THE INTERNATIONAL COMPARATIVE LEGAL GUIDE TO ALTERNATIVE INVESTMENT FUNDS 2021

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Alternative Investment Funds 2021

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Dechert LLP

Industry Chapter

Expert Analysis Chapters

Q&A Chapters

Preface

Dear Reader,

We are pleased to introduce *ICLG – Alternative Investment Funds 2021*. As practitioners, we play our part in ensuring that the industry runs efficiently, that it adapts to (and indeed helps to shape) the changing legal and regulatory landscape, and that new technologies and techniques are harnessed. This guide offers a wealth of expertise on these issues across 22 jurisdictions, in addition to four expert analysis chapters on a range of topics, and we would like to wholeheartedly thank all of the contributors.

Gus Black & Tricia Lee
Dechert LLP

The State of Play for the Alternative Investment Industry in 2021 and Beyond

AIMA

Jack Inglis

Introduction

For many investors, the traumatic events of 2020 provided a perfect case study on the value of alternative funds as a way to diversify their investment portfolio, mitigate beta risk and achieve uncorrelated returns. When COVID-19 first spread around the globe in Q1 2020, there was no escaping the turmoil; it was simply a question of how hard you were hit. The hedge fund industry, for its part, was able to insulate investors from the worst of the dramatic plunge in major equity indices. March alone brought volatility that dwarfed the worst days of the Global Financial Crisis, contributing to the S&P 500 and the FTSE 100 falling by 20% and 25% in value over the quarter, respectively. This compares with average losses of 10.46% for hedge funds over the same period, according to data from Preqin.

The data provider's report for Q1 2020 shows that the diversified model of fund-of-funds fared better than average, limiting losses to -6.12%, while CTA funds, with investment strategies comparatively uncorrelated to equity markets, on average, achieved modest positive returns for the quarter. Simply put, pension funds, endowments and other institutional and accredited investors with alternative investments in their portfolio during this period weathered the volatility far better than those subscribing to a classic 60/40 model.

Moreover, a year later hedge funds reported their best H1 performance since 1999, according to Hedge Fund Research's main Fund Weighted Composite (FWC) Index, which advanced +10.0% through the first six months of 2021. In the trailing nine-month period ending June 2021, the FWC has surged 22%, representing nine consecutive months of gains, the longest period since the index produced 15 consecutive positive months ending January 2018.

This strong performance has also led to assets under management (AuM) for the hedge fund sector reaching record highs, due to a combination of positive returns and fresh in-flows adding to overall AuM. Inflow for 2021 up to May reached around $57.8 billion, erasing outflows of roughly $23.4 billion for 2020, according to the latest Investor Intentions report by AIMA and HFM Global. As a result, the global hedge fund industry now manages more than US$4 trillion as of Q3, an all-time high.

More broadly, the alternatives asset industry is projected to grow from US$10.7 trillion this year to some US$17 trillion by 2025, according to Northern Trust,[1] as investors seek new sources of alpha and diversification options.

The fastest-growing subset of the broad alternatives sector is private equity, which has bloomed over the past decade and is predicted to thrive in the post-COVID market recovery environment. Specifically, private asset funds, a further subsection of this community, are well-positioned to offer much-needed financing options to the many small and medium-sized companies that fall outside the risk appetite of traditional lenders despite being successful businesses. One impact of COVID-19 is that there is likely to be an increase in these types of borrowers, with losses from COVID-related lending likely to further reduce the capacity of the banking sector to provide credit. Private credit market participants are supported and represented by AIMA's Alternative Credit Council (ACC).

Despite the impressive headline figures around performance and inflows, the alternative assets industry remains bedevilled with a wide variety of challenges ranging from increased regulatory scrutiny in the US, Europe, the UK and elsewhere, through to talent retention and operational hurdles; not to mention adjusting to the new post-COVID environment. In 2021, hedge funds and other alternatives industry participants find themselves in a world grappling with difficult questions around ESG, disruptive technology, such as DLT and cryptocurrencies, as well as the rapidly growing demographic of retail investors.

Growing Confidence

Looking ahead, our market research indicates that hedge funds are cautiously optimistic about their performance for the remainder of 2021. In AIMA's Q1 Hedge Fund Confidence Index,[2] produced in partnership with Simmons & Simmons and Seward & Kissel, more than 300 funds (accounting for approximately US$1 trillion in collective AuM) were asked to pinpoint their confidence in the economic prospects of their business over the coming 12 months on a scale of -50 to +50. The result was an average measure of +18, which marked a modest uptick from the previous quarter's index result of +14.

Larger funds (classified as respondents managing assets of more than US$1 billion) were on average more bullish than their smaller peers. Funds above this threshold had an average confidence score of +19.4, compared to +17.2 for those with less than US$1 billion AuM.

By region, funds based in North America boasted the highest average confidence score (+19.6), while those from the UK have the lowest average score (+16.4) – although all regions were clustered around this quartile of the scale.

Meanwhile, confidence will no doubt have been buoyed by the results of AIMA's latest Investor Intentions survey, which revealed that 90% of respondents were satisfied with the performance of their hedge fund investments in 2020, while 40% plan to increase the allocation to alternative funds this year.

Adapt and Thrive

From a hedge fund investor's perspective, the pandemic may have had little effect on the day-to-day allocation strategy,

assuming their fund(s) performance was satisfactory. But, for fund managers, the rapid switch to remote working posed a host of additional middle and back-office challenges.

Much like other businesses, hedge funds were forced to adopt decentralised working practices almost overnight. This meant navigating the myriad compliance, technical, operational, and team-management pitfalls that came with it. Prominent issues included ensuring employee welfare and suitable cybersecurity and data management policies were in place, as well as maintaining operational due diligence and other investor relation (IR) functions in a fully digital forum.

AIMA's research from July 2020 unsurprisingly found that that the vast majority of our members were prioritising investment in digital infrastructures and IT capabilities.

Half of the 144 managers surveyed last year as part of AIMA's Agile and Resilient report said they were investing in cybersecurity and one in three firms say they are building a central data warehouse to facilitate their firm's data analysis and reporting. The next edition of the Agile and Resilient report series, completed in partnership with KPMG, is due in September and this theme of technology investment is expected to remain prominent.

