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Offering UCITS to US Institutional Investors: A Post Dodd-Frank Overview—Part 1 of 2

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Over the past 25 years, UCITS (Undertakings for Collective Investments in Transferable Securities) have grown into a global investment fund brand. While originally developed to facilitate cross-border distribution within Europe, UCITS continue to grow in popularity outside of Europe, particularly in fast growing markets in Asia and South America. As the UCITS brand rapidly becomes the most popular cross-border investment fund product globally, one market remains largely untouched by the growth of UCITS, the United States. While there are a number of UCITS that do offer their shares to residents of the United States, most notably to tax-exempt investors, the regulatory hurdles to offering UCITS in the United States have historically been significant. In the aftermath of the financial

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crisis, the Dodd–Frank Wall Street Reform and Consumer Protection Act[1] (Dodd-Frank Act) and its progeny have made it even more difficult for UCITS to offer and sell shares to institutional investors in the United States. This article highlights the key regulatory challenges to offering UCITS to residents of the United States in the post Dodd-Frank Act era. Part 2 of this article, which will include a discussion of the impact of recent rulemaking by the US Securities and Exchange Commission (Commission) and the Commodity Futures Trading Commission (CFTC) on UCITS, will appear in an upcoming issue of *The Investment Lawyer*.

I. Background

In late 1985, the Council of the European Communities adopted a Directive on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS Directive).[2] The UCITS Directive established common basic rules for the authorization, supervision, structure and investment activities of collective investment undertakings (mutual funds) situated in the member states of the EU (EU Member States). The original objective of the UCITS Directive was to create a common market for investment funds in Europe that met certain stated criteria, namely a fund that was open-ended, raised assets from the public and invested those assets in "transferable securities"[3] in accordance with certain prudential investment limits and investor safeguards.[4] The regulatory framework for this highly regulated, retail investment product was also specifically designed to facilitate distribution within Europe through the use of a "passport," which allowed a UCITS authorized in one EU Member State (Home Member State) to be sold in an another Member State (Host Member State) without any further authorization upon notification to the Host Member State.[5] This "passport" was at the heart of the UCITS Directive and its single unified market objective.

In its early years, UCITS were mainly long-only products established by investment managers in Europe as "round-trip" funds—for example, funds organized in one EU Member State to be sold back into the EU Member State of the promoter (for example, a German bank establishing a Luxembourg fund to be sold back into Germany).[6] As the product has evolved over time, UCITS have slowly become the dominant cross-border investment product globally. This is largely due to the changes that have been made to the original UCITS Directive to address perceived shortcomings in the original legislation.[7] Over the last decade, the UCITS Directive has been amended and/or interpreted several times to, among other things: expand the range of eligible investments for UCITS[8] and the range of product offerings; expand the range of investment strategies that fit within the UCITS framework, including ETFs and money market funds;[9] provide increased flexibility to management companies to UCITS;[10] improve efficiencies in the practical application of the UCITS passport to increase the speed to market on a cross-border basis and decrease the cost of operating a cross-border fund product;[11] and improve the level of investor protection and disclosure to UCITS shareholders.[12]

These legislative changes, the decline of many national regulatory and tax barriers, the introduction of the Euro and the expansion of open-architecture (among other factors) have fueled the dramatic growth in the assets under management in UCITS over the past decade.[13]

Despite the fact that no "passport" outside of the European Economic Area exists for UCITS, the UCITS brand continues to gain traction outside of Europe, including in fast growing markets in Asia, South America and the Middle East. Despite its success as a "global" brand, the United States fund industry, which remains the largest in the world with more than $12 trillion under management,[14] remains largely a domestic fund market with little penetration from UCITS. While the retail market remains largely off-limits to UCITS, there are opportunities for UCITS in the US institutional market, particularly the US tax-exempt market. These opportunities can be difficult to access considering the myriad of regulation impacting the offer and sale of non-US funds in the United States.

II. Regulatory Considerations In Offering UCITS to US Institutional Investors

The most significant US federal securities laws covering the sale of shares/units of a UCITS in the United States are the US Securities Act of 1933, as amended (Securities Act), the US Investment Company Act of 1940, as amended (Investment Company Act), and the US Securities Exchange Act of 1934, as amended (Exchange Act).

The Securities Act covers the offer and sale of securities (for example, shares/units of a UCITS) and generally requires the registration of securities with the Commission. Securities sold in an exempt or private offering, however, need not be registered with the Commission under the Securities Act.[15] The Investment Company Act generally requires the registration with the Commission of "investment companies" (generally any type of collective investment scheme, including a UCITS) that "publicly offers" shares in the US and regulates the activities of registered investment companies. Sections 3(c)(1) and 3(c)(7) of the Investment Company Act provide exemptions from the definition of "investment company" (and thus almost all of the requirements of the Investment Company Act).[16]

While the Exchange Act governs both the registration and the reporting of "public" companies, it does have an impact on the potential reporting under the Exchange Act required for certain funds that offer and sell shares to US residents.

