCITS may not raise loans; however, the Danish FSA can consent to the UCITS on behalf of a sub-fund raises:

- short-term loans of a maximum of 10% of a sub-fund's assets except for loans with investment objectives; and
- loans of up to 10% of a sub-fund's assets for the acquisition of real property necessary for performance of the activities of the Danish UCITS.

The above-mentioned loans may in aggregate not exceed 15% of a sub-fund's assets.

AIFs

Danish authorised AIFMs shall have a minimum capital of no less than EUR 125,000, while self-managed Danish AIFs shall have a minimum capital of no less than EUR 300,000. The capital base shall be increased by 0.02% of the amount by which the value of the portfolios of the AIFs exceeds EUR 250 million. However, the capital base shall not exceed EUR 10 million, unless this results in the capital base corresponding to less than a quarter of the fixed costs for the previous year.

**iv. Limits on portfolio investments**

UCITS

UCITS are, by definition, limited to investing in transferable securities (and other liquid assets) and are subject to investment restrictions and rules on portfolio composition, asset diversification, concentration limits and risk-spreading.

AIFs

Generally, AIFs are not subject to any limits on portfolio investments (except for feeder funds, which are required to invest at least 85% of its assets in a master fund, and so-called capital associations, which are required to invest in liquid assets, including currencies, and financial instruments covered by Annex 5 to the Danish Financial Business Act (Act No. 1140/2017) (the "**DFBA**")).

**v. Conflicts of interest**

UCITS

Members of the board of directors and management board as well as other employees and auditors of a Danish UCITS, of its depositary and of its investment management company may not, without due cause, disclose or use confidential information obtained during the performance of their duties.

AIFs

Danish authorised AIFMs shall (i) take all reasonable steps to prevent conflicts of interest and, if unpreventable, identify, manage and monitor conflicts of interest in order to prevent inflicting damage to the interests of managed AIFs or the interests of their investors, and (ii) inform managed AIFs, their investors and any other relevant parties about any conflicts of interests in order to prevent them from adversely affecting the interest of the managed AIFs or investors and to ensure that the AIFs are fairly treated.

**vi. Reporting and recordkeeping**

UCITS

A Danish UCITS is required to report information about the UCITS to the Danish FSA. The frequency depends on the kind of reporting.

AIFs

Danish authorised AIFMs and Danish registered AIFMs are required to report information about the AIFM and the manged AIFs to the Danish FSA. The frequency of the reporting depends on the overall size of the portfolios of the managed AIFs.

Pursuant to the Danish Bookkeeping Act (Act No. 648/2006, as amended), accounting records shall generally be kept for five years from the end of the accounting year the material concerns. Please note that the retention period may be longer pursuant to special laws.

**vii. Other**

There are no other main regulatory restrictions and requirements to be aware of.

**2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?**

Yes, provided the investment advice is deemed rendered in Denmark. For example, where an AIFM delegates (part of) the portfolio management for a Danish AIF to a non-EEA securities dealer, such securities dealer will not need to obtain an authorisation to carry out portfolio management in Denmark, as the characteristic performance of the service is carried out outside of Denmark, provided that the following conditions are met:

1) the securities purchased under the portfolio management mandate are netted, cleared and safe-kept outside Denmark;
2) the securities dealer has obtained the required authorisations to carry out investment services in its home country;
3) the securities dealer is under supervision from the relevant financial authorities in its home country; and
4) the securities dealer's home country is an IOSCO member.

An entity rendering investment advice to a Danish UCITS, its investment management company or an AIFM must be one of the following entities:

- A Danish investment adviser, authorised by the Danish FSA (an application form is available on the Danish FSA's website).
- A Danish investment firm, authorised by the Danish FSA (an application form is available on the Danish FSA's website).
- An EEA investment firm, authorised to provide investment advice in its home EEA Member State, and having passported its authorisation into Denmark (by way of requesting the competent authorities in its home EEA Member State to notify the Danish FSA about the contemplated provision of investment advice in Denmark).
- A non-EEA investment firm, authorised to provide investment advice in its non-EEA home country and to carry out services with securities trading in Denmark by the Danish FSA (authorisation is obtained by applying to the Danish FSA, (i) specifying the services listed in Annex 4 to the DFBA that the non-EEA investment firm intends to provide in Denmark and the financial instruments listed in Annex 5 to the DFBA with respect to which the non-EEA investment firm intends to provide services, and (ii) attaching a declaration from the competent authorities in its non-EEA home country stating that the non-EEA investment firm is subject to supervision and that the services, which the non-EEA investment firm applies for authorisation to provide, are covered by its non-EEA home country authorisation).

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

Please note that a Danish investment adviser is subject to the requirements applicable to investment advisers in the Danish Financial Advisor, Investment Advisor and Property Credit Mediators Act (Act No. 1160/2018, as amended), including its rules on authorisation.

A Danish investment firm is subject to the requirements applicable to investment firms in the DFBA, including its capital requirement, restrictions on the type of business an investment firm is allowed to carry out, its rules on remuneration, its rules on governance (including "fit and proper" requirements applicable to its management), and its requirement to have owners of a qualifying interest (10% or more of the shares or votes) in an investment firm approved by the Danish FSA, etc.

An investment firm authorised in another EEA Member State, which passports its authorisation into Denmark, is generally subject to its home EEA Member State regulation and supervision in accordance with the Markets in Financial Instruments Directive (Directive 2014/65/EU) and the Markets in Financial Instruments Regulation (Regulation (EU) No. 600/2014).

A non-EEA investment firm authorised by the Danish FSA to carry out services with securities trading cross-border into Denmark is subject to selected provisions in the DFBA, including the requirement that the business must be operated in accordance with honest business principles and good practice within the field of activity, and the Danish Good Business Practice Order (Executive Order No. 330/2016).

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

In our assessment an investment in a digital currency will not qualify as an investment in a liquid asset, as digital currencies are generally not recognised as a currency for financial regulatory purposes. We refer to question 2.1, point iv.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

Please see section 1.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

Please see section 1.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

Securities dealers providing investment advice on an independent basis or discretionary portfolio management are not permitted to accept and retain fees, commissions or any monetary or non-monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of the service to the client. Minor non-monetary benefits that are capable of enhancing the quality of service provided to a client and are of a scale and nature such that they could not be judged to impair compliance with the investment firm's duty to act in the best interest of the client, shall be clearly disclosed and are excluded from the prohibition.

**ii. Advertising**

Any marketing in Denmark must be carried out in accordance with the general marketing restrictions applicable under Danish law. By way of example, this means that all marketing shall be carried out in accordance with good marketing practice and that, as a general rule, all unsolicited direct marketing to all types of investors, including professional investors, in Denmark, through e-mail, an automatic calling system or fax, is prohibited.

**iii. Investor suitability**

Pursuant to the Danish Investor Protection Order (Executive Order No. 1580/2018), securities dealers are required to categorise their clients as either retail clients, professional clients or eligible counterparties and, depending on the categorisation, the client will have different kinds of protection under Danish law.

**iv. Custody of investor funds or securities**

<u>UCITS</u>

An investment management company shall ensure that a depositary is appointed for each Danish UCITS that it administers, and the depositary is subject to certain provisions in the DFBA.

<u>AIFs</u>

An AIFM shall ensure that a depositary is appointed for each AIF that it manages, and the depositary is subject to certain provisions in the DAIFMA.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

<u>UCITS</u>

As a general rule, UCITS may be marketed to all investors.

<u>AIFs</u>

As a general rule, AIFs may only be marketed to professional investors, unless separate authorisation to market to retail investors has been obtained (please refer to questions 1.1 and 1.2).

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

There are no other main areas of regulation imposed with respect to the marketing of public funds.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

Depending on the qualification of the entity as an AIF or a UCITS, and subsequently the UCITS' organisation as an investment association, a SICAV or a securities fund, the entity may be set up for tax purposes pursuant to the Danish Corporation Tax Act (Act No. 1164/2016, as amended) as:

1. an account-holding fund;
2. a fund with minimum taxation;
3. having the status of an investment company; and
4. an accumulative fund.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

A Danish UCITS organised as an investment association or an AIF can, for tax purposes, be set up as:

**1. An Account-Holding Fund**

Entity-level Tax

- Income from interest, dividend and capital gains is tax-exempt.
- Any other business-related profits are taxable.

Taxation of Investors

- Income in the UCITS is allocated directly to the individual investors for tax purposes. The income is taxed according to the rules applicable to the individual investor.

**2. A Fund with Minimum Taxation**

Entity-level Tax

- Income from interest, dividend and capital gains is tax-exempt.
- Any other business-related profits are taxable.

Taxation of Investors

- The investors are subject to tax on their proportional part of the minimum income or the actual amount distributed if this exceeds the minimum income.
- The fund must, as a main rule, withhold 27% in withholding tax on their distributions. However, the income is taxed according to the rules applicable to the individual investor.

**3. Having the Status of an Investment Company**

Entity-level Tax

- Generally tax-exempt. However, dividends received from Danish companies are subject to a 15% withholding tax when paid to the investment company.

Taxation of Investors

- The entity must withhold 27% in tax on distributions.

**4. An Accumulative Fund**

Entity-level Tax

- Treated as a normal company for tax purposes. Income is taxed at the corporate tax rate of 22%.

Taxation of Investors

- The entity must withhold 27% withholding tax on distributions.

A Danish UCITS organised as a SICAV or a securities fund, has the following two possibilities for tax treatment:

1. A fund with minimum taxation.
2. Status of an investment company.

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

**1. An Account-Holding Fund**

- The investors (members) may only transfer/sell their share of the UCITS/AIF to the UCITS/AIF itself. It is also a requirement that each member is entitled to the same proportionate share of the yearly yield from each asset or debt in the fund.
- The fund must have at least eight members.

**2. A Fund with Minimum Taxation**

- The fund must compute and report on an annual basis a "minimum income" following the method set out in the Danish Tax Assessment Act, Section 16 C (Act No. 1162/2016, as amended).
- The fund must have at least eight members.

**3. Status of an Investment Company**

- If a UCITS/AIF does not qualify as a fund with minimum taxation or as an account-holding fund, it will be treated as an investment company for tax purposes.
- An investment company must be an entity liable to taxation.

**4. Accumulative Fund**

- If a UCITS/AIF does not qualify as an account-holding fund, a fund with minimum taxation or as an investment company, it will be treated as an accumulative fund for tax purposes.


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# France


Damien Luqué

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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Yes, in accordance with article L. 214-3 of the French Monetary and Financial Code ("**CMF**"), the creation and the marketing of any French undertaking for collective investment in transferable securities ("**UCITS**") or a sub-fund of any French UCITS are subject to a prior authorisation by the *Autorité des marchés financiers* (the "**AMF**" – the French financial markets regulator). Such authorisation process consists of filing with the AMF a complete file whose elements are referred to in question **1.2**. The marketing of shares or units of any UCITS may only begin once the AMF notifies the management company of its authorisation.

Directive 2009/65/EC of the European Parliament and of the council ("**UCITS Directive**") regulates UCITS, which are open-ended investment funds. UCITS may be defined by four criteria:

- they are undertakings whose exclusive purpose is the collective investment in transferable securities or other liquid financial assets;
- they raise capital from the public;
- they apply a principle of risk-spreading; and
- their units or shares may be repurchased or redeemed upon request of their investors.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

Under French law, there are two different approval procedures:

a. Standard process for filing UCITS authorisation applications:

The creation of a UCITS requires the prior authorisation of the AMF and the UCITS may not be marketed until such authorisation has been obtained. The application file must contain the following items:

- the operating rules or the articles of incorporation of the UCITS;
- the draft key investor information document ("**KIID**");
- the draft prospectus;
- the letter of undertaking: for each UCITS filed with the AMF, the portfolio management company must deliver a formal letter in which it undertakes, *inter alia*, to maintain technical resources, internal procedures and staff in order to comply with regulatory requirements applicable to UCITS; and
- if the UCITS is a structured fund or if it implements specific management strategies such as portfolio insurance, long/short strategies, index-tracking: it is necessary to provide the AMF with a marketing programme regarding the UCITS (including marketing materials).

The AMF controls the completeness of the file and verifies whether the portfolio management company and the custodian are duly authorised to manage this type of products. It also verifies whether the KIID is written in a clear, accurate and not misleading manner.

b. Fast track process for filing comparable UCITS:

A fast track authorisation process is only available to UCITS which are similar to another UCITS or an AIF that has been previously authorised pursuant to the standard process. As portfolio management companies tend to decline their investment strategies in multiple investment funds, the AMF has decided that these "comparable" investment funds could benefit, under certain conditions, from an accelerated approval procedure, referred to as "analogy procedure" (*procédure par analogie*).

The comparable UCITS must be based on a "reference UCITS or AIF" and meets certain conditions of comparison, in particular:

- they are both managed by the same portfolio management company or by portfolio management companies belonging to the same group;
- the "reference UCITS or AIF" has been authorised within an 18-month-period preceding the filing of the authorisation file for the comparable UCITS;
- they both have similar characteristics in terms of risk profile, functioning rules, investment strategy, etc.; and
- investors of the comparable UCITS may also invest in the "reference UCITS or AIF" in the same conditions.

Such conditions are appreciated by the AMF on a case-by-case basis.

The authorisation process for a comparable UCITS may only last eight business days from the receipt of a complete application file by the AMF.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

Failing to register a UCITS may trigger the application of:

- disciplinary sanctions and measures pronounced by the Sanctions Committee of the AMF;

- civil sanctions such as damages and the invalidity of the subscription of shares or units of the UCITS; and
- criminal penalties (fraud).

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

French regulation implements gold plating rules such as AMF fees to be paid. There is a fee of 2,000 euros per foreign UCITS or per sub-fund (if any) to be passported in France. The fee is payable on the day the notification is filed with the AMF and on 30 April of each subsequent year.

In addition, in the context of the "passport in" procedure, that enables any UCITS located in a country party to the European Economic Area treaty ("**EEA**") to be marketed in France, the latter must appoint one or more centralising correspondents which must be located in France. Pursuant to an agreement entered into with the relevant EEA UCITS or its management company, the centralising correspondent is responsible for providing the following services:

- processing subscription and redemption requests;
- paying coupons and dividends;
- making information documents available to investors; and
- providing shareholders/unitholders with specific information in certain cases.

The EEA UCITS must notify the AMF of their centralising correspondents.

Moreover, the marketing in France of units or shares of an EEA UCITS is subject to compliance with the marketing rules as set out in the French monetary and financial code and the General Regulation of the *Autorité des marchés financiers* (the "**GRAMF**").

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

Any French UCITS is constituted as either:

- a mutual fund (*fond commun de placement* – "**FCP**"). An FCP may not be self-managed and must always be managed by a UCITS management company; or
- an investment company with a variable capital (*société d'investissement à capital variable* – "**SICAV**") either in the form of a public limited company (*société anonyme* – "**SA**") or a simplified limited company (*société par actions simplifiée* – "**SAS**"). An investment company may be self-managed or may appoint a UCITS management company.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

Investment advice consists of providing personalised recommendations to a third party with respect to one or more transactions on financial instruments. Such activity is regulated and any person which contemplates providing investment advice must have either:

- the status of *conseiller en investissements financiers* ("**CIF**") (*financial investments adviser*);
- the status of investment services provider authorised to provide investment advice in France (either credit institutions, investment firms or portfolio management companies); or
- the status of tied agent acting on behalf of an investment services provider.

Moreover, any UCITS management company may delegate the portfolio management to an external investment manager (financial management delegation). Such delegation must comply with specific AMF constraints. In addition, the delegate may only be a person authorised for portfolio management purposes. The portfolio management company cannot delegate the entire management of the collective investments for which it is responsible. If it is not already provided for in its programme of operations, the portfolio management company must inform the AMF without delay of the existence of the delegation.

In addition, the financial management delegation must be formalised in a written agreement.

**iii. Capital structure**

- <u>Capital of the SICAV</u>: the initial capital may not be less than 300,000 euros. The SICAV's share capital is variable. Therefore, the amount of the SICAV's capital is at any time equal to its net assets value, deducting distributable amounts. The SICAV is required to issue and redeem its shares at any time at the request of its shareholders. The capital varies according not only to new subscriptions and redemption requests but also to the value of the financial instruments that are part of the asset composition. When, during the course of a SICAV's corporate life, its assets fall below 300,000 euros, the redemption of its shares must be suspended. If the assets remain below this amount for 30 days, the SICAV must be liquidated or merged into another UCITS.
- <u>Assets of the FCP</u>: the mutual fund is a co-ownership of securities, without any legal personality, and which issues units. The value of the net assets of an FCP may not be less than 300,000 euros. When the net assets of an FCP fall below 300,000 euros, the redemption of its units must be suspended. If the assets remain below this amount for 30 days, the FCP must be liquidated or merged into another UCITS.

**iv. Limits on portfolio investments**

The UCITS' investment strategy must comply with an essential principle of risk diversification. Therefore, risk-spreading ratios, control ratios and counterparty risk ratios apply to UCITS.

For instance, UCITS must comply with the risk spreading ratios provided for in article R. 214-21 of the CMF. This rule is the so-called "5/10/40" rule. According to this rule, a maximum of 10% of the fund's net assets may be invested in the assets of a single issuer, and total investments in issuers in each of which the fund invested more than 5% of its assets must not represent more than 40% of the total portfolio.

In addition, UCITS are subject to investment constraints regarding: (i) eligible assets; (ii) authorised financial markets; (iii) specific operations that are authorised under conditions (guarantees, securities financing transactions, cash borrowing, etc.); and (iv) prohibited operations.

Additional investment constraints apply to specific types of UCITS (*e.g.* index-tracking UCITS).

**v. Conflicts of interest**

Any portfolio management company must implement an adequate policy for managing conflicts of interest. Such policy must in particular:

- identify, in connection with the portfolio management company's activities, the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of the UCITS or one or more clients; and

- specify procedures to be followed and measures to be taken in order to manage such conflicts of interest.

**vi. Reporting and recordkeeping**

UCITS must draw up a half-yearly report at the end of the first half of their accounting period. This half-yearly report must be published no later than two months after the end of the first half of the year, or after the end of each quarter, where appropriate. Investors must also be provided with the assets composition of the UCITS upon request. Such document also includes information on the net assets value, the number of shares or units and its off-balance-sheet commitments.

Pursuant to the provisions of the GRAMF, the portfolio management company must take the necessary measures to set up appropriate electronic systems, allowing the rapid and correct recording of information relating to UCITS transactions. Such records must be kept for at least five years.

**vii. Other**

Other regulatory requirements are applicable, in particular with respect to the following matters:

- accounting rules, determination of distributable amounts and calculation of the net asset value;
- practices regarding fees and expenses (swing pricing, subscription and redemption fees, "shared fees", etc.);
- specific rules to prevent market timing and late trading practices; and
- specific rules on redemption requests (*e.g.* cap of redemption orders in case of exceptional circumstances) and subscription requests (*e.g.* suspension of subscription orders).

Moreover, additional requirements may apply to specific types of UCITS (see question **3.4**).

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

In order to be able to provide French UCITS with investment advice, any entity must either:

- be authorised and regulated in France by the ACPR as an investment services provider (either a credit institution or an investment firm), authorised to provide investment advice in France;
- be authorised and regulated in France by the AMF as a portfolio management company authorised to provide investment advice in France, provided that such activity is carried out on an ancillary basis;
- be registered with the ORIAS register as a French CIF and be affiliated with one of the professional associations authorised by the AMF;
- be registered with the ORIAS register as a tied agent acting on behalf of an investment services provider; or
- if it is located outside France but in another Member State of the European Union ("**EU**"), be authorised by its local regulatory authority as (i) an investment services provider and comply with the passporting notification procedure in accordance with the EU Directive 2014/65/UE (the "**MIFID**"), or (ii) a UCITS manager or an AIF manager authorised to provide investment advice and comply with the passporting notification procedure in accordance with either the UCITS Directive or the EU Directive 2011/61/EU (the "**AIFMD**").

For portfolio management delegates, such entity must either (i) be authorised to manage UCITS or AIFs by its competent regulatory authority, or (ii) be authorised for providing portfolio management services, whether located inside or outside the EU. If the delegate is located in a third-country, a cooperation agreement must have been entered into between the AMF and the competent regulatory authority of the relevant portfolio management delegate.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

Yes. Any investment adviser is subject to the MIFID regime which was implemented by French law. The investment adviser must comply with regulations and good conduct rules pursuant to the MIFID regime.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

Yes, UCITS are currently not authorised to invest in crypto-assets.

However, the future regime for regulating "initial coin offerings" in France has been introduced in article 26 of the draft law on the growth and transformation of undertakings (the "**PACTE**" law). The draft "PACTE" law is under consideration by the Senate, with the aim of final adoption in April 2019.

The draft "PACTE" law aims to enable specific investment funds opened to professional investors ( professional specialised investment funds ( *fonds professionnels spécialisés* – "**FPS**") and specialised financing vehicles (*organismes de financement spécialisé* – "**OFS**")) to invest in crypto-assets, whose property rights are based on the blockchain technology.

French professional private equity funds ( *fonds professionnels de capital-investissement* – "**FPCI**") would also be able to invest in crypto-assets, up to 20% of their assets.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

The regime for marketing UCITS in France only covers UCITS authorised pursuant to the UCITS Directive. All French UCITS must be authorised by the AMF prior to the marketing of their units or shares in France (see question **1.1** above).

EEA UCITS located outside of France may benefit from the passport regime pursuant to the UCITS Directive. Thus, in order to market the shares or units of an EEA UCITS or a UCITS sub-fund in France, the management company must comply with a notification procedure and file sufficient information on the relevant UCITS with its competent regulatory authority. Such notification file is then emailed directly to the AMF. The AMF informs the relevant competent authority within five business days that the complete notification file has been taken into account. The UCITS may then market its shares or units in France as from the date of that notification.

In addition, the AMF applies the concept of "pre-marketing", which does not qualify as marketing within the meaning of the UCITS Directive. Pre-marketing consists of testing investors' interest before launching a UCITS. This test must be performed via a maximum of 50 professional investors (or assimilated as such) and must not result in the delivery of a subscription form nor documentation including definitive information on the characteristics of the UCITS.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

Even though marketing is not *per se* a regulated activity, the marketing of financial products usually leads the distributor to provide one or more investment services such as investment advice or service of reception and transmission of orders on behalf of third parties. Such investment services may only be provided by:

- a portfolio management company, duly authorised for providing such investment services (on an ancillary basis);
- another investment services provider (either an investment firm or a credit institution);
- a tied agent acting on behalf of an investment services provider; or
- a CIF.

(See question **2.2**.)

The MIFID provides for a list of exceptions according to which entities providing investment services are exempt from any authorisation requirement. However, such exceptions are subject to a strict interpretation from competent regulators.

Distributors which provide investment services in France while marketing shares or units of UCITS must comply with good conduct rules, in particular rules on product governance, investors' information, inducements, suitability or appropriateness assessment, etc.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

In accordance with article L. 533-12-4 of the CMF, investment services providers shall not pay or receive any fee or commission or provide or receive a non-monetary benefit in connection with the provision of an investment service to any person, unless the following conditions are met:

- the purpose of the commission or benefit is to enhance the quality of the relevant service; and
- such inducement does not interfere with the investment services provider's obligation to act honestly, fairly and professionally in accordance with the best interests of the client.

In such cases, investors must be clearly informed of the existence, nature and amount of the payment or benefit referred above or, where this amount cannot be established, of its method of calculation, in a complete, accurate and comprehensible manner before the investment service or related service concerned is provided to them.

**ii. Advertising**

The GRAMF defines the general principles that apply to the contents of marketing materials. Any information provided in a marketing material:

- must be correct, clear, and not misleading;
- may not include statements that are in contradiction with the information provided by the prospectus and the KIID; and
- must have balanced information, *i.e.* if the distributor emphasises the advantages of the product, it must also emphasise the risks associated with it.

AMF position No. 2011-24 on drafting of marketing materials provides details on the good conduct rules to be adopted when drafting marketing materials with respect to collective investment schemes. It also provides for a list of bad practices which are prohibited.

**iii. Investor suitability**

The MIFID requires investment services providers to assess the suitability or the appropriateness of investment services or financial instruments proposed to their clients or potential clients:

a. Suitability test: such assessment is required when investment advice or portfolio management services are provided. This test consists of obtaining the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, that person's financial situation including his ability to bear losses, and his investment objectives including his risk tolerance so as to enable the investment services provider to recommend to the client or potential client the investment services and financial instruments that are suitable for him and, in particular, are in accordance with his risk tolerance and ability to bear losses.

b. Appropriateness test: such assessment is required when any other investment services are provided. This test consists of asking the client or potential client to provide information regarding that person's knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment services provider to assess whether the investment service or product envisaged is appropriate for the client.

Investment services providers may not be required to conduct an appropriateness test in case of an "execution only" service, *i.e.* when it only provides execution or reception and transmission of client orders. However, specific conditions must be met in order to benefit from such an exemption.

**iv. Custody of investor funds or securities**

In France, it is mandatory to appoint a custodian for each UCITS, which is independent from the management company. The custodian must be authorised to carry out the activity of safekeeping and administration of financial instruments. The custodian may be a French credit institution, a French branch of an EEA credit institution or an investment firm which complies with specific own funds requirements.

Article L. 214-10-5 of the CMF governs the depositary functions. The custodian has, *inter alia*, two main duties:

- asset custody; and
- monitoring function. In this respect, the custodian ensures that the portfolio management company manages its UCITS in accordance with the management policy defined in the prospectus and that it effectively complies with the various prescribed ratios.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

No. However, additional requirements and/or marketing restrictions apply to specific types of UCITS, such as:

- structured UCITS (*OPCVM à formule*), which qualifies as "complex financial instruments" (see AMF Position No. 2010-05);

- "guaranteed" UCITS (*OPCVM garantis*) (see AMF Position No. 2013-12); and
- listed UCITS (ETFs) or index-tracking UCITS (see ESMA's guidelines on ETFs and other UCITS issues, ESMA/2014/937).

**3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?**

There are specific marketing rules concerning (this is a non-exhaustive list):

a. The financial solicitation (*démarchage*) which is an active method of marketing financial products governed by articles L. 341-1 to L. 341-16 of the CMF. The financial solicitation is constituted by:
   - unsolicited contact. There is no solicitation if an investment service provider responds spontaneously to a solicitation from an investor;
   - by any means whatsoever;
   - with an individual or a legal entity; and
   - in order to obtain "the execution of a transaction" or "the provision of a service" referred to in article L. 341-1 of the CMF. The act must therefore be intended to obtain the consent of the solicited person to the execution of a transaction in financial instruments, a bank transaction or the provision of an investment service.

This legal framework includes additional good conduct rules that must be complied with.

b. French consumer law rules that apply to distance contracts for financial services entered into with French consumers (articles L. 222-1 *et seq*. of the French consumer code).

## 4 Tax Treatment

**4.1 What are the types of entities that can be public funds in your jurisdiction?**

As mentioned above, a UCITS can either be set-up as a SICAV or as an FCP.

**4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?**

**1) SICAVs**

**Tax treatment applicable to SICAVs**

SICAVs fall within the scope of corporate income tax ("**CIT**"). However, they are expressly exempt from CIT with respect to the profits they derive from operations realised in accordance with their corporate purpose. Such profits are taxed at the level of the investors.

**Tax treatment applicable to investors**

Given that SICAVs have a legal personality, profits they distribute are generally taxed as dividends at the level of the investors.

However, to the extent that SICAVs ventilate their profits according to their nature and origin, their distributions are taxed according to the rules that are applicable to each corresponding category of income (*i.e.* distributed dividends are treated as dividends, distributed capital gains as treated as capital gains for tax purposes). This holds true both for resident and non-resident investors.

(i) French resident individuals

Individual investors are treated as if they had directly derived the underlying profits of the SICAV, save that taxation only occurs at the time when such profits are effectively distributed to them (via a distribution of assets or a share buy-back).

Accordingly, dividends that are redistributed by a SICAV are subject to a flat tax at the rate of 30% (12.8% income tax + 17.2% of social levies) or to income tax at scaling rates if a specific option is made in this respect (in that case, a 40% deduction applies on the gross amount of distributed dividends). The same taxation rates apply to capital gains on shares that are distributed by a SICAV, except that when an investor has elected to be taxed at scaling rates of income tax (instead of the 30% flat tax rate), a 50% or 65% deduction in basis (depending on whether they have held the shares since more than two or eight years) may be applicable provided that the SICAV's assets are composed of shares at 75% or more.

(ii) French corporate investors

As a rule, French corporate investors are subject to a mark-to-market taxation rule with respect to the shares they hold in a SICAV. In this case, corporate investors are subject to standard CIT rates (31% in 2019, 28% from 2020, 26.5% from 2021 and 25% from 2022) on increases in the liquidation value of the SICAV shares they hold. As an exception, certain SICAVs that invest at least 90% of their assets in shares (*SICAVs actions*) are not concerned by this mark-to-market rule.

In any case, income that is distributed by a SICAV is subject to taxation at standard CIT rates (net of any mark-to-market taxation). It should be noted that SICAV shares are not eligible to the French parent-subsidiary regime (*régime mère-fille*), nor to the French participation-exemption regime on capital gains (*régime des plus-values long terme*).

(iii) Non-resident investors

Alike resident investors, non-residents are technically deemed to directly derive a SICAV's profits on the year when such are effectively distributed.

As a result, non-residents are subject to a withholding tax ("**WHT**") on the distributions paid by SICAVs according to the rules applicable to each corresponding category of income (as the case may be, such WHT may be reduced or removed under certain double tax treaties).

Accordingly, distributions reflecting dividends are subject to a 12.8% WHT when they are distributed to individuals or to a 30% WHT when they are distributed to corporate investors (*i.e.* reduced progressively to 28% from 2020, 26.5% from 2021 and 25% from 2022). Also, provided certain conditions are met, such dividends may benefit from a WHT exemption when they are paid to European UCITS or UCITS of non-European States having entered into a double tax treaty with France containing an administrative assistance clause.

Distributions reflecting capital gains realised by SICAVs upon the disposal of assets are generally not subject to taxation in France provided that the concerned investor, his/her spouse and their relatives in the ascending and descending line, do not hold, directly or indirectly, at any time during the five years prior to the distribution, more than 25% of the rights in the underlying company (*distribution d'une participation substantielle*).

**2) FCPs**

**Tax treatment applicable to FCPs**

As opposed to SICAVs, FCPs are co-ownerships of assets with no legal personality. Consequently, they benefit from a tax transparency regime. Profits are taxed at the level of investors who enjoy a tax regime which is very close to the one that applies to investors in SICAVs.

**Tax treatment applicable to investors**

(i) Resident investors (individuals and corporates)

When they invest in an FCP, unitholders are technically deemed to directly derive the income realised by the FCP on the year when they are effectively distributed. As a result, unitholders are generally subject to income tax (for individuals) or to CIT (for corporate investors) on distributions made by the FCPs according to the rules applicable to concerned category of income.

For example, distributions reflecting dividends perceived by the FCPs are subject to a flat tax at the global rate of 30% or, subject to an election being made for that purpose, to scaling rates of individual income tax (in that case, a 40% deduction applies on the gross amount of dividends distributed). Capital gains also follow the same tax regime as the one that we describe above in paragraph **1)**.

Corporate investors are subject to a tax treatment that is similar to the one that we describe above in paragraph **1)**.

(ii) Non-resident unitholders

Alike residents, non-residents investing in an FCP are technically deemed to directly derive the income realised by the FCP on the year when they are effectively distributed. As a result, non-residents are subject in France to a WHT on the distributions paid by FCPs according to the rules applicable to each corresponding category of income.

For example, dividends received by FCPs from French companies and distributed to non-resident individuals are subject to a 12.8% WHT, or to a 30% WHT when they are distributed to corporate companies' unitholders (*i.e.* reduced progressively to 28% from 2020, 26.5% from 2021 and 25% from 2022). In contrast, distributions of capital gains will generally not be subject to taxation in France (please see paragraph **1)** for a more detailed analysis).

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

SICAVs are exempt from CIT and FCPs are tax transparent without being bound by any legal obligation to distribute their income and capital gains. However, in order for their investors to be taxed according to the tax regime of each category of underlying profits or gains, both forms of public funds must satisfy certain conditions. Notably, they must:

- allocate their distributions according to their nature (dividends, capital gains, interests, etc.) and their source (domestic or foreign) (*règle du couponnage*);
- communicate this allocation to investors; and
- disclose a detailed follow-up status report mentioning profits received and distributed at the first request of the French tax authorities.

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# Germany

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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Yes. Under the German Investment Code, any fund that is intended to be marketed to investors in Germany must be notified to the German supervisory authority (Federal Financial Supervisory Authority, Bundesanstalt für Finanzdienstleistungsaufsicht or "BaFin" (please visit https://www.bafin.de/EN/Homepage/homepage_node.html for more information)). Since the Alternative Investment Fund Managers Directive ("AIFMD") was transposed into German law in 2013, Germany no longer provides for a private placement regime; therefore, a distinction between public funds or private funds does not apply. Rather, a distinction must be made between retail funds and non-retail funds (so-called "Special AIFs" which may be marketed solely to professional and semi-professional investors as defined in the German Investment Code). For purposes of this information, we use the term public fund as an equivalent for retail funds.

The European fund universe is divided into undertaking for the collective investment in transferable securities ("UCITS") and alternative investment funds ("AIFs"). UCITS are defined as retail funds. AIFs can be retail or non-retail funds.

In Germany, notifications of foreign UCITS for marketing to retail investors are made under the EU's UCITS passport regime. German UCITS and all AIFs for retail investors are notified directly to the BaFin. The AIFMD marketing and passport regime is available only for the marketing of AIFs to professional and semi-professional investors in Germany.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

Foreign UCITS can be marketed to retail investors under the passport regime of the UCITS Directive 2009/65/EU, i.e. the fund manager notifies the competent authority of its home Member State of its intention to market the fund in Germany (regulator-to-regulator notification procedure). Special rules apply to certain funds under European regulations, such as European Long-Term Investment Funds.

The terms and conditions of German retail funds (including sub-funds of an umbrella) must be set forth in a separate document (*Anlagebedingungen*) which is subject to the BaFin's approval.

Before a fund can be marketed to retail investors, the fund manager must submit to the BaFin the following documents:

- a business plan;
- the fund's terms and conditions;
- if applicable, the constituting documents (for funds which are organised as investment companies);
- information relating to the fund's depositary;
- the prospectus and the key investor information document; and
- if the fund is a feeder fund, certain information relating to the master fund.

If a foreign AIF (i.e. a non-UCITS fund) is intended to be marketed to retail investors in Germany, the foreign fund manager (the "AIFM") must submit a notification letter plus accompanying documents for such AIF (or the sub-fund of an umbrella). The notification letter must include, for example, evidence of the AIFM's licence and compliance with the AIFMD, a description of the fund, the custodian, the German paying agent and the German representative, the fund documents, a business and a marketing plan, the most recent audited annual report and the semi-annual report, the prospectus and the key investor information document. Documents in a foreign language must be accompanied by a German translation. In addition, the foreign AIFM must agree to provide certain information and reports to the BaFin and submit itself to the BaFin's instructions regarding use of leverage. The BaFin has published a guidance notice for such marketing notification. The BaFin charges fees for the notification procedure, the review of the periodical reports and orders prohibiting marketing.