Likewise, hedge fund IR teams have also had to adapt to the most severe business disruption event since the 2008 financial crisis. Luckily, since then procedures have been enhanced and lessons have been learned. In part, the enhanced response of the IR function over the past year is due to the significant work that has taken place over the past decade to enhance investor reporting (depending on the strategy or fund structure, this can be as frequent as daily, monthly or quarterly), including position-level risk reporting or other forms of portfolio attribution.

Undoubtedly, the shift to the decentralised workplace has added some new complexities to the IR function. With face-to-face meetings still rare, it is not surprising that the majority (58%) of hedge fund managers surveyed for the Agile and Resilient report said they needed to optimise their use of digital tools (such as video conferencing and data rooms) within the IR function.

That being said, the lack of in-person meetings has forced many managers to rethink the way they manage investor due diligence and reporting. Around one in five said they are working to enhance the transparency and risk reporting of their underlying funds. One in 10 said they are considering offering bespoke reporting and services when it is required.

In terms of adapting strategies and products, appeal for customised arrangements, such as separately managed accounts and funds-of-one, grew further in 2020 given the greater control and transparency which these structures offer.

New partnerships are also emerging with co-investment arrangements becoming more popular across both public and private markets. Special Purpose Acquisition Companies are also being increasingly taken up by hedge funds, although more recent regulatory scrutiny and poor performance by some high-profile public listings are predicted to dampen demand somewhat going forward.

This change reflects a growing trend within the hedge fund industry as it moves away from the product-led environment of the past to a marketplace increasingly populated by more bespoke investor solutions and value advisory services.

Meanwhile, perennial pressures on fees appear to have levelled off over the past year or two, with the classic 2/20 model being replaced by a series of new fund and fee arrangements.

Performance fees across the industry continue to hold up reasonably well, with investors prepared to incentivise hedge funds that deliver for them. In Q4 2020, AIMA surveyed more than 250 fund managers and found that the average incentive fee paid to hedge funds was 17.5% of annual net profits. The average management fee was 1.35%.

Under the Spotlight

Over the next 12 months, alternative investment funds will face new regulatory headwinds, although many questions remain around just what form and scale many of these challenges will take. As such, a comprehensive review of each of these individual issues across all geographic regions is not practical in this instance, but an overview of the most prominent near-time regulatory hurdles can be offered.

Short selling

Hedge funds' successes in avoiding the severe losses seen by major indices is even more impressive given that managers invested in several European and Asian markets could not employ their primary hedging tool: short selling. The initial reaction to the turmoil by market regulators in Italy, France, Spain, Greece, Belgium and Austria, along with others in South Korea, Malaysia and elsewhere, was to impose short selling bans of various severities and durations; the last of these restrictions, in South Korea, only lifted in May 2021. The European Securities and Markets Authority (ESMA), the EU financial markets regulator, resisted public pressure to apply a blanket ban across the EU but did endorse national bans. It also halved the supervisory notification threshold under the EU Short Selling Regulation (SSR) to net positions valued at 0.1% of the issued share capital.

At the time, ESMA said the decision reflected the need for greater clarity for regulators of short selling activity during the period of volatility. The initial three-month timeframe was repeatedly extended and finally expired earlier this year. However, ESMA has now recommended to the European Commission that the threshold should be permanently set at the 0.1% level. Greater regulatory clarity may at first glance appear an easy-to-support concept, but the move has concerned market participants who argue the requirement is a major operational burden, particularly given that reports are filed at the national level, meaning there are 27 different reporting systems to navigate.

Meanwhile, in the UK, the reduced threshold was initially scrapped at the end of the Brexit transition period – 31 December 2020 – before being reinstated shortly thereafter. AIMA is in an ongoing dialogue with HM Treasury to better understand how the change of heart occurred and to represent the view of our members on this matter.

Short selling is also under scrutiny in the US, most notably as a result of the January short squeeze of GameStop and other so-called "meme stocks". The episode is understood to have been driven by retail investors joining forces to buy shares *en masse* in retail brands that held sentimental value, although there has been discussion of the role that institutional muscle could have played as well.

The furore led to a series of hearings held by the House of Representatives Financial Services Committee, and the launching of an investigation by the Securities and Exchange Commission (SEC) – which at time of writing is still ongoing. Central to the debates during the hearings were questions around whether hedge funds should be required to disclose their short positions like in the EU, and if access to this data would have helped the situation. Several committee members, including the chair, Representative Maxine Waters, are pushing the US regulator to lay down new rules to achieve greater transparency in the securities lending and short selling market, but even months on the conclusion to this drama remains unknown. AIMA has been active in sharing our perspective on the positive role that short selling plays in terms of liquidity and providing a check on corporate malfeasance while highlighting the harmful impact of public disclosure in terms of copycat trading behaviour and loss of market efficiency.

The events around meme stocks, which appear to be set to capture investor attention for some time yet, also resonated in the EU, where the SSR is likely to be reviewed later this year. AIMA has written to and met with both European parliamentarians and ESMA to discuss the role of short selling following the GameStop event and will respond to the expected ESMA call for input on this topic in the context of the SSR review.

Leverage and Liquidity

The past 18 months brought several distinct shocks within markets, which have policymakers looking very closely at the possibility of systemic risk caused by leveraged strategies. The first of these was the distortion in government bond markets, especially in US treasuries in March 2020, which required not insignificant central bank intervention, most notably by the US Federal Reserve. In the immediate aftermath, some fingers were pointing at leveraged hedge funds. Through our work with the Financial Stability Board, IOSCO, the European Systemic Risk Board, the Federal Reserve Bank and the Bank of England, AIMA has demonstrated that there are many more factors at play in determining the cause of these market events, and steered decision makers away from kneejerk reactions that may inadvertently increase market instability.

AIMA has responded to and engaged in various topical consultations, such as ESMA's consultation on liquidity stress testing and its consultation on leverage-related risks. Several roundtables were also organised last summer to discuss the impact of the March 2020 events on our members and their management of liquidity risks.

More recently, the sudden collapse of Archegos in March 2021 proved disturbingly costly to several of its prime brokers. The banks were forced to rapidly unwind leveraged equities collateral after the US family office failed to meet its margin commitments.

AIMA is now actively involved in discussions with regulators and policymakers around the topic of leverage. We do not want to see arbitrary leverage caps put in place, especially as leverage is such an elusive concept as a measurement of risk. If controls need to be tightened, then these should be deployed through basic capital markets trading structures, and their infrastructure, not at the fund level. Our discussions with central banks, regulators and policymakers on the subject have so far been constructive and we will continue to defend the use of leverage.