The sale of shares of a UCITS in the US also raises potential broker-dealer issues, issues relating to the US Employee Retirement Income Security Act of 1974, as amended (ERISA), and state securities law issues. Further, if a UCITS offers or sells its interests to US persons and the UCITS is permitted to invest directly or indirectly in futures on futures markets, the rules and regulations of the CFTC are implicated.

A. Securities Act Considerations

Section 5 of the Securities Act makes it illegal to offer or sell unregistered securities through any means of US interstate or international commerce through the United States unless the security or the transaction is exempt from registration with the Commission.[17] Shares of a UCITS would be regarded as a security for purposes of the Securities Act.[18] As such, the shares of a UCITS offered to US Persons (as defined in Regulation S of the Securities Act) must either be (1) registered with the Commission, (2) exempt from registration, or (3) sold in an exempt transaction. UCITS funds typically have relied upon Regulation S, Section 4(2) and Regulation D of the Securities Act for transactions in their shares in order to avoid the registration provisions under the Securities Act.

1. Regulation S

The Commission interprets the scope of Section 5 of the Securities Act very broadly.[19] However, the Commission historically has taken the position that the registration requirements of the Securities Act do not apply to offers and sales of securities made abroad when the offers and sales are made with only incidental US contacts and are made in such a way as reasonably to preclude redistribution of the securities in the US.[20]

Regulation S represents an attempt by the Commission to clarify the extraterritorial application of the Securities Act's registration requirements.[21] In Regulation S, the Commission embraced a territorial approach to the application of registration under the

Securities Act. Regulation S comprises four rules: Rules 901, 902, 903 and 904. Rule 901 states that only offers and sales of securities inside the US are subject to Section 5.

To clarify when offers and sales of securities are deemed to occur outside the US for purposes of the Securities Act, Regulation S provides two non-exclusive "safe harbor" provisions in Rules 903 (issuer safe harbor) and 904 (safe harbor for resales). If the offer and sale satisfy the conditions of either of the safe harbor provisions, such transaction will be deemed to have occurred outside of the US and outside the reach of Section 5.

Many UCITS rely on Regulation S, and in particular the issuer safe harbor, when offering and selling shares to non-US Persons through US based intermediaries that may have non-resident alien clients (NRA Clients). The Regulation S safe harbor also is available when the offer or sale is made in the US to a discretionary account (other than an estate or trust) held by a US professional fiduciary for the benefit of a non-US person.[22] Such offers and sales of securities are deemed to be "offshore transactions" and contacts with such fiduciaries are permitted under Regulation S.

As such, UCITS generally require that US third-party dealers or financial intermediaries (Dealers), which offer UCITS shares to NRA Clients, represent and warrant that the Dealer has procedures in place to comply with Regulation S. Specifically, a UCITS will generally require the following representation in any sub-distribution agreement with a Dealer:

> The Dealer understands the Shares have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or its territories or possessions or to US Persons (as such term is used in Regulation S promulgated under the [Securities] Act), unless pursuant to an applicable exemption or exception. Neither the Dealer, nor any person acting on its behalf, will offer the Shares, solicit an offer to buy the Shares, otherwise negotiate in respect of the sale of the Shares, or take any action, as a result of which the offer and sale of the Shares may be required to be registered under the Securities Act or the Funds may be required to register under the Investment Company Act. The Dealer will offer and sell the Shares only in "offshore transactions" and without "directed selling efforts" in the United States (as such terms are used in Regulation S promulgated under the Securities Act).

While Regulation S is routinely utilized by UCITS funds that offer shares to non-US persons through facilities in the United States, the Regulation S safe harbor is generally not available for direct sales to US persons.[23] When offering shares of a UCITS directly to US institutional investors, the UCITS will need to rely on an available exemption from the Securities Act much in the same way a private hedge fund would.

2. Section 4(2)

The Commission Staff has indicated that, in the context of a global private offering, an offshore fund may rely simultaneously on both Regulation S and Section 4(2) of the Securities Act in avoiding registration under both the Investment Company Act and the Securities Act.[24] Section 4(2) of the Securities Act exempts from registration any security offered or sold by the issuer in a transaction "not involving any public offering."[25] The availability of the Section 4(2) exemption does not depend upon the identity of the issuer of the security, but rather is measured by the extent to which the offering is limited in scope and not generally available to the public in the United States.[26]

While Commission Staff interpretations and court cases have provided some guidance regarding what constitutes a private offering, the scope of the private offering exemption under Section 4(2) remains subject to ongoing judicial and regulatory interpretation.[27] Due to the uncertainty surrounding Section 4(2), it is difficult for a UCITS and its sponsor to be confident that its offering under Section 4(2) would withstand scrutiny from the Commission. As such, many UCITS rely on the provisions of Regulation D, a safe harbor to Section 4(2) discussed more fully below, in addition to Regulation S when offering shares/units to US institutional investors.