While EU-AIFMs can market their EU-based AIFs to non-retail investors under the AIFMD passport regime, non-EU AIFMs have to notify the BaFin of marketing intent to non-retail investors (since the AIFMD passport regime has not yet been extended to non-EU AIFMs). As with the notification procedure for retail marketing, the AIFM must submit a notification letter to the BaFin which includes the required information and accompanying documents. However, the documents can be provided either in English or German. The BaFin provided a "Guidance Notice on the marketing pursuant to section 330 of the Investment Code", and a non-binding English translation thereof. Please visit https://bepartners.pro/en/pathfinder/bafin/ for more information.

**1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?**

If unauthorised marketing is undertaken, the BaFin may take all measures necessary and appropriate to protect the investors, including an order to cease any further marketing. The BaFin may charge a fee therefor from EUR 1,000 to EUR 15,000, plus expenditures.

In certain cases, such a BaFin order triggers a one-year lockout period.

If such an order is violated, the BaFin may impose a fine of up to EUR 5 million, or, in case of legal persons or associations, an amount equalling 10 per cent of the annual total turnover, which may exceed EUR 5 million. If the addressee is part of a group, the basis for calculating the fine is the whole group's total turnover. Alternatively, the fine can be calculated as twice the amount of the economic benefits resulting from the violation, which may exceed both EUR 5 million and 10 per cent of the turnover.

Unauthorised management of funds in Germany is a criminal offence and punishable with up to five years of incarceration.

**1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?**

Foreign funds are permitted to register, provided that the fund manager and the fund fulfil the applicable requirements set forth in the Investment Code. If marketed to retail investors, the AIF and its AIFM must be domiciled in the same country. UCITS are not subject to the same restriction, i.e. cross-border management within the EU Member States is allowed.

If an AIF is marketed to retail investors, the AIFM must appoint a German representative and a German paying agent.

## 2 Regulatory Framework

**2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?**

**i. Governance**

Any German fund manager must be licensed by the BaFin (or at least registered in accordance with the *de minimis* rules, which are based upon the AIFMD). The governance requirements of the Investment Code are based upon the AIFMD or the UCITS Directive:

- General principles (such as: acting honestly, with due skill, care and diligence and fairly; acting in the best interests of the fund or the fund investors and the integrity of the market; taking all reasonable steps to avoid conflicts of interest and, if unavoidable, identifying, managing and monitoring and, where applicable, disclosing those conflicts of interest; complying with all regulatory requirements so as to promote the best interests of the fund or fund investors and the integrity of the market; and treating all investors fairly).
- Remuneration policies.
- Functional and hierarchical separation of the risk management functions from the operating units, including the portfolio management.
- Sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing and adequate internal control mechanisms, including, in particular, rules for personal transactions by employees or for the holding or management of investments in order to invest on its own account.
- Valuation policies (appropriate and consistent procedures so that a proper and independent valuation of the assets of the fund can be performed).
- Delegation of functions (due diligence, monitoring and final responsibility of the fund manager).
- Appointment of a depositary.
- Investor information prior to subscription and ongoing reporting and disclosure obligations.

Retail funds are subject to detailed rules relating to the portfolio, e.g. with regard to eligible assets, leverage or diversification. Additional European regulation must be observed, such as the Commission Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions or Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (the "Delegated Regulation").

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

In terms of the Investment Code, an investment adviser advises the fund manager without taking any investment decisions. Obtaining such advice is not subject to specified requirements, whereas providing such advice if it relates to financial instruments is (e.g. no requirements if in relation to real estate).

However, the fund manager may delegate the portfolio management function to a service provider, i.e. to an external portfolio manager. Unlike an investment adviser, the portfolio manager has the discretion and is authorised to make and implement investment decisions. The delegation of portfolio management functions is subject to a specified delegation regime. The fund manager must notify the BaFin of its intention to delegate the portfolio management to a service provider (before the delegation arrangement enters into force). The BaFin may require the fund manager to provide the agreements with the external portfolio manager.

Generally, an external portfolio manager must be licensed or registered for portfolio or asset management services, and must be subject to effective supervision. For example, an EU-based portfolio manager of a fund investing in financial instruments is typically authorised in accordance with the provisions of the UCITS Directive, the AIFMD or the Markets in Financial Instruments Directive ("MiFID"). If the portfolio management is delegated to a non-EU portfolio manager, the supervisory authorities of the portfolio manager's country of domicile must have concluded a cooperation agreement with the BaFin. By 10 December 2015, the BaFin had concluded 23 of such agreements, *inter alia*, with Switzerland's FINMA, the United States' SEC and the Cayman Islands' CIMA.

On a case-by-case basis, the BaFin may approve the appointment of a portfolio manager who is not licensed or registered.

**iii. Capital structure**

The Investment Code provides minimum capital requirements relating to the fund manager.

German funds are basically financed with the investors' equity. Limitations of debt financing apply, depending on the type of fund and the target investors (retail or non-retail investors).

As a general rule, the BaFin is authorised to limit the use of leverage of funds in order to ensure the integrity and stability of the financial systems.

With regard to retail funds, the Investment Code imposes strict limits on debt financing. UCITS and open-ended AIFs may take up loans only on a short-term basis and limited to 10 to 20 per cent of the relevant fund's NAV. Open-ended real estate funds for retail investors may use additional long-term financing not exceeding 30 per cent of the loan to value of the real property portfolio. Closed-ended retail funds may take up loans not exceeding 60 per cent of the committed capital.

Foreign funds which seek approval for marketing to retail investors in Germany must observe these limits.

The intended use of leverage must be set forth in the prospectus for retail funds, and the use of leverage must be reported on an ongoing basis.

**iv. Limits on portfolio investments**

Different limits on portfolio investments apply to German funds, depending on the type of fund and the target investors. Generally speaking, German retail funds are subject to detailed rules relating to a fund's portfolio, such as eligible assets including target funds, leverage, use of derivatives and diversification. Foreign funds which seek authorisation for marketing to retail investors in Germany must apply equivalent limits.

**v. Conflicts of interest**

The fund manager (of retail funds as well as of non-retail funds) has to take all reasonable steps to identify any conflicts of interest that arise in the course of managing funds. It shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to identify, prevent, manage and monitor conflicts of interest in order to prevent such conflicts from adversely affecting the funds' and their investors' interests. Details are set forth in the Investment Code, the Regulation specifying Rules of Conduct and Organisational Requirements for Investment Services Enterprises and, in particular, in Articles 30–37 of the Delegated Regulation. Further guidance is also available from the BaFin.

**vi. Reporting and recordkeeping**

Fund managers of open-ended retail funds must provide audited annual reports and non-audited semi-annual reports. Such reports must include the basic information as set forth in the Investment Code and supplemental information for certain types of funds. Additional reports are required when the fund manager is replaced or the fund is liquidated. The annual reports must be published in the German Federal Gazette. For closed-ended investment limited partnerships, no semi-annual reports are required.

Operations must be documented in a manner which allows reconstruction of each transaction (portfolio transactions and subscription and redemption orders). All required records must be retained for a period of at least five years. However, the BaFin may require a longer retention period. Details are set forth in the Investment Code, the Regulation specifying Rules of Conduct and Organisational Requirements for Investment Services Enterprises and in Articles 64–66 of the Delegated Regulation.

**vii. Other**

Please note that a single depositary must be appointed for each fund. The depositary is responsible for the safekeeping of the assets and the monitoring of cash flows.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

Yes. Investment advisers which provide financial services to investors (including investors which are funds) must generally be licensed to provide financial services in accordance with the German Banking Act. The term "financial services" includes, *inter alia*, investment advice, brokerage and portfolio management for individual clients (as opposed to the management of collective investment schemes) in connection with financial instruments.

However, a fund manager which is licensed under the Investment Code may also provide investment advice or portfolio management services to individual clients without having to obtain a licence under the German Banking Act.

EU-based investment advisers can provide financial services in Germany under a passport regime of one of the applicable EU directives, such as the MiFID (provided that they are licensed for such services by the competent authority of their country of domicile). Services can be provided either directly as cross-border service or via a German branch or so-called "tied agent". Since EU-based investment advisers are subject to supervision in their country of domicile, they do not require a licence from the BaFin. Rather, their intention to provide services in Germany must be notified in a regulator-to-regulator notification procedure, similar to the notification procedures for marketing funds under an EU passport regime (see question 1.2 above).

Non-EU based investment advisers cannot provide cross-border services; they must establish a branch or a subsidiary in Germany. Such branch or subsidiary is subject to German law and requires a licence as a credit institution or financial services provider under the German Banking Act. The application for the licence must contain certain particulars; for example, a viable business plan, the organisational structure, the envisaged internal monitoring procedures, evidence of sufficient resources needed for business operations, information of the knowledge and reputation of (at least two) responsible managers and significant holdings in the applicant.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

Yes. An investment adviser is subject to the MiFID regime which was transposed into German law in particular as the Securities Trading Act (*Wertpapierhandelsgesetz*). The MiFID regime is a complex framework of EU directives (transposed into domestic law), EU regulations and other delegated acts which are directly binding law in the EU Member States.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

Digital currencies are currently not explicitly addressed in the German legal framework for retail funds. The BaFin examines and decides on a case-by-case basis whether a token qualifies as a financial instrument or a security. To the extent that a token qualifies as a security, such digital currency might principally be investable for a retail fund. However, many questions in connection with investments in digital currencies are not yet answered, such as the safekeeping of tokens by the depositary.

## 3 Marketing of Public Funds

**3.1 What regulatory frameworks apply to the marketing of public funds?**

The fund manager must observe the Investment Code which includes marketing provisions, such as the mandatory investor information (prospectus and key investor information document), the eligible target investors (retail or non-retail investors) and reporting and disclosure obligations.

A distributor marketing a fund in Germany is not directly subject to the Investment Code but to the MiFID regime, in particular the Securities Trading Act (plus government regulations and BaFin guidance), since marketing of funds qualifies as a financial service. However, a distributor must indirectly observe the Investment Code. An obligation to observe the Investment Code is typically included in the contractual arrangements between the fund manager and the distributor.

**3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.**

Yes, a person engaged in marketing activities generally must be licensed as a financial services provider in accordance with the Banking Act. Such licence requires: a minimum capital; managers of sufficient knowledge and good reputation (at least two managers who are German residents); that holders of significant interests in the applicant are appropriate; sufficient resources; and an organisation which allows the business to operate properly.

However, a distributor which markets (licensed) funds only in Germany does not necessarily require a licence as a financial services provider under the Banking Act. Such distributors may market funds under a licence under the German Trade Ordinance (subject to some additional requirements) which is easier to obtain. The licence requires evidence of sufficient knowledge and reputation, sufficient credit standing and professional liability insurance (E&O). Sufficient knowledge must be evidenced by an exam passed with the local Chamber of Industry and Commerce. Each natural person involved in marketing activities must provide such an exam and a good reputation.

Persons licensed as a financial services provider in accordance with the Banking Act are subject to the MiFID regime (Securities Trading Act, EU and German regulations, BaFin guidance and, in particular, Circular 4/2010 (WA) – Minimum Requirements for the Compliance Function and Additional Requirements Governing Rules of Conduct, Organisation and Transparency ("Circular 4/2010")).

**3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?**

**i. Distribution fees or other charges**

Fees and charges are subject to restrictions and extensive disclosure obligations under the MiFID regime and the Investment Code (in particular, the Securities Trading Act and Article 50 of the Commission Delegated Regulation (EU) No. 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, plus BaFin guidance, such as section BT 3.3.4.1.7 of the Circular 4/2010).

**ii. Advertising**

Advertising for UCITS and retail AIFs must be readily identifiable as advertising. As a general principle, advertising must be honest and clear and not misleading. In particular, advertising must not include any statements which contradict or decrease the importance of any information provided in the prospectus or the key investor information document. Written advertising must include a note that a prospectus and a key investor information document are available (plus information where to obtain said documents and in which language). For specified types of funds or investment strategies, additional information must be included in the advertising material.

Distributors are subject to the abovementioned MiFID regime.

**iii. Investor suitability**

The MiFID regime includes an obligation to determine whether an investment is suitable for the relevant potential investor, including extensive documentation obligations.

**iv. Custody of investor funds or securities**

Custody of investor funds or securities generally requires an appropriate licence under the Banking Act.

However, custody of investors' shares or units in funds can also be undertaken by German management companies licensed under the Investment Code, provided that such licence is extended to include individual portfolio management services.

**3.4 Are there restrictions on to whom public funds may be marketed or sold?**

Under German law, no distinction is made between public funds and private funds. The restriction applies to non-retail funds which may not be marketed to retail investors.

**3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?**

Marketing is subject to the Investment Code, the Banking Act and the Securities Trading Act, plus EU law (directives, regulations and other delegated acts) and German regulations and ordinances relating thereto. With regard to investment stock corporations with fixed capital which are offered to the public or listed in an organised market, the Securities Prospectus Act (*Wertpapierprospektgesetz*) applies.

## 4 Tax Treatment

**4.1 What are the types of entities that can be public funds in your jurisdiction?**

German funds can be contractual funds (*Sondervermögen*) or investment companies.

The *Sondervermögen* is an open-ended type of fund which is available for both retail and non-retail investors.

Investment companies for retail investors can have the form of a closed-ended investment limited partnership (*geschlossene Investmentkommanditgesellschaft*), a closed-ended investment stock corporation with fixed capital (*Investmentaktiengesellschaft mit fixem Kapital*) or an open-ended investment stock corporation with variable capital (*Investmentaktiengesellschaft mit variablem Kapital*).

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

Since 1 January 2018, a revised investment tax regime with both an entity-level tax and taxation of investors applies. The revised Investment Tax Act applies to "Investment Funds"; such term generally includes most pooled investment vehicles, whether established in Germany or abroad. However, investment vehicles structured as partnerships (including limited partnerships) do not qualify as Investment Funds if they do not qualify as UCITS.

Investment Funds within the meaning of the Investment Tax Act are subject to taxation at entity level. Tax is levied on certain German source income and capital gains: income from participations (dividend income and equivalent compensation payments under stock lending and security repurchase agreements); real estate income (real estate income and real estate capital gains); and certain other income (*inter alia*, income and capital gains attributable to a German permanent establishment of an enterprise). Both German and foreign Investment Funds suffer a 15 per cent tax on such income and gains (there is an exemption insofar as fund investors (domestic and foreign) themselves are tax-exempt). German investors receive a partial tax exemption on income and capital gains generated out of their Investment Fund investments regardless of whether they have invested in a German or a foreign Investment Fund. The exemption will only be granted if the Investment Funds provide for a certain minimum quota for their investments. For example, an exemption of at least 30 per cent applies (depending on the tax status of the investor in Germany) if at least 51 per cent of the fund assets are comprised of shares, an exemption of 60 per cent applies if the fund assets are comprised of real estate, and an exemption of 80 per cent applies if the fund assets are comprised of non-German real estate.

In addition to Investment Funds, there exists the category of so-called Special Funds. Tax treatment is different insofar as the fund can elect to have certain income and capital gains taxed only at investor level, and not at fund level. Special Funds need to be open-ended, risk-diversified and are subject to strict investment limits. Special Funds must not be offered to individuals and the total number of investors is restricted to 100.

Investment vehicles structured as partnerships (other than UCITS) are subject to the general rules applicable to partnerships, i.e. such funds are generally tax-transparent but may be subject to trade tax if they derive commercial income. Investors are subject to tax depending on the income allocated to them and the investor's individual tax status.

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

German tax law differentiates between Investment Funds and Special Funds. For Investment Funds, the scope is broad. In practice, all AIFs and UCITS fall into this category. Special Funds need to fulfil certain additional criteria (see question 4.2 above).

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Bödecker Ernst & Partner is an investment management boutique firm, with offices in Düsseldorf and Luxembourg, specialising in legal, tax and regulatory advice to a wide range of clients, including fund sponsors, investment management service providers and institutional investors, such as insurance companies and pension schemes. Since 1996, its team has been recognised in the market as one of the pioneers and leading experts in the field of alternative investments. The firm's expertise lies in the areas of fund structuring, international tax, real estate and capital investment products, insurance and investment fund regulatory issues. The firm has built a strong network based on both business and personal contacts worldwide. As a result, it is able to offer high-quality, seamless and tailored advice to its clients in a national and international setting.

# Hong Kong

Alwyn Li

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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Under the Securities and Futures Ordinance (SFO), authorisation by the Securities and Futures Commission (SFC) is required before a collective investment scheme may be offered to the public in Hong Kong.

There are, however, a limited number of exemptions to this requirement.

The first exemption is when an offer is intended only to professional investors, which is defined in the SFO and its subsidiary legislation to include various institutional investors: trust corporations entrusted with at least HK$40 million in assets; and individuals, corporations and partnerships with an investment portfolio of at least HK$8 million in assets.

Authorisation is also not required where a fund constituted in corporate form is offered: (i) to not more than 50 people; (ii) with a consideration not exceeding HK$5 million; or (iii) with a minimum investment of not less than HK$500,000. Authorisation is also not required for a fund not constituted in a corporate form if such fund is offered to not more than 50 people.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

The authorisation process for retail funds in Hong Kong involves the SFC's review of: (i) the fund itself; (ii) the offering documents in respect of the fund; and (iii) the key operators of the fund (e.g. the trustee/custodian, the manager and investment manager/advisor delegated with investment management power over the fund). The main requirements are set out in the SFC's Code on Unit Trusts and Mutual Funds (the Code) which has recently been updated by the SFC with effect from 1 January 2019. Existing SFC-authorised funds and new funds with existing SFC-approved managers or trustees/custodians have a 12-month transition period for compliance with the new Code, subject to certain exceptions. The information set out herein is based on the updated Code.

To initiate an application for the SFC's authorisation of a fund, the applicant should submit to the SFC a duly signed and completed application form and information checklist, accompanied by the draft offering documents and constitutive documents of the fund.

Further, there are various documents required to be submitted pursuant to the information checklist. For instance, funds that are managed by managers or delegates not currently managing SFC-authorised funds are required to submit a copy of the valid certificate(s) demonstrating the manager/delegate's licensing/registration status, and confirmation in relation to the financial and human resources, internal controls and procedures, disciplinary status and licensing/registration status of such manager/delegate, as well as documentation setting out the fund management experience of the key investment personnel of the manager/delegate. Likewise, a fund with a trustee/custodian not currently acting in such capacity for any other existing SFC-authorised funds is required to submit, *inter alia*, a certificate of incorporation/registration of the trustee/custodian, and, for trustees/custodians whose functions are mainly carried out in Hong Kong, an audit certificate with respect to the trustee's/custodian's internal controls and systems in accordance with the Code.

Applications are subject to a lapse period of six months from the date an application is taken up by the SFC, after which the applicant is required to make a new application and repeat the relevant application procedures, including payment of the application fee in respect of such new application, if the applicant still intends to seek authorisation of the fund. In general, the SFC expects overall processing time for new fund applications to be between one to three months from the date an application is taken up by the SFC, taking into account factors such as the extent of the fund's use of derivatives, whether the fund is managed by existing approved managers managing other existing SFC-authorised funds with good regulatory records, and any material issues and/or policy implications relating to the application.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

Subject to the applicable exemptions, it is a criminal offence to offer a fund that has not been authorised by the SFC to the public in Hong Kong. The maximum penalty is a fine of HK$500,000 and imprisonment for three years.

**1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?**

Both local and foreign funds may be authorised by the SFC for offers to the public in Hong Kong.

The SFC may accept that some funds already comply in substance with certain provisions in the Code by virtue of prior authorisation in a recognised jurisdiction. The list of recognised jurisdictions is listed on the SFC's website and currently includes Australia, France, Germany, Guernsey, Ireland, Isle of Man, Jersey, Luxembourg, Malaysia (in respect of Islamic funds), Switzerland, Taiwan (in respect of exchange-traded funds), the United Kingdom and the United States of America. The SFC will generally review applications for authorisation of funds from a recognised jurisdiction on the basis that the fund's structural and operational requirements and core investment restrictions already comply in substance with the Code. Nevertheless, the SFC expects such funds to comply in all material respects with the Code, and reserves the right to require compliance with specific provisions of the Code as a condition of authorisation.

For instance, in addition to the general procedures and requirements detailed in the Code, the SFC has adopted a fast-track procedure to facilitate the processing of UCITS funds domiciled in Ireland, Luxembourg, and the United Kingdom. Furthermore, the SFC has entered into "Mutual Recognition of Funds" schemes with a number of jurisdictions, including Australia, France, Mainland China, Switzerland, and most recently, Luxembourg and the United Kingdom, whereby eligible overseas and Hong Kong funds can be distributed in each other's market through a streamlined authorisation process.

Where the manager is not incorporated and does not have a place of business in Hong Kong, the fund is required to appoint a Hong Kong representative responsible for, *inter alia*, receiving applications/redemption/conversion notices, providing holders with information on the fund including the fund's financial reports, offering documents, circulars, notices and announcements, and representing the fund and the manager in relation to all matters in which any holder normally resident in Hong Kong has a pecuniary interest or which relate to units sold in Hong Kong. Such Hong Kong representative must be licensed or registered under the SFO, or a trust company registered under the Trustee Ordinance which is an affiliate of a Hong Kong authorised financial institution.

## 2 Regulatory Framework

**2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?**

**i. Governance**

The Code requires every fund to appoint a trustee (in the case of a unit trust)/custodian (in the case of a mutual fund corporation)/depositary (in the case of a UCITS) and a manager acceptable to the SFC. Notwithstanding this, a self-managed scheme may be managed by its own board of directors who performs the functions of a manager where the scheme's investment management function is delegated at all times to a qualified investment delegate in compliance with the Code.

The role of the trustee/custodian is to take into its custody or under its control all the property of the fund and hold it in trust for the holders or the fund in accordance with the constitutive documents of the fund. The trustee/custodian must segregate the property of the fund from the property of the manager, trustee/custodian, and their delegates, nominees, agents, connected persons, and other clients, and put in place appropriate measures to verify ownership of the property of the fund. In addition, the trustee/custodian is obligated to, amongst others, take reasonable care to ensure that the sale/issue/repurchase/redemption/cancellation and the valuation of units/shares are performed in accordance with the constitutive documents of the fund. Cash and registrable assets must be registered in the name of or to the order of the trustee/custodian.

The trustee/custodian must be: (a) a bank licensed in Hong Kong; (b) a trust company registered under the Trustee Ordinance which is a subsidiary of such a bank or a banking institution falling under (d) below; (c) a trust company which is a trustee of any registered scheme as defined in the Mandatory Provident Fund Schemes Ordinance; or (d) a banking institution incorporated outside Hong Kong which is subject to prudential regulation and supervision on an ongoing basis, or an entity which is authorised to act as trustee/custodian of a fund and prudentially regulated and supervised by an overseas supervisory authority acceptable to the SFC. The trustee/custodian should: be subject to prudential regulation and supervision on an ongoing basis; appoint an independent auditor to periodically review its internal controls and systems on terms of reference in compliance with the Code; and file the report with the SFC, unless such trustee/custodian is prudentially regulated and supervised by an overseas supervisory authority acceptable to the SFC.

Further, the trustee/custodian should have paid-up share capital and non-distributable capital reserves of HK$10 million. Nevertheless, if it is a wholly owned subsidiary of a bank or financial institution with minimum paid-up capital of HK$150 million, the issued paid-up capital and non-distributable capital reserves may be less than the aforementioned monetary threshold if the holding company of the trustee/custodian issues certain standing commitment or undertaking in relation to the share capital of such trustee/custodian.

The general obligations of a manager of an SFC-authorised fund are to, *inter alia*, manage the fund in accordance with the fund's constitutive documents in the best interest of the holders and to fulfil the duties imposed on it by the general law. The eligibility criteria for the manager is detailed in question 2.1(ii) below.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

The eligibility criteria for the manager and the investment advisor delegated with investment management function in respect of the fund are detailed in Chapter 5 of the Code. In particular, an investment advisor must: (i) be engaged primarily in the business of fund management; (ii) have minimum paid-up share capital and non-distributable capital reserves of HK$10 million; (iii) not lend to a material extent; and (iv) maintain at all times a positive net asset position.

The manager/investment advisor must also have at least two key investment personnel and each of them must have at least five years of investment experience in managing public funds with reputable institutions. The expertise gained should be in the same or similar type of investments as those proposed for the fund seeking SFC authorisation. Further, such key investment personnel shall have a demonstrable track record in the management of public funds in accordance with the foregoing requirements on investment experience and must dedicate sufficient time and attention in the management of the relevant fund.

With respect to a manager/investment advisor belonging to a well-established fund management group, the foregoing requirement for the key investment personnel to possess public funds experience may be satisfied if the manager/investment advisor on a group-wide basis is able to demonstrate that it possesses the requisite experience and resources to administer public funds. In other words, the key investment personnel of a manager/investment advisor are required to possess at least five years of investment experience in funds, but not necessarily in public funds, if the manager/investment advisor belongs to a fund management group of at least five years of establishment in managing public funds and with good regulatory records.

In addition to local fund managers which are required to be licensed or registered with the SFC to carry out asset management activities, fund managers based in and licensed with the relevant regulator of a jurisdiction acceptable to the SFC may act as managers or delegated investment advisors of SFC-authorised funds. Currently, such acceptable inspection regimes (AIR) are Australia, France, Germany, Hong Kong, Ireland, Luxembourg, Malaysia (in respect of Islamic funds), Switzerland, Taiwan (in respect of exchange-traded funds), the United Kingdom and the United States of America.

**iii. Capital structure**

The SFC does not impose any specific requirements on the minimum capital or net asset value of a retail fund. In practice, the fund size should be maintained at a level at which the fund could be managed in a cost-efficient manner in the best interest of its holders.

**iv. Limits on portfolio investments**

Plain vanilla equity, bond and mixed asset funds, as well as feeder funds, guaranteed funds, and funds investing in other funds are required to comply with the diversification, investment type and exposure limits set out in Chapter 7 of the Code.

Chapter 8 of the Code imposes additional and/or alternative requirements for "specialised schemes", namely money market funds, unlisted index funds, hedge funds, structured funds, funds that invest extensively in financial derivative instruments, active ETFs, and closed-ended funds.

**v. Conflicts of interest**

The Code requires the manager and the trustee/custodian to be independent of each other. Notwithstanding this, they may belong to the same ultimate holding company if: (i) neither the manager nor the trustee/custodian is a subsidiary of the other; (ii) there are no common directors between the manager and the trustee/custodian; and (iii) both the manager and the trustee sign an undertaking that they will act independently of each other in their dealings with the fund. Notwithstanding the above, the Code specifies that there should be systems and controls in place to ensure that persons fulfilling the custodial function/safekeeping of the fund's assets are functionally independent from persons fulfilling the fund's management functions.

Moreover, the Code stipulates restrictions on connected party transactions in respect of, amongst others, cash deposits with connected persons, transactions with connected persons as principals, soft dollar arrangements, and transactions with connected brokers or dealers. In general, all transactions carried out by or on behalf of the fund must be at arm's length and in the best interests of investors.

In addition to the Code requirements above, managers should maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to identify, prevent, manage and monitor any actual or potential conflicts of interest, including conducting all transactions in good faith at arm's length and in the best interests of the fund on normal commercial terms. Where an actual or potential conflict arises, the conflict should be managed and minimised by appropriate safeguards and measures to ensure fair treatment of fund investors, and any material interest or conflict should properly be disclosed to fund investors. For instance, when fund managers are transacting for themselves, they must give their clients priority and avoid conflicts of interest. In addition, cross trades between house accounts and client accounts require the prior written consent of the client, to whom any actual or potential conflicts of interest should be disclosed.

According to the SFC's guidance on internal product approval process, managers are expected to avoid or manage any actual or potential conflicts of interests by conducting all transactions at arm's length and maintaining necessary "Chinese walls". In cases where a conflict cannot be avoided, and provided that investors' interests can be sufficiently protected, the conflict should be managed and minimised by appropriate safeguards, measures and product structure, and these measures and safeguards shall be properly disclosed to investors.

**vi. Reporting and recordkeeping**

**Reporting requirements**

Annual reports prepared in compliance with internationally recognised accounting standards containing information stipulated in the Code must be published and distributed to holders within four months from the end of the fund's financial year and interim reports applying the same accounting policies and method of computation as are applied in the annual report must be published and distributed to holders within two months from the end of the period they cover. Holders may be notified of where such reports, in printed and electronic forms, can be obtained within the relevant timeframe as an alternative to the distribution of printed financial reports.

The fund's latest available offer and redemption prices or net asset value must be calculated and made public free of charge on every dealing day in an appropriate manner by means of dissemination, which may include newspapers, telephone hotlines and websites. If dealing in units/shares is suspended, the SFC must be notified immediately. In addition, the fact that dealing is suspended must be published immediately following decision of such decision and at least once a month during the period of suspension in an appropriate manner.

Moreover, there are further reporting requirements pertaining to various types of circumstances. For instance, the SFC and the trustee/custodian must be informed immediately if an error is made in the pricing of units/shares. Likewise, the manager shall inform the SFC promptly should there be any material breach of the SFC's product requirements.

In general, the manager should provide holders with reasonable prior notice or inform holders as soon as reasonably practicable, of any information concerning the fund which is necessary to enable holders to appraise the position of the fund.

**Recordkeeping requirements**

In general, a fund manager should keep its accounts and records properly, which, *inter alia*, requires such fund manager to keep all transaction records and records of investment processes adopted, and maintain appropriate procedures for the safekeeping, retrieval and storage of documents and records.

The fund manager should also keep records which are sufficient to explain and reflect the financial position and operation of its businesses, enable profit and loss accounts and balance sheets to be prepared from time to time, and reconcile on a monthly basis differences in balances or positions with other entities such as custodians, banks, clearing houses and other intermediaries.

Records should be maintained that show, in respect of each client for whom the fund manager holds client assets, the particulars of the client's assets and liabilities, including any financial commitments and contingent liabilities. Such records should be retained for a period of not less than seven years.

In addition, a fund manager should adequately record all audit work performed in respect of the adequacy, effectiveness and efficiency of such manager's management, operations and internal controls, and record the findings, conclusions and recommendations.

**vii. Other**

The Code requires: (i) changes to constitutive documents (subject to certain exceptions); (ii) changes to the trustee/custodian, manager, investment delegates, and Hong Kong representative and their regulatory status; (iii) material changes in investment objectives, policies and restrictions of the fund (including expansion in the purpose and extent of use of financial derivative instruments for investment purposes); (iv) introduction of new fees and charges, or increase in fees and charges payable out of the property of the fund or by the investors (other than an increase within the permitted maximum level as disclosed in the Hong Kong offering documents of the fund); (v) material changes in dealing arrangements, pricing arrangements or distribution policy of the fund; and (vi) changes that may have a material adverse impact on holders' rights or interests (including changes that may limit holders' ability in exercising their rights), to be submitted to the SFC for prior approval. The SFC will also normally expect one month's prior written notice to be provided to holders in respect of the aforementioned changes. The Hong Kong offering documents of a fund revised to reflect such changes are also required to be submitted to the SFC for prior authorisation.

Notice is also required to be given to investors where a fund is to be merged or terminated. Such notice should contain information stipulated by the SFC, and be submitted to the SFC for prior approval.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

An investment advisor delegated with discretionary investment management function not currently acting in the same function for other existing SFC-authorised funds is required to be vetted by the SFC. As part of such vetting process, the SFC requires submission of confirmations and/or documentation in respect of the registration status of the investment advisor to manage funds, the disciplinary history of the investment advisor and the directors thereof, and compliance with the financial and key investment personnel requirements detailed in question 2.1(ii) above.

Local investment advisors delegated with investment management functions are required to be properly licensed or registered by the SFC to carry on asset management activities. A copy of the valid certificate showing such licensing/registration status should also be submitted to the SFC as part of the foregoing vetting process.

In applying to the SFC for the licensing/registration status required for managing funds in Hong Kong, the investment advisor is required to submit comprehensive information and various prescribed forms to the SFC consisting of a proposed "business plan", shareholding structure, organisational chart, key business lines, managers in charge, internal control framework and financial situation. In addition, the SFC requires information in relation to the fitness and properness of the substantial shareholders of the investment advisor, the proposed responsible officers overseeing its regulated activity of asset management, and both executive and non-executive directors of the investment advisor. The investment advisor applying for its asset management licence and its directors and substantial shareholders will also be required to submit SFC application forms.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

Notwithstanding the requirements on AIR detailed in question 2.1(ii), managers may delegate investment management functions to non-AIR investment advisors, subject to conditions. In particular, the delegated investment advisor should be an affiliate of the manager and is subject to a system of internal controls and compliance procedures similar to that of the manager and/or corporate group to which both the manager and the investment advisor belong.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

The SFC has to date, offered no express prohibitions against SFC-authorised funds investing in virtual assets (including digital currencies, utility tokens or security or asset-backed tokens and any other virtual commodities, crypto assets and other assets of essentially the same nature). However, in view of the practical difficulties in managing the various risks inherent in virtual assets, including custody and liquidity risks, and that there are currently no generally accepted valuation principles for virtual assets, it is unlikely that a fund investing directly in virtual assets will obtain SFC authorisation.

For funds not authorised by the SFC, the licensed or registered person distributing such funds should ensure that the recommendation or solicitation made is suitable for the client in all circumstances, having regard to information about the client of which the licensed or registered person is or should be aware through the exercise of due diligence, including the client's financial situation, investment experience and investment objectives. Managers which manage or plan to manage funds with a stated investment objective to invest in virtual assets, or an intention to invest 10% or more of the gross net asset value of the fund in virtual assets will be subject to an additional set of licensing conditions by the SFC in relation to disclosure to investors, safeguarding of assets, portfolio valuation, risk management, appointment of auditors, and liquid capital to ensure that the risks associated with virtual assets are addressed by such managers.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

Retail funds which have been authorised by the SFC may be advertised and marketed to the Hong Kong public. Advertisements and other invitations to invest in such funds must comply with the Advertising Guidelines Applicable to Collective Investment Schemes Authorised Under the Product Codes (Advertising Guidelines) and its related FAQs. In general, advertisements for a fund should: (i) not be false, biased, misleading or deceptive; (ii) be clear, fair and present a balanced picture of the fund with adequate risk disclosures; and (iii) contain information that is timely and consistent with the fund's offering documents.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

Generally, persons marketing retail funds in Hong Kong must be licensed by the SFC for Type 1 regulated activity (dealing in securities). There is an "incidental exemption" to such requirement where the dealing is done wholly incidentally to the business of a licensed asset manager. As such, managers holding a licence for Type 9 regulated activity (asset management) may promote the funds for which they manage – marketing activities should fall within the exemption.