AIFMD

More regulatory uncertainty comes in the form of a review of the EU's AIFMD. AIMA was among the stakeholders to respond to the European Commission's public consultation in October 2020 and stakeholders are now waiting for policymakers to make a decision regarding the extent and scope of the review. The commission is expected to publish its legislative proposal in Q4 of this year. Primarily, AIMA and others are advocating that the current terms of the regulatory framework be left largely unchanged. The requirements have so far proved effective and the need for regulatory stability and certainty is paramount.

Additionally, AIMA and its ACC are working with the European Commission to provide insights and data on loan originating funds and private debt in the context of the potential integration of organisational rules for loan originating funds in the AIFMD framework.

MiFIR

ESMA is also consulting on potential changes to MiFID II and AIMA recently contributed to the discussions around algorithmic trading rules ahead of expected proposals from the European Commission later in the year.

The UK's FCA has also launched a consultation that targets changes to UK MiFID to remove the requirement to publish RTS27 and RTS28 reports on best execution and to moderate the rules on payment for research by scoping out fixed income and SME research.

SFDR

At the centre of the EU's sustainable finance action plan is the Sustainable Finance Disclosure Regulation (SFDR). This new framework is the commission's first attempt to tighten up ESG disclosures to reduce the potential for greenwashing and motivate the selection of greener investments. The first phase of SFDR came into effect on 10 March, but several months on there is still a lively debate about how to read some of the key terms in the legislation.

Steven Maijoor, chair of the European Supervisory Authorities joint committee, penned a letter in early January to the European Commission seeking to resolve several areas of ambiguity and facilitate an "orderly application of SFDR". Chief among these areas of concern is the interpretation of Article 8, which refers to the need for any product that "promotes" ESG to comply with additional disclosure rules. In the meantime, AIMA will continue to work in respect of SFDR Level 2 provisions and on taxonomy-alignment reporting for in-scope products and entities, which is due in January 2022.

Another part of the commission's ESG agenda was the recent Corporate Sustainability Reporting Directive proposal, which envisages a drastic overhaul of corporate sustainability reporting, significantly broadening the scope of reporting rules and pushing the concept of double materiality, which quantifies an investment's financial and wider environmental and societal effects.

In the UK, AIMA responded to the recent BEIS consultation on the UK's corporate reporting rules, which will enshrine the Task Force on Climate-related Financial Disclosures' (TCFD) standards for both listed and unlisted firms. We await further proposals on reporting requirements for investment managers, which will similarly be based around the standards (an AIMA guide on TCFD reporting is in development).

The View From DC

While the EU arguably remains the front-runner in the race to develop a framework of ESG-focused rules, the US has no shortage of developments in this sector, and the mood music coming from the SEC would indicate there is much more to come. In February, a former member of the SEC's Investor Advisory Committee, Satyam Khanna, returned to the Commission as its first senior policy advisor for climate and ESG. A month later, the regulator formed a Climate and ESG Task Force in the Division of Enforcement. Its initial focus will be to identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules, with an associated call for input on corporate disclosure of climate risks published in March. The task force will also analyse disclosure and compliance issues relating to investment advisers' and funds' ESG strategies.

Since then, the leadership of the commission was taken over by former CFTC chair Gary Gensler, who has outlined ambitions to continue the momentum created by his predecessor Allison Lee. Primarily, he says firms should expect ESG-related disclosure rules, mostly focused on social issues around workforce diversity, in addition to additional initiatives focused on environmental protection.

ESG: Challenge or Opportunity? Maybe Both

Beyond existing and upcoming regulatory requirements, the introduction of ESG to investment strategies has also created opportunities for investors seeking passive and active opportunities within the alternatives assets sector.

As environmental issues and social justice movements continue to dominate the news, 2021 will see efforts ramped up to integrate ESG and sustainable investment across investment products universally. Many managers are actively seeking to address investor demands to incorporate ESG factors into the various solutions their funds' offer.

Data collected as part of AIMA's Global Hedge Fund Benchmark survey, published in March 2021, revealed that just under 60% of all hedge funds integrate ESG into investment decisions, with one in four firms stating that they are doing so to seek a positive impact through their investment decisions.

Looking ahead, a quarter of hedge funds surveyed expect to launch ESG-oriented funds over the coming 12 months. While this estimate may appear quite high, the extent of ESG incorporation will vary among hedge funds, from those that are simply screening stocks through to finding ways to invest in pure ESG strategies.

Over the same period, 8% of hedge funds are expecting to launch a new ESG strategy. This number is likely to grow over the coming years, driven by an increase in demand from investors for pure ESG products, improving ESG data sets and the wider availability of technology that makes it easier to reconcile such data.

Throughout AIMA's research and conversations with members, the question of data standards around ESG, or lack thereof, remains at the heart of many managers' challenges with adoption. Moreover, for as long as data around the sector remains sparse and unstandardised, the sustainable finance movement will be undermined by examples of greenwashing – the misrepresentation or exaggeration of ESG credentials to attract investor interest.

Concerns around greenwashing are prevalent across all business sectors, including in the community of funds with ESG strategies and products. AIMA's ESG-focused paper, *Sustainable investing: fast-forwarding its evolution* (published in February 2020), found that 41% of institutional investors surveyed saw a "significant amount of greenwashing", with a further 11% acknowledging "some greenwashing". No respondents stated that they believed only a "minimal amount" of greenwashing existed. Part of the solution to this problem will come naturally as ESG data develops and market standards crystalise, thereby allowing managers to more easily market their products in the right light. Moreover, the more pernicious examples of greenwashing will also come under increased pressure from regulatory and market forces in the years ahead.

Digital Assets

No overview of financial markets in 2021 would ever be complete without reference to the digital assets industry. Cryptocurrencies and the broader digital asset ecosystem have seen significant rises in the past year as well as high levels of volatility in recent weeks. Though, like any asset, volatility can bring opportunity as well as risk.