3. Regulation D

The SEC has adopted Rule 506[28] of Regulation D under the Securities Act as a "safe harbor" under Section 4(2) of the Securities Act. This means that an offering made in accordance with the provisions of Rule 506 is deemed to have complied with Section 4(2). Generally, Rule 506 provides that an offering is deemed to comply with Section 4(2) if: sales are made only to "accredited investors" and up to 35 non-accredited investors; there is no general solicitation or advertising involved with the offering;[29] and the investors buy the securities for investment and not for resale.[30]

As a practical matter, most UCITS targeting the US (other than those relying on Regulation S under the Securities Act) accept only investors that meet qualification standards well above that of the accredited investor definition.

In addition, Regulation D also technically requires a UCITS to file a short notice (Form D)[31] with the SEC within 15 days of the first sale of interests in a UCITS sub-fund to US Persons. While failure to file the Form D does not generally prevent a UCITS from relying on the Regulation D safe harbor, it could complicate the ability of a UCITS to comply with state "blue sky" filing requirements (as discussed below). Compliance with Regulation D (and other US securities laws) can be achieved through the use of a US "wrapper" to the UCITS prospectus and application form, which contains both a supplemental subscription agreement for US investors as well as supplemental US regulatory and tax disclosure.

B. Investment Company Act Considerations

In addition to the considerations under the Securities Act, UCITS that offer and sell to US Persons will need to consider the implications of the Investment Company Act. Section 7(d) of the Investment Company Act prohibits an investment company organized outside the United States from making a public offering of its securities in the United States unless the Commission has issued an order permitting the foreign fund to register under the Investment Company Act.[32] Section 7(d) provides that to issue such an order the Commission must determine that "it is both legally and practically feasible effectively to enforce the provisions of the Investment Company Act against such [foreign fund]."[33] Additionally, the Commission has stated that it would expect applicants seeking an order to meet certain requirements.[34] As a practical matter, the required determination and the Commission-imposed requirements have made it difficult for non-US investment companies to receive such orders from the Commission.

While Section 7(d) does not prohibit private offerings in the United States by foreign investment companies, generally foreign investment companies may only make such offerings to the same extent as US investment companies. As such, to avoid registration under the Investment Company Act, UCITS will typically seek to come under one of the private investment company exemptions from the definition of investment company, which are found in Sections 3(c)(1)[35] and 3(c)(7)[36] of the Investment Company Act and not engage in a public offering in the United States to retail clients.

1. Section 3(c)(1)

Section 3(c)(1) of the Investment Company Act is routinely used by UCITS (as well as other non-US private funds) as an exemption from registration under the Investment Company Act. Generally, Section 3(c)(1) requires that: (i) the outstanding securities of a fund must not be beneficially owned by more than 100 US Persons; and (ii) the fund must not make or propose to make a public offering of its securities.[37]

Investors in a private fund (including a UCITS for US purposes) relying on Section 3(c)(1) are not currently required to meet any investor qualification standards other than the "accredited investor" standard of the Securities Act.[38] Very generally, the term "accredited investor" is defined in Rule 501(a) under the Securities Act as any person who, at the time of investment, comes within any of the following categories, or who the issuer reasonably believes comes within any of the following categories: (a) an individual whose net worth (or joint net worth with that person's spouse) exceeds $1 million (excluding the value of that person's primary residence and generally including only the portion of the person's mortgage or other debt secured by the person's primary residence that exceeds the estimated fair market value of the residence[39]); (b) an individual whose income was in excess of $200,000 in each of the preceding two years (or, together with that person's spouse, in excess of $300,000 in each of the preceding two years) and who reasonably expects to reach the same level of income in the current year; or (c) corporations, partnerships, trusts or foundations with total assets in excess of $5 million.