Licensed/registered persons are subject to ongoing supervision and monitoring by the SFC, and the various codes, circulars and guidelines issued by the SFC from time to time, in particular the Code of Conduct for Persons Licensed by or Registered with the SFC and, for holders of a Type 9 licence, the Fund Manager Code of Conduct. The first-mentioned Code of Conduct applies to licensed or registered persons for all types of regulated activities (including Types 1 and 9 mentioned above) and includes requirements in respect of honesty, diligence and capabilities of the licensed or registered person, know-your-client procedures, adequate disclosure on relevant material information to clients, conflicts of interest, client assets and responsibility of senior management.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

There are no specific requirements in respect of distribution fees that may be levied by intermediaries involved in the marketing of retail funds. However, the manager is expected to ensure that fees are fair, proportionate and clearly disclosed to investors at the point of sale. When considering the fee structure at launch, and if applicable, throughout the life-cycle of the fund, the manager should take into account: (i) whether the fees and charges payable by the investor for the fund are fair, proportionate and commensurate with the investment objectives and risk/return profile; (ii) the charging mechanism should be simple and transparent so that investors can easily identify and be able to assess the fees and charges; and (iii) whether the fund is cost-efficient, taking into consideration the profiles and features of any comparable substitute products.

In addition, the Code specifies several types of fees, costs and charges that must not be paid from the fund's assets, which include expenses arising out of any advertising or promotional activities in connection with the fund, and commissions payable to sales agents arising out of any dealing in units/shares of the fund.

**ii. Advertising**

As briefly noted in question 3.1 above, advertisements and other invitations to invest in SFC-authorised funds must comply with the Advertising Guidelines, which are intended to apply to all forms of advertisements, including but not limited to distribution materials (e.g. factsheets, newsletters, and brochures), display-only materials (e.g. posters, exhibition panels, and outdoor displays), broadcasts and interactive systems (most notably, the internet).

The Advertising Guidelines consist of SFC requirements in relation to, *inter alia*, the language and graphics, performance information, use of comparative indices and warning statements.

**iii. Investor suitability**

The SFC's Code of Conduct sets out suitability requirements. In general, having regard to information about the client, including the client's financial situation, investment experience and investment objectives, of which a licensed or registered person is or should be aware through the exercise of due diligence, the licensed or registered person should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for that client is reasonable in all the circumstances.

**iv. Custody of investor funds or securities**

Where a licensed or registered person or a third party on behalf of the licensed or registered person is in possession or control of investor funds or securities, the licensed or registered person should ensure that such investor funds or securities are adequately safeguarded.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

Retail funds authorised by the SFC may be marketed and sold to the public in Hong Kong. However, as detailed in question 3.2(iii) above, when making a recommendation or solicitation in respect of a fund, the person marketing the fund must ensure the suitability of that recommendation or solicitation for its client.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

An SFC-authorised fund that acquires financial derivative instruments for non-hedging purposes that results in the fund's net exposure relating to these financial derivative instruments exceeding 50% of the fund's total net asset value will be subject to enhanced distribution requirements applicable to "derivative products". In providing services to a client in respect of such derivative products, a licensed or registered person is required to assure itself that the client understands the nature and risks of the product and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products.

For SFC-licensed entities and registered persons conducting regulated activities in providing order execution, distribution and advisory services in respect of investment products (including public funds) via online platforms, SFC-authorised funds exceeding the above 50% threshold are also classified as "complex products". A platform operator is required to ensure a transaction in such an SFC-authorised fund (as a complex product) is suitable for the client in all circumstances.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

Retail funds established in Hong Kong have generally been unit trusts constituted under bilateral trust deeds, under which the trustee and manager are parties, and the assets of the trust may be held by the trustee or a custodian appointed by it. Until 2018, Hong Kong law had not provided for companies with variable capital. Accordingly, open-ended retail funds structured as companies, although available to retail investors in Hong Kong, have been domiciled offshore. In such a fund, the directors operate the fund in accordance with their powers as prescribed by the fund's articles of association. Investment management, custodial and administrative functions are usually delegated to third-party operators.

The government has introduced a new investment vehicle in the form of a corporate structure known as the "open-ended fund company" (OFC). The OFC is an open-ended collective investment scheme set up in corporate form with the flexibility to create and cancel shares and without restriction on distributions out of capital applicable to companies constituted under the Companies Ordinance. The OFC regime, consisting of the Securities and Futures (Amendment) Ordinance 2016, Securities and Futures (Open-ended Fund Companies) Rules, Securities and Futures (Open-ended Fund Companies) (Fees) Regulation, and the Code on Open-ended Fund Companies, became operational on 30 July 2018. Retail funds constituted as OFCs are required to obtain the SFC's authorisation and also comply with the authorisation and ongoing post-authorisation requirements set out in the Code.

**4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?**

**Entity level**

Retail funds authorised by the SFC are specifically exempted from Hong Kong profits tax under the Hong Kong Inland Revenue Ordinance. Accordingly, there is no requirement for such funds to file Hong Kong profits tax returns. Stamp duty is payable on transfers of Hong Kong registered stock, subject to some exemptions.

**Investor level**

No tax is generally payable by holders of a retail fund in Hong Kong in respect of income distributions from the fund or capital gains arising from the sale or redemption of units/shares in the fund.

However, investors carrying on trade or business in Hong Kong are subject to tax on distributions and gains (which are not capital profits) arising from the sale of units/shares that arise from that trade or business and that have a Hong Kong source.

**4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?**

The profits tax exemption detailed in question 4.2 above only applies where the fund is authorised by the SFC.

## Note

Please note that the information provided in this chapter is up to date as of 4 March 2019.

Whilst every effort has been made to ensure the accuracy of this chapter, it is for general guidance only and should not be treated as a substitute for specific advice. If you would like advice on any of the issues raised, please speak to any of the contacts listed.


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Alwyn is a key member of the investment funds team. He has extensive experience in establishing and advising clients on seeking authorisation by the Securities and Futures Commission (SFC) of unit trusts and mutual funds domiciled in Hong Kong and overseas jurisdictions including RMB-denominated funds, QFII and RQFII funds, and UCITS funds. He also advises on ongoing compliance and post-authorisation issues.

In addition, Alwyn advises on the structuring and establishment of private investment funds. He regularly advises on regulatory matters across a broad spread of issues affecting the asset management industry in Hong Kong. He helps clients to set up their Hong Kong offices and obtain appropriate SFC licences.


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# Ireland

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## 1 Registration

**1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?**

There are two primary types of regulated investment fund in Ireland that can be sold to the public; namely undertakings for collective investment in transferable securities ("UCITS") and alternative investment funds ("AIFs" which, in essence, covers all non-UCITS funds). There is a sub-category of retail AIFs available to the public at large (other sub-categories are restricted) but it is not frequently used and the overwhelming majority of funds sold to the public are UCITS. As such, this section focuses on UCITS.

UCITS are collective investment schemes established and authorised under a harmonised EU legal framework. UCITS benefit from a marketing passport, which means that a UCITS authorised in one EU Member State can be sold cross-border into other EU Member States without the requirement for additional authorisation. UCITS authorised in Ireland go through an authorisation process with the Central Bank of Ireland and, by default, may be sold in Ireland. UCITS authorised elsewhere in the EU go through an authorisation process with their local regulator, which then sends a simple regulator-to-regulator notification for the UCITS to be registered for sale in Ireland.

**1.2 What does the fund registration process involve, e.g., what documents are required to be filed?**

In order for an Irish UCITS to be authorised by the Central Bank, various documents need to be put in place. The Central Bank imposes minimum standards for the majority of these documents and, in the case of the offering document (prospectus), it reviews the document in advance and provides comments which must be addressed. Other fund documents (such as the depositary, investment management, distribution and administration agreements, the risk management process and the Key Investor Information Document) are not reviewed by the Central Bank but executed/final versions of the agreements are filed with the Central Bank, along with a confirmation that they meet the minimum requirements. Once the draft prospectus is filed with the Central Bank for review, a non-complex UCITS is typically approved by the Central Bank within six to eight weeks (during which period the other, non-review documents are finalised).

It is worth noting that every UCITS must either: (1) appoint a UCITS management company; or (2) be a self-managed UCITS. The former category is becoming far more common that the latter but, in the event that a given UCITS decides to be self-managed, then it must obtain a particular authorisation as a self-managed UCITS. This process involves different documents (including a business plan) and the appointment of designated persons (individuals, some of whom must be based in the EEA and potentially Ireland, who oversee the UCITS on a day-to-day basis). The authorisation process for a self-managed UCITS can take several months, whereas the appointment of a UCITS management company does not add any time to the six- to eight-week period mentioned above.

**1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?**

There are various supervision and enforcement laws that will apply in circumstances where an Irish fund is held out as authorised when it is not or where a foreign fund is sold in Ireland when it is not suitably registered for sale. These laws provide the appropriate authorities with a range of sanction powers, including fines.

**1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?**

As noted in the answer to question 1.1, UCITS established in EU Member States other than Ireland can be sold in Ireland once a simple regulator-to-regulator notification process is completed.

## 2 Regulatory Framework

**2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?**

**i. Governance**

A UCITS established as a corporate vehicle (e.g., an ICAV or plc) is required to have a minimum of two Irish-resident directors appointed to its board and the board must comprise at least three directors in total. The corporate governance code (which applies on a comply-or-explain rather than mandatory basis) recommends at least one director from the promoter. The size of a board of the fund generally depends on the requirements of the promoter – boards would typically comprise four or more directors, a majority of whom are interested directors (i.e., are employees of the promoter).

The Central Bank must be satisfied that all directors are fit and proper in terms of: (i) competence and capability; (ii) honesty, integrity, fairness and ethical behaviour; and (iii) financial soundness. Letters of appointment must be put in place with each director setting out the terms of their engagement. The Central Bank must also be notified of all resignations from a board of directors.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

A UCITS must have one or more discretionary investment managers/advisors who manage the portfolio of investments. Each discretionary manager/advisor must be cleared to act as such by the Central Bank. Essentially, the Central Bank must be satisfied that it is authorised by an appropriate regulatory authority and is subject to ongoing supervision in its home jurisdiction (the jurisdiction itself must also be considered appropriate by the Central Bank). Where the given entity is regulated in Europe under a pan-European framework such as MiFID, this process is a simple notification. Where the entity is not regulated in Europe (e.g., it is an SEC registered manager), there is a more formal process which involves an application setting out information regarding the entity's history, performance record, AUM, details of senior staff and their experience, financial resources and regulatory status. This process typically takes four to five weeks. The process need only be completed once – thereafter, the entity is cleared to act for any Irish fund (whether UCITS or AIF). The only ongoing obligation owed to the Central Bank is to notify it of any change in regulatory status, name or registered address

**iii. Capital structure**

A UCITS is not itself subject to any capital requirements. As noted above in question 1.2, every UCITS must either (1) appoint a UCITS management company, or (2) be a self-managed UCITS. In the former case, the UCITS management company is subject to a minimum capital requirement of €125,000 or one-quarter of its preceding year's fixed overheads, whichever is the greater. In addition, the management company must maintain additional capital of 0.02% of the value of the assets under management in excess of €250 million, subject to a maximum level of capital of €10 million. In the case of a self-managed UCITS, it is subject to a minimum capital requirement of €300,000, which can be withdrawn once and for so long as the UCITS has received subscriptions from investors of at least €300,000.

**iv. Limits on portfolio investments**

A UCITS can invest in a diverse range of investments such as transferable securities, bank deposits, money market instruments, financial derivatives and units of other funds, either as a fund of funds or a feeder fund. A UCITS cannot invest in real estate or invest directly in commodities (but can obtain exposure to commodities using derivatives). The UCITS legislative framework imposes a number of investment restrictions, including concentration limits, exposure limits, counterparty requirements, use of FDI, etc.

**v. Conflicts of interest**

The Central Bank of Ireland UCITS Regulations contain requirements regarding management of conflicts of interest. The primary obligations in this regard are disclosure related; the prospectus of the relevant UCITS must include a description of the potential conflicts of interest and details of how they will be managed. In addition, the annual reports must contain details of soft commission arrangements and any amounts paid to the investment manager for directed brokerage services. Furthermore, where an investment manager negotiates the recapture of a portion of the commissions charged by brokers or dealers in connection with the purchase and/or sale of securities for a UCITS, the rebated commission must be paid to the UCITS.

**vi. Reporting and recordkeeping**

The Central Bank of Ireland UCITS Regulations contain requirements regarding reporting and recordkeeping, including the requirement for annual and semi-annual reports to investors and monthly and quarterly returns and other necessary reports to the Central Bank.

**vii. Other**

In circumstances where a UCITS is listed, there may be stock exchange rules to be followed, including in relation to notices, reports and material changes. In addition, where a UCITS obtains a secondary authorisation (e.g., as an ETF or a money market fund), further obligations are imposed.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

As noted in question 2.1 (ii), advisers or managers with discretionary portfolio management powers must be cleared to act as such by the Central Bank. Essentially, the Central Bank must be satisfied that the adviser/manager is authorised by an appropriate regulatory authority and is subject to ongoing supervision in its home jurisdiction (the jurisdiction itself must also be considered appropriate by the Central Bank). Where the given entity is regulated in Europe under a pan-European framework such as MiFID, this process is a simple notification. Where the entity is not regulated in Europe (e.g., it is an SEC registered manager), there is a more formal process which involves an application setting out information regarding the entity's history, performance record, AUM, details of senior staff and their experience, financial resources and regulatory status. This process typically takes four to five weeks. The process need only be completed once – thereafter, the entity is cleared to act for any Irish fund (whether UCITS or AIF). The only ongoing obligation owed to the Central Bank is to notify it of any change in regulatory status, name or registered address.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

The above sets out the primary requirements that apply.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

As noted in question 2.1 (iv), a UCITS can invest in transferable securities, bank deposits, money market instruments, financial derivatives and units of other funds. The Central Bank (and equivalent European regulatory authorities) have not yet satisfied themselves that digital currencies fall into one of those categories. As such, and until that changes, a UCITS cannot invest directly in digital currencies. It may be able to invest in such currencies (and other ineligible assets) indirectly, e.g, through indices.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

Marketing of UCITS funds in Ireland is subject to the UCITS regime but may also be subject to other regimes (e.g., MiFID), depending on the entity undertaking the marketing.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

Yes, entities marketing UCITS must be suitably authorised for the same under a relevant regime (generally MiFID, UCITS or AIFMD). There are no commonly available exemptions (e.g., private placement).

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

The primary obligations in this regard are disclosure based. The UCITS must provide disclosures in relation to fees, including the mechanism for altering fees and restrictions regarding paying fees out of capital. Depending on the other entities involved, further obligations may be relevant, e.g., a MiFID distribution may be subject to restrictions against certain commissions or fees being paid in respect of distribution of a UCITS.

**ii. Advertising**

The Central Bank imposes certain obligations as regards advertising, including the overriding requirement that advertising must be clear, fair, accurate and not misleading, and that the advertisement can be understood easily and clearly. In addition: (a) the name of a UCITS and its regulatory status shall be shown clearly in any advertisement relating to that UCITS; (b) any advertisement relating to a UCITS shall not contain information which is false or misleading or presented in a manner that is deceptive; (c) any advertisement relating to a UCITS shall refer to the key investor information document and the prospectus; and (d) no advertisement relating to a UCITS shall be inconsistent with any relevant provision of the key investor information document or of the prospectus.

**iii. Investor suitability**

There is a UCITS obligation to identify a typical investor and disclose the profile of that investor in the prospectus. In addition, distributors may be subject to their own regulatory requirements. As regards distributors operating in Ireland, these requirements are likely to be MiFID requirements, including, in particular, the product governance rules and the obligation to carry out a target market assessment.

**iv. Custody of investor funds or securities**

Each UCITS must appoint an Irish depositary, which is responsible for safekeeping the assets, ensuring that the cash flows are properly monitored and carrying out oversight in relation to the management of the UCITS, amongst other things.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

UCITS are designed to be suitable for broad distribution to the public. Promoters of UCITS themselves may effectively restrict the sale of certain fund types to more institutional investor types through setting high minimum investment amounts or other means and a UCITS has the ability to reject a given subscription request for any or no reason. Where a UCITS is sold in an EU Member State other than Ireland, the simple notification procedure described in question 1.1 must be completed.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

No, the above sets out the main areas of regulation with regard to the marketing of public funds in Ireland.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

ICAVs, unit trusts, Common Contractual Funds (CCFs) and variable or fixed capital companies can be public funds.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

At the entity level and assuming that a UCITS conducts its affairs so that it is Irish tax-resident, an Irish UCITS qualifies as an “investment undertaking” for Irish tax purposes and, consequently, is exempt from Irish corporation tax on its income and gains, save for certain limited cases where the UCITS holds Irish real estate or Irish equity assets.

At the investor level, where an investor is not resident (or ordinarily resident) in Ireland for Irish tax purposes, an Irish UCITS will not deduct any Irish tax in respect of the investor’s shares once a declaration has been received by the UCITS confirming the investor’s non-resident status. With respect to Irish resident investors, an Irish UCITS will be obliged to account for Irish income tax to the Irish Revenue Commissioners if shares are held by Irish resident investors, unless they fall into an exemption category (for example, pension schemes, charities, etc.). For non-exempt Irish resident investors, the UCITS will deduct Irish tax on distributions, redemptions and transfers and, additionally, on “eighth anniversary” events (being the eighth anniversary of the acquisition of shares, where they are not disposed previously). Depending on the nature of the Irish resident investor, Irish tax is levied at either 25% or 41% of the distribution/gain in value.

No Irish stamp duty (or other Irish transfer tax) applies to the issue, transfer or redemption of shares.

**4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?**

As described in question 4.2, for a UCITS to qualify as an "investment undertaking" for Irish tax purposes it must conduct its affairs so that it is Irish tax-resident. This would include, for example, holding board meetings in Ireland.

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Established in 1825 in Dublin, Ireland and with offices in Cork, London, New York, Palo Alto and San Francisco, more than 700 people work across Matheson's six offices, including 96 partners and tax principals and over 470 legal and tax professionals. Matheson services the legal needs of internationally focused companies and financial institutions doing business in and from Ireland. Our clients include over half of the world's 50 largest banks, six of the world's 10 largest asset managers, seven of the top 10 global technology brands and we have advised the majority of the Fortune 100.

Chapter 14

# Japan


Yusuke Motoyanagi

Nishimura & Asahi

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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

In Japan, domestic funds that are offered to the public are generally structured as either investment trusts or investment corporations. In addition, foreign funds that are publicly offered are categorised as foreign investment trusts or foreign investment corporations.

For a domestic investment trust, a notification that contains the basic terms and conditions of the investment trust contract must be filed with the relevant authority (the commissioner of the FSA or the director general of a local finance bureau) prior to entering into the investment trust contract, regardless of whether the units are publicly offered or privately placed.

For a domestic investment corporation, registration of the investment corporation is required prior to commencing its operations, regardless of whether the units are publicly offered or privately placed.

For a foreign investment trust or foreign investment corporation, a notification that contains an outline of the foreign investment trust or foreign investment corporation must be filed with the commissioner of the FSA prior to (a) an offering and sale of, or (b) providing intermediary, brokerage or agency services regarding, the units/shares of the fund, unless an exemption applies. Although exemptions from the notification requirement are available to foreign investment trusts and foreign investment corporations, these exemptions are quite limited and a notification will generally be required.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

The registration and filing requirements differ depending on whether the fund is structured as an investment trust or investment corporation, and whether it is categorised as domestic or foreign.

Domestic investment trusts must file a notification including the name, the type (open-ended or closed-ended, etc.) of investment trust, and the type of assets which are to be the subject of investment, the investment policy, the planned size of the investment trust, the establishment date, and the period of the trust agreement. The notification is required to attach a draft of the basic terms and conditions of the investment trust and a written consent of the trustee.

When registering a domestic investment corporation, the application for the registration must include the purpose, trade name, whether it is open-ended or closed-ended, the subject and policy of asset investments, the policies for distributing monies, information concerning the corporate officer(s), supervisory officers, accounting auditor(s), the asset management company, the asset custody company, and major investors. The attachments to the application include the certificate of incorporation, a certificate of registered information of the investment corporation, a resume or history of the executive managing officers, supervisory officers and organiser(s), a copy of the written entrustment contract for asset investment concluded with an asset management company, and a copy of the custody contract concluded with the asset custody company.

A foreign investment trust must file a notification including an outline of the settlor, trustee, beneficiary, the beneficiary certificates, the management and investment of the trust, calculation of the trust and the distribution of profits and the offering/placement. A foreign investment corporation must file a notification including the purpose, trade name, and address of the investment corporation, outline of its organisation and officers, the management and investment of its assets, the accounting for and distribution of profits, the rights represented by the units, and the refund and repurchase of the units. The attachments to the notifications of a foreign investment trust and foreign investment corporation include: a certificate of incorporation (only foreign investment corporation); a copy of the written approval, written authorisation, written permission, notification or documents equivalent thereto in cases where an approval, authorisation, permission, notification or the equivalent thereto has been made with regard to the establishment of the relevant fund based on laws and regulations of the state in which the fund was established; a legal opinion by legal experts stating that the establishment of the relevant fund is legal as well as copies of the relevant provisions of the relevant laws and regulations set forth in the legal opinion; and a document describing the contents of the entrustment in cases where a person who has the authority for the investment of the relevant fund has entrusted the authority to another person.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

Regarding domestic investment trusts, a person who has failed to make a notification or has made a false notification of the basic terms and conditions of the investment trust shall be punished by imprisonment with labour for not more than six months, a fine of not more than JPY 500,000, or both.

Domestic investment corporations, organiser(s) of an investment corporation, corporate officer(s) or supervisory officer(s), etc., who have conducted a sale or purchase of securities and certain other transactions without obtaining registration shall be punished by imprisonment with labour for not more than one year, a fine of not more than JPY 1 million, or both.

Regarding foreign investment trusts or foreign investment corporations, a person who has failed to make a notification or has made a false notification of certain matters shall be punished by imprisonment with labour for not more than six months, a fine of not more than JPY 500,000, or both.

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

For a domestic investment trust, the settlor of the trust, which manages the assets of the investment trust, must be a financial instruments business operator (a "FIBO") who conducts investment management business, and is required to have an office in Japan.

A domestic investment corporation needs to be established under the Investment Trust and Investment Corporation Act of Japan, and be headquartered in Japan.

For a foreign investment trust or foreign investment corporation that makes a notification concerning (a) an offering and sale of, or (b) intermediary, brokerage or agency services regarding, its units or shares, the issuer must appoint a person who has an address in Japan and who has the authority to represent the issuer for any acts concerning the notification. In addition, the Japan Securities Dealers Association ("JSDA") allows its members to market units of a foreign investment trust to the public in Japan only where the management company of the foreign investment trust has appointed a person with an address in Japan and with the authority to represent the issuer for any acts in Japan and a representative firm from members of the JSDA. For an investment corporation, the JSDA allows its members to market shares of a foreign investment corporation to the public in Japan only where the foreign investment corporation has appointed a person who has an address in Japan with the authority to represent the issuer for any acts in Japan and a representative firm from members of the JSDA.

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

For a domestic investment trust, a settlor of the trust and a trustee are required. A domestic investment trust is generally managed by a settlor, which must be a FIBO who conducts investment management business, though written resolution by beneficiaries is required for a material change to the basic terms and conditions of an investment trust or consolidation of investment trusts. A trustee of a domestic investment trust must be either a bank that is allowed to engage in trust business, or a trust company licensed or registered under the Trust Business Act.

A domestic investment corporation must have one or more corporate officers, supervisory officers numbering at least one more than the number of corporate officers, a board of officers which is composed of all the corporate officers and supervisory officers, and an accounting auditor. A domestic investment corporation is generally managed by the corporate officer(s) and/or board of officers, though resolution by an investors' meeting is required in order to, among others, entrust its business pertaining to asset investment to an asset management company and change its certificate of incorporation or appoint its corporate officer(s) and supervisory officers. In addition, a domestic investment corporation must entrust its business pertaining to asset investment to an asset management company, which must be a FIBO that is registered under the FIEA to conduct investment management business. Further, a domestic investment corporation must entrust its business pertaining to custody of assets to an asset custody company, and entrust business affairs related to the solicitation of persons to subscribe for, or the issue of, its equity interests or bonds, business affairs related to the operations of the administrative instruments, or business affairs related to accounts to specified persons.

For a foreign investment trust, there are no governance requirements except that the JSDA allows its members to market units of a foreign investment trust to the public in Japan only when a change in the officers of the management company shall require the approval, etc. of the relevant authorities, investors or trustees.

There are no governance requirements on a foreign investment corporation, except that the JSDA allows its members to market shares of a foreign investment corporation to the public in Japan only when a change in the officers of the foreign investment corporation shall require the approval, etc. of the relevant authorities, investors or trustees.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

For a domestic investment trust, a settlor of a trust generally gives instructions on the investment. A settlor may entrust another person with the authority to do so, if the person is registered to conduct the investment management business under the FIEA or a foreign judicial person conducts the investment management business in a foreign state. The registration may be required for the foreign judicial person unless an exemption applies.

A domestic investment corporation must entrust its business pertaining to asset investment to an asset management company, which must be a FIBO that is registered under the FIEA to conduct investment management business. The registration may be required in order for the investment advisor to work for the asset management company unless an exemption applies.

For a foreign investment trust or foreign investment corporation, there are no restrictions.

**iii. Capital structure**

For a domestic investment trust, a settlor of a trust must have both capital of JPY 50 million and net assets amounting to JPY 50 million and trustees must also have a certain amount of capital and net assets depending on the type of licence/registration.

A domestic investment corporation must have at least JPY 50 million both for its capital amount and its net asset amount.

For a foreign investment trust, the JSDA allows its members to market units of a foreign investment trust to the public in Japan only when the net assets of the management company are at least JPY 50 million and net assets of the foreign investment trust are at least JPY 100 million.

For a foreign investment corporation, the JSDA allows its members to market shares of a foreign investment corporation to the public in

Japan only when the net assets of the foreign investment corporation are at least JPY 100 million and net assets of the asset management company are at least JPY 50 million.

**iv. Limits on portfolio investments**

A domestic investment trust and domestic investment corporation may invest only in "specified assets" which include securities, derivatives, real estate, loans and commodities. Restrictions relating to management of credit risk and other restrictions also apply.

For a foreign investment trust or foreign investment corporation, the JSDA allows its members to market units of a foreign investment trust or shares of a foreign investment corporation to the public in Japan only when investments by the fund comply with the JSDA's rules.

**v. Conflicts of interest**

A settlor of a domestic investment trust and a management company of a domestic investment corporation must not make an investment that involves a transaction being conducted with itself or its directors or executive officers, or make an investment that involves a transaction being conducted between or among funds it manages.

For a foreign investment trust, the JSDA allows its members to market units of a foreign investment trust to the public in Japan only when there is a prohibition against improper transactions, under which, among others, the management company is forbidden to conduct transactions for the purpose of its own benefit or for the benefit of third parties other than beneficiaries, and other transactions that go against the protection of a beneficiary or that hamper the appropriate management of the investment trust.

For a foreign investment corporation, the JSDA allows its members to market shares of a foreign investment corporation to the public in Japan only when there is a prohibition against improper transactions, under which, among others, the asset management company is forbidden to conduct transactions for the purpose of its own benefit or for the benefit of third parties other than investors, and other transactions contrary to the protection of the investors or that hamper the appropriate management of the investment corporation.

**vi. Reporting and recordkeeping**

For a domestic investment trust, a settlor must prepare an investment report for the investment trust that it manages, on the last day of the accounting period for the fund, and deliver it to known beneficiaries of the investment trust, unless an exemption applies. In addition, the settlor of the trust, as a registered FIBO, must prepare and archive its business books and documents, and must file annual business reports with the relevant authority in accordance with the FIEA.

A domestic investment corporation is required to prepare financial statements, asset investment reports, and statements on the distribution of monies for each business period. In addition, an asset management company, as a registered FIBO, must prepare an investment report for the investment corporation and deliver it to the investment corporation, unless an exemption applies, prepare and archive its business books and documents, and must file an annual business report with the relevant authority in accordance with the FIEA.

For foreign investment trusts and foreign investment corporations, the JSDA allows its members to market units of a foreign investment trust or shares of a foreign investment corporation to the public in Japan only when information concerning the fund is disclosed to investors and the relevant authority, unless an exemption applies.

**vii. Other**

There are no other main regulatory restrictions and requirements to be aware of.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

A domestic investment trust is generally managed by the settlor of the trust. A domestic investment corporation is generally managed by an asset management company. An investment advisor to a settlor or asset management company must be registered as a FIBO that engages in investment management business if it has the discretionary power to invest in and dispose of assets. If an investment advisor does not have that discretionary power, it must be registered as a FIBO that engages in investment advisory and agency business.

An investment advisor to a foreign investment trust or foreign investment trust is not subject to Japanese law as long as no advisory-related activity is conducted in Japan.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

An investment advisor to a settlor of a domestic investment trust or asset management company of an investment corporation that is registered as a FIBO is subject to obligations under the FIEA, which include reporting and bookkeeping obligations.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

As mentioned above in question 2.1 iv. "Limits on portfolio investments", a domestic investment trust and domestic investment corporation may invest only in "specified assets", which does not include digital currencies. Therefore, public funds investing only in digital currencies do not fall under the definition of a domestic investment trust or domestic investment corporation under the Act on Investment Trusts and Investment Corporations (the "AITIC").

If a domestic public fund, as a fund of funds, invests in equity of a fund which invests only in digital currencies, the fund of funds can be a domestic investment trust or domestic investment corporation under the AITIC.

Whether a fund falls under the definition of a foreign public funds depends on the similarity between the foreign public fund and a domestic investment trust or domestic investment corporation. Therefore, foreign public funds which invest only in digital currencies are not likely to fall under the definition of a foreign investment trust or foreign investment corporation under the AITIC.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

Basically, the regulatory framework is divided into: requirements regarding disclosure; and requirements regarding the conduct of business.

As for the disclosure requirements, in the event of an offering of interests in funds to the public in Japan (i.e., where no private placement exemption is available), the issuer must file a securities registration statement (an "SRS") with a local finance bureau with respect to the proposed offering in Japan, unless an exemption applies. The SRS becomes effective, at the earliest, 16 days after it is filed, and the offeror cannot execute a sale and purchase agreement with the offerees until the SRS has become effective. The offeror must also deliver a prospectus to each offeree with respect to the proposed offering in Japan. In addition, an issuer who has filed an SRS becomes subject to the continuous disclosure requirements under the FIEA, which include the requirement to file a securities report for each calculation period.

One possible exemption from the abovementioned disclosure requirements is the "secondary distribution of foreign securities" exemption that is applicable to foreign investment trusts and foreign investment corporations. When secondary distributions of foreign securities meeting prescribed requirements are conducted by a FIBO or a bank, or certain other financial institutions registered as engaging in financial instruments business (a "FIBO, etc."), an SRS need not be filed with respect to the offering of such secondary distribution, provided that prescribed "foreign securities information" must, in general, be provided or publicised simultaneously with, or in advance of, the distribution.

As for the requirements regarding the conduct of business, please see question 3.2 below.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

A distributor, in principle, must be registered as a FIBO, etc. that conducts "type I financial instruments business", provided that a foreign securities firm that engages in securities transactions in its home jurisdiction having a proper licence or being properly exempted may engage in marketing to a qualified financial institution from outside of Japan.

There are various requirements to be registered as a FIBO, etc. that conducts "type I financial instruments business". For example, the applicant must be a company incorporated in Japan having a board of directors as its governance organisation, or a non-Japanese company having a branch in Japan with sufficient human resources and prospects of financial soundness to carry on regulated financial instruments business.

If marketing activities are conducted by a settlor of an investment trust, the settlor must be registered as a FIBO, etc. that conducts "type II financial instruments business". There are various requirements to be registered as a FIBO, etc. that conducts "type II financial instruments business", though the requirements are less strict to some extent than those for "type I financial instruments business".

If marketing activities are conducted by a foreign investment corporation, the investment corporation does not have to be registered as a FIBO, etc. A domestic investment corporation must entrust business affairs related to the solicitation of persons to subscribe for, or the issue of, its equity interests or bonds and is not allowed to conduct marketing activities by itself.

For marketing activities, a FIBO, etc. must comply with the requirements regarding the conduct of business, which include restrictions on advertising, requirement of delivering a document stating prescribed particulars to the customer in advance, prohibition of engaging in fraudulent, misleading and other prescribed acts, and principle of suitability.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

This is not applicable in our jurisdiction.

**ii. Advertising**

A FIBO, etc. must, when advertising the contents of its financial instruments business or conducting any similar acts, indicate its trade name, registration number, the amount of fees, risks and other prescribed matters clearly and accurately.

**iii. Investor suitability**

A FIBO, etc. must not conduct solicitations with regard to a financial instruments transaction in a manner that is inappropriate in light of the customer's knowledge, experience, the status of property or the purpose of concluding a contract for a financial instruments transaction, which results in or is likely to result in insufficient protection for investors.

**iv. Custody of investor funds or securities**

For a domestic investment trust, a trustee must comply with the requirements under the Trust Act, Trust Business Act and Act on Engagement in Trust Business Activities by Financial Institutions.

A domestic investment corporation must entrust its business pertaining to custody of assets to an asset custody company, which must comply with the requirements under the Trust Act, Trust Business Act and Act on Engagement in Trust Business Activities by Financial Institutions or the FIEA.

For a foreign investment trust or foreign investment corporation, no restrictions apply.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

No, there are no restrictions.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

If the aggregate subscription amount is JPY 1 billion or more, the foreign issuer is required to submit a report to the Minister of Finance within 20 days following the issuance of the shares. In addition, an annual report regarding the status of redemption, etc. of securities would be required.

In relation to subscription by Japanese investors of interests in a fund, identity confirmation is generally required pursuant to the Act on Prevention of Transfer of Criminal Proceeds. In addition, in the event assets received are suspected of being criminal proceeds, or in the event the counterparty is suspected of engaging in actions which correspond to the concealment of criminal proceeds or other crimes, the facts related to the suspicious transactions must be reported promptly to the Commissioner of the Financial Services Agency.

The preparation of certain legends may be required under the Act on Sales, etc. of Financial Instruments.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

In Japan, domestic funds that are offered to the public are generally structured as either investment trusts or investment corporations. Foreign funds that are publicly offered are categorised as foreign investment trusts or foreign investment corporations.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

A domestic investment trust would generally not be treated as a taxpayer for Japanese corporate income tax purposes.

A domestic investment corporation is able to deduct the amount of distributions to its shareholders from its taxable income if certain requirements are satisfied, which include:

(i) it is registered under the Investment Trust and Investment Corporation Law;

(ii) either of: (a) when established, it makes a public offering of its shares, the aggregate sale price of which exceeds JPY 100 million; or (b) at the end of the fiscal year, shares are held by 50 or more persons, or held by specified institutional investors only;

(iii) the majority of its shares were offered in Japan;

(iv) its fiscal year is one year or shorter;

(v) it is not a "family company" (a company is a family company if the majority of the shares are held only by one person and his/her/its affiliated person(s));

(vi) it distributes more than 90% of its distributable amount;

(vii) it does not hold 50% or more of the shares of another company; and

(viii) it does not borrow money from any person other than specified institutional investors.

A foreign investment trust or foreign investment corporation is not subject to Japanese taxation unless it has income from sources within Japan.

As for the taxation of individual investors, although tax treatment differs depending on type of the fund, individual investors, in general, may choose separate taxation at the rate of 20.315% for income from distributions. If an investor chooses comprehensive taxation, the maximum income tax rate for individuals is roughly 56%. Capital gains qualify for separate taxation at the rate of 20.315%. Withholding tax may apply.

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

For details of the special tax regime applying to a domestic investment corporation, please see question 4.2 above.