In the first quarter of this year, before the most recent period of heightened market movements, AIMA's Digital Assets Working Group surveyed around 40 "traditional" hedge funds with a combined US$180 billion in AuM. We discovered that around a fifth of hedge funds are currently investing in digital assets with on average 3% of their total hedge fund AuM invested. Diversification and exposure to a new value creation ecosystem are cited as key drivers for these investments. Just under 90% of those hedge funds intend to deploy more capital into the asset class by the end of 2021. Moreover, around a quarter of managers who are not yet investing in digital assets confirmed that they are in late-stage planning to invest or looking to invest. The most common rationale given for not already entering the digital assets market included regulatory uncertainty and client reaction or reputational risk. More than two-thirds of funds also said the scope of their current investor mandate precluded them from investing in digital assets.

Given the recent volatility in the market, it is perhaps foolhardy to predict prices, but we remain confident that the market infrastructure and service provider stack will continue to mature and would expect further institutionalisation of the asset class.

Endnotes

1. https://cdn.northerntrust.com/pws/nt/documents/asset-servicing/from-pressure-comes-diamonds.pdf.
2. https://www.aima.org/educate/aima-research.html.

Jack Inglis, chief executive officer of AIMA, has been in the financial services industry and closely involved with hedge funds for over 30 years. He has held senior management positions at both Morgan Stanley, where he served for 16 years, and Barclays, where he was prior to joining AIMA. From 2007 to 2010 he was CEO of London-based hedge fund manager Ferox Capital Management. He served as a non-executive director of London Capital Group plc from 2007 to 2010 and currently sits on the board of the Chartered Alternative Investment Analyst Association (CAIA). He began his career in 1983 at UK stockbrokers James Capel (which was subsequently acquired by HSBC) and has extensive experience in origination, distribution, financing and trading across the fixed income and equity capital markets. He holds a Master of Arts in Economics from Cambridge University.

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The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than US$2 trillion in hedge fund and private credit assets.

AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry.

AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 200 members that manage US$450 billion of private credit assets globally.

AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

www.aima.org

Three Trends in Private Funds


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Customisation and Allocation

A number of developments over recent years have changed the way that fund sponsors and investors view the allocation of investment opportunities and participation therein by multiple fund vehicles.

More funds investing alongside one another

Many investors have been seeking to consolidate their investments with a small set of trusted sponsors with whom they have existing relationships (a trend that has been accelerated by the COVID-19 environment). Sponsors have responded by offering a plethora of investment solutions. Put simply, sponsors are forming more funds. Sometimes, additional funds focus on very different strategies (which can create internal competition for investor capital). However, often there is some overlap in investment mandates. For example, a sponsor might manage a global credit fund, a European-focused credit fund, and an ESG-focused fund – all of which could potentially be interested in debt issued by a German wind farm. In addition, when a sponsor pursues both equity and credit strategies, the due diligence that it performs on a particular portfolio company might be useful for both investment mandates, and there might be a compelling argument for both funds to invest. This has resulted in an increase in the number of deals co-invested across multiple funds managed by a sponsor, as well as instances where different funds make investments in different layers of the capital stack of a single company.

More bespoke investor arrangements

Investors are now increasingly demanding bespoke arrangements with an underlying manager in the form of funds-of-one, separately managed accounts that co-invest alongside the sponsor's blind-pool funds, customised allocations, co-investment and direct investment programmes, note issuances instead of fund investments or other arrangements. The co-investment participation is either based on a strategy allocation set by the investor or determined by the investor accepting or declining to participate in a particular investment. The increase in the number of investors having an "opt-in" or "opt-out" right has led to greater uncertainty regarding what the ultimate allocations will be between that co-investment vehicle and the sponsor's other funds.

To meet other investors' recent demand for exposure to more bespoke strategies, sponsors have responded by forming "overage funds", which participate in excess allocation. Such funds can be used to syndicate portions of deals that are too large to sit in the fund in their entirety. While it is possible to structure these overage funds to participate in deals based on a set formula (such as participating a fixed ratio based on commitments to the main fund and overage fund or participating in the entire excess opportunity over a fixed dollar amount), fund sponsors are increasingly desiring flexibility to take a more holistic approach with respect to allocations.

Result: the importance of allocation policies

As a result of this proliferation of investment strategies by sponsors and this desire for tailored and diverse investment mandates by investors, there has recently been a shift away from the classic "exclusivity" model (where a particular fund would be presented with all applicable investment opportunities during its investment period) toward an "allocation policy" model (where the sponsor's internal policy determines whether and to what extent one or more funds or other vehicles will participate in a particular investment opportunity).

Under the "allocation policy" model, there is a further trend away from formulaic allocation approaches toward methods that grant the sponsor a greater measure of discretion to make the allocation decision. This raises the question: who will make such decisions, and what factors should they take into account in so doing?

In order to give multiple funds exposure to good deals, some fund sponsors have recently followed the approach of co-investing the vast majority of their deals across funds in their platform. As a result, the fund documents for these sponsors also include a pre-approval for one of its funds to acquire an asset with the view to transferring all or a portion of the investment to another of its funds. The fund documents may set a prescribed formula for determining the price that is paid in connection with these transfers, which may be calculated as cost plus a fixed interest rate and subject to a ceiling or a floor

(depending on whether the fund is the buyer or the seller). Any income generated will need to be addressed, along with other issues (such as the apportionment of origination fees or original issuer discounts in the context of a credit fund).

Affiliated Service Provision

Along with branching into new investment strategies, over recent years we have seen more fund sponsors explore greater vertical integration by providing investment-level services that have historically been undertaken by unaffiliated third parties.

While it has been a typical practice for real estate fund sponsors to have affiliated development companies or property managers, similar types of relationships are now becoming more common in the private equity, venture capital and credit sectors. For example, there has been a rise among credit fund sponsors that use affiliated loan servicers or collateral agents or other businesses that provide country-specific functions depending on where the borrowers are located. In addition, in the venture capital realm, affiliated businesses may provide commercialisation services to tech companies in which the funds invest.

While some fund sponsors have established these businesses from the ground up, others have acquired third-party servicers with whom they have built alliances or otherwise had long-standing relationships. In the latter case, these affiliates usually operate as standalone businesses, which provide services to companies regardless of whether or not any of the sponsor's funds are invested. In the former case, the affiliates are more likely to act as a "captive" service provider, which is solely engaged with respect to a fund's investments.