An owner of shares of a UCITS who is not a US Person at the time of purchasing shares in such UCITS is not required to be counted towards the 100 person limit described above even if the owner later becomes a US Person (for example, by taking up residence in the United States).[40] However, the owner should be counted towards the 100 person limit if the owner subsequently purchases additional shares of the UCITS after becoming a US Person.[41]

2. Section 3(c)(7)

The Section 3(c)(7) exemption from registration under the Investment Company Act does not restrict the offering of securities to fewer than 100 beneficial owners. However, in order to rely on the Section 3(c)(7) exemption, a UCITS must not conduct a public offering of its securities in the United States (essentially imposing the accredited investor requirements). In addition, the US beneficial owners of the UCITS must be limited exclusively to persons who, at the time of their investment, are "qualified purchasers."[42] A qualified purchaser is generally defined in Section 2(a)(51) of the Investment Company Act and the rules promulgated thereunder to include the following:

(i) Natural persons who own at least $5 million in "investments" (as such term is defined for purposes of the Investment Company Act);[43]
(ii) Certain family-owned companies, partnerships, trusts or similar entities that own at least $5 million in investments;
(iii) Certain trusts that are not formed to acquire the interests in the Section 3(c)(7) fund if the trustee or other person authorized to make decisions for the trust, and each settler or other person who contributed assets to the trust, is a qualified purchaser;
(iv) Entities that, in the aggregate, own and invest on a discretionary basis at least $25 million in investments;
(v) Entities that are beneficially owned by qualified purchasers; and
(vi) Most "qualified institutional buyers" (as defined in Rule 144A under the Securities Act), which term generally encompasses institutions with at least $100 million of investment securities.[44]

In addition, there are "look-through" provisions applicable to a Section 3(c)(7) analysis that require a private investment fund (that is, private for US purposes) to "look-through" an investor that is an entity formed for the specific purpose[45] of making the investment to determine whether beneficial owners of the investing entity are, in fact, qualified purchasers. If a UCITS relies on Section 3(c)(7), only investors who are US Persons[46] and who purchase their interest in the UCITS directly from such UCITS or someone else acting on behalf of the UCITS need to be qualified purchasers.[47] A UCITS must look behind simple nominee relationships that do not remove the owner from the definition of US Person. Further, any US Person who purchases interests from an existing US investor must also be qualified (as an accredited investor and, if appropriate, a qualified purchaser).

An owner who is not a US Person at the time of purchasing interests is not required to be qualified even if the owner later becomes a US Person (for example, by taking up residence in the United States).[48] A US Person who acquires his or her interests from a non-US Person in a secondary market transaction outside the United States that does not involve the UCITS or anyone acting on its behalf does not have to be qualified.

C. Exchange Act Registration/Reporting Considerations

Section 12(g)(1) of the Exchange Act provides that an issuer whose securities are traded by any means of interstate commerce shall be required to register with the Commission under the Exchange Act if it has assets over $1 million dollars and if it is held of record by persons in excess of the numeric limits set forth in this section, as amended.[49] The Commission is authorized to exempt securities of foreign issuers from this registration requirement and has adopted Rule 12g3-2 under the Exchange Act to exempt securities of any "class" issued by a "foreign private issuer" if the class has fewer than 300 shareholders resident in the United States (Rule 12g3-2(a)). Rule 3b-4 under the Exchange Act defines the term "foreign private issuer" to mean any "foreign issuer" other than a foreign government or an issuer who meets the following conditions as of the last business day of its most recently completed second fiscal quarter: (i) more than 50 percent of the issuer's outstanding voting securities are held of record, directly or indirectly, by US residents; and (ii) any of the following: (a) the majority of the issuer's executive officers or directors are US citizens or residents; (b) more than 50 percent of the issuer's assets are in the United States; or (c) the issuer's business is administered principally in the United States. Pursuant to Rule 3b-4, the term "foreign issuer" means any issuer that is a foreign government, a foreign country national or a corporation or other organization that is incorporated or organized under a foreign country's laws.[50]

Pursuant to Rule 12g3-2, securities held of record by persons resident in the United States are determined as provided in Rule 12g5-1 under the Exchange Act, except that securities held of record by a broker, dealer or bank, or their nominee, for the accounts of US resident customers are counted as being held in the United States by the number of such accounts. Historically, UCITS (as well as foreign private funds) offered to US residents have attempted to rely on Rule 12g3-2 to avoid registration.[51]

D. Broker-Dealer Regulation Considerations

1. Sales Activities in the United States

Under Section 15 of the Exchange Act, any person who utilizes US interstate commerce to engage in the business of acting as a broker or a dealer is required to register with the Commission as a broker-dealer or as an associated person of a broker-dealer unless an exemption from such registration is available. The term "broker" is defined in Section 3(a)(4) of the Exchange Act as "any person engaged in the business of effecting transactions in securities for the account of others." A "dealer" is defined in Section 3(a)(5) of the Exchange Act as a "person engaged in the business of buying and selling securities for such person's own account," except for "a person that buys or sells … but not as part of a regular business."[52] When using a third party for solicitation services, a UCITS should be careful to ensure that the party is registered with the Commission as a broker-dealer if the third party's activities subject it to such registration. In the event that a UCITS utilizes the services of a third party that should have been registered as a broker-dealer, or as a registered representative of a broker-dealer, but is not so registered, any investor introduced to the UCITS by that third party may have the right to rescind its investment and receive the full value of its investment.[53]