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# Netherlands

Rogier Raas

Stibbe

Jeroen Smits

## 1 Registration

**1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?**

Yes. Alternative Investment Funds ("**AIFs**") and Undertakings for Collective Investment in Transferable Securities ("**UCITS**") that are offered to the public in the Netherlands need to be registered.

Under the Dutch Financial Supervision Act (*Wet op het financieel toezicht* or "**Wft**"), offering means making a sufficiently specific proposal, either directly or indirectly, to act as the other party to a contract regarding a participation right in an AIF or UCITS, or to request or acquire, either directly or indirectly, funds or other goods from a client in order to hold participations in an AIF or UCITS.

If participation rights are offered at the request of a Dutch investor without any solicitation by the management company, no marketing is deemed to have taken place in the Netherlands.

**AIFMs**

Dutch Alternative Investment Fund Managers ("**AIFMs**") must obtain a licence from the Dutch Authority for the Financial Markets (*Autoriteit Financiële Markten* or "**AFM**") before they may start marketing the AIFs they manage in the Netherlands.

A *de minimis* exemption is available to AIFMs whose assets under management do not exceed EUR 100 million, or EUR 500 million in certain circumstances. AIFMs making use of this exemption do not need to obtain a licence but are subject to registration and reporting requirements.

EU AIFMs that are licensed under the Alternative Investment Fund Managers Directive ("**AIFMD**") are allowed to market in the Netherlands with a marketing passport. AIFMs can obtain such a passport through its home state regulator. Non-EU AIFMs can make use of the Dutch private placement regime. They must submit a notification form and attestation to the AFM.

When marketing to retail investors in the Netherlands, the AIFM must comply with a top-up regime, comprising, among other things, additional disclosure obligations. Non-EU AIFMs may only market to professional investors, unless they comply with the designated state regime.

**UCITS ManCos**

UCITS management companies ("**UCITS ManCos**") must obtain a licence from the AFM. EU management companies may market in the Netherlands with a marketing passport. As with AIFMs, UCITS ManCos can obtain such a passport through its home state regulator.

**1.2 What does the fund registration process involve, e.g., what documents are required to be filed?**

**Licence application for AIFMs**

AIFMs applying for a licence have to submit an application form, together with the following documents, to the AFM. Please note that additional documents may be required depending on the specific facts and circumstances:

- extract from the trade register relating to the AIFM;
- business plan;
- description of the administrative organisation and internal control;
- structure chart, including day-to-day policymakers;
- outsourcing policy;
- remuneration policy;
- overview of AIFs and assets under management;
- financial statements and auditor's report;
- regulation on inside information and trading;
- overview of risk takers, whose professional activities have a material impact on the risk profile of the AIFM or the AIF it manages, and employees receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers;
- integrity and suitability screening forms for (day-to-day) policymakers and supervisory directors of the AIFM;
- AIF notification form; and
- depositary notification form.

**Article 42 notification**

Non-EU AIFMs making use of the Dutch private placement regime must submit a notification form and attestation to the AFM.

**Licence application for UCITS ManCos**

UCITS ManCos applying for a licence have to submit an application form, together with the following documents, to the AFM. Please note that additional documents may be required depending of the specific facts and circumstances:

- articles of associations of the UCITS ManCo, the UCITS and the depositary;
- extract from the trade register relating to the UCITS ManCo, the UCITS and the depositary;
- auditor's statement of the net asset value of the UCITS ManCo and depositary;
- structure chart of the group of the UCITS ManCo, the UCITS and the depositary;
- structure chart of the UCITS ManCo and depositary, including the names of policymakers and shareholders, and foreign branches (if applicable);
- (draft) prospectus;
- description of the administrative organisation and internal control of the UCITS ManCo, the UCITS and depositary, together with an auditor's report (if applicable);
- business plan of the UCITS ManCo;
- agreement on management and custody;
- registration document; and
- integrity and suitability screening forms for (day-to-day) policymakers, co-policymakers and supervisory directors of the UCITS ManCo, the UCITS and the depositary.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

In the event of a breach of the Wft, the AFM can take enforcement measures, such as: (i) making a formal information request; (ii) issuing a formal instruction (*aanwijzing*); (iii) imposing an incremental penalty for non-compliance (*last onder dwangsom*); and (iv) imposing an administrative fine (*bestuurlijke boete*) or withdrawing a licence. In addition, acting without a licence qualifies as an economic offence.

In addition, the AFM can impose an administrative fine on those individuals who: (1) exercise actual control (*feitelijk leidinggevende*) at the time the financial undertaking is in breach of the applicable regulatory rules and regulations; or (2) give instructions to the financial undertaking to commit such a breach (individuals *de facto* in charge).

These administrative sanctions do not impact the enforceability of otherwise valid contracts. Civil claims can be filed when a breach has caused damage.

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

Yes. A Dutch AIFM must have its headquarters in the Netherlands. There is no similar requirement for UCITS ManCos. However, the policymakers of a Dutch UCITS ManCo and Dutch UCITS must carry out their activities in connection with these entities from the Netherlands.

(Day-to-day) Policymakers and supervisory directors of the Dutch AIFM, Dutch AIF with legal personality, Dutch UCITS ManCo and Dutch UCITS with legal personality must be screened on integrity and suitability by the AFM.

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

Dutch AIFMs and UCITS ManCos must have a clear and transparent governance structure. At least two private individuals must determine the day-to-day policy of a Dutch AIFM, Dutch UCITS ManCo or Dutch self-managed Fund. Subject to the principle of proportionality, a general requirement applies to AIFMs to have a risk management function hierarchically and functionally separate from other parts of the business, including the portfolio management function.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

The Wft provides that the business activities of an AIFM or UCITS ManCo must be controlled and business processes and risks must be managed effectively. If an AIFM or UCITS ManCo decides to outsource activities and business processes, it must comply with specific rules.

In accordance with the Wft, "outsourcing" or "delegation" entails the instruction by the AIFM or UCITS ManCo to a third party (the "delegate" or "outsourcee") to provide services that:

- are part of, or follow from the business undertaking of the AIFM or UCITS ManCo or the provision of financial services; or
- are part of the essential business procedures supporting such operations or the provision of financial services.

Note that a Dutch AIFM or UCITS ManCo is prohibited from delegating the determination of its investment policy.

Outsourcing within the meaning of the Wft is subject to strict requirements. This means that if the appointment of an investment advisor by the AIFM or UCITS ManCo qualifies as outsourcing, the AFM may have to be notified, the written agreement between the AIFM or UCITS ManCo and the investment advisor must meet the Dutch outsourcing requirements, and the investment advisor will be responsible for the insourcing entity's compliance with the relevant rules and regulations. Moreover, the specific outsourcing provisions set out in the AIFMD and UCITS Directive (each as implemented in Dutch law) will apply.

**iii. Capital structure**

An externally managed fund must have an initial capital of at least EUR 125,000, whilst a self-managed fund must have an initial capital of at least EUR 300,000. In specific circumstances, the AIFM or a self-managed AIF must provide additional equity capital (*eigen vermogen*) in accordance with the provisions of the AIFMD (as implemented in the Netherlands). AIFMs are also subject to the solvency requirements set out in the Wft and the underlying regulations.

**iv. Limits on portfolio investments**

**AIFMs**

For AIFs, no limits on portfolio investments apply. However, if an AIF acquires control over non-listed companies and issuers, certain restrictions come into play. Moreover, related provisions on asset stripping would apply in such case.

**UCITS ManCos**

The provisions of the UCITS Directive as regards the investment restrictions have been implemented in the Wft and the regulations promulgated thereunder.

**v. Conflicts of interest**

**AIFMs**

Pursuant to the Wft, a Dutch AIFM must structure its operations in such manner that appropriate measures can be taken to identify, prevent, manage and control conflicts of interest. Moreover, the AIFM must take appropriate measures to preclude that the interests of the AIFs it manages, and the interests of the investors in such AIFs, will be prejudiced as a result of the materialisation of a conflict of interest. The rules promulgated under the Wft refer to the provisions on conflicts of interest set out in the AIFMD.

**UCITS ManCos**

Pursuant to the Wft, a UCITS ManCo must have an adequate policy to prevent conflicts of interest from materialising. The UCITS ManCo must also ensure that the UCITS managed by it and the investors in these UCITS will be treated fairly in case a conflict of interest materialises. The regulations promulgated under the Wft provide for detailed provisions in this respect.

**vi. Reporting and recordkeeping**

**AIFMs**

Within six months after the financial year has ended, a Dutch AIFM must file with the AFM the audited annual statements and the management report for each EEA AIF it manages and for each AIF it offers in the EEA.

Within six months after the financial year has ended, a non-Dutch AIFM must file the audited annual statements and management report for each Dutch AIF it manages with the AFM. At the investor's request, these financial statements must be sent to such investor too.

In the event an AIF is closed-ended and listed on a regulated market operated in the Netherlands, these requirements do not apply. Listed closed-ended AIFs must make available their financial statements within four months after their financial year has ended.

**UCITS ManCos**

Within four months after the financial year has ended, a Dutch UCITS ManCo and Dutch UCITS must file the audited annual accounts, the management report and other information with the AFM, and make these publicly available. Half-year financials of a Dutch UCITS ManCo and Dutch UCITS must be filed with the AFM too. These must be made publicly available within nine weeks after the end of the first half of the financial year. At the investor's request, these financial statements must be sent to such investor. In the event a Dutch UCITS is closed-ended and listed on a regulated market operated in the Netherlands, these requirements do not apply. Listed closed-ended UCITS must make available their financial statements within four months after their financial year has ended.

**vii. Other**

**Remuneration**

In addition to the remuneration rules under the AIFMD and UCITS Directive, the Dutch Act on Remuneration Policies in Financial Undertakings (*Wet beloningsbeleid financiële ondernemingen* or "**Wbfo**") applies to AIFMs and UCITS ManCos with their corporate seat in the Netherlands. In addition, the Wbfo may also apply if an AIFM or UCITS ManCo with its corporate seat outside the Netherlands is a subsidiary of a financial undertaking with its corporate seat in the Netherlands, or is part of a group where the ultimate parent company has its corporate seat in the Netherlands, and where the main activities of such group consist of offering financial products or providing financial services.

In the Netherlands, the variable part of remuneration is not allowed to exceed 20% of the fixed remuneration. This is stricter than the 100% cap used elsewhere in the EU. This bonus cap does, however, not apply to AIFMs and UCITS ManCos.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

MiFID II (as implemented in the Wft) and MiFIR apply to entities providing investment management and advisory services to public funds.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

No, we are not aware of any additional regulatory restrictions and requirements imposed on investment advisors that advise public funds.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

No, we are not aware of any specific requirements or restrictions that apply in the Netherlands to funds investing in digital currencies.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

The marketing of public funds to professional investors and retail investors is regulated by the Wft. As mentioned under section 1 above, AIFMs and UCITS ManCos must obtain a licence or be able to make use of a specific regime or exemption before they can start marketing in the Netherlands. Whether or not marketing in the context of the AIFMD or the UCITS Directive takes place depends on whether the marketing activities qualify as an "offer" as defined in question 1.1 above.

The definition of "offer" in the Wft is broad. This definition may already be relevant in the early stages of contact with proposed investors, depending on whether the information provided to investors is sufficiently specific to enter into a contract with a fund. It is possible, for example, that draft documentation such as information memoranda or presentations qualify as an offer regardless of whether disclaimers are included to the effect that the document does not constitute an offer. This depends on the specific information included in the documentation.

In the context of marketing a fund in the Netherlands, it is also necessary to consider whether the offering qualifies as an investment service or investment advice and is therefore regulated by MiFID II. MiFID II may trigger additional licensing requirements.

As mentioned in question 1.1 above, if participation rights are offered at the request of a Dutch investor without any solicitation by a management company, no marketing is deemed to take place in the

Netherlands. The AFM applies the "initiative test" in determining whether active or passive marketing has taken place.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

Marketing of AIFs or UCITS may qualify as the provision of investment management or investment advisory services within the meaning of MiFID II, as implemented in the Wft. Entities or natural persons providing these MiFID services must obtain a licence prior to providing the services, unless they are able to make use of an exemption.

Various exemptions are available; for example, if the services are provided to a group company or as an ancillary service. Also note that AIFMs or UCITS ManCos may perform certain MiFID services without obtaining a full MiFID licence.

Depending on the entity that performs the marketing activities, a licence must be obtained under one of the following regimes: MiFID II; UCITS Directive; or AIFMD. Alternatively, no licence would be required if the entity is able to make use of its European passport as long as it has already obtained a licence to provide investment management or advisory services in another EEA Member State.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

Strict rules apply in the Netherlands to inducements for investment services (receiving and transmission of orders, order execution, asset management, investment advice and placing or underwriting of financial instruments) provided to retail or professional clients. Inducements include all fees, commissions and non-monetary payments received or paid that relate to the provision of investment services.

Exemptions generally apply to investment firms providing investment services in case the inducements, are paid directly by the client, are necessary to provide the service (necessary means such as custody costs, settlement and exchange fees, regulatory levies or legal fees), or relate to small non-monetary inducements or other minor non-monetary benefits capable of enhancing the quality of the service. All of these must be reasonable and proportionate and of such a scale that they are unlikely to influence the investment firm's behaviour in any way that is detrimental to the interests of the relevant client.

**ii. Advertising**

Advertisements are subject to general conduct rules prescribed by the Wft. Advertisements must be accurate, clear and not misleading. The commercial objective of the advertisement must be recognisable as such. Depending on the type of fund and the type of investors, specific disclaimers and warning signs must be included in the advertisement (or in the offering documentation).

**iii. Investor suitability**

MiFID II rules as implemented in the Wft require entities or persons that market participation rights in the funds to assess whether the product is suitable for the client. This suitability assessment is required for individual portfolio management or advice regarding the participation rights and requires the investment firm to obtain information from the client before it provides the investment services.

**iv. Custody of investor funds or securities**

If funds or securities are held in custody as part of the provision of investment services, the custodian must have a licence. If funds or securities are held in custody and no investment services are provided, it does not qualify as a regulated activity.

Under Dutch law, AIFMs and UCITS ManCos must appoint a depositary for the safekeeping of assets. Certain exemptions and light regimes are available.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

Different requirements apply to the marketing of funds to professional and retail investors; however, there are no generic restrictions on to whom funds may be marketed or sold.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

Marketing activities must comply with the requirements of the Dutch Act on Unfair Commercial Practices (*Wet oneerlijke handelspraktijken* or "**AUCP**"). Pursuant to the AUCP, retail investors must not be provided with misleading information, and essential information – such as the key features of the offered investment funds – must not be withheld.

Although developments are underway, currently (until 31 December 2019) AIFs and UCITS are exempt from the requirement to prepare a key investor document in accordance with the PRIIPs Regulation, provided that these Funds have already published a Key Investor Information Document in accordance with the Dutch implementation of the relevant regulations.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

The most commonly used Dutch entities for public funds are:

- The public limited liability company (*naamloze vennootschap* or "**NV**"). An NV is a legal entity and as such can hold the legal title to the fund assets. An NV is incorporated by having a notarial deed of incorporation executed in front of a Dutch civil law notary.
- The fund for joint account (*fonds voor gemene rekening* or "**FGR**"). An FGR is not a legal entity and therefore cannot hold the legal title to the fund assets. Instead, an FGR is a contractual arrangement between one or more investors, a fund manager and a legal titleholder (typically a foundation). The legal titleholder holds the legal title to the fund assets for the risk and account of the participants.

An FGR can be structured as a taxable entity or as tax transparent. In order for an FGR to be tax transparent the transfer of participations has to be subject to certain statutorily described limitations.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

**Taxation at entity level**

*NV or taxable FGR*

An NV or taxable FGR is subject to Dutch corporate income tax ("**CIT**") at the regular rates. Distributions by an NV or taxable FGR are, in principle, subject to 15% Dutch dividend withholding tax ("**DWT**"). However, Dutch public funds in the form of an NV or taxable FGR often apply the fiscal investment institution regime (*fiscale beleggingsinstelling* or "**FII**") or the exempt investment institution regime (*vrijgestelde beleggingsinstelling* or "**EII**"). See question 4.3 for a description of these regimes.

*Tax transparent FGR*

A fund in the form of a tax transparent FGR is not subject to Dutch CIT. The assets and liabilities of a tax transparent FGR (including income and capital gains from underlying investments) are attributed to the participants on a *pro rata* basis and are taxed accordingly.

Distributions by a tax transparent FGR are, in principle, not subject to Dutch DWT.

**Taxation at investor level**

*Dutch resident individuals*

A Dutch resident individual is generally subject to Dutch personal income tax ("**PIT**") with respect to an investment in a public fund under the regime for savings and investments (*sparen en beleggen, box 3*). Under this regime, the actual income (or losses) of the investment are not taxed. Instead, the individual is subject to PIT on a deemed return. This deemed return is calculated by multiplying applicable deemed return percentage(s) with the individual's particular yield basis (*rendementsgrondslag*), insofar this exceeds a certain threshold (*heffingvrij vermogen*). The individual's yield basis is determined as the fair market value of certain qualifying assets (*e.g.*, savings, shares held as investment and certain property) less the fair market value of certain qualifying liabilities, both determined on January 1st of the relevant year. The deemed return percentages to be applied to the portion of the yield basis in excess of the threshold, increase progressively from 1.94% to 5.60%, depending on the individual's particular yield basis. The deemed return is subject to a flat tax rate of 30% (rates for 2019).

Dutch resident individuals are generally able to offset Dutch DWT withheld on distributions received from an NV or taxable FGR against Dutch PIT due (or claim a refund), subject to certain limitations.

*Dutch resident entities*

A Dutch resident entity is generally subject to Dutch CIT with respect to income and capital gains derived from an investment in a public fund that is an NV or taxable FGR at the regular statutory CIT rates (certain exceptions apply). Dutch resident entities may generally offset Dutch DWT withheld on distributions received from an NV or taxable FGR against Dutch CIT due (or claim a refund), subject to certain limitations.

In respect of an investment in a public fund that is a tax transparent FGR, a Dutch resident entity is generally subject to Dutch CIT with respect to income and capital gains derived from the underlying investment.

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

| | **Fiscal Investment Institution** | **Exempt Investment Institution** |
|---|---|---|
| Legal form | NV, BV or taxable FGR. | NV or taxable FGR. |
| Shareholder restrictions | Yes, in brief:<br>■ no single individual person may own an interest of 25% or more;<br>■ no taxable entity (or whose beneficiaries are taxable entities), may alone or together with affiliated entities, own or control an interest of 45% or more; and<br>■ no single Dutch resident entity may own an interest of 25% or more through a non-Dutch resident FGR or entity with a capital divided into shares. | No, but there should be more than one participant. |
| Directors' requirements | No managing director and no more than half of the supervisory directors may at the same time be a managing director or supervisory director, respectively, or employee of a participant that, alone or together with affiliated entities, owns an interest of 25% or more. | No. |
| Restriction on activities | The aim and the actual activities need to solely consist of passive investment activities. | The aim and the actual activities need to solely consist of passive investments in financial instruments (*e.g.*, equities and bonds) or bank deposits, whereby the principle of risk spreading needs to be applied. |
| Distribution obligation | Yes, an FII has to distribute its profit within eight months after the end of the book year (exceptions may apply). | No. |
| Dutch CIT position of public fund entity | An NV, BV or taxable FGR is, in principle, subject to Dutch CIT. However, under the FII regime the applicable Dutch CIT rate is 0%. | An NV or taxable FGR is, in principle, subject to Dutch CIT. However, under the EII regime an exemption from Dutch CIT applies. |

| | Fiscal Investment Institution | Exempt Investment Institution |
|---|---|---|
| Dutch DWT on distributions from the public fund entity | Yes, subject to 15% Dutch DWT. However, an FII may claim a DWT remittance rebate with regard to the Dutch DWT foreign withholding taxes withheld on income received by an FII. | No, exempt. |
| Eligibility of the public fund entity for tax treaties | Yes, based on current Dutch tax treaty policy, the aim of the Dutch government is that an FII is eligible for tax treaty benefits. However, whether benefits may be obtained is ultimately determined by the source state. | No. |
| Advance request required | No. It is, however, advisable to request the Dutch tax authorities for advance confirmation that the FII regime applies. | Yes, the EII regime is applied upon request to the Dutch tax authorities to be filed ultimately in the year in which the NV or taxable FGR wants to apply the EII regime (the EII regime can only be applied as from the beginning of a book year). |
| Miscellaneous requirements | The debt financing may not exceed: (i) 60% of the tax book of real estate investments; and (ii) 20% of the tax book value of other investments. | In order to qualify for the EII regime, the participations in the public fund should be repurchased or redeemed directly or indirectly out of the fund assets if the participants request so. |

For the sake of completeness, it is noted that the above requirements of the FII regime assume that the public fund is considered to be regulated, which is the case if the public fund or its manager holds a licence from the AFM within the meaning of the Wft (or is exempted therefrom) or if its participations are admitted to trading on a market for financial instruments within the meaning of the Wft. If the public fund is not considered regulated, the requirements of the FII regime are slightly different.


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Rogier is the partner responsible for the fund and financial services regulation matters within our Investment Management practice. He also represents financial institutions and institutional investors on the negotiation and documentation of investment management mandates.

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He joined Stibbe in 2001 and spent three years in our London office. Jeroen has (co-) authored several publications on Dutch international taxation.

Stibbe

Stibbe is an independent law firm with around 400 lawyers advising on the laws of the Netherlands, Belgium and Luxembourg, as well as EU law. Stibbe has main offices in Amsterdam, Brussels and Luxembourg and also branch offices in Dubai, London and New York.

# Norway

Advokatfirmaet Schjødt AS

Andreas Lowzow

## 1 Registration

**1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?**

Following the implementation of directive 2011/61/EU on Alternative Investment Fund Managers ("AIFMD") there are, broadly speaking, two types of funds in Norway: (i) UCITS (established pursuant to national legislation implementing directive 2009/65/EU on undertaking for collective investment in transferable securities); and (ii) alternative investment funds ("AIFs"). AIFs essentially comprise all collective investment schemes that are not UCITS.

The marketing of UCITS follows the Norwegian Act on Investment Funds of 25 November 2011, which implements the UCITS directive in Norway. UCITS may be marketed to the public in Norway following the UCITS marketing regime.

AIFMD only regulates the marketing of AIFs to professional investors. Norway do allow the marketing of AIFs also to non-professional investors, but this requires that the manager (the "AIFM") is authorised, and that the AIF is approved for marketing to non-professional investors by the Financial Supervisory Authority of Norway ("FSAN"). We will, in the following, only focus on authorised AIFMs.

The FSAN is the Norwegian authority responsible for the supervision of UCITS and AIFMs in Norway (including those that are marketed cross-border into Norway), and has a public register of all funds.

**1.2 What does the fund registration process involve, e.g., what documents are required to be filed?**

The establishment of a Norwegian UCITS requires the prior approval from the FSAN. Certain documents shall be provided to the FSAN in relation to the application procedure, such as articles of association, the agreement with depositary and information regarding delegation arrangements. If approved, the FSAN will update its registry accordingly.

An authorised AIFM that wants to market a Norwegian AIF to non-professional investors in Norway must seek the prior approval from the FSAN. The application shall comprise, amongst others, fund documentation, a business plan and a key information document. If approved, the FSAN will update its registry accordingly.

Please see question 1.4 below for non-Norwegian funds.

**1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?**

The FSAN has in place various supervision and enforcement legislation and procedures that may apply should a fund (UCITS or AIF) be established and marketed without proper authorisation or registration.

**1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?**

Non-Norwegian UCITS funds (established in EEA) may be marketed in Norway after the relevant home state authority has notified the FSAN of the marketing. This follows the UCITS regime. The FSAN updates its register accordingly.

With respect to AIFs, the marketing regime to professional Norwegian investors depends on where the AIFM and the AIF are established. If both the AIFM and the AIF are established within the EEA and the AIFM is authorised, the AIF may be marketed to professional Norwegian investors following the passporting regime set out in the AIFMD. In other cases, the marketing to professional investors in Norway requires the prior approval from the FSAN.

## 2 Regulatory Framework

**2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?**

**i. Governance**

For UCITS, there are certain requirements as to the content of the articles of association, share classes, costs, distribution, calculation of NAV, subscription, redemption, etc. There are also rules as to the convening of unit holders meeting. However, the main governance requirements lie on the management company, which is subject to rules on, amongst others, suitability requirements for large shareholders, directors and management.

AIFMD regulates the AIFM, and there are requirements as to initial capital, governance, etc. of the AIFM. Governance requirements with respect to the AIF depends predominantly on how the AIF is structured and which form it takes (e.g. limited company, limited partnership, etc.).

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

The management of UCITS may only be done by an authorised entity. Authorised EEA UCITS management companies may manage Norwegian UCITS either cross-border or through a Norwegian branch. Non-EEA companies may manage Norwegian UCITS following the prior approval from the FSAN.

As mentioned above, the requirements relating to an AIFM depend on whether it is required to be authorised or not (which follows the AIFMD). The management of a Norwegian AIF by a foreign AIFM requires the AIFM to be authorised.

**iii. Capital structure**

A UCITS management company is subject to minimum capital requirements of EUR 125,000. With respect to the UCITS itself, it should be noted that there are certain legal requirements with respect to, amongst others, costs that can be charged from the management company and subscription and redemption of units (which shall be possible at least twice a month).

An authorised AIFM is subject to minimum capital requirements; both initial capital (minimum EUR 125,000) and own funds.

**iv. Limits on portfolio investments**

UCITS must comply with certain legal requirements as to what the UCITS may invest in and diversification of investments, including the possibility to borrow and invest in derivatives. The UCITS directive (and Norwegian implementing legislation) provide the full details of relevant investment restrictions.

AIFMD, on the other hand, does not generally restrict what types of investments can be made, nor does it require any diversification.

**v. Conflicts of interest**

A UCITS management company shall be organised in such a way as to minimise the risk of UCITS' or clients' interest being prejudiced by conflicts of interest between the company and its clients, between two of its clients, between one of its clients and a UCITS, or between two UCITS.

An authorised AIFM shall take all reasonable steps to avoid conflicts of interest and, when they cannot be avoided, to identify, manage and monitor and, where applicable, disclose those conflicts of interest in order to prevent them from adversely affecting the interest of the AIFs and their investors and to ensure that the AIFs they manage are fairly treated.

**vi. Reporting and recordkeeping**

A UCITS management company shall, for each UCITS it manages, issue an audited annual report (within four months from the end of the fiscal year), and an un-audited semi-annual report within two months after the end of the period to which it refers. In addition, the UCITS management company shall issue a prospectus and a KID for each UCITS it manages. There are also certain reporting requirements to the FSAN.

Authorised AIFMs shall, for each of the EEA AIFs it manages and for each of the AIFs it markets in the EEA, make available an annual report for each financial year no later than six months following the end of the financial year. There are also certain pre-investment disclosure requirements, as well as a requirement to periodically disclose certain information to investors. There are also reporting requirements to the FSAN.

**vii. Other**

Both UCITS management companies and authorised AIFMs are subject to legal obligations with respect to disclosure and recordkeeping. Additional requirements may follow from other relevant legislation such as AML, GDPR, FATCA, CRS, etc.

If the UCITS management company or the AIFM also is authorised to conduct one or more MiFID investment services, parts of MiFID II will apply.

In addition, it should be mentioned that the marketing of UCITS and AIFs may be subject to the Norwegian Marketing Act of 9 January 2009 No. 2.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

Please see above.

In order to be authorised as a UCITS management company, an application must be sent to the FSAN comprising, amongst others, information/documentation regarding: (i) which investment services are to be conducted; (ii) articles of association; (iii) calculation of capital requirements; and (iv) information on owners, directors and managers, etc.

In order to be authorised as an AIFM, an application must be sent to the FSAN comprising, amongst others, information/documentation regarding: (i) which investment services are to be conducted; (ii) description of the business to be conducted; (iii) articles of association or similar; (iv) calculation of capital requirements; (v) information regarding the compliance function, auditor, depositary, etc.; and (vi) information on owners, directors and managers, etc.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

No, there are not.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

There are no particular national requirements. UCITS have their own investment and diversification rules as mentioned above.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

The marketing of UCITS in Norway is regulated by the Norwegian Act on Investment Funds of 25 November 2011 No. 44, with appurtenant regulations. This act transposes UCITS IV into Norwegian law.

The marketing of AIFs in Norway is regulated by the Norwegian Act on Management of Alternative Investment Funds of 20 June 2014 No. 28, with appurtenant regulations. This act transposes AIFMD into Norwegian law.

In addition, it should be mentioned that the marketing of UCITS and AIFs may be subject to the Norwegian Marketing Act.

**3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.**

For UCITS, the marketing may be conducted by a UCITS management company, a credit institution authorised to conduct financing activity in Norway, an insurance company authorised to conduct insurance activity in Norway or an investment firm authorised to conduct investment services in Norway.

For AIFs, an authorised AIFM may conduct the marketing. Third parties may also market AIFs, provided they have the necessary authorisation.

**3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?**

**i. Distribution fees or other charges**

Both the UCITS directive (KID) and AIFMD (art. 23) provides for certain pre-investment disclosures regarding fees and other charges. Further, if the marketing is conducted by a party where investment services pursuant to MiFID II are provided (typically investment advice), the entity may be subject to MiFID II rules on restrictions on inducements.

**ii. Advertising**

In addition to specific disclosure and transparency rules pursuant to UCITS, AIFMD and potentially MiFID II, marketing in Norway must comply with the Norwegian Marketing Act of 9 January 2009 No. 2 which stipulates, amongst others, that marketing shall not conflict with good marketing practice and all marketing shall be designed and presented in such a way that it is clear, fair and not misleading.

**iii. Investor suitability**

For AIFs that are allowed to be marketed to non-professional investors in Norway, the AIFM must conduct a suitability test pursuant to MiFID II of all non-professional investors.

**iv. Custody of investor funds or securities**

A UCITS management company shall appoint a depositary for each UCITS, and the depositary shall at the outset be entrusted with the assets of the fund.

An authorised AIFM shall appoint a depositary for each AIF it manages, and the assets of the AIF shall at the outset be entrusted to the depositary for safe-keeping.

**3.4 Are there restrictions on to whom public funds may be marketed or sold?**

Please see section 1 above.

**3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?**

There are no other main areas of regulation imposed with respect to the marketing of public funds.

## 4 Tax Treatment

**4.1 What are the types of entities that can be public funds in your jurisdiction?**

As mentioned, there are, broadly speaking, two types of funds in Norway; UCITS and AIFs. As you will see below, AIFs may take a range of legal forms, but Norwegian "*aksjeselskap*" (limited company) and "*indre selskap*" (a type of limited partnership) are the most typical.

**4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?**

1. **UCITS**

1.1 **Entity level**

1.1.1 *Dividends*

UCITS are pursuant to the participant exemption method generally not taxable for legally received dividends on shares in companies/units in mutual funds resident in Norway or the EEA. However, three per cent of such dividends are taxable as ordinary income at a current rate of 22 per cent, implying that dividends distributed are effectively taxed at a rate of 0.66 per cent. Dividends from shares in companies resident in a low-tax country outside the EEA are not covered by the participant method. Dividends from shares in companies resident in countries outside the EEA which are not considered as low tax countries, are covered by the participant exemption method provided that the fund continuously, for a period of two years including the recovery time, has owned at least 10 per cent of the share capital, and has had 10 per cent or more of the voting rights in the distributing entity.

1.1.2 *Capital gains and losses*

Capital gains upon realisation of shares in companies resident in the EEA are, due to the participation exemption method, generally exempt from tax and losses are not deductible. According to a special regulation, UCITS are also exempt from tax on gains on shares in companies outside of the EEA, including companies in low-tax countries. Losses on such shares are not deductible. This also applies to foreign funds, which are considered tax resident in Norway, provided that the fund meets the conditions to be considered as a mutual fund according to Norwegian rules.

1.1.3 *Interest income*

Interest income is taxed as ordinary income at a current rate of 22 per cent.

1.1.4 *Deductions*

UCITS may claim deduction in income for the part of the distributions to the unit holders that shall be taxed as interest (see point 1.2.1) in the hands of the recipient.

1.2 **Unit holder level**

1.2.1 *Dividends*

Taxation of distribution from UCITS depends on the fund's ratio of shares *vs*. other investments. If the ration of shares is more than 80 per cent, all distributions from the fund shall be taxed as share dividends. If the ratio of shares in the fund is less than 20 per cent, all distributions from the fund shall be taxed as interest income. Distribution from funds with a ratio of shares between 20 per cent and 80 per cent, shall be split into one part that is taxed as share dividends and one part that is taxed as interest income, calculated proportionally based on the fund's actual investments.

Share dividends distributed to Norwegian resident corporate unit holders (i.e. limited liability companies and certain similar entities) are generally exempt from tax pursuant to the participation exemption method. However, three per cent of such dividends are taxable as ordinary income at a current rate of 22 per cent, implying that dividends distributed are effectively taxed at a rate of 0.66 per cent. The participation exemption method applies even if the dividend is due to income from shares in companies that are not in themselves subject to the exemption method, and thus also if the dividend is due to income from shares in low-tax countries outside of the EEA. The distribution taxed as interest income is taxable at a current rate of 22 per cent and is not subject to the participation exemption method.

Share dividends distributed to Norwegian resident personal unit holders are taxed as ordinary income at a current rate of 22 per cent to the extent the dividends exceed the tax-exempt allowance. The tax basis is adjusted by ×1.44 before taxation, implying that dividends exceeding the tax-free allowance are effectively taxed at 31.68 per cent. The distribution taxed as interest income is taxable at a rate of 22 per cent.

Share dividends distributed to non-resident unit holders are, in general, subject to Norwegian withholding tax at a statutory rate of 25 per cent, unless otherwise provided for in an applicable tax treaty or the recipient is tax resident within the EEA. Share dividends distributed to corporate unit holders tax resident within the EEA are, however, subject to the participant method if the company is equivalent to a Norwegian company subject to the participant method and is genuinely established and performs genuine economic business activities within the EEA. The distributions taxed as interest income are currently not subject to Norwegian withholding tax.

1.2.2 *Realisation of units*

The capital gains/losses are taxed based on the fund's ratio of shares, similar as described in point 1.2.1 above. When calculating the ratio of shares, the basis shall be the average of the ratio of shares in the acquisition year and the year of sale.

Capital gains from realisation of units by a Norwegian resident personal unit holder are taxable as ordinary income in the year of realisation and have a corresponding right to deduct losses that arise upon such realisation. The tax rate for ordinary income is currently 22 per cent. For capital gains/losses that shall be taxed as share gains, the tax basis shall, however, be adjusted by ×1.44 before taxation/deduction, implying an effective taxation of 31.68 per cent.

For Norwegian resident corporate unit holders, which are subject to the participation exemption method, the participation method applies for the gains/losses that shall be taxed as share gains. The participation exemption method applies even if the fund consists of shares in companies that are not in themselves subject to the exemption method, and thus also to funds even if the funds hold shares in low-tax countries outside of the EEA.

## 2. <u>AIFs</u>

### 2.1 Limited liability companies (AS and ASA)

2.1.1 *Entity level*

Funds organised as limited liability companies are generally exempt from tax liability on dividends and capital gains upon realisation of shares from companies resident in the EEA, due to the participation exemption method. Due to the participation exemption method, losses are not deductible. Three per cent of the dividends are taxable as ordinary income at a current rate of 22 per cent, implying that dividends distributed are effectively taxed at a rate of 0.66 per cent.