The proposition to investors is often that these affiliated service providers have specialised knowledge and expertise and are able to execute transactions pursuant to the exact specifications desired by the fund sponsor, and often for less cost to the fund than would be the case if a third party provided the services. On this basis, fees charged by these affiliated service providers are borne by the fund.

Investors are understandably cautious about multiple fee streams going to the sponsor. However, when it can be demonstrated that such services would otherwise have to be resourced externally, perhaps at higher cost, services by affiliates can be a compelling value proposition. This needs to be backed up by specific disclosure regarding the parameters of the services that will be provided and details of the fees received in return. Certain fund sponsors have included disclosures about the potential for these arrangements in their fund documents, even if none are currently being contemplated, just to provide flexibility for if they decide to form such affiliate service providers in the future. Such disclosures need to be carefully considered in the context of regulatory requirements and prior regulatory enforcement action in relation to disclosure issues.

End of Life Lessons

Any established fund sponsor that has managed several vintages of closed-end funds has learned a lesson or two about the fund liquidation process.

As background, the typical closed-end fund structure contemplates a specified term (let's say, 10 years) with the possibility for a limited number of one-year extensions in the general partner's discretion, which may or may not require consent of the investors. In the ideal world, all of the fund's investments will be sold within the normal term or any extensions. However, there are many funds that end up holding assets for which there is no readily available market at that time. In addition, certain funds may become stuck holding a receivable, litigation claim or other asset that is unlikely to pay out for a number of years. This scenario can present the fund manager with difficult decisions about how long to hold onto such assets, and how much time and resources to devote to trying to monetise them.

This context can lead to the problem of "zombie" funds (i.e., where management fees are charged for managing assets that do not have a foreseeable prospect for realisation). Investors have responded to this by focusing on fees charged during the liquidation period, and have in some cases asked for a hard cut-off date for paying management fees or required that an investor consent must be obtained in order for management fees to continue.

Fund sponsors have been focusing on how to avoid the situation altogether. Recently, there has been a trend to incorporate provisions into fund documents that seek to avoid a repeat of difficulties encountered during prior funds' liquidations. Such provisions may include:

- *Liquidating trust.* Fund documents can include specific authorisation for the establishment of a liquidating trust into which any or all of the remaining assets are transferred and in respect of which the fund's investors are beneficiaries. A similar approach is available for escrow accounts when the asset being held is cash that is subject to a repayment risk (which makes it inappropriate to distribute to the investors). The fund documents generally provide that the liquidating trustee or escrow agent will have full power and authority to sell assets and settle liabilities and that the trust or escrow agreement will require all fees and expenses incurred in connection with its organisation, management and ultimate termination thereof to be borne by the investors. This allows the fund to wind up its affairs, while keeping control of the problematic positions. It can provide important flexibility in some circumstances.
- *Secondary transactions.* Fund documents often now include authorisation for the general partner and/or the manager to seek secondary purchasers (or engage placement agents to find them) for acquiring (i) the limited partners' direct interests in the fund, and/or (ii) a pool of underlying portfolio companies. While secondary transactions have been on the rise in recent years, a clear authorisation under the fund documents can help set certain parameters (such as how costs are borne, what the timing is for notice for participating in secondary transaction and other terms relating to the relevant procedures), which would otherwise need to be addressed by other mechanisms (e.g., approval from the fund's advisory board). A secondary transaction can be the cleanest approach for neatly wrapping up a fund, if there is an appropriate buyer who offers the right price.
- *Continuation funds.* There is a nascent trend for including authorisation in the fund documents for the organisation of a successor fund or other affiliated investment entity to hold or acquire some or all long-tail assets to achieve a liquidity event for the fund (including through a merger or sale of assets). These affiliated investment vehicles can provide appropriate solutions if there is an expectation for significant increases in the value of the assets, but under a time horizon that is too far out for the current investors. That said, such transactions would typically give the current investors the option to participate in the other vehicle in order to access the future gains on the asset, while the sponsor would be able to "crystallise" its carried interest in the fund being liquidated.

Other sponsors take the view that it is extremely difficult – and perhaps counterproductive – to seek to legislate for all scenarios, and such matters are best addressed with the fund's advisory board and/or investors as a whole at the relevant time. Many investors would share this view.

Gus Black, co-chair of Dechert's global financial services group and a member of the Policy Committee, focuses his practice on investment funds (emphasising private equity, debt and hedge funds), establishing and restructuring international asset management businesses, corporate and commercial transactions in the asset management sector and general UK financial services regulation.

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Fund Finance: 2020 Year in Review

Cadwalader, Wickersham & Taft LLP

Michael C. Mascia

It was almost Valentine's Day. We were in Miami at the Fund Finance Association (the "FFA") conference at the Fontainebleau Hotel. Magic Johnson had given what amounted to a stand-up comedy routine and then we all went outside laughing on the veranda for cocktails. The weather was perfect. Hillary Clinton had spoken the day before; David Rubenstein of the Carlyle Group had given arguably the best presentation in the history of the FFA. All of us were gushing optimism and our businesses were absolutely humming. On the veranda, I tried to convince Jeff Johnston, the Chairman of the FFA and the Head of Asset Management at Wells Fargo, that next year we should hire a great band – I suggested Darius Rucker – and have a charity concert to raise money for non-profit Project Sunshine as part of our FFA Cares initiative. Um. Did I mention there were cocktails? Perhaps COVID originated to temper my froth. As it turns out, we were lucky to even have a conference at all.

By February 24th, the pull back in the equities market had arrived with a jolt, and all our travel plans were cancelled. The markets vacillated wildly thru early March, with multiple limit up and limit down days whipsawing the NYSE. By March 20th, "WFH" had made Urban Dictionary and the FFA had postponed the European conference, which had been scheduled for June. And then the press assault on fund finance commenced. It started with articles suggesting private equity funds were accelerating capital calls, threatening already impaired limited partner liquidity. The denominator effect was going to cut off all fund formation. And then on March 31st, the now infamous article in Private Funds CFO titled "*LP defaults 'already happening.' Here's why, and what GP's options are*" hit our inboxes.

As if our April was not going to be busy enough doing KYC on all the qualified borrowers being joined to subscription facilities, a tsunami of information requests crashed down from senior management and risk departments at the banks. Every banker's calendar became blanketed with senior management presentations on the perceived risks in their portfolios (such overblown risks having been both forecasted by young members of the press without actual transaction experience and their likely impact embellished as systemically catastrophic by long-time private equity professor and critic Ludovic Phalippou).