Rule 3a4-1 under the Exchange Act (Associated Persons of an Issuer Deemed not to be Brokers) provides a non-exclusive safe harbor by which persons associated with an issuer of securities may avoid the need to register with the Commission as a broker-dealer (or for individuals to be licensed as associated persons of a broker-dealer) in connection with offering and selling shares of an investment fund.[54] When relying on this safe harbor, directors of an investment fund, or directors or employees of the investment fund's investment manager, should not receive commissions on the interests that they sell, nor should they otherwise be compensated in a manner that reflects the success of their selling efforts.[55]

Such sales-based compensation would give rise to broker-dealer registration issues under the Exchange Act. UCITS and their investment managers that wish to rely on Rule 3a4-1 to avoid registration should review the rule in detail in light of all the facts and circumstances, including the organizational structure of the UCITS.

2. New Issues

To the extent a UCITS will participate in "new issues" of securities, the requirements of FINRA Rule 5130 may apply. The term "new issue" generally refers to initial public offerings (IPOs) of securities in which a member of FINRA is part of the underwriting syndicate.[56] Pursuant to FINRA Rule 5130, participation in the profits and losses of investments in such new issues is subject to significant restrictions. Specifically, certain persons associated with broker-dealers and other financial-type accounts (restricted persons) are limited in their ability to participate in the profits and losses of new issues. The term "restricted person" generally includes any of the following: broker-dealers, their officers, directors, general partners, associated persons and employees, their agents engaged in the investment banking or securities business, and their immediate family members, except for broker-dealers and their employees who limit their business to the purchase and sale of investment company, variable contract, or direct participation securities; finders and fiduciaries and their immediate family members, but only with respect to IPOs in which they are involved; portfolio managers and their immediate family members; and owners of a broker-dealer and their immediate family members.[57]

While there are a number of exceptions that would allow a UCITS to invest in "new issues" under FINRA Rule 5130, there may be operational and administrative issues in implementing this investment strategy within a UCITS, including establishing a separate class of the UCITS for "restricted persons" or collecting information from subscription documentation (for example, in the US "wrapper") on "restricted persons."

E. ERISA Considerations

The Employee Retirement Income Security Act of 1974, as amended (ERISA), is the comprehensive US statutory scheme that governs the operation and administration of most private US pension and welfare benefit plans.[58] It imposes special duties on, and prohibits certain transactions by, persons who are defined to be "fiduciaries" with respect to such plans. In addition, certain provisions of the Internal Revenue Code of 1986, as amended (Code), such as the prohibited transaction rules and the tax imposed on unrelated business taxable income (UBTI) of US tax-exempt entities (discussed below), are applicable to such plans. Whether a UCITS is subject to the requirements of ERISA will depend largely on the extent to which any class of a sub-fund of a UCITS contains "plan assets."

Generally, ERISA and the Code apply to an investment manager's management of employee benefit plan assets that are subject to ERISA and/or the Code. "Employee benefit plans" include both employee pension benefit plans and employee welfare benefit plans. Employee pension benefit plans are plans, funds or programs maintained by an employer, an employee organization or both that provide retirement income to, or result in a deferral of income by, employees.[59] Employee welfare benefit plans are plans or programs that provide medical, hospital, accident, death, disability or similar benefits to employees. Certain plans, such as (i) individual retirement accounts (IRAs) under Section 408 or 408A of the Code if there is no employer contribution or other employer involvement and (ii) tax-qualified plans in which only self-employed persons and their spouses participate (Keogh Plans), are not subject to ERISA but are subject to applicable provisions of the Code, such as the excise tax on prohibited transactions and the tax imposed on the UBTI of retirement plans and other tax-exempt entities. Other plans, such as (i) governmental plans, (ii) certain church plans, and (iii) plans maintained outside of the United States primarily for the benefit of persons substantially all of whom are nonresident aliens, are not subject to ERISA or the prohibited transaction provisions of the Code. They may, however, be subject to fiduciary duty, prohibited transaction, or other similar rules under their governing law and any governing instruments.

A US Department of Labor (DOL) regulation provides that when ERISA plans invest in a pooled fund, that fund's assets will not be deemed to include plan assets if "benefit plan investors" do not own 25 percent or more of the value of any class of equity interests in the fund.[60] A "benefit plan investor" is defined to include (i) plans subject to ERISA and the prohibited transaction provisions of the Code, and (ii) any entity whose underlying assets include "plan assets" by reason of a plan's investment in the entity (generally because 25 percent or more of a class of equity interests in the entity is owned by plans). An entity described in (ii) immediately above will be considered to hold plan assets only to the extent of the percentage of the equity interests in the entity held by benefit plan investors.