Dividends distributed and capital gains received from shares in companies outside of the EEA which are not considered as low tax countries, will also be covered by the participant exemption method provided the fund, continuously for a period of two years including the recovery time, has owned 10 per cent or more of the capital, and has had 10 per cent or more of the voting rights.

Interest income is taxed as ordinary income at a current rate of 22 per cent.

2.1.2 *Shareholder level*

Dividends:

Dividends distributed from the fund to Norwegian resident corporate unit holders (i.e. limited liability companies and certain similar entities) are generally exempt from tax pursuant to the participation exemption method. However, three per cent of such dividends are taxable as ordinary income at a current rate of 22 per cent, implying that dividends distributed effectively taxed at a rate of 0.66 per cent.

Dividends distributed from the fund to Norwegian personal unit holders are taxed as ordinary income at a current rate of 22 per cent to the extent the dividends exceed the tax-exempt allowance. The tax basis is adjusted by ×1.44 before taxation, implying that dividends exceeding the tax-free allowance are effectively taxed at 31.68 per cent.

Dividends distributed from the fund non-resident unit holders are, in general, subject to Norwegian withholding tax at a statutory rate of 25 per cent, unless otherwise provided for in an applicable tax treaty or the recipient is tax resident within the EEA. Dividends distributed to corporate unit holders tax resident within the EEA are exempt from Norwegian withholding tax, provided the unit holder is the beneficial owner of the units and genuinely established and performs genuine economic business activities within the EEA.

2.1.3 *Realisation of units*

For Norwegian resident personal unit holders, capital gains upon realisation of units are taxable as ordinary income in the year of realisation and have a corresponding right to deduct losses that arise upon such realisation. The tax liability applies irrespective of time of ownership and the number of units realised. The tax rate for ordinary income is currently 22 per cent. The tax basis is adjusted upward by ×1.44 before taxation/deduction, implying an effective taxation of 31.68 per cent.

For Norwegian resident corporate unit holders, capital gains upon realisation of units are generally exempt from tax and losses are not deductible, due to the participant exemption method.

Gains from realisation of units by non-resident unit holders will not be subject to taxation in Norway unless (i) the units are effectively connected with business activities carried out or managed in Norway, or (ii) the units are held by an individual who has been a resident of Norway for tax purposes with unsettled/postponed exit tax.

### 2.2 Internal partnership ("IS") and limited partnership ("KS")

2.2.1 *Entity level*

Funds that are organised as internal partnership and limited partnership will be treated as transparent entities for tax purposes and profits are taxed at the hands of the partners. The fund's ordinary income will, however, be determined as if the fund was a taxpayer. The net result is divided among the partners for taxation. Ordinary income, including interest income, is taxable a current rate of 22 per cent. Foreign partners in a fund that carries out business activities in Norway, will be liable to taxation in Norway for their shareholding in the Norwegian partnership.

2.2.2 *Unit holder level*

Dividends:

Distributions from the partnership to a personal partner are subject to tax for the partner in addition to the ordinary income taxation as described in point 2.2.1 above. Distributions are taxed at the same rates as dividends from limited companies, allowing reduction for the corporate tax paid, resulting in the same effective tax rates for partners in limited companies and partnerships.

Partners that are companies covered by the participation exemption method are not subject to taxation on distributions. However, distributions to partners which are covered by the participant exemption method shall make a recognition according to the three per cent rule, *cfr.* point 2.2.1 above.

2.2.3 *Realisation of units*

Capital gains from realisation are, in general, taxable as ordinary income at a current rate of 22 per cent for the partner who realises the unit. Similarly, losses are deductible in ordinary income. The tax basis on capital gains/losses for a personal partner are, in general, adjusted by ×1.44 before taxation/deduction, implying an effective taxation of 31.68 per cent.

Partners that are companies covered by the participant exemption method are not liable for tax on capital gains and losses are not deductible.

**4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?**

This is not applicable.

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Andreas works primarily with asset management, including fund establishments, regulatory matters, ESG, compliance and family office matters.

Andreas holds wide experience with establishment and structuring of all types of investment funds and structures (PE, VC, infrastructure, hedge funds, co-investments, etc.). He has also in-depth knowledge of regulatory matters for the asset management industry. Andreas has followed the development and focus on environmental, social and governance ("ESG") matters from the start in Norway, and has advised on all matters of the subject, *inter alia*, drafting and review of contract obligations, policies, ongoing supervision and ESG due diligence.

He has previously worked at the law firm BAHR and was seconded to Sector Fund Services (a fund manager of both UCITS and AIFs) where he advised on regulatory compliance matters.

SCHJØDT

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Our banking & finance team is continuously named as a leader in its field by clients and international publications. Further, Schjødt has one of the largest and strongest teams within finance regulatory matters, which also includes all aspects of asset management and fund raising.

# Singapore


Sarah Teo

Allen & Gledhill

Sunit Chhabra


## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Offers of units/shares of a collective investment scheme ("**CIS**") in Singapore are primarily governed by the Securities and Futures Act, Chapter 289 of Singapore ("**SFA**"), the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 ("**SFR**") and the Code on Collective Investment Schemes ("**Code**"), which are administered by the Monetary Authority of Singapore ("**MAS**").

In general, an offer of units/shares of a CIS may be made to the retail public in Singapore ("**Retail CIS**") only if:

(1) the CIS is (in the case of a CIS constituted in Singapore) authorised pursuant to section 286 of the SFA ("**Authorised Scheme**") or (in the case of a CIS constituted outside Singapore) recognised pursuant to section 287 of the SFA ("**Recognised Scheme**") by the MAS;

(2) such offer is made in or accompanied by a prospectus ("**Prospectus**") in respect of the offer that is prepared in accordance with prescribed requirements and registered by the MAS; and

(3) such offer is accompanied by a product highlight sheet ("**PHS**") in respect of the offer that is prepared in accordance with prescribed requirements and lodged with the MAS.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

The seeking of the MAS' approvals for offers of units/shares in a CIS to the retail public in Singapore requires the filing of:

(1) a prescribed application form (a "**Form 1**" authorisation application or a "**Form 2**" recognition application);

(2) a Prospectus; and

(3) a PHS,

together with certain documents prescribed in the CIS Practice Note 1/2005 on Administrative Procedures for Retail Schemes issued by the MAS, and the requisite filing fees payable to the MAS. A 21-day review period by the MAS is applicable for each of Form 1/Form 2 and the Prospectus.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

Any person who makes an offer of units/shares in a CIS to the retail public in Singapore where the CIS has not been authorised/recognised may, upon conviction, be liable for a fine not exceeding S$150,000 or to imprisonment for a term not exceeding two years or to both, and to a further fine not exceeding S$15,000 for every day or part thereof during which the offence continues after conviction.

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

The MAS may recognise an offshore CIS under section 287 of the SFA if it is satisfied, *inter alia*, of the following:

(1) the laws and practices of the jurisdiction under which the offshore CIS is constituted and regulated afford to investors in Singapore protection at least equivalent to that provided by comparable local CISs authorised under the SFA (e.g. the MAS may only recognise an offshore CIS if it is satisfied, amongst others, that the offshore CIS is subject to/can comply with investment guidelines and restrictions that are substantially similar to those set out in the Code);

(2) the manager of the offshore CIS is licensed or regulated in the jurisdiction of its principal place of business and a fit and proper person in the opinion of the MAS. The Code also requires that the manager (together with its related corporations) should be managing at least S$500 million of discretionary funds in Singapore unless the units/shares in the offshore CIS have been approved for listing for quotation and will be traded on an approved exchange or where the offshore CIS will be offered in Singapore pursuant to the ASEAN CIS Framework; and

(3) a Singapore representative for the offshore CIS (an individual resident in Singapore or a company or a foreign company registered under Part XI, Division 2 of the Companies Act, Chapter 50 of Singapore) is appointed to carry out or procure the carrying out of the prescribed functions set out in section 287(13) of the SFA.

Offshore CISs established in the jurisdiction of an ASEAN Capital Markets Forum member which is a signatory to the Memorandum of Understanding in respect of the ASEAN CIS Framework dated 1st October 2013 (currently comprises Singapore, Malaysia and Thailand) and which are offered to the general public of that member jurisdiction, may avail themselves of the streamlined authorisation process under the ASEAN CIS Framework for retail offer in Singapore.

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

***Trustee***

An Authorised Scheme which is constituted as a unit trust, is required to appoint a trustee for the scheme which is an approved trustee under section 289 of the SFA. The MAS may approve a public company as an approved trustee if it is satisfied that, *inter alia*, the public company has a paid-up capital of not less than S$1 million, shareholders' funds of not less than S$1 million, a sound financial position, a sufficient number of qualified personnel with experience in performing the duties of an approved trustee or other relevant experience and that it (and each of its officers) is a fit and proper person.

The operational and other additional requirements of trustees are set out in regulations 7(1) and 8(2)(b) of the SFR and Chapter 2 of the Code which includes, *inter alia*, taking into custody or control the property of the scheme and holding it on trust for the participants and maintaining a register of the participants in the scheme.

The above requirements in relation to trustees do not currently apply to Recognised Schemes, and the MAS generally looks to the laws and regulations of the home jurisdiction for the trustee's appointment (if applicable).

***Manager***

The manager of an Authorised Scheme is required to hold a capital markets services licence ("**CMSL**") for fund management (or be exempted from the same) and satisfy the MAS that it is a fit and proper person. Conversely, the manager of a Recognised Scheme is required to satisfy the MAS that it is a fit and proper person and is licensed or regulated in the jurisdiction of its principal place of business.

Except where the units/shares in a Recognised Scheme have been approved for listing for quotation and will be traded on an approved exchange or where it will be offered in Singapore pursuant to the ASEAN CIS Framework, it is currently a requirement that the manager of the Recognised Scheme (together with its related corporations) manages at least S$500 million of discretionary funds in Singapore.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

As stated above, the manager of an Authorised Scheme must hold a CMSL for fund management.

There are no specific requirements in respect of the review and approval of investment advisory agreements.

**iii. Capital structure**

There is currently no specific requirement under the SFA which imposes a minimum fund size for a CIS. However, if the CIS imposes a minimum fund size for its launch or continued operation, the SFR requires this fact and the minimum fund size to be stated in the Prospectus.

**iv. Limits on portfolio investments**

The core investment guidelines and restrictions for Authorised Schemes are set out in Appendix 1 to the Code. Additional or different investment guidelines and restrictions are applicable to money market funds, hedge funds, capital guaranteed funds, index funds and precious metals funds ("**specialised CISs**").

Recognised Schemes should in general be subject to substantially similar/comparable investment guidelines and restrictions in its home jurisdiction.

**v. Conflicts of interest**

The trustee of an Authorised Scheme should be independent of the manager (i.e. an entity should not have an interest in 20% or more of the shares issued by the trustee and by the manager or its related corporations). Such interest would include deemed interest in the shares of the trustee or manager as the case may be under sections 4(4) and (5) of the SFA.

Generally, the manager and the trustee of an Authorised Scheme should conduct all transactions with or for the scheme at arm's length. The Code imposes restrictions on transactions carried out by the manager with its related corporations, and where such transactions are carried out, the Code generally requires the manager to have effective arrangements in place to manage potential conflicts of interest.

Additionally, the SFR requires the Prospectus of a CIS to disclose any potential or actual conflicts of interest in relation to the CIS and its management and whether these conflicts will be resolved or mitigated and, if so, how they will be resolved or mitigated.

**vi. Reporting and recordkeeping**

***Reporting***

The hard copies or electronic copies of the semi-annual accounts and reports relating to Authorised Schemes should be made available to holders within two months from the end of the period covered by the accounts and reports. Annual accounts and reports and the auditors' report on the annual accounts for Authorised Schemes should be made available to holders within three months from the end of each financial year of the scheme.

The manager of an Authorised Scheme is required to make notifications to the MAS in certain circumstances. For instance, the manager should inform the MAS within three business days after it becomes aware of any breach of the guidelines or limits set out in Part I and Part II of the Code. This obligation is also imposed on the Authorised Scheme's trustee in respect of the manager's breaches of the Code. Similarly, when the manager becomes aware of an error in the calculation of an Authorised Scheme's net asset value per unit, the manager should notify both the MAS and the trustee as soon as practicable and in the manner as set out in the Code.

Recognised Schemes will need to comply with the relevant laws of their home jurisdiction, and the MAS generally expects investors in Singapore to be accorded with equivalent treatment as the investors in the home jurisdiction of the scheme.

When there are any changes to the particulars of the CIS submitted in the Form 1 authorisation application/Form 2 recognition application, the MAS should be notified of the changes immediately via the filing of a Form 1-A/Form 2-A.

***Recordkeeping***

The Code requires the manager of an Authorised Scheme to maintain a record of the instructions (if any) to the trustee as to how votes in relation to investments of an Authorised Scheme should be exercised as well as a record of all soft dollars received (if any).

**vii. Other**

For Authorised Schemes, the manager should inform the MAS and existing holders of any significant change to be made to the scheme at least one month before the change is to take effect. Where a significant change cannot be determined by the manager at least one month in advance, the manager should inform the MAS and existing holders of the significant change as soon as practicable.

The MAS has yet to prescribe any specific requirement on notices to holders in respect of Recognised Schemes. The MAS will look to the laws of the home jurisdiction to regulate such matters and will expect investors in Singapore to be accorded with equivalent treatment as the investors in the home jurisdiction of the scheme.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

The provision of fund management services (this includes managing the property of, or operating, a CIS) is a regulated activity under the SFA. A company that carries on fund management is *prima facie* required to hold a CMSL for fund management unless otherwise exempt from such licensing requirement. There are prescribed licensing criteria for fund management companies, including minimum base capital requirements and minimum competency requirements for key individuals. Fund management companies that service retail clients have to meet higher requirements than those that service only non-retail clients.

The licensing process would involve the submission of prescribed application forms to the MAS. The MAS usually takes approximately three to six months to process and approve an application, during which the MAS may ask follow-up questions or request further information on the application.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

Licensed fund management companies are subject to ongoing financial, conduct of business, filing and reporting requirements. For instance, a licensed fund management company must ensure that (this is a non-exhaustive list):

(1) it meets ongoing capital and financial requirements prescribed by the MAS;

(2) assets under management are subject to independent custody, independent valuation and customer reporting;

(3) there is adequate disclosure to its customers, in respect of each fund or account that it manages, which is provided at the inception of the fund or at the point that the customer's account is set up, as well as on a periodic basis or as and when material changes occur. The disclosures should cover, among other things, the investment policy and strategy, valuation policy and performance measurement standards, and the counterparties and service providers used by the fund or account;

(4) any decision to terminate a fund and the process of termination are in the interests of investors in the fund, and that all investors are treated fairly and equitably; and

(5) it complies with notification/approval obligations for certain transactions (e.g. a change in control of the fund manager) and changes in particulars.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

The MAS has yet to prescribe specific guidelines and restrictions for a retail CIS' investment in digital currencies/token under the Code.

However, there are guidelines and restrictions on an Authorised Scheme's investments in securities/units of a CIS ("**underlying scheme**") in the Code. It is possible that digital currencies may be construed to be securities or units in a CIS. If so, the Authorised Scheme (in investing in such digital currencies) will need to comply with the applicable restrictions on investment in securities/units in a CIS, as set out in the Code.

In the case of an offer of digital currencies which are securities/units in a CIS to persons in Singapore, the regulatory regime under Part XIII of the SFA for offers of securities/units in a CIS would apply. A person intending to make an offer of such digital currencies which are securities/units in a CIS will need to consider the authorisation/recognition, prospectus and licensing requirements as discussed above. There are nonetheless, certain licensing and prospectus registration exemptions which may be available (for instance, if a person offers digital currencies which are securities/units in a CIS to an institutional investor as defined under the SFA).

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

The regulatory regime under the SFA applies to the marketing of CIS in Singapore.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

The marketing of units/shares of a CIS would be regarded as conducting the regulated activity of "dealing in capital markets products", and hence must be conducted in Singapore by a holder of a CMSL for dealing in capital markets products that are a CIS, or a person who is exempt from such requirement (such holder or person, an "**Authorised Distributor**").

In relation to retail CIS, the "responsible person" for a CIS (i.e. where the CIS is constituted as a corporation, the corporation; in any other case, the manager for the CIS) can rely on an exemption to market units of that CIS where: (a) it is the holder of a CMSL, or an exempt person, in respect of fund management; or (b) the dealing is effected either through the holder of a CMSL to deal in capital markets products that are securities, units in a CIS or specified exchange-traded derivatives contracts, or an exempt person in respect of dealing in capital markets products that are units in a CIS.

In addition, a corporation that carries on business in fund management is exempt from this licensing requirement where it markets units/shares of a CIS that is managed by the corporation or any of its related corporations. Accordingly, a licensed fund management company can market units/shares of a Retail CIS which it manages.

A person licensed for dealing in capital markets products would be subject to ongoing capital and other financial requirements, representative registration requirements, fit and proper requirements, customer's money and assets rules, conduct of business requirements, and financial reporting requirements.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

Where the units in a CIS are marketed by a licensed fund management company, the fund management company must disclose to customers the terms with respect to fees (this would include distribution fees and other charges), as part of its ongoing conduct of business requirements. The Code of Ethics and Standards of Professional Conduct ("**IMAS Code**") issued by the Investment Management Association of Singapore ("**IMAS**") provides that all relevant fees chargeable by members of IMAS and other material costs to be charged to the client by members and their appointed agents should be disclosed to the client in members' business representations, investment management agreements and prospectuses. While the IMAS Code applies only to its members, it represents industry guidelines as to the minimum standards of conduct applicable to investment managers in Singapore.

The Eighth Schedule to the SFR, which sets out the prescribed form for the PHS, requires that the fees and charges (including management fees and distribution fees) of the investment product be stated in the PHS.

**ii. Advertising**

Advertisements or publications in respect of offers or intended offers of units in CISs (each an "**Advertisement**") are primarily regulated under sections 300 and 341 of the SFA, Division 2 of Part III of the SFR and paragraphs 4.5, 9.1 and 8 of Chapters 4, 9 and Appendix 1 respectively of the Code. Additional advertisement requirements/restrictions are applicable to specialised CISs which can be found in the relevant Appendices to the Code.

In particular, the SFR requires that an Advertisement must, *inter alia*, not be false or misleading, provide a fair and balanced view of the units, present information in a clear manner, (where it is in visual form) be clearly legible and contain the statement: "This advertisement or publication has not been reviewed by the Monetary Authority of Singapore."

The SFR also sets out other requirements regulating the contents as well as the legibility/audibility of Advertisements for CISs. In addition, such Advertisements must be approved by the senior management of the person disseminating or publishing the Advertisements prior to the dissemination or publication.

The Code further prescribes additional guidelines and requirements in relation to the preparation of an Advertisement. In particular, paragraph 4.5 of Chapter 4 of the Code provides that Advertisements in relation to a CIS should be prepared in accordance with:

(1) the Code of Best Practices in Advertising Collective Investment Schemes and Investment-Linked Life Insurance Policies jointly issued by the IMAS and the Life Insurance Association; and

(2) the Guidance Notes on Recommended Disclosures to Support the Presentation of Income Statistics in Advertisements issued by the IMAS.

**iii. Investor suitability**

As prescribed in the Eighth Schedule to the SFR, product suitability information must be provided in the PHS.

If a person marketing units in a CIS also provides advice concerning the CIS, such provision of advice concerning the CIS would separately be regulated as the provision of a financial advisory service under the Financial Advisers Act, Chapter 110 of Singapore ("**FAA**"). A person who provides financial advisory services is *prima facie* required to hold a financial adviser's licence unless otherwise exempt from such licensing requirement.

The FAA requires a financial adviser to have a reasonable basis for recommending any investment product to any person who may reasonably be expected to rely on the recommendation. To have a reasonable basis, the financial adviser must have: had regard to the information provided by the customer concerning his investment objectives, financial situation and particular needs; given such consideration to, and conducted such investigation of, the subject matter of the recommendation as is reasonable in all the circumstances; and made a recommendation based on the foregoing consideration and investigation.

**iv. Custody of investor funds or securities**

One of the main functions of the trustee for an Authorised Scheme is to take into custody or control of the property of the CIS and hold the property on trust for the holders of the CIS, and to ensure that the property of the scheme is kept distinct from its own property and the property of its other clients. Regulations 7 and 8(2)(b) of the SFR set out the requirements that an approved trustee of an Authorised Scheme is expected to observe and comply with.

A licensed fund management company is also subject to customer's monies and assets rules under Part III of the Securities and Futures (Licensing and Conduct of Business) Regulations ("**SF**(**LCB**)**R**"). In particular, a licensed fund management company is required under regulation 13B(1)(c) of the SF(LCB)R to segregate assets under its management from its proprietary assets (or those of its related corporations or connected persons) and maintain them in either a trust account or custody account (as the case may be) with a licensed custodian.

In addition, Chapter 2 of the Code also sets out certain responsibilities and operational obligations which are expected of a trustee for an Authorised Scheme. They include, amongst others:

(1) the trustee should be independent of the manager; and

(2) the trustee should conduct all transactions with or for a scheme at arm's length.

There is currently no equivalent requirement for the appointment of a trustee for a Recognised Scheme.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

Upon the authorisation/recognition of a CIS and the registration of the Prospectus in respect of the offer of units/shares of such CIS, the CIS can be marketed or sold to retail investors in Singapore by an Authorised Distributor. There is currently no restriction on whom or the number of investors such CIS may be marketed or sold to in Singapore.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

The main areas of regulation have been addressed above.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

Currently, the only requirements for authorisation of a CIS which is constituted as a unit trust are prescribed in the SFA, hence Authorised Schemes are structured as unit trusts constituted by way of trust deeds. The Variable Capital Companies Act 2018, which is expected to come into force in 2019, introduces a legal framework for a new type of corporate structure tailored for CISs known as the Variable Capital Company ("**VCC**") in Singapore. The VCC framework seeks to provide investment managers with greater operational flexibility and allow investment funds to consolidate the fund domicile with the respective fund management activities in Singapore.

There is generally no restriction on how a Recognised Scheme may be structured. In practice, the MAS may recognise offshore CISs which are structured as unit trusts or investment companies in its place of domicile, if the requirements under section 287 of the SFA are met.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

In Singapore, pursuant to the Income Tax Act, Chapter 134 of Singapore ("**ITA**"), income tax is chargeable on income accruing in or derived from Singapore and foreign-sourced income received (or deemed received) in Singapore from outside Singapore. In this regard, case law has held that the source of income is a "practical, hard matter of fact" and that no simple, single legal test can be employed, so the facts of each case will have to be considered in the relevant context. Broadly speaking, one would generally look to where the activities giving rise to the income took place to determine if income is Singapore-sourced.

**(i) Fund level**

In the context of a public fund, the discretionary management of investments by a manager in Singapore would generally be regarded as the carrying on of a business in Singapore by the manager for the public fund, and the profits of the public fund arising from such discretionary management in Singapore could then be subject to Singapore income tax on the basis that the manager is a permanent establishment in Singapore of the public fund.

Please see question 4.3 for information on certain schemes for tax exemption in relation to fund management that is available.

**(ii) Investor level**

An individual is tax resident in Singapore in a year of assessment if, in the preceding year, he was physically present in Singapore or exercised an employment in Singapore (other than as a director of a company) for 183 days or more, or if he resides in Singapore. A company is tax resident in Singapore if the control and management of its business, which is typically evidenced through the conduct of board meetings discussing matters of strategic importance, is exercised in Singapore.

Individuals who are Singapore tax residents are subject to Singapore income tax on income accrued in or derived from Singapore. All foreign-sourced income received (except for income received through a partnership in Singapore) in Singapore on or after 1 January 2004 by Singapore tax resident individuals will be exempt from tax. Corporate taxpayers who are Singapore tax residents are subject to Singapore income tax on income accrued in or derived from Singapore and, subject to certain exceptions, on foreign-sourced income received or deemed to be received in Singapore from outside Singapore.

Non-resident corporate taxpayers are subject to income tax on income accrued in or derived from Singapore, and on foreign-sourced income received or deemed received in Singapore, subject to certain exceptions. Non-resident individuals, subject to certain exceptions, are subject to income tax on income accrued in or derived from Singapore and are exempt from tax on foreign-sourced income remitted or deemed to be remitted into Singapore.

However, foreign-sourced income in the form of dividends, branch profits and service income ("**specified foreign income**") received or deemed to be received in Singapore by Singapore tax resident companies on or after 1 June 2003, is exempt from tax if certain prescribed conditions are met, including the following:

(1) such income is subject to tax of a similar character to income tax under the law of the jurisdiction from which such income is received; and

(2) at the time the income is received in Singapore, the highest rate of tax of a similar character to income tax (by whatever name called) levied under the law of the territory from which the income is received, on any gains or profits from any trade or business carried on by any company in that territory at that time ("**headline tax rate**"), is not less than 15%.

In the case of dividends paid by a company resident in a territory from which the dividends are received, the "subject to tax condition" in (1) above is considered met where tax is paid in that territory by such company in respect of its income out of which such dividends are paid or tax is paid on such dividends in that territory from which such dividends are received.

Certain concessions and clarifications have also been announced by the Inland Revenue Authority of Singapore with respect to the above conditions.

In the case of the public fund being a foreign unit trust or non-resident company, individuals (whether resident or non-resident) in Singapore are exempt from Singapore tax on income distributions received from such a public fund where the units are held for investment purposes and not pursuant to a trade, business or partnership carried on in Singapore. Income distributions from such public funds may otherwise be treated as Singapore-sourced income in the hands of an individual investor where the income distributions constitute gains or profits from a trade or business carried on by the investor in Singapore.

Corporates or other entities in Singapore will be taxed on the income distributions received from such a foreign or non-resident public fund at the applicable corporate tax rates. The point of taxation may be: (1) upon remittance or deemed remittance into Singapore (for entities receiving the income distributions as passive investment income, subject to the exemption mentioned above in respect of specified foreign income in the form of foreign-sourced dividends received by Singapore tax resident companies); or (2) upon such income being derived and irrespective of remittance into Singapore (for entities receiving the income distributions as income from a trade or business carried on in Singapore).

In the case of the public fund being a locally-constituted trust which is tax exempt, distributions from such public fund should generally be tax exempt in the hands of its investors, subject to meeting the conditions prescribed under such schemes.

Where the public fund is a company incorporated and tax resident in Singapore, the public fund (being a Singapore-resident company) can pay tax-exempt (one-tier) dividends which are exempt from Singapore income tax in the hands of its shareholders, regardless of their tax residence status.

**4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?**

In order to encourage fund management activities in Singapore, the following schemes for tax exemption in relation to fund management are available where the relevant conditions are met:

(1) the "Qualifying Fund Scheme" for non-resident or offshore companies and trusts pursuant to section 13CA of the ITA;

(2) the "Resident Fund Scheme" for Singapore-resident companies incorporated in Singapore pursuant to section 13R of the ITA; and

(3) the "Enhanced-Tier Fund Scheme" for fund vehicles constituted in all forms in respect of standalone funds and master-feeder fund structures, pursuant to section 13X of the ITA. Separate rules apply in respect of Master-Feeder-SPV fund structures. Pursuant to the Singapore Budget Statement 2019, fund vehicles in the form of managed accounts would also be eligible for the Enhanced-Tier Fund Scheme from 19 February 2019. Further details will be announced by the MAS in due course.

The scope of the tax exemption under each of the tax exemption schemes is the same, i.e. "specified income" from "designated investments" of such funds under each of such schemes would be exempt from tax in Singapore. The categories of "specified income" and "designated investments" are set out in the Income Tax (Exemption of Income of Prescribed Persons Arising from Funds Managed by Fund Manager in Singapore) Regulations 2010 and are sufficiently wide for most funds.

In order to rely on the above schemes, one of the requirements is that the public fund must be managed or advised by a fund manager in Singapore. A "fund manager" for this purpose refers to a company that holds a CMSL under the SFA for fund management or that is exempted under the SFA from holding such a licence.

(1) The Qualifying Fund Scheme

With respect to the Qualifying Fund Scheme under section 13CA of the ITA, the fund ("**Qualifying Fund**") must meet certain conditions, including the Qualifying Fund being: (A) a non-resident company that neither carries on any business in Singapore, nor has a permanent establishment in Singapore (other than a fund manager); or (B) a trust whose trustee neither carries on any business in Singapore, nor has a permanent establishment in Singapore (other than due to its functions as the trustee, or the presence of a fund manager).

In addition, all the investors in the Qualifying Fund must also be "Qualifying Investors" on the last day of the Qualifying Fund's financial year ("**basis period**") relating to a particular year of assessment ("**Relevant Day**"), failing which a proportion of the income derived by the Qualifying Fund and attributable to non-qualifying investors ("**Non-Qualifying Investors**") may be subject to tax in the hands of the Non-Qualifying Investors ("**Financial Amount**"). In order to be a "Qualifying Investor", an investor in the Qualifying Fund includes one of the following:

(i) an individual investor; or

(ii) a *bona fide* entity not resident in Singapore which:

(A) does not have a permanent establishment in Singapore (other than a fund manager) and does not carry on a business in Singapore; or

(B) carries on an operation in Singapore through a permanent establishment in Singapore where the funds used by the entity to invest directly or indirectly in the Qualifying Fund are not obtained from such operation;

(iii) a "Designated Person" (which category is limited and comprises certain government-related entities); or

(iv) any other investors other than those listed in paragraphs (i) to (iii) above:

(A) where the Qualifying Fund has less than 10 beneficial investors, an investor who, either alone or together with its associates, beneficially owns on the Relevant Day not more than 30% of the total value of the Qualifying Fund or the issued securities of the Qualifying Fund; or

(B) where the Qualifying Fund has 10 or more beneficial investors, an investor who, either alone or together with its associates, beneficially owns on the Relevant Day not more than 50% of the total value of the Qualifying Fund or the issued securities of the Qualifying Fund.

The fund manager of a Qualifying Fund would be required to comply with certain reporting obligations.

(2) The Resident Fund Scheme

The Resident Fund Scheme under section 13R of the ITA applies to a fund that is a Singapore incorporated and tax-resident company which meets certain conditions, including the following:

(i) did not previously carry on business in Singapore where the income of that business would not have been tax exempt in Singapore (subject to certain exclusions);

(ii) uses a Singapore-based fund administrator;

(iii) incurs at least S$200,000 of expenses in each financial year; and

(iv) investment strategy remains unchanged after approval for the tax exemption has been granted.

In order to qualify under the Resident Fund Scheme, a specific application for approval has to be made to the MAS.

As with the Qualifying Fund Scheme, any "non-qualifying investor" of the fund is liable to pay a Financial Amount, and the fund manager is obliged to meet the reporting requirements similar to that imposed under the Qualifying Fund Scheme. In addition, the fund manager will also be required to make an annual declaration to the authorities attesting that the conditions of the tax exemption have been met.

(3) The Enhanced-Tier Fund Scheme

The Enhanced-Tier Fund scheme under section 13X of the ITA applies to fund vehicles constituted in all forms in respect of standalone funds and master-feeder fund structures, and which meet certain conditions, including the following:

(i) a minimum fund size of S$50 million (which may include committed capital for a private equity, real estate or infrastructure fund ("**Committed Capital Concession**")). Pursuant to the Singapore Budget Statement 2019, debt and credit funds would be allowed to access the Committed Capital Concession from 19 February 2019;

(ii) the fund manager employs at least three investment professionals in Singapore;

(iii) if the fund is a Singapore incorporated and resident company, the fund uses a Singapore-based fund administrator;

(iv) incurs at least S$200,000 of local business spending in each financial year;

(v) the fund must not change its investment objective/strategy after being approved for the scheme (although an application for change may be made if it is for *bona fide* commercial purposes); and

(vi) the fund does not concurrently enjoy any other tax incentive scheme in Singapore.

Special rules are applicable for master-feeder fund structures and master-feeder-SPV fund structures under the Enhanced-Tier Fund Scheme.

In order to qualify under the Enhanced-Tier Fund Scheme, a specific application for approval has to be made to the MAS. In addition, the fund manager will also be required to make an annual declaration to the authorities attesting that the conditions of the tax exemption have been met.

## Acknowledgments

This chapter has been prepared with invaluable contribution from Allen & Gledhill Partners, Francis Mok and Adrian Ang.

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Francis is ranked Band 1 in *Chambers Global* and *Chambers Asia-Pacific* for Banking & Finance: Regulatory, where he is described as "*well known for his work in the area of financial services and commodities regulations*" and "*clients and peers alike confirm his leading position in the market, explaining that his 'regulatory knowledge and proactiveness are second to none'*". Francis is also ranked Band 1 in *Chambers Asia-Pacific* for Capital Markets: Securitisation & Derivatives and is lauded by a client as "*the leading authority on Singapore regulatory matters and derivatives*". He is listed as a Leading Individual in *The Legal 500 Asia Pacific* for Financial Services Regulatory. Francis graduated from the National University of Singapore with an LL.B. (Hons) degree (First Class) in 1996. He was called to the Singapore Bar in 1997 and joined Allen & Gledhill in 1998.

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Adrian is recommended as a key practitioner in several leading publications. He is recognised for his expertise in financial regulatory work by both *Chambers Global* and *Chambers Asia-Pacific 2019*. In *The Legal 500 Asia Pacific*, Adrian is noted to be an "*excellent lawyer with a first-class mind, who always ensures his clients' interests are properly protected*". He is "*extremely knowledgeable*", with the ability to navigate "*myriad regulations with ease*" and balance "*technical excellence with a commercial mindset*", as well as going "*the extra mile to provide prompt advice when time is of the essence*".

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Sarah has extensive experience in advising fund managers on the listing of exchange traded funds on the Singapore Exchange Securities Trading Limited and the ongoing listing obligations and compliance issues. She also regularly advises trust companies and approved trustees of retail collective investment schemes on fund offering and constitutive documents and related regulatory and compliance issues.

She is recommended for her expertise in investment funds by *The Legal 500 Asia Pacific 2019* and is noted to be a "*responsive and hands-on*" lawyer who "*provides advice that is commercially viable*" to her clients.


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Sunit also assists corporate and individual clients in replying to queries raised by IRAS, seeking resolution and settlement of disputes between them and IRAS and in representing clients in tax hearings before the Board of Review and the appellate courts.

He has been recognised as a leading tax practitioner in Singapore and ranked in Band 1 since 2010 by *Chambers Asia-Pacific*. The publication also notes that Sunit "*remains a pre-eminent tax practitioner in this market*", with interviewees praising his "*very thorough knowledge and understanding of tax legislation in Singapore*".

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# Spain


Miguel Cases

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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Yes. Spanish funds and third-country funds offered to the public require prior authorisation from the Spanish National Securities Market Commission ("CNMV"), the Spanish authorising, supervisory and control authority. Therefore, funds shall not carry out their activities until duly authorised by the CNMV, and once the key investment information document ("KIID") and information brochure are registered in the relevant CNMV's administrative register. Please note that the registration of funds at the Spanish Commercial Register is optional.