What happened next made me very proud to be a part of the FFA. Jeff Johnston called a board meeting. The agenda: how can we get accurate information out to the market to redirect the inflammatory and misleading narrative? The response? The FFA Board members converted into walking whirlwinds. Jeff recorded a podcast with me where he shared Wells Fargo information that, despite the massive economic dislocations, the bank had not yet seen a single exclusion event from an institutional investor in its vast portfolio. At Cadwalader, we shifted Chris van Heerden from legal work to market analysis, and each week *Fund Finance Friday* put out written updates and video clips confirming the credit resilience of the fund finance market. Nick Mitra, the Vice Chairman of the FFA and Head of Fund Finance – US at Natixis, led a major initiative, somewhat akin to squirrel herding, whereby he organized group calls of all of the FFA sponsors, almost all of whom attended and continually reported near perfect funding performance by limited partners. On these calls, Mary Touchstone and Jocelyn Hirsch, leading borrower-side attorneys, confirmed that their fund clients were operating effectively and that their investors were funding capital calls, even out of China. Blackstone, TPG and Goldman Sachs participated, all projecting calm and confidence. Then on April 9th, the FFA, with extensive input from FFA board members Jeff Maier, Terry Hatton and Tina Meigh, published a COVID-19 market update response addressing the negative press and setting straight the actual facts, as reported by the FFA sponsors on the update calls. That piece became widely circulated throughout the market, and has even been referenced in quarterly bank earnings announcement calls. By April 15th, *The Drawdown* ran a headline: "*Nothing to see here: LP defaults are fake news.*" Narrative corrected. Mission accomplished. The market steadied.

Truly great and impactful (and unpaid) industry leadership by Jeff Johnston and Nick Mitra during a time of real crisis. On behalf of the fund finance industry, thank you gentlemen.

However, steady did not exactly mean calm. While the leveraged finance and real estate markets hibernated in the second quarter, fund finance transaction volume exploded (Tiger King had ended so people were able to return to business I guess). April and May were incredibly busy; deal volume and portfolio maintenance at record levels. Prospective NAV financing calls dominated the days, as sponsors sought solutions to get liquidity into stressed portfolio companies. And the subscription finance market was full out. We all assumed that the increased flow was largely demand pulled forward; that is, deals that in the normal course that would have closed later in the year were being accelerated into early closings while financing remained available. That seemed validated to some extent in August and early September, as deal volumes moderated a good bit to a more familiar pace. But it was not the whole story.

During the summer, a giant injection of fiscal stimulus had reached the pockets of both individuals and (mostly) small businesses in the United States. Many local governments eased stay-at-home mandates and the consumer started buying things beyond toilet paper. And for those of us that thought Ben Bernanke had pushed the limits of aggressive monetary policy, Jerome Powell pulled the ultimate "hold my beer." The Fed ensured savers would earn no yield in fixed income for the foreseeable future and injected an elephant's worth of liquidity into the market (just commentating here, not criticizing: most

global markets reacted with a standing ovation). Fund finance was no different. The summer's policy maneuvers buoyed the equity markets and in turn investor and banker confidence, thus drawing back into the market many of the banks that had sat on the sidelines for the crisis' early innings.

And then came the autumn. With the benefit of hindsight, the stars seemed to have aligned in a way that should have completely constricted our pipeline. COVID infections spiked, and then spiked again month-after-month. Quarantine orders were reinstated, including in large metro areas like London and San Francisco. Fund formation had leveled off materially, with Preqin reporting a first half decline of 26% year-over-year, reducing opportunities. Social justice issues took center stage, rightly taking our attention from business as usual to more immediately pressing societal needs. And as if needing to pile on, the U.S. Presidential election and Brexit negotiations developed quite an unfortunate animosity and attempted to monopolize mindshare. The FFA had to again postpone its European and Asia conferences, ultimately converting them instead to a virtual program.

And yet fund finance deal flow, ever the salmon immune to the upstream, accelerated mightily again. In November and December, Cadwalader opened new fund finance matters at a pace that set two straight consecutive monthly records. Many of the lenders active in the market grew loan outstandings extensively during the fall, well into double digits. Even some of the banks that paused originations in the second quarter put on so much volume in the fourth quarter that they ultimately outperformed their 2019 results by a material spread. We at Cadwalader estimate something close to $100 billion of new fund finance commitments were extended during the course of 2020, an amount far in excess of corresponding runoff.

2020 was an amazing roller coaster of a year for fund finance. The credit wherewithal of the products, not only in subscription finance but also in virtually all of the NAV lending spheres, was battle tested and proven fit for service. And while we were certainly blessed and incredibly fortunate, the pristine credit performance in such unprecedented economic dislocation is a testament to the great liquidity management of the funds and their investors as well as the prudent transactions structured by the lenders and their counsel. I doubt many fund finance bankers or lawyers have been recognized, praised or rewarded for the outstanding work they did structuring transactions that thrived through this difficult environment. But they should be.

I know the year that fund finance professionals have had; I lived it with them. They were worried their parents were going to get sick. They were worried about their personal finances. They were worried pensions would walk away from capital commitments, undermining our entire industry's underpinnings. The urgency of the matters they were called on for counsel was more intense than anything in our recent past; probably more intense than ever. Our firms all enacted hiring freezes. So, while our transaction volumes and client needs accelerated, hiring was prohibited from keeping pace. The exhaustion just had to be carried; people just had to make do. And in most cases make do from their own kitchen table while trying to help a crying nine-year-old log onto an iPad for remote learning since school had gone virtual. And yet, they steered the fund finance market to both growth and zero credit losses.

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

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GP-Led Transactions: The Investor's Perspective


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As an increasing number of funds launched in the post-global financial crisis alternatives boom mature, and as investors generally look for smoother and more regular liquidity throughout the lives of the funds to which they have exposure, managers are exploring ever-more innovative ways of providing liquidity solutions for their investors. Alongside more traditional options, including net asset value (NAV)-based borrowing facilities and preferred equity solutions (which, as well as being applied for their more traditional use of allowing further capital deployment to support a portfolio, can be used to provide some liquidity), there has been significant recent growth in the number of general partner (GP)-led secondary transactions being brought to the market. A number of potential structures have emerged to meet varying investor and manager needs, from relatively straightforward limited partner (LP) tender offers to more sophisticated continuation fund arrangements.