For example, if ERISA plans own 10 percent of a class of shares in a sub-fund of a UCITS and IRAs own 20 percent of that class of shares, a proportionate undivided interest in such fund's assets would be deemed to be plan assets because "benefit plan investors" own 30 percent of the shares. In determining whether "benefit plan investor" ownership exceeds the 25 percent rule, the value of any equity interests held by any person who has discretionary authority or control with respect to the entity's assets or who provides investment advice for a fee, or any affiliate of such a person, will be disregarded. A determination of whether "benefit plan investor" ownership exceeds the 25 percent rule must be made after each "acquisition" of an equity interest in a fund. The DOL has taken the position that the redemption of an interest in a fund constitutes an "acquisition" triggering a determination of significant plan participation.[61]

If a UCITS allows benefit plan investor ownership of any class of shares of a sub-fund of a UCITS to exceed the 25 percent rule (and accepts at least one ERISA plan investor), the UCITS' investment manager must be prepared to comply with the provisions of ERISA and the Code to which it becomes subject as a consequence. Some of those provisions include those that: impose responsibilities and duties on persons who are fiduciaries with respect to plans subject to ERISA; prescribe the methods by which ERISA plan assets may be held outside the jurisdiction of the US district courts; require that ERISA fiduciaries be bonded; and prohibit engaging in certain kinds of transactions with plan assets.

To avoid the provisions of ERISA, many UCITS managers that offer and sell to US residents, either (i) prohibit benefit plan investors from subscribing for shares/units or (ii) collect information from all US investors through the use of a US "wrapper" to rely on the 25 percent rule exemption.

F. State Law (Blue Sky) Considerations

The individual US states also have their own securities laws and registration requirements. Although an offering of shares/units of a UCITS may be exempt from registration under US federal securities laws, the US states may have different requirements.[62] Many US states have enacted private placement exemptions from their state registration requirements. These exemptions often mirror US federal law, in particular Regulation D under the Securities Act. In addition, the National Securities Markets Improvement Act of 1996,[63] among other things, preempts state securities laws and state registration requirements where issuers have relied on Regulation D, provided any required state notice filings have been made and applicable fees paid. Once sales in a state begin, a UCITS should be particularly diligent about compliance with these filing requirements. Failure to timely make the required state filings can result in civil liability (for example, rescission offers plus interest) and regulatory action by the state securities regulator (for example, penalties and injunctive relief against the issuer).[64]

G. Other Material Considerations

Part 2 of this Article will highlight a number of other significant considerations for promoters of UCITS considering offering shares/units of a UCITS to the US institutional market in the post Dodd-Frank Act era. As a result of Commission rulemaking, the registration provisions under the Advisers Act (and the applicable exemptions thereunder available to managers of UCITS that wish to undertake an offering in the US) have significantly changed since the passage of the Dodd-Frank Act. In addition, the regulatory landscape for registration as a commodity pool operator and a commodity trading adviser continues to change at a rapid pace. Many of the exemptions previously afforded to UCITS by the CFTC no longer exist.[65] In their wake, a complicated maze of regulation has surfaced along with new inadvertent applications of US law. Part 2 of this article will explore in further detail recent US regulations that should be considered by UCITS promoters before entering the US market, including the application of Form PF, the Volcker Rule, the Foreign Account Tax Compliance Act of 2009 and certain other material considerations.

Notes

1. Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

2. Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities OJ No. L 375, 31.12.1985, at 3, as amended by Directive 88/220/EEC, OJ No. L 100, 19.04.1988 [hereinafter UCITS I Directive].

3. As UCITS I did not define the term "transferable securities," such term was interpreted to mean listed bonds and equities. UCITS I required UCITS to invest 90 percent of their assets in transferable securities while the remaining 10 percent could be invested in certain other investments. *See id.*

4. Commission of the European Communities, Green Paper on the Enhancement of the EU Framework for Investment Funds, at 24 (July 12, 2005); *see also* UCITS I, art.1(2). For example, UCITS could not invest for speculative purposes in, among other instruments, shares of other funds, derivative products, or money market instruments. Moreover, generally no more than five percent of a UCITS' assets could be invested in a single issuer, absent an increase in this level authorized by an individual Member State.

5. *See* UCITS I Directive, at 2.

6. Christopher D. Christian, *UCITS Outside Europe*, Law and Regulation of Investment Management (Sweet & Maxwell ed., 2d ed. 2011).

7. *Id.*

8. Directive 2007/16/EC amending Council Directive 85/611 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities as regards the clarification of certain definitions OJ No. L 79, 20.3.2007.

9. *See* Directive 2001/108/EC, modifying Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, with regard to investments of UCITS OJ No. L 041, 13.02.2002.

10. Directive 2009/65/EC of the European Parliament and the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) OJ No. L 302 of 17.11 2009 [hereinafter UCITS IV Directive].