For UCITS open-ended harmonised funds, the Spanish statutory *framework is mainly composed of Law 35/2003, of 4 November, on Collective Investment Schemes applying to open-ended funds* ("Law 35/2003"), and *Royal Decree 1082/2012, of 13 July, approving the Regulation for the Development of the Collective Investment Schemes Law* ("RD 1082/2012"). During 2018, the most relevant change has been the approval of Royal Decree 1464/2018 of 21 December in order to complete the transposition of MiFID II to the Spanish legal framework. For the purpose of this chapter, the most relevant issue is the new regime for the research cost which implies that research and transactions fees are unbundled in order to provide investors with a more transparent regime. Please note that all references in this chapter to Spanish legislation include the proper amendments carried out in the last years in order to transpose all relevant EU Directives.

Since Spain is a Member State of the European Union, the freedom to provide financial services throughout the European territory applies, so funds already authorised in any of the Member States may be able to carry out their activities on a cross-border basis through the EU passport, which mainly requires prior communication by the relevant authority of the fund's home Member State to the CNMV, and the submission of relevant information of the fund and its management company. In registering non-EU registered funds, please note that the CNMV applies the reciprocity principle.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

To address this question, a distinction must be made between (i) Spanish funds, and (ii) third-country funds (non-EU funds), although in both cases, the registration process involves the filing of an application before the CNMV that must be accompanied with several documents related to the fund and its management company.

In case of Spanish funds, under article 10.2 of Law 35/2003, the registration process involves filing an application before the CNMV, which will be accompanied with the following documents: (i) a report; (ii) a certificate of professional competence and good repute of the fund's directors and managers; (iii) any further data, reports and information which is considered necessary to verify the fulfilment of the requirements and conditions for the authorisation and registration of the fund; (iv) the prospectus; (v) the KIID; and (vi) its management regulations of the fund.

In case of third-country funds (non-EU funds), prior to its authorisation, the following conditions shall be evidenced to the CNMV:

(i) that the Spanish laws regulate the same category of fund, and that the fund itself or its management company ("SGIIC") is subject, in its home country, to specific regulations protecting the interests of the unitholders, similar to the existing regulations in Spain;

(ii) a favourable report from the fund's home country authority responsible for the control and inspection of the fund or its management company;

(iii) the existence of proper cooperation agreements subscribed between the CNMV and the relevant authorities in the fund's home country; and

(iv) the fund's home country shall not be included in the GAFI's list of non-cooperative countries and territories ("NCCT") on money laundering.

Once the aforementioned conditions are proven, the SGIIC shall submit and register in the relevant CNMV's registry the following information: (i) the identification and domicile of the fund which is intended to be marketed in Spain; (ii) any information concerning the method of distribution of units and shares in Spain; (iii) the fund's rules or company incorporation documents, including the last annual report; (iv) the prospectus (or equivalent document); (v) the identification of the depositary; (vi) the fund description and any other information available to investors; (vii) measures adopted to avoid marketing to retail investors; and (viii) documentation evidencing that the fund or its SGIIC is subject to the relevant regulation and statutory provisions in its home country.

Finally, for the proper authorisation of the fund by the CNMV, both the fund and its SGIIC shall be registered at the CNMV. Once they have been authorised and registered, the SGIIC must provide the unitholders: any payments due; the acquisition by the fund of their units or the redemption of their units; the dissemination of the information that must be provided to the unitholders resident in Spain; and, in general, the exercise of their rights in relation to their investment.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

Marketing and distribution of units of funds to investors without prior authorisation from the CNMV constitutes a very serious infringement under article 80 of Law 35/2003. The sanctions that may be imposed by the CNMV to a SGIIC due to the infringement of the prior authorisation and registration requirement are:

(i) a fine of an amount greater than the equal and up to five times the gross profit obtained as a consequence of the acts or omissions in which the infraction consists. If the benefit obtained from the infringement is not quantifiable, the fine will be up to EUR 300,000;

(ii) a revocation of the authorisation with definitive exclusion of the special registers. In cases where the entity itself or the SGIIC is a foreign institution authorised within other Member States of the European Union, the revocation will be replaced by the prohibition to operate or be marketed in Spain;

(iii) a temporary exclusion of the non-complying entity from the special registers, for not less than two years and not more than five years;

(iv) a suspension or limitation of the type or volume of transactions that the infringer may carry out for a term not exceeding five years; or

(v) the mandatory replacement of the depositary, where appropriate.

Furthermore, other sanctions may be imposed on individuals responsible for the infringement who hold directorship or management positions:

(i) an individual fine of not more than EUR 300,000;

(ii) removal from office including disqualification from exercising directorship or management responsibilities, whether in the entity or in any other financial institution of the same nature for a maximum period of 10 years; or

(iii) the suspension of the exercise of their position for a period of up to three years.

Moreover, a public reprimand may be imposed, including the publication of a statement in the Spanish Official State Gazette ("*Boletín Oficial del Estado*"), stating both the identity of the infringer, the nature of the infringement and sanctions imposed.

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

Local residence and other local qualification requirements only apply for Spanish-based funds or SGIICs registered in Spain, and for those third-country funds (non-EU funds) intended to be marketed or distributed in Spain.

Thus, those funds or SGIICs which carry out their activities in Spain will be subject to local residence or qualification requirements, except in those cases where the SGIIC is already authorised to carry out its activities in Spain on a cross-border basis through the EU passport.

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

Under Law 35/2003, public investment funds shall be managed by a SGIIC and the choice of a depositary. In addition, in order to access and exercise the marketing of funds in Spain, all the managers and directors of the fund shall have professional competence and good repute. To evaluate professional competence, the CNMV will assess all of the available information on the individual.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

There are no specific requirements regarding the selection of an investment adviser. However, the selected adviser must comply with the general rules under the Spanish statutory regulations regarding professional competence and good repute requirements, and must not imply any conflict of interest for the entity.

Furthermore, and although investment advisers may only issue recommendations, they may also advise the SGIIC about any relevant aspect it requires, provided that it complies with the statutory provisions. Thus, the investment adviser may recommend the purchase or the selling of certain securities, when to carry out the relevant transaction and the order to be executed, etc.

Under RD 1082/2012, the prospectus will include a reference to any external investment adviser, including its legal name or identity. Likewise, it will state all the conditions foreseen in the contract which may be of relevance for the participants, including a reference to the assessment costs incurred by the fund.

**iii. Capital structure**

The initial share capital depends on the type of fund: (i) article 76 of RD 1082/2012 foresees an initial share capital requirement of EUR 3 million in case of financial investment funds; and (ii) article 93 of RD 1082/2012 establishes an initial share capital requirement of EUR 9 milllion for real estate investment funds.

If a financial investment fund is constituted by compartments, each of them shall have a minimum share capital of EUR 600,000 and the aggregate of all compartments shall not be less than EUR 3 million.

There is an exception in relation to the initial share capital requirement of funds or those funds incorporated by compartments. This exception foresees the possibility that funds can be constituted with an initial share capital of EUR 300,000 and EUR 60,000 in case of funds constituted by compartments, as long as within a period of six months (since their registry date in the relevant CNMV register), these funds achieve the general rule stated in article 76 of RD 1082/2012. In case they do not achieve the minimum share capital requirement set out in article 76 of RD 1082/2012 within the aforementioned period of six months, the funds shall be wound up.

If a real estate investment fund is incorporated by compartments, each of them shall have a minimum share capital of EUR 2.4 million and the aggregate of all compartments shall not be less than EUR 9 million.

Moreover, the initial share capital shall be entirely issued and disbursed, subject to the exception mentioned in the paragraph above.

**iv. Limits on portfolio investments**

Regardless of the assets constituting the object of investment of the relevant fund, and under Law 35/2003, all entities shall carry out their investments in compliance with the following principles:

(i) Liquidity: funds must have sufficient liquidity according to their own nature, its participants and the assets in which they invest in.

(ii) Risk diversification: entities should limit the concentration of counterparty risk, thereby ensuring sufficient diversification.

(iii) Transparency: funds must clearly define its investment profile, which will be reflected in the information they provide.

Moreover, funds must comply with the relevant statutory provisions and Spanish regulations in terms of eligible assets for investment (which will depend on the type of fund, i.e. financial or non-financial funds), investment rules and obligations towards third parties. Those requirements are foreseen, in respect of financial funds, in articles 29 to 31 of Law 35/2003 and 48 to 53 of RD 1082/2012, and, regarding non-financial funds, in articles 36 and 38 to 39 of Law 35/2003 and 90 to 93 of RD 1082/2012.

**v. Conflicts of interest**

Under RD 1082/2012, SGIICs shall be organised and structured in such a way that they are able to identify and avoid any potential risk which leads to a damage of the institution itself or its clients as a consequence of a conflict of interest arisen between:

(i) the SGIIC and the funds (or other IICs) it manages or its investors;

(ii) the directors, employees or a relevant person of the SGIIC, or someone who has a direct or indirect control relationship with the SGIIC, the funds (or other IICs) it manages or its investors;

(iii) clients;

(iv) the funds (or other IICs) managed by the SGIIC or its investors and other clients of the SGIIC; and

(v) the funds (or other IICs) managed by the SGIIC or its investors and any other IIC managed by the same SGIIC or its investors.

For such purposes, the SGIIC must have an appropriate written policy on management of conflicts of interest, according to the size of the organisation and the nature, level and complexity of its activities.

The SGIIC shall guarantee an adequate independence and separation between those tasks and responsibilities which may eventually be considered as incompatible or which could give rise to systematic conflicts of interests. The policies and procedures established in the organisation shall guarantee the existence of a regularly updated registry of those transactions and activities carried out by the SGIIC or in their name in which a conflict of interest emerged or could potentially emerge.

Regarding related transactions, RD 1082/2012 foresees a special regime on conflicts of interest.

**vi. Reporting and recordkeeping**

Regarding reporting and recordkeeping obligations, a distinction must be made between: (i) the information that must be provided and disclosed to the participants, shareholders and public in general; and (ii) the reporting requirements to the CNMV.

Those SGIICs which manage funds must make available to their participants, and to the public in general, the following information and/or documentation: (i) the prospectus; (ii) the KIID; (iii) immediately, any relevant facts which may affect either the situation or performance of the entity; (iv) an annual report; (v) a semi-annual report; and (vi) two quarterly reports. The content of these documents and information is set forth in articles 23 to 25 and 26 to 30 of RD 1082/2012.

Furthermore, the SGIIC must provide the CNMV with: (i) any information regarding the principal markets and instruments in which the SGIIC trades on behalf of the fund; (ii) the main instruments in which the fund trades; (iii) the principal exposures and concentrations of each of the funds it manages; (iv) an annual report of each of the funds managed or marketed by the SGIIC; and (v) prior to the end of each quarter, a detailed list of all the funds (and any other IICs) it manages. Moreover, and on a quarterly basis, the SGIIC of the funds must provide the CNMV with the identification of the participants that, during the relevant quarter, have increased, decreased or acquired certain percentages of units (triggers set at 20%, 40%, 60%, 80% or 100%).

**vii. Other**

Pursuant to article 21 of Law 35/2003, the annual accounts of public investment funds shall be audited. There are no other relevant requirements or restrictions; however, we do recommend undertaking an in-depth analysis on a case-by-case basis.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

It depends on the type of adviser. The most common advisers are regulated investment firms (i.e. securities companies, securities agencies, portfolio management companies and independent advice companies), and other companies and agencies.

Under *Royal Decree Law 4/2015, approving the Consolidated Text of the Spanish Securities Market Act* ("Spanish Securities Market Act"), regulated investment firms are subject to an activity reservation, so they require prior authorisation from the CNMV before carrying out their activities. The request for authorisation will include the relevant statutory documentation, the activities programme and information regarding the measures and organisation of the entity. Moreover, they must be incorporated under the legal form of a public limited company, have an internal code of conduct, a business plan and must comply, among others, with the minimum share capital and financial requirements, and suitability of its directors and managers. Moreover, and prior to the commencement of its activities, the regulated adviser shall be registered in both the Commercial Register and in the relevant administrative register of the CNMV. In case of individuals, registration in the CNMV will suffice.

Furthermore, under Law 35/2003, it must be noted that the SGIIC may also carry ancillary activities as an investment adviser regarding one or multiple financial instruments, prior authorisation from the CNMV and amendment of its articles of association, where appropriate.

Finally, it must be noted that those entities (regulated investment firms and SGIICs acting as investment advisers) are subject to supervision by the CNMV.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

There are no other requirements or restrictions from a UCITS perspective, but in the rendering of investment services, investment advisers shall observe the obligations imposed by MiFID II that have been fully transposed in 2018. We recommend undertaking an in-depth analysis on a case-by-case basis, especially regarding the type of client, profile of the UCITS and type of investment service being rendered.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

During 2018, the CNMV has issued several guidance documents including issues referring to digital or cryptocurrencies. The CNMV considers that a collective investment scheme investing in digital currencies cannot be registered as a public investment fund (UCIT open-ended harmonised fund), only as an alternative investment fund ("AIF") governed by *Law 22/2014, of November 2014*, regulating private equity entities and other closed-ended investment entities.

In addition, and in line with ESMA, EBA and EIOPA criteria, the CNMV and Bank of Spain have highlighted the risk of virtual currencies for consumers.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

The Spanish legal framework for the marketing of public funds is mainly composed of: (i) Law 35/2003; (ii) RD 1082/2012; (iii) the Spanish Securities Market Law, which states, in general terms, the basic conditions for marketing materials; (iv) *Act 34/1998, of 11 November 1998, for advertising*; and (v) *Royal Decree 217/2008, of 15 February 2008, on investment firms*, and *Royal Decree-Law 21/2017, transposing MiFID II.*

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

Those SGIICs which carry out marketing activities by themselves or through their own agents or representatives must submit to the CNMV its activities statement evidencing its intention, including an explicative report about how these activities will be carried out and justifying its capacity, to fulfil the requirements further established by the CNMV.

Under article 95 of RD 1082/2012, when marketing activity is directly performed by the SGIIC, the opening and closure of both Spanish and foreign branches shall be reported to the CNMV. Moreover, when marketing is conducted by agents or representatives, the following requirements must be fulfilled:

(i) prior (a) communication by the SGIIC to the CNMV, including a specific mention stating that the relevant agent or representative complies with the professional competence and good repute requirements, (b) registration in the Commercial Register, and (c) granting of the relevant power of attorney. They are also required to have the proper administrative and accounting organisation, as well as the human and material resources, in relation to its objectives;

(ii) neither agents nor representatives must have a labour relationship with the company (or any of its group entities). In case of a legal person, the performance of marketing activities must be compatible with its company purpose;

(iii) these relationships must be formalised through the granting of a power of attorney that must specify the territorial scope of action, companies and investment funds included, type of clientele and the manner of execution of acquisitions or subscriptions and disposals or reimbursements. In addition, entities may subscribe an agreement which regulates different aspects of the representation (i.e. obligations arising from the contract, incompatibility regime, where applicable, commission billing systems and the rules of conduct for the agent or representative);

(iv) they cannot carry out their activities through contracted sub-agents or establish any legal relationship creating any personal link with the clients;

(v) in any of the activities carried out by agents or representatives with clients, they shall clearly identify themselves as representatives of the company; and

(vi) those agents or representatives of the SGIIC being legal entities must comply with a minimum share capital requirement.

The SGIIC shall implement the appropriate internal control measures and procedures of the activities performed by its agents or representatives to monitor their transactions and relationships with shareholders and participants. Prior to the formalisation of the power of attorney, the entity shall verify the sufficiency and adequacy of the administrative organisation and means, operating procedures, internal control and accounting and, where appropriate, computer systems that will be used to carry out their activities. In case of a legal person, the verifications must include its economic and financial situation. Therefore, the designation of agents and representatives is subject to successful verification of the aforementioned information.

Any delivery of funds shall be made directly between the management company and the investor, without the funds being able to be, even temporarily, in the possession or in the account of the agent or representative. Under no circumstances may the units of the unitholders be in the possession or deposit of the agents or representatives.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

Both SGIICs and depositaries may receive, respectively, management fees or custodian fees from the funds. In case of SGIICs, they must receive subscription and reimbursement fees from the participants. It may also be possible to apply subscription and reimbursement fees in favour of the funds.

The aforementioned fees will represent a percentage of the fund's assets or performance (or on a combination of both) or, as the case may be, the net asset value of the participation, which may not exceed the limits foreseen in the relevant regulations. The prospectus and the KIID must provide for the method of calculation and the maximum limit of the fees, the commissions effectively charged and its beneficiary.

Notwithstanding the foregoing, different fees may be charged to the different classes of units issued by the same fund. In any case, the same management and depositary fees will be applied to all units pertaining to the same class.

**ii. Advertising**

Advertising activities aimed at promoting the subscription or acquisition of units of a fund will be subject to the general rules set forth in the relevant Spanish regulations and statutory provisions (i.e. the information provided shall be reliable and not misleading).

However, it must be noted that any publicity containing an invitation to acquire units of a fund should indicate the existence of both the prospectus and the KIID, including the place and means for obtaining them. This publicity cannot contradict or diminish the importance of the information contained in either the prospectus or the KIID.

Moreover, it must be noted that, under article 81 of Law 35/2003, the performance of advertising activities infringing the general rules provided therein will constitute a severe infringement.

**iii. Investor suitability**

Public funds can be marketed and distributed to both retail and professional investors. Please note that the framework provided by MiFID II, has reinforced the level of transparency and protection for retail investors.

**iv. Custody of investor funds or securities**

Depositaries are those entities which deposit and custody securities, cash and, in general, any assets constituting the object of the fund. Those entities may be banks, savings banks, credit unions, securities companies and securities agencies, provided they hold the condition of a participating entity in the clearing, settlement and registration systems in the relevant markets in which they will carry out their activities.

The depositary must have its registered office or branch, as the case may be, located in Spain and each institution will have a sole depositary. In general terms, no entity can be simultaneously the manager and the depository of the same entity (except in the cases expressly provided for in the relevant regulations).

The designation of a depositary shall be made through a written contract. Furthermore, depositaries shall be authorised by the CNMV and registered in its relevant administrative register.

Also, the depositary of a fund may delegate to third parties who, in turn, can sub-delegate it a custodian function in respect of the assets, provided that such third party complies with all of the relevant requirements to act as a depositary, and any conditions, including that there is an objective reason that justifies the delegation.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

Funds can be marketed to both professional investors and retail investors, with the observance of the relevant applicable statutory requirements.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

There are no other areas of regulation imposed regarding the marketing of public funds. However, we recommend that further analysis must be undertaken with regards to any specific concern in relation to the intended marketing activities of public investment funds.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

According to Law 35/2003, the entities that can be public investment funds in Spain are:

(i) Collective Investment Institutions of a Financial Nature ("*Instituciones de Inversión Colectiva de carácter financiero*");

(ii) Collective Free Investment Institutions ("*Instituciones de Inversión Colectiva de Invesión Libre*");

(iii) Real Estate Collective Investment Institutions ("*Instituciones de Inversión Colectiva Inmobiliaria*"); and

(iv) Other non-Financial IIC ("*Instituciones de Inversión Colectiva de Carácter no Financiero*").

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

Public funds are subject to a special tax regime foreseen in the Spanish Corporate Income Tax Act. If certain requirements are met, public funds will be taxed at a special tax rate of 1% (mainly, it is required that the fund has a minimum 100 participants).

Individuals will be subject to a 19% to 23% tax rate on the capital gains arising from the public fund. In this regard, Spanish tax-resident individuals will not be taxed on capital gains derived from the redemption or transfer of participations in an investment fund, provided a subsequent investment in a qualifying investment fund is made. In this particular case, and if certain conditions are met, the participations acquired would have the same acquisition cost as the participations redeemed or transferred.

Companies will be subject to a 25% tax rate. Moreover, companies will not benefit from the participation exemption regime on the transfer of participations in public funds.

Capital gains obtained by non-resident investors will be taxed in accordance with the tax treaty in force. However, as a general rule, Spain reserves the right to be subject to taxation capital gains at a 19% tax rate. Notwithstanding, capital gains arising from the transfer of funds negotiated in a Spanish secondary official stock market obtained by non-resident investors without permanent establishment are exempt from taxation as long as the state of residence of the investor has a Double Taxation Agreement with an exchange of information clause with Spain in force.

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

Spanish legislation does not foresee any special tax regime for public funds other than the 1% tax rate.

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# Switzerland


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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

Under Swiss law, both Swiss and non-Swiss funds and collective investment schemes (together, CISs) distributed in Switzerland are subject to licensing requirements (e.g., authorisation or registration) as per the Collective Investment Schemes Act (CISA) and its implementing ordinances, the CISO and the FINMA-CISO.

The type of licensing requirement a CIS is subject to mainly depends on (i) its place of incorporation, and (ii) the category of its targeted investors.

***Swiss CISs***

The CISA provides for the following four different types of Swiss CISs:

1) the contractual investment fund;
2) the Swiss investment company with variable capital (SICAV);
3) the Swiss investment company with fixed capital (SICAF); and
4) the Swiss limited partnership (LP).

All Swiss CISs and the products they issue or manage are supervised by the Swiss Financial Market Supervisory Authority (FINMA), irrespective of the category of the targeted investors. As opposed to contractual investment funds, CISs established under corporate law have a dual role in this context: one as a product, in the form of a company; and one as an institution benefitting from a licence. One of the common requirements of those entities is to have substance in Switzerland.

***Non-Swiss CISs***

The CISA defines non-Swiss CISs as comprising all forms of CISs, regardless of their legal form and structure (e.g., open- or closed-ended, corporate or contractual), which are established and managed from outside Switzerland.

Non-Swiss CISs which are distributed in Switzerland are to be registered with FINMA in the event that they target non-qualified investors (as defined under question 3.1). By contrast, foreign CISs which target unregulated qualified investors are subject to certain limited requirements, but no regulatory approval of the CIS is required (see question 1.4).

Finally, non-Swiss CISs exclusively targeting regulated qualified investors fall outside the ambit of the CISA and are therefore not subject to any licensing requirement.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

***Swiss CISs***

Swiss CISs are to be authorised by FINMA prior to performing any activity. In practice, both the Swiss CIS and its manager are authorised through a single regulatory process. In a nutshell, the general requirements to obtain FINMA's authorisation are the following:

- the persons in charge of the management and the business operations of the applicant have a good reputation, offer all the guarantees of proper management and have appropriate professional qualifications;
- qualified shareholders in the applicant (i.e., individual or legal entity which directly or indirectly owns at least 10% of the capital or voting rights or which may have a material influence in another way) must have a good reputation and must not exercise their influence to the detriment of a cautious and sound management;
- internal regulations and a proper organisation are in place in order to ensure compliance with the obligations provided for in the Swiss fund regulations;
- sufficient financial guarantees are available; and
- any further requirements specific to the applicant listed in the CISA are met.

The application is to be reviewed by an audit firm recognised by the Federal Audit Oversight Authority (FAOA). It is worth noting that the auditor in charge of the review of the application is barred from acting as the auditor of the Swiss CIS.

In addition to the above, the Swiss CIS must submit for FINMA's approval the fund documentation (e.g., the collective investment contract, the articles of association and investment regulations, the partnership agreement), including the fund prospectus. In this respect, the Swiss Funds and Asset Management Association (SFAMA) has developed model agreements and prospectuses which have been recognised by FINMA for the purposes of the authorisation applications.

***Non-Swiss CISs***

The registration process with respect to non-Swiss CISs distributed to non-qualified investors implies that FINMA approves the fund documentation (see also question 1.4). The following documents are to be submitted in such context:

- the prospectus;
- the simplified prospectus or key investors information document;
- the collective investment agreement with respect to contractual funds, the articles of association and the investment regulations or the partnership agreement with respect to CISs organised under company law; and
- any other documents that would be necessary for approval under applicable foreign laws and those for Swiss CISs.

The above authorisation and approval requirements must be complied with at all times. Any change having an impact on the requirements underlying the obtained authorisation or approval must be notified in advance for FINMA's approval (see also question 2.1 (vi)). From a practical point of view, FINMA provides on its websites a series of templates to simplify the authorisation, registration and notification of the changes process.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

Under the CISA, the constitution of a CIS without authorisation or the unauthorised distribution of CISs (e.g., distribution of non-registered foreign CISs to non-qualified investors) may be punished by a fine of up to a maximum of CHF 540,000 or by imprisonment of up to three years. A negligent violation is punishable by a fine of up to a maximum of CHF 250,000.

Further, activities carried out in breach of the CISA requirements may trigger regulatory sanctions from FINMA, which may range from a warning to licence withdrawal and liquidation of the entity in question. As the case may be, violations of those requirements may also give rise to tort liability.

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

As indicated above, foreign CISs targeting non-qualified investors are to be registered with FINMA prior to being distributed in or from Switzerland.

In addition to the fund documentation approval by FINMA, the following material conditions are to be met for the purposes of the registration:

- the CIS, the fund manager and the custodian bank (if any) are subject to public supervision, with a focus on investor protection;
- the above are subject to equivalent regulations in terms of organisation, investor rights and investment policy;
- the CIS is not presented in such a way so as to deceive or confuse (namely, as regards its investment policy);
- a representative and paying agent have been appointed with respect to units distributed in Switzerland; and
- there is a cooperation and information exchange agreement between FINMA and the relevant foreign supervisory authorities.

In practice, FINMA almost exclusively registers funds which are organised as Undertakings for Collective Investments in Transferable Securities (UCITS).

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

The persons in charge of the management and business operations of a Swiss CIS and its fund manager are subject to a "fit and proper test" in order to ensure that they do not exercise any adverse influence on the CIS. Both CIS and managers are to further ensure that they have proper and appropriate risk management, an internal control system and compliance covering their entire business activities. In this context, risk management functions, the internal control system and compliance must be separated in functional and hierarchical terms from the investment decision function.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

Swiss CISs usually appoint their investment advisers on the basis of a written asset management or advisory agreement setting out the terms of their relationship or directly, as the case may be, in the partnership agreement.

Swiss fund asset managers may delegate certain tasks to other advisors to the extent that such delegation is in the best interest of the CIS. The asset management function (e.g., investment decision) may, however, only be delegated to asset managers of CISs which are subject to recognised supervision (see question 2.2). Such delegation shall, in addition, not give rise to conflicts of interests with respect to the investors and asset managers themselves.

**iii. Capital structure**

The minimum required capital structure and net assets depend upon the type of the Swiss CIS:

- contractual funds, sub-fund of an umbrella fund and SICAVs must have net assets of at least CHF 5 million at the latest one year following their launch;
- SICAFs must have shares amounting to at least CHF 500,000 fully paid-up in cash at the time of formation. Such minimum investment amount must be maintained at all times; and
- the Swiss LP is not subject to any capital requirements (while the minimum share capital of the general partner must amount to CHF 100,000 and be fully paid-in).

**iv. Limits on portfolio investments**

Generally speaking, Swiss CISs and their agents must pursue the investment policy corresponding to the investment characteristics of the CIS, as set out in the relevant fund documentation.

As regards open-ended funds and SICAFs, depending on whether the fund qualifies as a securities fund, a real estate fund, or other fund for traditional and alternative investments, the following restrictions to investments apply:

- securities funds are allowed to invest in securities, derivative financial instruments, units of CISs, money maker instruments and sight or time deposits with a term to maturity not exceeding 12 months. On the other hand, they are not allowed to invest in precious metals and commodities or to engage in short-selling;
- real estate funds may invest in real estate, real estate companies, units in real estate funds and foreign real estate assets. Real estate funds must spread their investments over at least 10 properties and the market value of a single property may not exceed 25% of the fund's assets; and

- other funds for traditional and alternative investments are allowed to make the same investments as securities funds, and, in addition, they may invest in precious metals and structured products.

Finally, Swiss LPs are specifically authorised to invest in construction, real estate, infrastructure projects and alternative investments.

**v. Conflicts of interest**

In order to protect the interests of the investors, Swiss CISs must implement effective organisational and administrative measures to identify, prevent, settle and monitor conflicts of interests. In the event that a conflict of interest cannot be avoided, the same shall be disclosed to the investors.

The SFAMA Code of Conduct specifies that CISA-authorised institutions must implement the above measures in accordance with their size and structure. They must also apply an appropriate wage and remuneration policy that protects the investors' interests, as well as adopting written regulations on the receipt and granting of rebates and other benefits by employees and prohibit churning (i.e., shifts in clients' portfolios without any economic reason).

**vi. Reporting and recordkeeping**

Swiss CISs are required to publish an annual report within four months after the closing of the financial year. In addition, a semi-annual report must be issued within two months after the end of the first half of the financial year.

Furthermore, Swiss CISs, as well as third parties involved in the distribution of units, are required to record in writing the client's needs and document their recommendations made in view of the subscription to a CIS. This written record must be handed over to the client.

Finally, as indicated above (see question 1.2), any change in the circumstances underlying the authorisation or approval must be reported to FINMA.

**vii. Other**

For the time being, there are no other main regulatory restrictions and requirements to be aware of.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

Under the CISA, asset managers of both Swiss and non-Swiss CISs must obtain a licence from FINMA. To this end, in addition to the general requirements (see question 1.2), asset managers of CISs must:

- be organised as a legal entity in the form of a limited company (necessary for Swiss LPs), a partnership limited by shares or a limited liability company under Swiss law, as a general or limited partnership, or as a Swiss branch of a foreign asset manager of CISs;
- have an appropriate organisation;
- have the required equity capital and financial guarantees;
- ensure that the articles of association, partnership agreement or organisational rules include a factually and geographically accurate description of its proposed operations; and
- manage at least one CIS.

The CISA, however, contains a *de minimis* rule, according to which asset managers of non-Swiss CISs whose investors are qualified investors (as defined under question 3.1) are not regulated if they satisfy one of the following requirements:

- the assets under management, including those resulting from the use of leverage, are below the threshold of CHF 100 million;
- the assets under management do not exceed CHF 500 million, and the CISs are unleveraged and closed-ended for a five-year period; or
- the investors are exclusively group companies.

The asset manager of a non-Swiss CIS that is exempt under the *de minimis* rule may, however, opt in and apply for a FINMA licence, provided that its registered office is in Switzerland, and Swiss law or the applicable foreign law requires such regulated status for the management of the CIS.

Non-Swiss managers of both Swiss and non-Swiss CISs with a branch in Switzerland are also required to register with FINMA.

The European Commission, Parliament and Council are currently reviewing the potential extension of the marketing passport under the EU Alternative Investment Fund Managers Directive (AIFMD) to Switzerland, as a third country. For the time being, Swiss-based alternative investment fund managers are to rely on the national private placements regimes in each EU country for the purposes of their marketing activities.

For the rest, it is worth noting that since 2 December 2016, in accordance with the cooperation agreement entered into between FINMA and the Securities and Futures Commission of Hong Kong, regulated Swiss CIS managers may manage CISs distributed to public investors (i.e., retail clients) in Hong Kong, while fund managers in Hong Kong are granted reciprocal rights in Switzerland.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

***FINMA Circular 2009/1 on Guidelines on Asset Management***

Asset managers of CISs are required to comply with the requirements set out in FINMA Circular 2009/01 which provides for the minimum standards applicable for asset management. Among other things, the Circular imposes certain duties of care, loyalty and information, namely with respect to third-party inducements (retrocessions).

***Swiss Pension Fund Asset Managers***

In Switzerland, the management of pension funds is subject to a specific regime. Only financial intermediaries subject to official supervision in Switzerland or abroad (e.g., regulated fund asset managers) are allowed to manage such funds without the need to obtain a specific licence from the Swiss Supervisory Commission for Pension Funds.

***Swiss Anti-Money Laundering Regulations***

Under the Swiss Anti-Money Laundering Act (AMLA), Swiss fund asset managers are generally treated as financial intermediaries and, as such, are subject to the Swiss regulations against money laundering. In particular, they are to comply with know-your-customer rules and procedures, as well as certain organisational requirements (e.g., internal controls, documentation and continuing education). They are subject to the direct supervision of FINMA in this context.

**2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?**

On 7 December 2018, the Swiss Federal Council adopted a report on the legal framework for blockchain and distributed ledger technology in the financial sector. According to this report, the current state of Swiss legislation does not provide for material restrictions as regards funds investing in digital currencies or crypto-currencies (or crypto-funds).

With respect to open-ended CISs, the Swiss Federal Council has confirmed that only the category "other funds for alternative assets" (see question 2.1 (iv) above) may invest in crypto-currencies. The risk profile of those funds is typically in line with such alternative investments (whether in terms of structure, investment techniques and restrictions). By contrast, as regards closed-ended CISs, both SICAFs and LPs may invest in such alternative products. In any event, managers of CIS invested in crypto-currencies and their custodian banks are to take organisational measures for appropriate risk management in such context.

It worth noting that the Swiss Federal Council further confirmed that the regime applicable to the distribution of foreign CISs in Switzerland applies without restriction to CISs investing in crypto-currencies. FINMA has not approved any foreign crypto-funds for distribution in Switzerland yet. That being said, such funds are generally targeting exclusively qualified investors and are not subject to any approval (see question 1.2. above).

In 2018, FINMA issued distributor authorisation to an institution with its registered office in Switzerland to distribute a crypto-fund in a foreign jurisdiction to qualified investors. A few months before, FINMA also granted the same institution with a fund manager authorisation allowing it to manage crypto-funds.

## 3 Marketing of Public Funds

**3.1 What regulatory frameworks apply to the marketing of public funds?**

*Concept of Distribution*

Any offer or advertisement for a CIS that is not exclusively directed towards regulated qualified investors (as defined below) is construed as distribution which is subject to specific CISA requirements both for the CIS and the distributor. Indirect distribution is also subject to the same requirements (e.g., offering managed accounts in CIS or fund-linked notes, depending on the specific facts).

It is worth noting that the concept of offering will replace the concept of distribution in January 2020, upon the entry into force of the new Financial Services Act (FinSA) and the Financial Institutions Act (FinIA). The concept of offering will be defined more narrowly than distribution. It is therefore expected that the new regime will be more liberal.

The CISA excludes the four situations outlined below from the definition of distribution. The provision of information and/or the offer of CISs are therefore deemed not to constitute a form of distribution if they take place:

- at the instigation of or at the own initiative of investors in relation to a specific investment (reverse solicitation);
- at the investor's request within the context of a long-term and remunerated advisory agreement or an execution-only relationship with a regulated financial intermediary or with an independent asset manager (subject to certain conditions);
- within the context of a written discretionary management agreement entered into by the investor with a regulated financial intermediary or an independent asset manager (subject to additional conditions); and
- the publication of prices, net asset values and tax data by regulated financial intermediaries.

*Concept of Qualified Investors*

The concept of qualified investor is another important regulatory concept in the context of the distribution of CISs. The concept of qualified investors under the CISA comprises:

- Regulated qualified investors:
  - Regulated financial intermediaries, including banks, securities dealers, fund administration companies and managers of CISs, as well as central banks.
  - Regulated insurance companies.
- Unregulated qualified investors:
  - Public entities, retirement benefit institutions (pension funds) and companies with professional treasury management.
  - Companies with professional treasury management.
  - Investors who have concluded a written discretionary asset management agreement, provided they do not exercise their right to "opt-out" of the "qualified investors" status and the agreement is entered into with a regulated Swiss financial intermediary or with an independent asset manager (subject to certain conditions).
  - High-net-worth individuals (HNWI) and private investment structures created for HNWI that have requested, in writing, to be considered as "qualified investors" (opt-in declaration), provided they meet certain financial and technical requirements.