Why are Managers Pursuing GP-Led Solutions?

Much has been written about the merits of these transactions from the manager's perspective. Whilst they offer an opportunity to potentially enhance a fund's internal rate of return (IRR) and distribution to paid-in (DPI) ratio, just as important from a manager's point of view is the ability to retain its own exposure to quality, high-performing asset portfolios (and, increasingly, single assets) over an extended horizon (whether by extending the existing term as part of an LP-tender process or with the use of a new continuation vehicle), whilst meeting the desire of those investors who would prefer an exit to continued investment exposure with a suitable liquidity solution. Pausing or resetting the ticking clock on the fund's presumed lifecycle allows managers to avoid realising the fund's portfolio within a fixed and arbitrary timeframe, with the attendant depressive effect on values this may have. Managers may have a vision for the next stage in a portfolio company's evolution which is not consistent with the exit timing imposed by the impending termination of the fund; this is perhaps particularly likely in the context of investments made late in the fund's investment period or those which have been adversely impacted by unforeseen external events (such as the COVID-19 pandemic). Where this is additive to the portfolio (or relevant asset), GP-led transactions allow managers to raise additional capital to bring those visions to fruition in a manner that best maximises value, for example by facilitating a route to an initial public offering that the company may simply not have been in a position to achieve at the end of the original fund's term. Additionally, a new continuation vehicle or amended governance structure with a more wide-reaching investment mandate potentially frees a manager from the restrictions in the original fund agreements relating to the permitted lifecycle stage of portfolio companies.

Maintaining personal contact with premium companies over an extended horizon will be increasingly important in a world where managers are looking to create value by building and managing their portfolios as business ecosystems, leveraging the network of relationships and synergies between the companies within the portfolio. Generally, the secondaries market has shown itself to be resilient during the COVID-19 crisis with only a modest drop in activity, and it looks set to make a strong recovery in the second half of 2021 with a significant amount of dry powder available. Recent data shows that, in 2020, for the first time, GP-led transactions accounted for more than half of all secondary deals and we envisage them continuing to increase in number and complexity in the immediate and medium-term future.

The Investor Perspective

Investors themselves generally favour more active management of investments and the realisation of companies throughout the hold period of the portfolio rather than a raft of exits towards the end of a fund's life, and so GP-led secondary transactions can present an attractive commercial option for investors as well as managers. The requirement for an investor to determine whether or not it wishes to maintain its exposure to a particular asset or portfolio means that it is clearly moving away from blind pool capital to a deployment option where the investor is able to exercise its own commercial judgment as to the growth prospects of the companies which it is being invited to back on a continuing basis. Whilst the investors will inevitably be able to take much comfort from the level of experience and knowledge of the assets that the manager will have gleaned since their acquisition, and therefore its decision that there remain further opportunities to extract value from the portfolio, the investors will gain an element of control over their capital which may be attractive (particularly for those with, for example, a complementary co-investment programme which means that they have the skills and expertise to undertake a sophisticated analysis of individual portfolio companies).

However, as investors are asked to consider more and more of these transactions, it will be important for them, and those who have appointed advisory committee members of underlying funds in particular, to be aware of the implications and potential pitfalls of the different transaction structures beyond their immediate commercial drivers.

First and foremost, investors need to consider whether they, and the limited partner advisory committee (LPAC) itself, have the appropriate expertise to properly assess the implications of the proposed transactions. The complexity, form and substance of the deals that are being presented to LPACs and investors vary greatly from one to the next, and it is of course

fundamental to being able to properly evaluate an opportunity that investors understand, and are fully informed in relation to, the proposal which is being put to them. Do LPACs and investors have the experience and knowledge to raise pertinent questions and to challenge the manager on both the thesis behind the contemplated transaction and the specific characteristics of the proposal being advanced? It is important for LPACs or investor groups that they have a central role in negotiations with managers and buyers, and so they will need to ensure that they are appropriately advised on a consolidated basis from an early stage; it is far too easy for individual investors to seek their own independent advice which, whilst perhaps giving them a level of protection as to their own position, limits the scope for holistic thinking and a centralised and consistent approach to issues being raised with the manager.

Taking a step further back, investors should now have one eye on GP-led transactions when assessing the investor protection package being offered by a manager at the point of their initial commitment to a fund. At the time the majority of funds approaching maturity were established, GP-led secondaries were rarely envisaged as an option to provide liquidity and so many limited partnership agreements (LPAs) are not designed with these types of transactions in mind. Nowadays, investors should seek to ensure that they or the LPAC have all the necessary oversight and information rights to allow for any proposals advanced to be properly reviewed and consider how they wish the investor base to be involved in any process, whether via consent or consultation rights for the investor base and/or LPAC. If the LPAC is going to have a material role in the process, it should have the right to procure legal advice by engaging counsel, with this being a permitted ongoing expense of the fund. Additionally, any attempt by managers to carve out GP-led secondary transactions from the conflict provisions if certain conditions are met should be resisted. This is a particularly acute risk for co-investors who take direct positions alongside lead GPs and who expect to have tag rights in relation to any transfer by the GP, as there will often be a carve-out from the tag right for transfers to 'affiliates', which could include a continuation vehicle managed by the lead GP. Investors in multi-investor funds should also consider if and where there is scope to reference GP-leds in other contexts, for example to make any extension of a fund term conditional upon the manager exploring at that stage whether a liquidity option could be offered.

Conflicts of Interest

Given the number of stakeholders, there is a host of potential conflicts of interest that are inherent in GP-led transactions: existing investors either participating in a tender process or taking liquidity out; existing investors rolling into any new structure; new investors backing the portfolio going forward; and the GP's own stake and fee package on both sides of the transaction all need to be considered. Thus, access to information, oversight and early engagement by the manager are likely to be key considerations for investors who will be concerned to understand the commercial drivers behind the deal and the advantages each of the options on the table might present given its particular return priorities. Managers should be forthcoming with all relevant information relating to the deal and smaller investors will be keen to ensure that the manager complies with its regulatory obligations relating to equality of information *vis-à-vis* larger or strategic investors. An increasing number of deals concern more recent vintages rather than mature funds, and whilst particularly early liquidity can be an attractive prospect for some investors, clearly the rationale that additional time is required to fully maximise the value of an asset that has upside potential towards the end of a fund's life does not apply. As a result, investors will need to have a stronger focus on the true drivers of the deal and the heightened risk of conflicts arising; whether these conflicts can be effectively managed or mitigated will depend on the particular situation under consideration.