11. Directive 2001/107/EC amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities with a view to regulating management companies and simplified prospectuses OJ No. L 041 13.02.2002.

12. UCITS IV Directive, *supra* n.10.

13. Christian, *supra* n.6.

14. Investment Company Institute, *Worldwide Mutual Fund Assets and Flows* (July 5, 2012), available at *http://www.ici.org/research/stats/worldview/ww_03_12* (last visited July 13, 212).

15. 15 U.S.C. § 77e (2011).

16. 15 U.S.C. § 80a-3(c)(1) (2011); 15 U.S.C. § 80a-3(c)(7) (2011).

17. 15 U.S.C. § 77e(2011).

18. *See, e.g.*, SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

19. *Offshore Offers and Sales,* Securities Act Release No. 6863, 55 Fed. Reg. 18306 (May 2, 1990).

20. *See id.*

21. *Id.*

22. *See* 17 C.F.R. § 902(h)(1)(ii)(B)(3) (2012); 17 C.R.R. § 902(k)(2)(i) (2012).

23. However, Rule 902(k)(2)(i) does classify "any discretionary account or similar account (other than an estate or trust) held for the benefit or account of a non-US person by a dealer or other professional fiduciary organized, incorporated, or (if an individual) resident in the United States" as a non-US person for purposes of Regulation S, and thus direct sales are permitted in this class of investors. 17 C.F.R. § 902(k)(2)(i) (2012).

24. *See* Goodwin, Proctor & Hoar LLP, SEC No-Action Letter (Feb. 28, 1997); *See also* Wilmer, Cutler & Pickering, SEC No-Action Letter (pub. avail. Oct. 5, 1998); Treas. Reg. § 1.864-2(c)(2)(iii).

25. 15 U.S.C. § 77d(a)(2) (2011).

26. Section 4(2) is a "self-executing" exemption, meaning that no regulatory filing or approval is required at the federal level in order for an issuer conducting a private placement of securities to rely on the exemption. The courts, however, have construed this exemption narrowly, and the issuer has the burden of proof to demonstrate that the offering qualifies under Section 4(2). *Id.*

27. The courts have generally looked at a combination of some or all of the following factors to determine whether a particular offering qualified under Section 4(2): (i) the nature of the investors (*i.e.*, whether the investors were financially sophisticated); (ii) the relationship between the investors and the issuer; (iii) the number of investors; (iv) the access to information about the issuer; and (v) the manner of the offering (whether there was any general solicitation of, advertising with respect the offering). *See, e.g.,* SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953); Western Federal Corp. v. Erickson, 739 F.2d 1439 (9th Cir. 1984); SEC v. Murphy, 626 F.2d 633 (9th Cir. 1980).

28. 17 C.F.R. § 230.506 (2012).

29. *But see* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (Apr. 5, 2012) (JOBS Act). Section 201(a) of the JOBS Act requires the Commission to revise Rule 506, no later than 90 days after the enactment of the Act, to provide that the prohibition against general solicitation and general advertising for offerings, contained in Rule 502(c), shall not apply to offers and sales of securities made pursuant to Rule 506, provided that all purchasers of such securities are accredited investors. Until Rule 506 is amended by the SEC, as directed by the JOBS Act, Rule 506 remains unchanged. Once the Commission completes its rulemaking, an issuer or a person acting on behalf of an issuer will be able to promote the sale of a security through a general solicitation or general advertising without registering the security under the Securities Act, provided the other requirements of Rule 506, as amended, are satisfied. In addition, since Section 4 of the Securities Act specifies that offerings made pursuant to Rule 506 will not be deemed to be public offerings under the full range of the federal securities laws, reliance on the revised Rule 506 would satisfy the restrictions on public offerings found in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. *Id.*

30. 17 C.F.R. § 230.506 (2012).

31. 17 C.F.R. § 230.500 (2012).

32. 15 U.S.C. § 80a-7(d) (2011).

33. *Registration of Foreign Investment Companies Under the Investment Company Act of 1940 – Commission Policy and Guidelines for Filing of Application for Order Permitting Registration Under the Act and Sale of Shares in the United States*, Investment Company Act Release No. 8959, 40 Fed. Reg. 45224 (Sept. 26, 1975).

34. *Id*. Such requirements include, among others, that the applicant should: (i) have been in operation for at least three years; (ii) have, at the time of registration, at least $50 million in net assets and at least $25 million in net assets while it offers its shares for sale in the United States; (iii) have, at the time of registration, at least 500 shareholders who are residents of the country in which the applicant is organized and the value of whose aggregate investment is at least $25 million; (iv) limit the number of shares to be sold to US investors to 50 percent of its total outstanding shares at the time of sale; and (v) have more than 60 percent of the value of its portfolio invested in securities of issuers in the country under the laws of which such applicant is organized or at least 75 percent in securities of non-US issuers.