Investors who do not fall into one of the above categories are non-qualified investors. The characterisation of an investor as being qualified has a bearing on the regulatory restrictions applicable to the distribution of interests in CISs (please see below).

*Distribution of Foreign CISs to Non-Qualified Investors*

As indicated above, the distribution of non-Swiss CIS to non-qualified investors presupposes a prior registration of the CIS with FINMA, as well as, *inter alia*, the appointment of a Swiss representative and paying agent (see question 1.4).

*Distribution of Foreign CISs to Qualified Investors*

Non-Swiss CISs offered to unregulated qualified investors are not required to be registered with FINMA. That being said, they must:

- appoint a Swiss representative, as well as a paying agent (usually Swiss banking institutions may act in both capacities); and
- not have a misleading name for the investors, in particular in view of their investment policy.

In addition, any foreign distributors of the non-Swiss CIS are to be subject to appropriate supervision in their jurisdiction. This presupposes that their foreign regulatory status allows them to distribute CISs in their own country.

In both situations (distribution to non-qualified and qualified investors), all distributors involved in the distribution of the CIS must enter into a written, Swiss law-governed distribution agreement with the Swiss representative, based on the requirements of the SFAMA Guidelines on distribution of CISs and its template distribution agreement.

**3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.**

Anyone who distributes CISs to non-qualified investors in Switzerland or foreign CISs to qualified investors in Switzerland is deemed to be a distributor and must be authorised by FINMA. Authorisation can be issued to natural persons, legal entities and incorporated partnerships. It should be noted that this licensing requirement will, however, be abolished upon the entry into force of the FinSA and FinIA.

To obtain authorisation from FINMA, a distributor, must meet the general requirements under the CISA (see question 1.2), as well as have:

- appropriate professional indemnity insurance;
- acceptable distribution modalities and practices; and
- concluded a written distribution agreement with a fund manager, SICAV, limited partnership, SICAF or representative of a foreign CIS which should include a prohibition to accept payments to acquire units.

Certain regulated institutions are exempt from obtaining an authorisation from FINMA to conduct distribution activities; namely, fund management companies, asset managers of CISs, representatives of foreign CISs, banks, securities dealers and insurance companies.

**3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?**

**i. Distribution fees or other charges**

The SFAMA Guidelines on the charging and use of fees and costs (Transparency Guidelines) which, in accordance with FINMA Circular 2008/10 were recognised as the minimum standard, impose certain information duties on distributors and Swiss representatives of CISs. In a nutshell, investors are to be informed on fees, costs, rebates and retrocessions paid or received in relation to the CIS. This information shall be disclosed in the fund documentation. Furthermore, with respect to retrocessions, their recipients are to spontaneously inform the investor of the amounts received by giving the calculation parameters or the spread of those inducements. Upon the investor's request, the recipients are to further disclose the amount actually received. Finally, the recipient is to indicate the existence and nature of any conflicts of interest that are or may be triggered by the payment of retrocessions.

**ii. Advertising**

According to FINMA Circular 2013/9 on the distribution of CISs, the concept of distribution covers any concrete offer to enter into a contract and any advertising (i.e., use of any form of advertisement made in view of the subscription of units in CISs) in relation thereto. The nature and the means used to this end are irrelevant and may take any form.

In terms of content, it should be noted that under the CISA, foreign fund documentation, marketing materials and any other publications or websites must disclose the identity of the Swiss representative and paying agent, the home jurisdiction of the CIS, the place where the relevant fund documents are available, as well as the place of performance and jurisdiction at the registered office of the Swiss representative. In practice, a specific language to the attention of Swiss investors is added to those materials.

**iii. Investor suitability**

From a regulatory perspective, there is no particular requirement with respect to investor suitability for the time being (subject to Swiss civil law requirements which are not covered here and the entry into force of the new FinSA). That being said, the Distribution Guidelines issued by the SFAMA which apply, *inter alia*, to fund distributors include, with respect to the distribution to non-qualified investors, the obligation to provide them with objective information on the investment character, opportunities and risks associated with the relevant CIS, by taking into account their experience and knowledge and the complexity of the CIS.

For the rest, in accordance with FINMA Circular 2009/1, asset managers subject to the CISA are, among other things, to establish a risk profile to cover the client's experience and knowledge in the financial field, risk appetite and risk capacity, and set out in their asset management mandate the investment objectives of the client reflecting this risk profile.

**iv. Custody of investor funds or securities**

Unlike Swiss LPs, fund management companies, SICAVs and SICAFs must designate a custodian bank with respect to their CISs. Custodian banks are to be authorised by FINMA.

The custodian banks' role comprises the holding of fund assets on deposit, the handling of payments processing and the issuance and the redemption of units. Safe-keeping tasks may be delegated to third-party or collective depositories in Switzerland or abroad, provided this appears appropriate. In that event, investors are to be informed of the risks associated with such a delegation in the fund prospectus.

**3.4 Are there restrictions on to whom public funds may be marketed or sold?**

Please refer to question 3.1 as regards the different types of investors.

**3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?**

In addition to the above requirements, in accordance with the Swiss Code of obligations, a prospectus must be prepared in the event newly issued equity securities are to be offered to the public in Switzerland, unless (i) the offer of the specific series of security is made to a limited circle of offerees (as a rule of thumb this is construed as meaning less than 20 offerees in Switzerland, irrespective of their residence), and (ii) no public press announcement or similar publicity is made in Switzerland. As a general rule, any publication of advertising materials for newly issued shares also triggers a prospectus requirement. In the absence of court precedent in this respect, it is not clear whether the prospectus requirement also applies to non-Swiss issuers.

Further, it should be noted that any marketing activities in Switzerland are subject to the Swiss Unfair Competition Act (UCA) which addresses commercial communication with customers and prohibits unfair business practices. Under the UCA, any behaviour or business practice that is deceptive or that infringes the principle of good faith with the result of affecting the relationship between suppliers and customers is deemed unfair and unlawful.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

Please refer to question 1.1.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

As a matter of principle, Swiss CISs are not liable to income and capital taxes. Taxation does not take place at the level of the CIS, but usually directly targets investors, provided the CIS is deemed transparent for tax purposes. The taxation regime largely depends upon the legal structure under the CISA.

***Swiss CISs***

Open-ended CISs, such as the contractual investment fund and the SICAV, are not considered to be entities subject to Swiss corporate income tax. Taxation is applied directly to investors according to their country of tax residence. The same regime is applicable to the Swiss LP. That being said, there are two exceptions to these general taxation principles:

- a SICAF is subject to Swiss corporate income tax, as it is treated as a separate taxpayer under Swiss tax law; and
- CISs owning real estate are taxed as corporations on the portion of their income that is directly derived from real estate.

All income that is distributed by these CISs is subject to a withholding tax of 35%, which is entirely or partially recoverable by the investor (as regards investors based outside of Switzerland, the reimbursement of the withholding tax depends upon the provisions of the applicable double tax treaty). Exceptions to this general principle are possible. For example, a distribution of net capital gains realised by a CIS is exempted to the extent that these capital gains are clearly separated from the income.

***Fund Administration Companies***

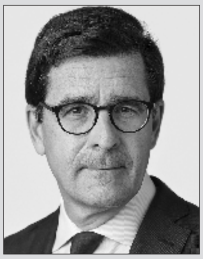
Fund administration companies are considered as taxpayers in their own right as they are incorporated as a corporation. As any other legal entity, they are subject to corporate income tax. Management and distribution services provided by such companies to Swiss and non-Swiss CISs remain generally exempt from Swiss value-added tax.

***Investors***

Swiss-resident investors of CISs that are transparent for tax purposes are taxed on their share of fund income. This taxation principle depends upon the structure of the fund (i.e., distributing or growth) and the income received (i.e., capital gains or other ordinary income realised by the CIS). Capital gains attributable to private investors are normally exempted to the extent that they are distributed with a separate coupon or they are separately booked in the accounts of the CIS.

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

This is not applicable in our jurisdiction.



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# United Kingdom


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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

For UK purposes, a collective investment scheme ("**CIS**") is defined very widely under s.235 Financial Services and Markets Act 2000 ("**FSMA**") as being, essentially, arrangements the purpose of which is the sharing of profit or income by the participants in circumstances where the participants do not have day-to-day control over the management of the property in question.

It is important to be aware that not all "public funds" are CISs for UK purposes. In particular, the Alternative Investment Fund Managers Directive ("**AIFMD**") extends to certain types of closed-end corporate funds which are specifically excluded from the CIS definition. Where such corporate funds are listed, they can be regarded as an alternative to an authorised CIS for retail investors; however, the requirements relating to such funds are beyond the scope of this note.

The relevance of the CIS definition for marketing purposes is that s.238 FSMA restricts the promotion of CIS by authorised persons (as defined in FSMA) to the general public in the UK, except in relation to the following types of CIS established in the UK:

1. an authorised unit trust scheme ("**AUT**"), being a CIS under which the property is held on trust for the participants and which has been authorised by the FCA pursuant to s.243(1) FSMA;
2. an authorised contractual scheme ("**ACS**"), being a specific type of tax-transparent CIS introduced under the Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013 and which may take one of two forms: (a) a co-ownership scheme; or (b) a limited partnership scheme; or
3. a scheme constituted by an authorised open-ended investment company ("**OEIC**"), being an open-ended investment company incorporated under the Open-Ended Investment Companies Regulations 2001 (the "**OEIC Regulations**") or equivalent prior legislation.

An overseas CIS may only be promoted to the general public in the UK by authorised persons under s.238 where it is a recognised scheme for the purposes of Chapter V FSMA, being either:

1. a UCITS scheme constituted in another EEA State which satisfies certain requirements under s.264 FSMA; or
2. a CIS which is managed in a country or territory outside the UK and which has been individually recognised by the FCA under s.272 FSMA.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

An application for authorisation of a UK CIS must be made to the FCA as follows:

1. in relation to an AUT by the manager and trustee under s.242 FSMA;
2. in relation to an ACS by the operator and depositary under s.261C FSMA; and
3. in relation to an OEIC by the authorised corporate director and depositary under regulation 12 of the OEIC Regulations.

In addition to the completed application form, various documents need to be provided when the application is submitted, including a draft copy of the Trust Deed (for AUTs), Co-ownership or Partnership Deed (for ACSs), Instrument of Incorporation (for OEICs), a solicitor's certificate stating that the CIS's constitutional document complies with applicable laws and regulations, the draft prospectus and related checklist, the draft Key Investor Information Document ("**KIID**") and a model portfolio.

The FCA must determine applications for authorisation of new UCITS schemes within two months, and has six months to process applications for authorisation of a Non-UCITS Retail Scheme ("**NURS**") or Qualified Investor Scheme ("**QIS**"). However, in 2015, the FCA announced that it was working towards approving: (i) NURS applications within two months of receiving a complete application; and (ii) QIS applications within one month of receiving a complete application.

Where the CIS is not a UCITS it will be an "AIF" for the purposes of the AIFMD and the AIF manager will need to make certain additional notifications to the FCA including an AIFMD new fund under management notification and an AIFMD marketing form.

**Non-UK CIS**

*S.264 schemes*

The Financial Services and Markets Act 2000 (Collective Investment Schemes Constituted in Other EEA States) Regulations 2001 sets out the requirements that a CIS must satisfy to be a recognised scheme under s.264 FSMA. These include that the CIS must be a UCITS and subject to the UCITS Directive. In addition, the regulator in the EEA Member State of the CIS's operator must provide notice to the FCA containing the UCITS's:

- rules or instrument of incorporation and prospectus;
- KIID; and
- where appropriate, latest annual report.

*S.272 schemes*

The operator of a CIS which is managed outside the UK and does not satisfy the prescribed requirements under s.264 may apply to the FCA to make an order declaring the scheme to be a recognised scheme. In determining whether to make such an order, the FCA will consider, among other things, whether the following requirements are satisfied:

- adequate protection must be afforded to participants in the scheme;
- the arrangements for the scheme's constitution and management must be adequate;
- the power and duties of the scheme's operator and, where applicable, trustee or depositary must be adequate;
- the operator and, where applicable, trustee or depositary must have permission or otherwise be fit and proper to act as such and must be able and willing to co-operate with the FCA by the sharing of information and in other ways; and
- the purposes of the scheme must be reasonably capable of being successfully carried into effect.

In relation to s.272 schemes, additional notifications may also be required under AIFMD.

*Brexit*

On 29 March 2019, the United Kingdom is due to leave the European Union ("**Brexit**"), though at the time of writing the political situation remains entirely uncertain. The content of this chapter therefore continues to reflect the existing (EU-based) regulatory framework, which the UK government intends as far as possible to maintain in the period post-29 March, subject to any agreement reached with the EU on the UK's future relationship with it. Readers should be mindful, however, that in the event of a "No-Deal" Brexit (i.e. where the terms of UK's withdrawal are not agreed with the EU) the EU rules currently applicable in the UK will immediately cease to apply and a national regime (based almost entirely on the existing regime) would come into force. The consequences of this will include:

- EEA firms will be treated as "third country" firms and subject to additional requirements (including incorporation requirements). EEA firms will lose their passporting rights and will require authorisation from the FCA to the extent that they wish to continue carrying out regulated activities in the UK.
- EEA UCITS and AIFs wishing to market in the UK will be treated as third country funds and will no longer be able to market via a passport. EEA UCITS will no longer benefit from marketing under s.264 FSMA (as described above) and will need to apply for individual recognition under s.272 FSMA (though we understand that Brexit has caused the FCA to review this process because it was not designed to support high volumes applications at any one time).
- UCITS funds established in the UK will no longer be UCITS (because they will not be established within an EU Member State). Although the FCA's "UK UCITS" regime will be substantially similar there are a number of consequences to this, most obviously in terms of:
  - restricting the ability to promote such funds in the EEA;
  - cross-border mergers involving a UK UCITS and an EEA UCITS will not be possible using the procedure in the UCITS directive; and
  - EEA UCITS feeder funds are not expected to be allowed to invest in a UK UCITS master fund after exit day. However, the FCA has elected not to treat assets from the rest of the world the same as EEA-based assets on the basis it would potentially change the risk-profile of funds.

The UK government has announced a Temporary Permissions Regime ("**TPR**") to preserve the "*status quo*" in a No-Deal Brexit. This will allow EEA firms to continue to carry out for a limited period any regulated activities in the UK that were previously covered by their passport and for EEA UCITS and AIFs to continue to be marketed in the UK provided they have notified the FCA of their intention to enter the TPR before exit day, with further flexibility for the marketing of new sub-funds of EEA UCITS (but not EEA AIF umbrella schemes) post-exit day where at least one other sub-fund of the relevant umbrella scheme is already in the TPR.

**1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?**

Where a CIS that has not been authorised or recognised by the FCA (as outlined in question 1.1 above) is promoted to the general public (and such promotion does not fall within a specific exemption), the consequences will differ depending on whether the promotion was made by an authorised person or an unauthorised person.

Promotion by an unauthorised person will, in the absence of an exemption, amount to a contravention of the financial promotion restriction under s.21 FSMA. Under s.25 FSMA, a person who contravenes s.21 FSMA will be guilty of a criminal offence and liable on conviction to a maximum term of two years' imprisonment or a fine, or both. In addition, s.30 FSMA provides that agreements resulting from unlawful communications are unenforceable by the guilty party, and the recipient is entitled to recover any money or other property paid or transferred by him under the agreement and compensation for any loss sustained by him as a result of having parted with it. However, the court may allow the agreement or obligation to be enforced or money or property paid or transferred under the agreement to be retained if it is satisfied that it is just and equitable in the circumstances of the case.

Promotion by an authorised person will, in the absence of an exemption, amount to a contravention of the restriction under s.238 FSMA outlined in question 1.1 above. Under s.241 FSMA, such contravention is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breaches of statutory duty. The FCA also has wider powers to impose sanctions on the relevant firm and/or individuals for breaches of its rules.

**1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?**

As indicated above, a foreign fund may only be marketed to the general public in the UK where it is a recognised scheme under ss.264 or 272 FSMA and, in relation to s.272 recognised schemes, additional notifications may also be required under AIFMD.

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

As outlined above, each type of UK-authorised fund has its own constitutional document which, together with the prospectus and applicable FCA rules, will set out the operating rules of the fund.

Responsibility for the governance of the fund is divided between the segregated duties of the fund's manager and its depositary. The manager is responsible for the day-to-day operation of the fund in accordance with the above requirements, including arranging for the issue and cancellation of units, valuing the scheme property, calculating the price of units, maintaining the register of unitholders and ensuring investment decisions are made in line with the fund's investment objectives, policy and investment and borrowing powers. The depositary oversees the manager's performance of certain key functions (including unit pricing, dealing, valuations and compliance with investment and borrowing restrictions) and is also responsible for safeguarding the fund's assets.

Both the manager and the depositary have fiduciary duties to the fund's investors and must act in the best interests of such investors. The FCA regulates the governance of authorised funds and has powers to fine or require investor compensation for breach of the governance rules. Although the manager and depositary are permitted to delegate certain activities to third parties, they retain regulatory responsibility for the performance of such activities.

Individuals performing what are considered to be controlled functions (e.g. directors) within authorised firms must be approved by the FCA before they can undertake such functions. There are separate FCA rules governing such approved persons and any failing or misconduct on the part of that individual may result in industry bans or disciplinary action being imposed against them.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

As outlined above, the fund manager is responsible for the day-to-day management of the authorised fund including investment decisions relating to the scheme property. The FCA rules permit the fund manager to delegate the performance of its duties to a third party, subject to certain conditions. For example, a mandate in relation to managing investments of the scheme may not be given to any other person operating from an establishment outside the UK unless such person: (a) is authorised or registered in such country for the purpose of asset management; and (b) is subject to prudential supervision in such country. In addition, where the proposed delegate is not an EEA firm, there must be co-operation arrangements in place between the FCA and the overseas regulator of the delegate.

There are also certain requirements relating to the content of the agreement under which investment management services are delegated, including that: the fund manager must be permitted to give further instructions to the delegate and to withdraw the mandate with immediate effect when this is in the interests of the unitholders; and the mandate must not prevent the effective supervision of the fund manager and must not prevent the fund manager from acting, or the scheme from being managed, in the best interests of the unitholders.

**iii. Capital structure**

There are no prescribed capital requirements at the level of the authorised fund itself, although the FCA raises queries as part of the fund authorisation application (and in relation to any application to terminate or wind up a fund) around the minimum size for the fund to be considered viable. However, fund managers are subject to the Capital Requirements Regulation (No. 575/2013), including the requirement to hold eligible capital of at least one-quarter of their fixed overheads for the preceding year.

**iv. Limits on portfolio investments**

The FCA rules impose limits on the type of investments in which an authorised fund can invest and the proportion of the fund's capital property that may be invested in particular assets. Different restrictions apply depending on whether the fund is a UCITS or NURS, with greater flexibility generally being given to NURS. In each case, however, it is the fund manager's responsibility to ensure that the fund provides a prudent spread of risk for investors. The following examples on limits to portfolio investments are non-exhaustive and given by way of illustration:

1. **Approved transferable securities and money market instruments**: A UCITS may not invest more than 5% of its assets in transferable securities and/or money market instruments issued by a single body, although this limit can be increased to 10% per single body, provided the total value of such holdings over 5% does not exceed 40% of the fund's total value (referred to as the 5/10/40 Rule). A NURS may not invest more than 10% of its assets in transferable securities or money market instruments in a single body.
2. **Unapproved securities**: A UCITS may invest up to 10% of scheme assets in unapproved securities, subject to the above maximum of 5% of scheme assets being issued by a single body. A NURS may hold a maximum of 20% of the fund's assets in unapproved securities.
3. **Derivatives**: Both UCITS and NURS are permitted to use derivatives for efficient portfolio management and for investment purposes to the extent appropriate to meet the scheme's objectives and subject to maximum permitted exposure limits for a UCITS and NURS respectively.
4. **Direct investments in property, gold and unregulated collective investment schemes ("UCIS")**: UCITS may not invest directly in property, whereas NURS are permitted to do so subject to certain concentration restrictions and other requirements. A NURS may also invest in other types of investment which may not be held directly by a UCITS including gold (up to 10%) and UCIS (up to 20% or otherwise 100% in respect of a NURS structured as a fund of alternative investment funds).
5. **Borrowing**: UCITS and NURS must not borrow in excess of 10% of the total value of the scheme's assets. In addition, for UCITS, any borrowing may only be on a temporary and infrequent basis.

In contrast, a "Qualified Investor Scheme" or "QIS" (which may only be marketed to certain categories of investors) is subject to very few investment restrictions, although the fund manager still needs to ensure the fund provides a prudent spread of risk for investors.

**v. Conflicts of interest**

The UK regime requires a fund's manager and depositary to be independent of each other and to be in different groups of companies. This is designed to assist in limiting and managing the potential for conflicts of interests.

In addition, UK-authorised fund managers and depositaries are required to comply with the FCA's rules on managing conflicts of interest, including the following requirements:

- to take all appropriate steps to identify and prevent or manage conflicts of interest between (i) the firm and its clients, and (ii) clients of the firm;
- to maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts of interest from adversely affecting the interests of its clients;
- to disclose the risk to investors where a firm's arrangements are insufficient to ensure, with reasonable confidence, that risks of damage to the interests of a client will be prevented; and
- (in the case of UCITS fund managers and depositaries) to keep and regularly update a record of conflicts of interest that have arisen or may arise and to establish, implement and maintain an effective conflicts of interest policy in the form prescribed by the FCA (further requirements apply to AIFMs).

**vi. Reporting and recordkeeping**

In the UK, there are requirements for authorised funds to provide investors with regular reports on performance and other matters. Investors can expect to receive the following reports:

- **Annual Reports** on the fund's performance comprising reports from the fund manager, depositary and auditor, accounts for the annual accounting period and comparative information for evaluation purposes.
- **Half-Yearly Reports** containing interim (unaudited accounts) and a manager's report for the period.
- **Periodic Reports** sent at least quarterly and designed to give investors a fair and balanced view of the activities undertaken by the fund and the performance of the portfolio over the period.
- **Other Reports** including reports to investors in the event that the overall value of the fund's portfolio depreciates by at least 10%.
- **Notifications** on certain changes to the fund are required to be sent to investors depending on the materiality of the change.

Fund managers are required to maintain appropriate records both to comply with and demonstrate compliance with the FCA rules. The FCA rules contain, amongst others, specific requirements for records to be held of any minutes of investor meetings, the issue and cancellation of any units and all portfolio transactions (for UCITS).

**vii. Other**

There are no other main regulatory restrictions or requirements.

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

As outlined in question 2.1(ii) above, the fund manager is responsible for investment decisions relating to the scheme property. The fund manager may be an FCA-authorised entity or may otherwise be carrying out activities pursuant to passporting rights as an EEA management company (in respect of a UCITS) or EEA AIFM (in respect of a NURS or QIS). In addition, investment management functions may be delegated by the fund manager to a third-party investment adviser, subject to certain requirements including, where the delegate is not an EEA firm, the existence of co-operation arrangements between the FCA and the delegate firm's regulator. Subject to such requirements, such a delegate would not need to be authorised by the FCA, provided they are not carrying out regulated activities in the UK or otherwise are doing so pursuant to the exercise of EEA passporting rights.

Applications for authorisation (also known as Part 4A permissions) are made to the FCA through Connect, the FCA's online application portal. The process is designed to assess whether the applicant meets the FCA's required threshold conditions and will be tailored according to the nature of the activities which require authorisation. Information regarding the applicant's proposed activities, its business plan, senior management and ownership as well as IT systems will need to be provided. Application fees range from £1,500 to £25,000, depending on the complexity of the application. A decision on complete applications will be given within six months of submission (and within 12 months for incomplete applications).

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

FCA-authorised managers will be subject to extensive requirements, including in relation to conduct of business, senior management, systems and controls, financial requirements and other rules relating to the operation of the fund.

Many of these requirements (in particular, around the operation of the fund) will continue to apply where an EEA management company or AIFM is providing services into the UK on a passported basis; however, such a manager will be subject to prudential supervision by its home-state regulator.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

Digital currencies are not currently a recognised investment in and of themselves for the purposes of the UK regulatory regime applicable to public funds. Consequently, the requirements or restrictions applicable to public funds investing in digital currencies must be considered on a case-by-case basis according to how the digital currency would be characterised under the regime (for example, whether it would be regarded as a form of derivative or unit in a collective investment scheme) and the requirements or restrictions applicable to such instruments or securities must then be applied.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

These are referred to in questions 1.1 to 1.4; in particular:

1. The financial promotion restriction in s.21 FSMA, which prohibits an unauthorised person in the course of business communicating an invitation or inducement to engage in investment activity except where: the content of the communication has been approved by an authorised person in accordance with the FCA rules; or the communication is covered by an exemption.
2. The restriction on promotion in s.238 FSMA, which prohibits an authorised person from communicating an invitation or inducement to participate in a CIS, except in relation to an authorised or recognised CIS as referred to in question 1.1 above, unless the communication is covered by an exemption.

3. Where the promotion relates to an authorised or recognised CIS (or is otherwise permitted under an exemption), the authorised person will need to comply with the FCA's rules on communicating with clients (including financial promotions) set out in Chapter 4 of the Conduct of Business Sourcebook ("**COBS**") of the FCA Handbook and the overriding principle to communicate information to clients in a way which is fair, clear and not misleading.
4. In addition, where a fund is being distributed by an FCA-authorised firm, they will be subject to certain additional requirements under the recast Markets in Financial Instruments Directive ("**MiFID II**") as implemented in the UK. These include certain governance requirements around identifying a target market for each fund and ensuring the fund is only distributed to that target market.

Where the CIS is not a UCITS, it will be an "AIF" for the purposes of the AIFMD, and the AIF manager will need to make certain additional notifications to the FCA including an AIFMD new fund under management notification and an AIFMD marketing form. In addition, the AIF manager will need to ensure that it makes available to investors before they invest certain prescribed information and any material changes to it.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

As above, an unauthorised person may only make a financial promotion where the communication has been approved by an authorised person or the communication is covered by an exemption. In relation to the latter, a number of commonly available exemptions can be relied on in order to make certain types of financial promotion (e.g. to certified high-net-worth individuals); however, broadly speaking these exemptions would not permit an unauthorised person to market to the general public in the UK without some kind of prior solicitation from the potential investors.

The FCA authorisation process and ongoing level of regulation on authorised persons is referred to at a high level in question 2.3 above.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

In 2006, the Financial Services Authority (the predecessor body to the FCA) launched the Retail Distribution Review ("**RDR**") with the aim of making the retail investment market work better for consumers. One of the key outcomes of this review was to improve the transparency of charges being levied against consumers by those involved in the lifecycle of retail investment products. Measures included a ban on the payment of commission from fund managers to financial advisers or platforms for recommending or selling their products. Such advisers and platforms can now only be paid by charging the client a direct fee.

In addition, under the FCA's inducement rules, there are very limited circumstances in which a firm may pay or accept any fee or commission, or provide or receive any non-monetary benefit, in relation to any regulated business carried on for a client.

**ii. Advertising**

The most relevant requirements are covered above, including the rules in COBS 4 applicable to authorised persons as referred to in question 3.1 above.

**iii. Investor suitability**

Where a firm advises a client or manages her investments, it will need to take reasonable steps to ensure that its advice or decision to trade is suitable for the client.

For other services, firms are required to carry out an "appropriateness test" where a non-advised sale relates to a product which is "complex" for the purposes of MiFID. In the FCA's view, NURS funds are neither automatically non-complex nor automatically complex and need to be assessed against certain specified criteria accordingly.

As outlined above, fund manufacturers and distributors are subject to certain product governance requirements which seek to ensure sufficient systems and controls are in place to design, approve, market and manage products. For product manufacturers, these include:

1. ensuring their products are designed to meet the needs of an identified target market;
2. ensuring the strategy for distribution of the product is compatible with the identified target market; and
3. taking reasonable steps to ensure that the product is distributed to the target market.

Fund distributors are also subject to product governance requirements including to: understand the products it is distributing; assess the compatibility of the products with the needs of its clients; and ensure that the products are distributed only when it is in the best interest of the clients.

**iv. Custody of investor funds or securities**

The depositary of the fund is responsible for safeguarding the fund's assets. All of the depositaries in the UK-authorised fund market are subsidiaries or divisions of large banking groups, although there is no regulatory requirement to this effect. It is not uncommon for the depositary to delegate the custody function to a third-party custodian; however, the depositary is effectively subject to a strict liability regime under UCITS and AIFMD respectively in respect of any fund assets held in custody that are lost.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

As outlined above, complex products may not be sold on an execution-only capacity to retail investors. This may potentially include Non-UCITS Retail Schemes depending on the level of complexity of the fund in question and whether it meets the relevant criteria.

In addition, regardless of whether a fund is considered to be complex, the product manufacturer and distributor/s will be required to comply with the MiFID II product governance requirements outlined above (including in respect of the proposed target market).

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

There are no other main areas of regulation to be aware of.

## 4 Tax Treatment

**4.1 What are the types of entities that can be public funds in your jurisdiction?**

Authorised UK funds comprise AUTs, OEICs and ACSs as outlined in question 1.1 above.

**4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?**

**Tax treatment of the fund**

The tax treatment of each type of authorised UK fund is broadly as follows:

(i) An AUT (or each sub-fund as a sub-fund of an umbrella fund will be treated as a separate taxable entity) is subject to corporation tax on any taxable income at the basic rate of income tax for the year of assessment. As such, the normal corporation tax rates do not apply to AUTs. Any capital gains made by AUTs are generally exempt from the taxation of chargeable gains.

(ii) An OEIC is taxed on the same basis as an AUT.

(iii) Neither form of ACS is a taxable entity. As such, they are not within the charge to direct taxes, and may generally be regarded as "tax transparent" (although special rules, discussed below, apply to investors in ACSs that are co-ownership schemes). Taxes on income and gains are generally applied, instead, at the level of the investor. However, where stamp taxes are payable on acquisitions, then the operator of the ACS will generally account for these.

**Tax treatment of the investors**

The following applies to UK tax-resident investors and is a general summary only. Special rules can apply, e.g. for certain categories of investors such as traders or registered pension schemes, and the investor's particular tax treatment may depend on their circumstances.

Interest distributions from an AUT or OEIC are taxed as interest, either under the loan relationship rules for corporates or as income for individual investors.

Dividend distributions from an AUT or OEIC are taxed as dividends. Individuals will generally pay tax at the relevant dividend rates. Corporate investors are generally charged to corporation tax on the unfranked part of the dividend distribution (with a credit for a deemed deduction).

Upon disposal of an interest in an AUT or OEIC, investors may be subject to a charge to capital gains tax or corporation tax on chargeable gains.

Investors in an ACS that is structured as a partnership are taxed on their share of income and gains as they arise (e.g. on the disposal of or changes to assets within the fund).

Investors in co-ownership ACSs are taxed on their share of income as it arises. However, because a holding in a co-ownership fund is treated as an asset for tax purposes, investors are only subject to tax on chargeable gains (if any) when they dispose of their interest in the fund (rather than upon disposals of underlying assets held in the fund).

**4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?**

Certain types of authorised UK funds may be subject to special tax regimes. For example:

- Certain authorised investment funds (AUTs or OEICs) that meet certain conditions can make an election to join the "tax elected fund" regime. Broadly, investors are taxed as if they held the underlying assets of the fund directly. An application to HM Revenue & Customs is required.
- AUTs and OEICs that invest more than 50% of their assets in non-reporting offshore funds (or that make an election) are within the regime for funds investing in non-reporting offshore funds ("**FINROF**"). Income gains are then taxed on the investors (rather than at the fund level).

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Tom is a partner in our financial services team and head of the firm's Funds and Financial Regulation practice. He specialises in investment funds and financial services regulatory work, with particular expertise in the structuring, establishment, operation and winding up of UK-regulated open-ended investment funds such as OEICs, AUTs and ACSs. He acts for fund operators and other product providers, administrators, investment managers, advisers, platforms, custodians as well as for institutional investors such as pension funds. Tom also co-authored the chapter on regulated collective investment schemes in *Financial Advice and Financial Products – Law and Liability* published by Oxford University Press.

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Gareth is an associate in our Funds and Financial Regulation team with considerable experience of advising financial institutions, fund managers, investment managers, fund and investment platform operators and businesses carrying out FCA-regulated activities.

Gareth's experience covers: UK-regulated investment fund structuring; Local Government Pension Scheme pooling, applications for Part 4A authorisation; providing regulatory advice on all aspects of financial regulation, in particular in respect on regulatory perimeter issues; and corporate transactions involving authorised persons. Gareth also focuses on sustainable finance and its impacts on the investment sector, and has assisted the CSFI in hosting its Sustainable Finance for Breakfast meetings.

Burges Salmon

Burges Salmon is the independent UK law firm which delivers the best mix of advice, service and value.

Our practice focuses on the establishment and structuring of a full range of investment funds and associated structures, products and services. We are recognised by the industry as one of the leading law firms with regard to UK open-ended investment funds. We act for a range of clients in the sector from major household names to smaller boutique operators. We advise on all aspects of the lifecycle of a fund – from initial set-up and authorisation to ongoing operational aspects and changes through to mergers, termination and wind-ups. We lead on all fund-related FCA applications and deal regularly with the FCA's CIS team.

We have an established international funds network with preferred law firms in other key funds jurisdictions which allows us to provide a seamless service to clients with an international business model.

# USA

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## 1 Registration

### 1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

A fund that is offered publicly in the U.S. must register under the U.S. Investment Company Act of 1940 (the "**1940 Act**") if the fund is organised under U.S. law and is an "investment company" as defined under the 1940 Act. Under Section 3(a)(1)(A) of the 1940 Act, an "investment company" is defined as any issuer that is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities. Section 3(a)(1)(A) is a subjective test designed to capture issuers that hold themselves out to the public as traditional funds, primarily engaged in the business of investing in securities. Additionally, the definition of "investment company" also includes an objective, numerical test designed to capture other types of issuers that may own significant amounts of investment securities, even if such issuers do not hold themselves out to the public as traditional funds. The objective, numerical test under Section 3(a)(1)(C) of the 1940 Act defines an "investment company" as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire "investment securities" having a value exceeding 40% of the issuer's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis. For these purposes, "investment securities" includes all securities except U.S. government securities, cash items and securities issued by majority-owned subsidiaries which do not themselves fall within the definition of "investment company" under the 1940 Act.