35. *See* Touche, Remnant & Co., SEC No-Action Letter (Aug. 27, 1984).

36. *See* SEC No-Action Letters, *supra* n.24.

37. 15 U.S.C. § 80a-3(c)(1) (2011).

38. Note, however, that an investment adviser registered with the SEC that advises a private investment fund relying on Section 3(c)(1) would have to require each investor to be a "qualified client" if the adviser charges each investor a performance fee or allocation. Pursuant to Rule 205-3 under the Advisers Act, a "qualified client" means the following:

(i) a client with at least $1,000,000 under management with the adviser;

(ii) a client that has a net worth of $2,000,000 or more (excluding the value of the client's primary residence and generally including only the portion of the client's mortgage or other debt secured by the client's primary residence that exceeds the estimated fair market value of the residence);

(iii) a client that is a "qualified purchaser," as more fully described in this article;

(iv) a client who is an executive officer, director, trustee, general partner, or serves in a similar capacity, of the adviser; or

(v) a client who is a non-clerical employee of the adviser who regularly participates in the adviser's investment activities and has performed such functions or substantially similar functions for at least 12 months.

39. The Dodd-Frank Act required upon its passage that the value of a natural person's primary residence be excluded in determining whether the individual net worth of that person (or the joint net worth with the spouse of that person) exceeded the $1 million dollar test for being an accredited investor under Regulation D. Prior to the Dodd-Frank Act, the value of the person's primary residence was included in the calculation of net worth to satisfy the $1 million minimum requirement. *See* Pub. L. No. 111-203, 124 Stat. 1376, 1577 (July 21, 2010); *see also* 17 C.F.R. § 230.501(a) (2012).

40. *See* Investment Funds Institute of Canada, SEC No-Action Letter (Mar. 4, 1996) [hereinafter IFIC Letter].

41. *See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Investment Advisers Act Release No. 3222, 76 Fed. Reg. 39646 (July 6, 2011) ("[W]e understand that, based on no-action positions taken by our [S]taff, non-US funds do not consider for purposes of section 3(c)(1) beneficial owners who were not US persons at the time they invested in the fund, but do consider those beneficial owners if they make additional purchases in the same fund after relocating to the United States.").

42. 15 U.S.C. § 80a-3(c)(7).

43. Very generally, the term "investments" encompasses assets that are held for investment purposes only. However, there are very specific parameters that define the term. For example, to the extent that cash is held for investment purposes, it may be included in the definition of investments for purposes of Section 3(c)(7). 17 C.F.R. § 270.2a51-1 (2012).

44. 15 U.S.C. § 80a-3(c)(7).

45. *See* 15 U.S.C. § 80a-2(a)(51)(A)(iii) (2011); 17 C.F.R. § 270.2a51-1 (2012).

46. *See Registration Under the Advisers Act of Certain Hedge Fund Advisers*, Investment Advisers Act Release No. 2333, 69 Fed. Reg. 72054, at n.226 (Dec. 10, 2004).

47. Touche, Remnant Letter, *supra* n. 35.

48. IFIC Letter, *supra* n.40.

49. Section 501 of the JOBS Act amended Section 12(g) of the Exchange Act to increase from 500 to 2,000 the permissible number of shareholders a company may have before it must register its equity securities with the Commission, so long as no more than 499 of such shareholders are non-accredited investors. Pub. L. No. 112-106, 126 Stat. 306, 325 (Apr. 5, 2012).

50. 17 C.F.R. § 240.3b-4 (2012).

51. 17 C.F.R. § 240.12g3-2 (2012).

52. 15 U.S.C. § 78c(a)(4) (2011).

53. *Id.*

54. 17 C.F.R. §240.3a4-1 (2012).

55. *Id.*

56. *See Order Approving Proposed Rule Change Relating to Adoption of NASD Rule 2790 as FINRA Rule 5130*, Exchange Act Release No. 58421, 78 Fed. Reg. 51032 (Aug 29, 2008).

57. 17 C.F.R. § 240.3a4-1 (2012).

58. Pub. L. No. 93-401.

59. *Id.*

60. 29 C.F.R. § 2510.3-101 (2012).

61. *See* Department of Labor Advisory Opinion No. 89-05A.

62. *See generally* National Securities Market Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (Oct. 11, 1996).

63. *Id.*

64. Christopher D. Christian, "State Regulation of Non-U.S. Investment Advisers and Portfolio Managers," in Regulation for Asset Managers Outside the United States 321 (Sweet & Maxwell ed., 2008).

65. *See e.g.,* Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 77 Fed. Reg. 11252 (Feb. 24, 2012) (rescinding Rule 4.13(a)(4)).