A fund that is organised under the laws of a jurisdiction outside the U.S. would not be permitted to register under the 1940 Act, even if it fell within the 1940 Act definition of "investment company". Thus, as further discussed in question 1.4 below, a non-U.S. fund that is an "investment company" as defined under the 1940 Act would be prohibited from conducting a public securities offering in the U.S., unless it: (a) is eligible for an exemption from 1940 Act registration requirements; or (b) applies for and obtains an order from the U.S. Securities and Exchange Commission (the "**SEC**") permitting such non-U.S. fund to register under the 1940 Act and conduct a public offering in the U.S. A number of exemptions are available under the 1940 Act for certain types of issuers, such as banks, insurance companies, broker-dealers, finance subsidiaries, commercial financing and mortgage banking businesses. An issuer that qualifies for one of these exemptions would be permitted to offer its securities publicly in the U.S. without registering under the 1940 Act, whether such issuer is organised under U.S. law or the laws of a non-U.S. jurisdiction. However, non-U.S. funds are unlikely to qualify for one of these exemptions, which are intended to exempt certain types of financial services businesses, and do not exempt funds that are primarily engaged in the business of investing in securities. Non-U.S. funds are also unlikely to be granted an order from the SEC permitting it to register under the 1940 Act and conduct a public securities offering in the U.S. Under Section 7(d) of the 1940 Act, the SEC is authorised to grant such an order if the SEC finds that "it is both legally and practically feasible effectively to enforce the provision of the [1940 Act] against the company, and further finds that granting the application is otherwise consistent with the public interest and the protection of investors". This standard is often difficult to meet because the regulatory frameworks applicable to funds outside the U.S. differ significantly from the 1940 Act. For these reasons, non-U.S. funds generally can only be offered in the U.S. on a private basis, as discussed in further detail in question 1.4 below.

### 1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

A U.S. fund may initiate registration under the 1940 Act by filing a notification of registration on Form N-8A. Within three months after filing its Form N-8A, the fund is required to file a registration statement that describes, among other things, the fund's investment objectives, principal investment risks, fees, performance and management, and the fund's policies with respect to borrowing money, issuing senior securities, underwriting securities issued by others, investment concentrations, purchase and sale of real estate and commodities, making loans and portfolio turnover. A fund's registration statement contains its Prospectus and Statement of Additional Information, and must be filed with certain other documents attached as exhibits, such as the fund's Articles of Incorporation and By-Laws, investment advisory agreements, custodian agreements, transfer agency agreements and other material agreements entered into by the fund. The form that is required to be used for the registration statement will depend on the type of fund that is being registered. For example, open-end funds that issue redeemable shares, such as mutual funds, register on Form N-1A, and closed-end funds that issue non-redeemable shares register on Form N-2. Registration fees are also required to be paid to the SEC in connection with a fund's registration, in the case of closed-end funds, prior to the effective date of the registration statement, and in the case of open-end funds, within 90 days after the end of the fund's fiscal year, based on the amount of securities sold and redeemed during such fiscal year.

Filings with the SEC must be done electronically on the SEC's Electronic Data Gathering and Retrieval System ("**EDGAR**"). After a registration statement is filed with the SEC on EDGAR, the SEC staff will review the registration statement and provide initial written comments, typically within 30 days of the EDGAR filing. The review process may involve several rounds of comments and exchanges with SEC staff, until all of the SEC staff's comments are resolved and the registration statement is declared effective. Typically, the review process will take at least 90 days or longer, depending on the nature of the SEC staff's comments. A fund may not make a public offering of its securities in the U.S. until its registration statement is effective.

### 1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

There are severe consequences for funds that fail to comply with the registration requirements under the 1940 Act. Section 47 of the 1940 Act states that contracts made in violation of the 1940 Act or the rules thereunder are unenforceable by either party, unless a court finds that enforcing such contracts would produce a more equitable result and would not be inconsistent with the 1940 Act's purposes. For example, under Section 7(a) of the 1940 Act, a U.S. fund that is required to register under the 1940 Act is prohibited from selling its securities publicly in the U.S. unless it is registered. If such fund conducts a public offering of its securities in the U.S. without having first registered under the 1940 Act, the sale of its securities would be in violation of Section 7(a) of the 1940 Act, and therefore voidable under Section 47 of the 1940 Act. Buyers of the fund's securities in such case would theoretically have an option to rescind their purchase of the fund's securities. Underwriters and other counterparties may also be unwilling to enter into underwriting or other agreements with such fund because of the risk that the indemnification provisions and other undertakings would be unenforceable against the fund.

For a non-U.S. fund, which as discussed above is not permitted to register under the 1940 Act, activities in the U.S. will be limited unless such non-U.S. fund qualifies for and complies with the requirements of an exemption under the 1940 Act. For example, most U.S. lenders require a legal opinion that the borrower is not required to register under the 1940 Act, and that the loan agreement is valid and enforceable against the borrower. If a non-U.S. fund does not qualify for or comply with an exemption under the 1940 Act, it may be unable to obtain such a legal opinion, and could have difficulty borrowing money in the U.S.

In addition, there are monetary fines and criminal penalties for knowing violations of the 1940 Act.

### 1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

A fund must be organised under U.S. law in order to be eligible to register under the 1940 Act. A fund organised outside the U.S. is not permitted to register under the 1940 Act and, under Section 7(d) of the 1940 Act, is generally prohibited from making a public offering of securities in the U.S. using "interstate commerce" as defined in Section 2(a)(18) of the 1940 Act (i.e., using trade, commerce, transportation or communication among the several states or possessions of the U.S., or between any such state or possession of the U.S. and any foreign country, place or ship outside of the U.S.). A non-U.S. fund therefore can only offer its securities publicly in the U.S. if it qualifies for an exemption, or applies for and obtains an SEC order. As discussed in question 1.1 above, non-U.S. funds generally are not likely to qualify for an exemption or SEC order allowing them to offer their securities publicly in the U.S. Thus, although non-U.S. funds may make public offerings outside the U.S., such non-U.S. funds typically only offer securities in the U.S. on a private basis, relying on the private fund exemptions in Sections 3(c)(1) and 3(c)(7) of the 1940 Act.

Section 3(c)(1) exempts from 1940 Act registration requirements funds whose securities are not offered publicly in the U.S. and are beneficially owned by not more than 100 holders. Section 3(c)(7) exempts from 1940 Act registration requirements funds whose securities are not offered publicly in the U.S. and are beneficially owned by investors who qualify as "qualified purchasers" as defined in Section 2(a)(51) of the 1940 Act (e.g., investors who own significant investment portfolios generally with a value of at least $25 million for institutions and $5 million for individuals). In a series of no-action letters, the SEC staff applied these private fund exemptions to non-U.S. funds, and permitted non-U.S. funds to conduct a private offering of securities in the U.S. in compliance with Section 3(c)(1) or 3(c)(7) concurrently with a public offering abroad, provided that after the offerings: (a) there were no more than 100 persons resident in the U.S. who were beneficial owners of the relevant fund's securities for purposes of Section 3(c)(1); or (b) all U.S. resident owners of the relevant fund's securities were qualified purchasers for purposes of Section 3(c)(7). See, e.g., Touche, Remnant & Co., SEC No-Action Letter (Aug. 27, 1984); Goodwin, Procter & Hoar, SEC No-Action Letter (Feb. 28, 1997). In other words, the SEC staff took the position generally that non-U.S. resident shareholders of a non-U.S. fund need not be counted toward the 100-beneficial-owner limit under Section 3(c)(1), and need not be qualified purchasers when relying on Section 3(c)(7). Non-U.S. funds may not, however, rely on both Sections 3(c)(1) and 3(c)(7) for private offerings in the U.S. This is consistent with the regulation of U.S. funds, which are not permitted to rely on a combination of Sections 3(c)(1) and 3(c)(7) to be exempt from registration under the 1940 Act.

## 2 Regulatory Framework

### 2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

**i. Governance**

The 1940 Act is a comprehensive regulatory regime that imposes strict requirements on funds that are registered under the Act. In addition, a special set of rules under the 1940 Act apply to money market funds, which are a type of registered fund typically used by retail and institutional investors as cash management vehicles. The 1940 Act money market fund rules are designed to promote principal stability and liquidity; for example, by imposing strict requirements regarding the credit quality, liquidity, maturity and diversification of investments made by money market funds.

For example, the 1940 Act imposes a number of requirements regarding a registered fund's corporate governance, which are intended to protect the fund's shareholders by ensuring that the fund's board is sufficiently independent, with specific oversight responsibilities, and that shareholders have the right to vote on director elections and other important matters. Section 10 of the 1940 Act permits up to 60% of a registered fund's board of directors to consist of "interested persons" of the fund. (Under Section 2(a)(19) of the 1940 Act, "interested persons" of a registered fund is broadly defined and includes, among others: persons who have a 5% ownership in, or otherwise controls, are controlled by or under common control with, such fund; persons who are affiliated with the fund's investment adviser; persons who have acted as legal counsel to the fund; and persons who have executed portfolio transactions for, engaged in principal transactions with, or loaned money to, such fund or any other fund sharing an investment adviser with such fund.) However, most registered funds rely on certain exemptive rules under the 1940 Act which were amended by the SEC to require compliance with additional fund governance standards that are set out in Rule 0-1(a)(7) under the 1940 Act. Rule 0-1(a)(7) requires that: (a) independent directors must constitute at least 75% of the fund's board; (b) only the independent directors select and nominate any other independent director of the fund; (c) legal counsel for the independent directors must be an independent legal counsel meeting the requirements of Rule 0-1(a)(6); (d) an independent director must serve as chairman of the board; (e) the board must perform an annual evaluation of itself and its committees; (f) the independent directors must meet at least quarterly in a session at which no directors who are interested persons of the fund are present; and (g) the independent directors must be authorised to hire employees and to retain advisers and experts necessary to carry out their duties. The requirements noted in items (a) and (d) above were subsequently vacated by U.S. federal court decisions, and to date, the SEC has not re-proposed them. Registered funds that rely on the 1940 Act exemptive rules therefore must comply with the fund governance standards set out in Rule 0-1(a)(7), other than items (a) and (d) above, and have independent directors that constitute at least a majority of the fund's board, which was the requirement in effect before Rule 0-1(a)(7) was adopted. See Role of Independent Directors of Investment Companies, SEC Release No. IC-24816 (Jan. 2, 2001).

The 1940 Act requires the board of directors of a registered fund to carry out specific responsibilities to monitor the activities of the fund and to monitor self-dealing by the sponsor or investment adviser to the fund. For example, the board of a registered fund is responsible for: (a) approving the fund's investment advisory agreement, underwriting agreement and distribution plans; (b) adopting a code of ethics governing the personal trading activity of the fund's personnel and access persons; (c) selecting independent auditors for the fund; (d) designating the Chief Compliance Officer of the fund, and his or her compensation; (e) adopting or approving the written policies and procedures of the fund, and its investment adviser, principal underwriter, administrator and transfer agent, based on a finding by the board that the policies and procedures are reasonably designed to prevent violations of U.S. securities laws; and (f) reviewing, at least annually, a written report of the fund's Chief Compliance Officer in order to determine the adequacy and effectiveness of the fund's compliance policies and procedures and those of its service providers.

The 1940 Act also imposes certain requirements regarding the voting rights of shareholders of a registered fund. Every share issued by a registered fund generally must have voting rights equal with every other voting share issued by the fund. Approval of a majority of the outstanding voting shares of a registered fund is required to approve, among other matters: (a) changes in the fund's investment objective (unless the prospectus specifically states that the investment objective can be changed without a shareholder vote); (b) changes in any fundamental investment policy of the fund; (c) the fund's investment advisory agreements and distribution plans; and (d) election and/or changes to the board of directors. Shareholder approval is also sometimes required to ratify the board's selection of independent auditors for the fund.

**ii. Selection of investment adviser, and review and approval of investment advisory agreement**

The investment advisory agreement between a registered fund and its investment adviser must be approved by a majority vote of the fund's shareholders, and is subject to procedural requirements regarding review and approval by the fund's board of directors. Under Section 15(a) of the 1940 Act, a registered fund's investment advisory agreement may continue in effect for more than two years only if it is approved at least annually by the fund's board of directors or a majority vote of the fund's shareholders. In addition, Section 15(c) of the 1940 Act requires that the investment advisory agreement, and renewals thereof, must be approved by a majority of directors who are not parties to the agreement or interested persons of any party to the agreement. Section 15(c) specifically imposes a duty on the fund's board of directors to request and evaluate such information as may be reasonably necessary to evaluate the terms of the investment advisory agreement, and obligates the investment adviser to provide such information to the board. According to guidance provided in U.S. federal court decisions and followed by the SEC, material factors that are reasonably necessary for the board to evaluate an investment advisory agreement include: the nature and quality of the adviser's services; the performance of the fund and the adviser; the adviser's cost in providing services to the fund; the profitability of the fund to the adviser; the extent to which the adviser realises economies of scale as the fund grows larger; fee structures for comparable funds; and any fall-out benefits accruing to the adviser or its affiliates. See, e.g., *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir. 1982); *Jones v. Harris Associates L.P.*, 559 U.S. 335 (2010). Recordkeeping rules under the 1940 Act require registered funds to retain copies of materials that the board reviewed in connection with approving the funds' investment advisory agreements. According to the SEC, maintenance of such records by a fund facilitates an SEC examiners' review of whether the fund's board of directors has obtained the necessary information to be able to conduct informed evaluations of the fund's investment advisory agreement. See Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies, SEC Release No. IC-26486 (Jun. 23, 2004).

**iii. Capital structure**

Section 18 of the 1940 Act imposes strict requirements on a registered fund's capital structure. The requirements are designed to ensure that all shareholders of the fund are treated equitably and that shareholders are not subject to the increased risks of a highly-leveraged investment strategy. For example, open-end funds are permitted to issue only one class of equity securities, and borrowing by open-end funds is only permitted under certain circumstances, including maintenance of asset coverage of at least 300% for all borrowings. Closed-end funds are permitted to issue only three classes of securities: one class of common; one class of preferred; and, generally, one class of debt. In addition, closed-end funds are required to maintain certain asset coverage ratios with respect to their senior securities: (a) preferred stock (together with any borrowings and debt securities) may not represent more than 50% of a closed-end fund's assets less liabilities other than borrowings and debt securities; and (b) borrowings and debt securities may not represent more than 33% of a closed-end fund's assets less liabilities other than borrowings and debt securities. If a closed-end fund fails to maintain the required asset coverage on its senior securities, the fund may be prohibited from paying dividends on or repurchasing any junior security and, if continued long enough, holders of senior securities issued in compliance with the 1940 Act may be entitled to elect a majority of the fund's directors.

Some registered funds may pursue alternative investment strategies through the use of derivative instruments. However, certain derivative instruments sold by, and certain derivative transactions entered into by, a registered fund may be considered an impermissible separate class of equity or debt securities unless the fund segregates assets or "covers" the transaction through an offsetting transaction. On December 11, 2015, the SEC proposed a new Rule 18f-4 which, if adopted, would supersede the SEC's previously issued guidance regarding the use of derivatives by registered funds. Proposed Rule 18f-4 would impose new exposure limits, asset segregation requirements and compliance obligations on registered funds that enter into derivative transactions. It currently does not appear likely that the SEC will adopt Rule 18f-4 as proposed.

**iv. Limits on portfolio investments**

The 1940 Act restricts the investments that can be made by registered funds. For example, a registered fund is limited in its ability to purchase securities of, or sell its securities to, other registered and unregistered funds. The 1940 Act also restricts investments by registered funds in securities-related issuers, such as broker/dealers, underwriters, investment advisers (or companies that derive more than 15% of their revenues from securities-related businesses) and insurance companies. Most derivative counterparties are investment banks that are generally considered securities-related issuers, and therefore, registered funds may be limited in their ability to enter into certain derivative contracts which involve economic exposure to such investment banks. The 1940 Act also limits the ability of a registered fund to acquire voting securities of an issuer if, to the knowledge of the fund, cross-ownership or circular ownership exists between the fund and the issuer. A registered fund may not concentrate more than 25% of its investments (including debt securities) in a particular industry unless the fund specifies in its registration statement such industry or group of industries in which it is concentrated.

Registered open-end funds, such as mutual funds, are also subject to restrictions regarding illiquid investments, and to the liquidity risk management requirements of new Rule 22e-4, which was adopted by the SEC on October 13, 2016. Under new Rule 22e-4, registered open-end funds are generally required to adopt and implement a written liquidity risk management programme and adhere to certain investment restrictions, such as: prohibiting a fund's acquisition of any illiquid investment if, immediately after such acquisition, the fund would have invested more than 15% of its net assets in illiquid investments; and establishing a minimum percentage of the fund's net assets required to be invested in highly liquid investments.

**v. Conflicts of interest**

The 1940 Act imposes strict limits on a registered fund's transactions with affiliates and affiliates of affiliates, which are designed to regulate situations where there is a risk that the fund may be overreached by such affiliated persons. For example, under Section 17 of the 1940 Act, a registered fund's affiliates, promoters, principal underwriters, and their affiliates, are prohibited from engaging in principal transactions to purchase property from or sell property to the fund, or borrow money from the fund. For these purposes, "affiliate" of a fund, as defined in Section 2(a)(3) of the 1940 Act, includes any person or entity which (a) holds 5% or more of the outstanding voting securities of the fund, (b) has outstanding voting securities, 5% or more of which are owned by the fund, (c) controls, is controlled by or is under the common control with the fund, (d) is an officer, director, partner or employee of the fund, or (e) is the fund's investment adviser or member of an advisory board thereof. Section 17 of the 1940 Act also limits the compensation that affiliates (and affiliates of such affiliates) of a registered fund may accept for acting as an agent in connection with the purchase or sale of property from or to such fund. A registered fund's affiliates and principal underwriters, and their affiliates, are also prohibited from engaging in "joint transactions" (interpreted very broadly by the SEC) with such fund. In addition, Section 10 of the 1940 Act restricts purchases of securities by a registered fund during an underwriting syndicate if any affiliate of such fund is a principal underwriter for the issuer. Rules under the 1940 Act exempt certain affiliated and other prohibited transactions, provided certain conditions are met, and upon an application request, other such transactions may be exempted by SEC order.

**vi. Reporting and recordkeeping**

Registered funds must send to their shareholders' audited annual reports and unaudited semi-annual reports within 60 days after the end of the fiscal year and second quarter, respectively. Such reports must contain financial statements and certain additional information, such as a list of amounts and values of securities owned on the date of the balance sheet, a statement of the aggregate remuneration paid to the directors by the fund during the period covered by the report, and a statement of the aggregate dollar amounts of purchases and sales of investment securities made during such period. These shareholders reports must be filed with the SEC on Form N-CSR, accompanied by certifications of the fund's principal executive and principal financial officers, and are made publicly available. Additional disclosure must be made on Form N-CSR filings, such as a description of matters submitted to a vote of the fund's shareholders during the period covered by the report.

Registered funds are also required to file with the SEC all shareholder meeting proxy materials sent to shareholders in accordance with proxy rules under the U.S. Securities Exchange Act of 1934 (the "**Exchange Act**"), file annual reports on Form N-PX disclosing how the fund voted proxies on portfolio holdings, and file additional annual reports on Form N-CEN. Currently, registered funds are also required to file a list of their investment holdings on Form N-Q, but such reports have been rescinded pursuant to amended rules adopted by the SEC on October 13, 2016. Under the amended rules, the SEC adopted a new monthly filing requirement on Form N-PORT, which will require data on a fund's portfolio holdings, such as pricing of portfolio securities, information regarding repurchase agreements, securities lending activities and counterparty exposures, terms of derivative contracts and discrete portfolio-level and position-level risk measures. According to the SEC, information reported on Form N-CEN and Form N-PORT will help the SEC understand trends in the fund industry, carry out regulatory responsibilities, and analyse and understand the various risks in a particular fund, as well as across the industry as a whole.

Registered funds are required to maintain specified records, including sales literature, advertisements and pamphlets, director-questionnaires, materials reviewed in connection with approving the advisory contract, certain transaction reports, research and advisory materials for at least six years (with such records being maintained for at least two years on site). Registered funds are also required to permanently maintain (with such records being maintained for at least two years on site) certain financial, transactional and shareholder records, and corporate charters, by-laws and minutes. The SEC is authorised to conduct examinations of such records.

**vii. Other**

Registered funds are subject to additional requirements under the 1940 Act, such as those relating to maintenance of fidelity insurance bonds, custody of fund assets, and share price determinations for sales, repurchases and redemptions of open-end fund shares, as well as requirements under other U.S. regulatory frameworks, including anti-money laundering regulations, customer privacy laws, and U.S. tax laws (as further discussed in section 4 below).

### 2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

An investment adviser to a fund that is registered under the 1940 Act generally must be registered as an investment adviser under the U.S. Investment Advisers Act of 1940 (the "**Advisers Act**"), and comply with all the requirements thereunder. Investment advisers register on Form ADV, which includes a submission to jurisdiction and service of process in the U.S., and an undertaking to make records available to the SEC. The Form ADV requires detailed disclosures regarding, among other things, the adviser's business practices, investment methods, ownership structure, disciplinary history, types of compensation and affiliations with financial industry participants. Part 1 and Part 2A of Form ADV are filed electronically through the Investment Adviser Registration Depository ("**IARD**"), and after filing, such documents are publicly accessible on the SEC's Investment Adviser Public Disclosure website. Part 2B of Form ADV may need to be completed with respect to certain supervised persons of the investment adviser and delivered to clients, but is not required to be filed with the SEC or made publicly available. The SEC must approve an adviser's application for registration within 45 days after the date of the filing or institute proceedings to determine whether registration should be denied.

### 2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

As registered advisers under the Advisers Act, investment advisers to registered funds are subject to numerous compliance obligations, including: adopting a Code of Ethics to address compliance with applicable U.S. securities laws and to monitor personal trading activity of certain employees; implementing a written compliance programme and appointing a chief compliance officer to administer such programme; providing adequate supervision of personnel who are subject to the adviser's control; establishing written policies and procedures reasonably designed to prevent the misuse of material, non-public information, including insider trading, front-running (trading ahead of client orders) and scalping (trading ahead of client recommendations); and complying with Advisers Act requirements and SEC guidance such as those regarding advertising and use of performance data, best execution, custody of client assets, principal and agency cross transactions, brokerage arrangements, aggregation and allocation practices, trade error correction, proxy voting procedures and recordkeeping.

If a registered fund invests or trades in "commodity interests", the fund's operator and investment adviser may be required to register as a commodity pool operator ("**CPO**") or commodity trading adviser ("**CTA**") under the U.S. Commodity Exchange Act ("**Commodity Exchange Act**") and the rules of the U.S. Commodity Futures Trading Commission ("**CFTC**"). The Commodity Exchange Act and CFTC Rules regulate sales and trading in "commodity interests", including swaps, futures contracts, options on futures contracts and commodity options. Registered CPOs and CTAs are subject to regulation under the Commodity Exchange Act and the CFTC Rules, and are required to become members of the National Futures Association ("**NFA**"), subject to NFA member rules.

### 2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

As of the time of writing, no public funds investing in digital currencies have been approved in the U.S. The SEC and its staff primarily cited concerns around the cryptocurrency spot market, including the online exchanges where such assets trade. For more information, please see Davis Polk & Wardwell LLP's chapter entitled "The Current State of U.S. Public Cryptocurrency Funds" within this guide.

## 3 Marketing of Public Funds

### 3.1 What regulatory frameworks apply to the marketing of public funds?

The marketing of securities in the U.S., including shares of funds registered under the 1940 Act, is subject to the Exchange Act, the U.S. Securities Act of 1933 (the "**Securities Act**") and the SEC rules thereunder. Persons subject to licensure, as described in question 3.2, are generally also subject to the rules of the Financial Industry Regulatory Authority ("**FINRA**"). The marketing of registered funds is also subject to 1940 Act requirements regarding advertising and distribution plans, and advertising restrictions under Advisers Act provisions applicable to the funds' investment advisers.

### 3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

The Exchange Act provides that a person "engaged in the business of effecting transactions in securities for the account of others" is a generally a "broker" and, absent an exception, must register with the SEC if the person "induces or attempts to induce the purchase or sale" of securities. As a result, a person (whether a legal entity or natural person) that solicits U.S. investors to purchase registered fund securities may be subject to registration with the SEC as a broker-dealer. Therefore, registered funds in the U.S. are typically sold through registered broker-dealers. Natural persons may avoid individual registration by becoming associated with an entity that is a registered broker-dealer.

Natural persons associated with a registered fund's investment adviser may seek to rely on a safe harbour from being deemed a "broker" subject to registration or association with a registered broker-dealer. Under Rule 3a4-1 under the Exchange Act, a partner, officer, director or employee of an investment adviser to a registered fund would not be deemed to be a "broker" in connection with the person's participation in the sale of the registered fund's securities, where a number of particular conditions are met, including that the person is not compensated through commissions or similar remuneration that is dependent on whether transactions in securities occur, and that the person limits their participation in particular ways.

Registered broker-dealers and their natural person associated persons are subject to extensive substantive regulation. In addition to registration with the SEC, broker-dealers are also generally required to become members of FINRA and register with applicable states. Broker-dealers are subject to minimum regulatory capital requirements, limitations on distribution of assets to affiliates, regulation of their handling of customers' fund and securities, limitations on margin lending, significant ongoing regulatory event and financial reporting, annual financial audits, record creation and maintenance obligations, maintaining internal supervision and surveillance, anti-money laundering and know-your-customer requirements, restrictions on the content of communications with the public and obligations in connection with the preparation and potential filing requirements relating to these communications, requirements to obtain FINRA approval for material changes in business or certain changes in ownership, generally adhering to high standards of commercial honour and just and equitable principles of trade, among other obligations. A natural person seeking to become associated with a broker-dealer must pass qualifying examinations administered by FINRA, subject themselves to fingerprinting and provide disclosure of extensive background information. Registered individuals may be subject to restrictions on the business activities that they engage in outside the scope of their association with the broker-dealer, including personal securities transactions, must meet continuing education requirements, and are subject to various ongoing reporting requirements. Broker-dealers and their natural person associated persons are subject to examination and enforcement by the SEC, applicable states, FINRA and any other self-regulatory organisation of which the broker-dealer is a member.

### 3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

**i. Distribution fees or other charges**

FINRA Rule 2341 prohibits FINRA member broker-dealers from engaging in the sale of registered fund securities if the sales charges are "excessive", as defined in the rule. The rule sets forth particular maximum sales charges that differ depending on the relevant fee structures and mix of fees, with the aggregate maximum sales charges generally ranging from 6.25% to 8.5%. FINRA also requires that, to the extent that volume breakpoints or other fee discounts are promised, FINRA members ensure that customers receive them.

**ii. Advertising**

FINRA Rule 2210 requires that all broker-dealer communications, including advertisements for registered funds, be based on principles of fair dealing and good faith, be fair and balanced, and provide a sound basis for evaluating the facts, while not omitting any material fact that would cause the communications to be misleading. Broker-dealers also may not include any false, exaggerated, unwarranted, promissory or misleading statement or claim in any communication, and must ensure that statements are clear and not misleading within the context in which they are made, and that they provide balanced treatment of risks and potential benefits. Communications may not predict or project performance, or imply that past performance will recur. FINRA generally interprets these requirements as prohibiting communications from containing performance information that is not the actual performance of the particular fund – such as hypothetical or backtested performance, information on targeted returns, or information regarding the performance of a related investment.

Advertisements that are expected to be distributed or made available to more than 25 retail investors within a 30-day period generally must be internally pre-approved by particular licensed personnel. When such advertisements relate to registered funds, they must be filed with FINRA within 10 days of first use. Additional obligations apply to the use of advertisements for registered funds that contain certain performance rankings or comparisons, including a requirement to file those materials with FINRA 10 days prior to first use.

Advertisements and sales literature regarding registered funds must also generally comply with specific form and content requirements under SEC rules, such as Rule 34b-1 under the 1940 Act, and Rule 482 under the Securities Act. Such marketing materials are also subject to anti-fraud provisions of the U.S. federal securities laws, including Rule 206(4)-1 under the Advisers Act, which prohibit misleading or deceptive advertising practices.

**iii. Investor suitability**

Under FINRA Rule 2111, a broker-dealer recommending a security transaction, including the purchase of registered funds, must have a reasonable basis to believe that the transaction is suitable for the customer, based on the customer's investment profile (including the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose). Suitability analysis requires consideration of (i) reasonable-basis suitability (that the registered fund is suitable for at least some investors), (ii) customer-specific suitability (that the recommended transaction is suitable for the particular customer), and (iii) quantitative suitability (that even if suitable in isolation, the recommended transaction is suitable and not excessive in light of other recommended transactions). The SEC has proposed, but not yet adopted, new Regulation Best Interest, which would impose a higher "best interest" standard on broker-dealers recommending investments, including registered funds, to retail investors.

With respect to certain institutional investors, a broker-dealer may satisfy its customer-specific suitability obligation under FINRA Rule 2111 if it has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently and the institutional customer has affirmatively indicated that it is exercising independent judgment in evaluating the broker-dealer's recommendations.

**iv. Custody of investor funds or securities**

Most broker-dealers that act as the marketing agent for registered funds do not themselves have the regulatory permission or capacity to maintain custody of customer funds or securities, but instead (i) market the funds, with actual sales effected through customer's own separate broker-dealers, (ii) arrange for transactions on a "subscription-way" basis, whereby the customer provides funds directly to the registered fund or its transfer agent, who maintains records of the customer's ownership, or (iii) introduce the customer transaction to a "clearing" broker-dealer that has the required regulatory permission and infrastructure to handle customer assets.

Clearing brokers are subject to particular requirements in connection with their maintenance of custody of customer funds and securities, including registered fund shares. With respect to securities, the broker must maintain physical possession or "control" of all fully-paid securities, and those securities pledged for margin loans exceeding specified thresholds. This means that the broker-dealer generally must keep these securities either on its own premises or at a U.S. bank, another U.S. broker-dealer or a central securities depository regulated by the SEC. The broker-dealer may not sell or pledge those securities or otherwise use them to support its own business. To the extent that the registered fund shares are not fully-paid, or otherwise have been pledged to the broker-dealer as collateral below the applicable margin threshold, the broker-dealer is permitted to pledge and otherwise rehypothecate those securities, subject to certain limitations.

With respect to cash, clearing brokers are required to conduct a periodic calculation that approximates the net amount of cash that it owes to customers (i.e., cash customers have deposited with the broker, less cash the broker has lent to customers, subject to a number of adjustments), and deposit that amount in a special reserve bank account held at an unaffiliated bank for the exclusive benefit of its customers. As a result, cash deposited with a clearing broker is effectively segregated into a separate omnibus bank account held for the broker's customers.

### 3.4 Are there restrictions on to whom public funds may be marketed or sold?

The 1940 Act imposes restrictions on the sale of securities issued by registered funds to other registered and unregistered funds. Otherwise, there are no investor eligibility restrictions on funds that are registered under the 1940 Act, assuming the fund is suitable for the investor.

### 3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

Registered funds are subject to 1940 Act restrictions on compensation arrangements relating to distribution of the funds' securities. For example, under Rule 12b-1(h) under the 1940 Act, a registered fund may not compensate a broker or dealer for any promotion or sale of its shares by directing portfolio securities transactions to such broker or dealer.

## 4 Tax Treatment

### 4.1 What are the types of entities that can be public funds in your jurisdiction?

Various types of entities can be registered funds, including entities treated as partnerships, grantor trusts or corporations for U.S. federal income tax purposes. The choice of entity depends on the fund's investment strategy, as well as other factors. If a registered fund will invest in stocks and securities (as opposed to commodities), it is quite common for the fund to elect to be treated as a regulated investment company (a "**RIC**") for U.S. federal income tax purposes. This section 4 will focus on the U.S. federal income tax treatment of, and qualification requirements for, a RIC.

### 4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

Assuming that a fund elects to be treated as a RIC and satisfies the relevant requirements for that status, the fund generally will not be subject to U.S. federal income tax on income that it distributes to its shareholders, provided that, for each taxable year, it distributes on a timely basis (i) at least 90% of "investment company taxable income" (generally, its taxable income other than net capital gain, with certain modifications), and (ii) at least 90% of its net tax-exempt interest income. Net capital gain is the excess, if any, of net long-term capital gains over net short-term capital losses. Gain or loss from the fund's disposition of an investment will be treated as long term if the fund's holding period for the investment is more than one year on the date of disposition. In addition, a RIC will be subject to a 4% excise tax on certain undistributed income if it does not distribute during each calendar year (which may be different from its taxable year) at least (i) 98% of its ordinary taxable income for the year, (ii) 98.2% of its net capital gains for the one-year period ending on October 31, and (iii) any income or gains not distributed in prior years.

Except as described below, distributions out of a RIC's current or accumulated earnings and profits will be treated as ordinary income, which is subject to U.S. federal income tax in the hands of the investors at the highest marginal rates. The portion of any such distribution that the RIC designates as made out of net capital gains or (if the investor meets an applicable holding period requirement with respect to his or her shares in the RIC) "qualified dividend income" will retain that character and will therefore be subject to lower tax rates in the hands of non-corporate investors. If at least 50% of the value of a RIC's assets consists of tax-exempt state and local bonds, the RIC can designate the portion of a distribution that is made out of tax-exempt interest as such, and that portion will be tax-exempt. If a RIC retains net capital gains, it may elect to treat those gains as distributed to the investors, in which case the investors will be entitled to tax credits equal to their shares of the tax paid by the RIC on the retained gains. A distribution in excess of the RIC's current and accumulated earnings and profits will be treated as a tax-free return of capital to the extent of the tax basis of the investor's shares and thereafter as capital gain from a sale of those shares.

Except as described below, a distribution by a RIC to a non-U.S. investor out of the RIC's current or accumulated earnings and profits will be subject to withholding tax at a 30% rate or such lower rate as may be specified by an applicable income tax treaty. Provided that certain requirements are satisfied, this withholding tax will not be imposed on the portion of any such distribution that is made out of the RIC's net capital gain, short-term capital gain (that is, the excess of net short-term capital gains over net long-term capital losses) or U.S.-source interest income. In certain circumstances, a distribution by a RIC of gains derived from U.S. real-estate-related investments could subject a non-U.S. investor to regular U.S. federal income tax and a U.S. tax return filing requirement.

### 4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

In order to qualify as a RIC, a fund must: (i) be organised as a U.S. entity that is treated as a corporation for U.S. federal income tax purposes; (ii) be registered under the 1940 Act or meet certain other regulatory requirements; (iii) elect to be treated as a RIC; and (iv) meet an annual "qualifying income" test and a quarterly asset diversification test. A fund will meet the "qualifying income" test for any taxable year if at least 90% of its gross income for the year consists of certain types of investment income derived from investments in stocks, securities or foreign currencies (including options, futures or forward contracts with respect to such assets). Investments in cryptocurrencies that are not treated as securities for purposes of the 1940 Act do not produce "qualifying income" and, as a result, a fund that invests primarily in such cryptocurrencies would not qualify as a RIC (as defined in this section 4). In order to meet the asset diversification test, a fund must generally diversify its holdings so that, at the end of each quarter, (i) at least 50% of the value of its assets consists of cash, U.S. government securities, securities of other RICs and other securities, with such other securities limited, in respect of any issuer, to an amount not greater than 5% of the value of the fund's assets and not greater than 10% of the issuer's voting securities, and (ii) not more than 25% of the value of its assets consists of (x) the securities (other than U.S. government securities and securities of other RICs) of any one issuer, or of two or more issuers that the fund controls and that are engaged in the same, similar or related businesses, or (y) in the securities of one or more publicly traded partnerships (other than such a partnership that would itself satisfy the RIC "qualifying income" test).

If a fund that has elected RIC status fails to satisfy the income or diversification test for any taxable year, it may be able to avoid losing its status as a RIC by timely curing such failure, paying a tax and/or providing notice of such failure to the U.S. Internal Revenue Service. If the fund does lose its status as a RIC, it could be required to recognise unrealised gains, pay taxes and make distributions (which could be subject to interest charges) before requalifying.

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