Transparency will always be crucial for investors but is of particular importance in relation to pricing and how the commercial conditions attaching to a proposal have been developed. Maximising value by achieving the best possible price for investors should be the principal aim for a manager, but inevitably there are complexities surrounding these types of transactions and investors should be on the lookout for circumstances with the potential to compromise this aim. Examples of this might include:

- Is the manager currently undertaking a primary fundraising? Is there a potential stapled commitment to that fund from a secondary buyer in the GP-led? This raises the prospect of a better bid being rejected on the basis that it does not come with the desired stapled commitment. Clearly, this risk is more acute where the terms of any such new fund are more manager-friendly than those of the existing vehicle.
- Similarly, in running the liquidity process at this stage in the first place, could the manager have one eye on freeing up capital from their investor base for this new fund; i.e. does the transaction provide the best outcome for investors or is it driven by a desire to demonstrate the delivery of returns (of itself important to supporting a fundraising) which can then be re-invested elsewhere in the manager's programme?
- Does the net carry position of the manager change even if there is no actual carry payment at the point of the transaction, i.e. are terms such as those relating to clawback, guarantees, escrow or even the headline carry rate improved under the new vehicle? GP-led transactions should not be used as a backdoor method of hiving off high-performing assets into a new vehicle with improved carried interest terms.

A robust price discovery procedure is therefore essential. Investors should expect a thorough explanation of the valuation process from the manager and may wish to consider requiring a 'fairness opinion' from an independent valuer to the effect that the price genuinely reflects the fair market value of the relevant interests. Alternatively, investors may be satisfied with auditor oversight and sign-off on the valuation and pricing process. Investors should note, however, that certain considerations other than the price, such as execution risk and suitability as a long-term participant in the manager's programme (for example, if the bidder is a competitor of the manager) may legitimately be taken into account by the manager in any GP-led process.

Maintaining Alignment

Typical blind-pool dynamics will still largely apply in the context of GP-led transactions, and so one key question for investors will be how, if at all, alignment with the manager is changing as part of the transaction. Certain transaction structures will involve the manager 'rolling over' and reinvesting any carried interest from the original fund which is generated by the transaction and, in some cases, the manager may be required to make an additional management commitment to the new vehicle (in particular where a component part of the transaction involves accessing new capital to support the manager's plans for the development of the portfolio). Investors may therefore benefit from enhanced alignment as a result (in addition to any 'soft' alignment inherent in the fact that the manager is willing to

stand behind the specific assets that are the subject of the transaction, given that it is in the best possible position to assess the position and potential of the assets). Careful consideration will need to be given, therefore, to the treatment of any carried interest on the transaction. If the manager is *not* reinvesting any carry it receives, this will fundamentally alter the conflict analysis; transactions should not be supported if they are simply trying to achieve an early payment of carried interest for the management team. Investors should also carefully consider the possible divergence in the alignment of the manager and the executive management team of the underlying asset (who are likely to only access incentivisation programmes on a full exit of the underlying portfolio).

On a related note, deal structures that do envisage the re-investment of carried interest may involve the notional payment of carry to the carry recipients (and investment returns to investors wishing to maintain their exposure) and the reinvestment of those amounts in the new vehicle. This tends to be the simplest and cheapest arrangement, and tax-exempt investors will generally be comfortable with the approach if there is no taxable event on such payments to them. This may not be the case for the carried interest recipients, however, who as individuals may have to pay tax on any amounts received and therefore only reinvest the net proceeds in the new vehicle. Therefore, if the manager is structuring to try and minimise tax leakage or if, more generally, the transaction seems disproportionately complex to deliver the underlying commercial objectives, investors will need to satisfy themselves that the proposed arrangements are justified, since there is a danger of structuring being undertaken (and significant costs incurred) purely for the carry holders' benefit or for the benefit of a particular sub-group of investors.

Liability Profile

GP-led processes should impose as little liability as possible on investors as compared with a 'stand still' position or traditional asset sale by a fund manager. A key question here is: what exactly is the role of investors or the LPAC in the process? What are they being asked to do? From an investor's or LPAC member's perspective, it will be important to ensure that their role is limited to those areas where they have a clear responsibility under the terms of the fund documentation. Ideally, they will be required only to waive certain conflicts or the application of LPA provisions rather than to positively approve the transaction or any part thereof; accordingly, the manager should define the LPAC's or investors' role as early as possible and clearly explain why it believes that is within the LPAC's mandate (where applicable). LPAC members who are involved in any decision-making process will need to ensure that they are adequately covered by the fund's exculpation and indemnity provisions (which, for LPAC members, should not be subject to any carve-outs other than in the case of fraud or bad faith). It will also be helpful if there are express limitations on any duty which may subsist for members of the LPAC to the wider investor base (typically this should be no more than to act in good faith).

When considering how liabilities are apportioned under the transaction documents, the structure of the deal will be important for the following reasons:

- In the case of an LP-tender process, as a counterparty to the sale documents, investors are likely to be required to give representations and warranties directly to the buyer of their LP interests. This contrasts with the normal position where a fund realises an asset as the counterparty and simply distributes the sale proceeds to investors (with no further action on their part). For this reason, investors need to ensure that they are not incurring undue obligations under the terms of the transaction documentation. Traditionally, private equity (PE) managers give very limited warranties on a sale of a portfolio company (typically limited to fundamental warranties relating to title and capacity), but because an LP-tender process involves the sale of partnership interests relating to a portfolio of assets rather than the assets themselves, there is a tension between the seller's ability to give warranties as an investor with no management control over the portfolio and the buyer's need to get some comfort as to the underlying investments (management of the underlying portfolio companies are unlikely to be willing to provide warranties as they are not achieving an exit). A number of solutions have been seen in the market in this regard, including the manager itself giving limited warranties (perhaps backed by any carried interest arising as a result of the transaction), but ultimately this needs to be addressed on a case-by-case basis. Investors, however, should look to avoid taking on liability for warranties and indemnities that are in excess of those it would indirectly be liable for as an investor in the fund on a normal PE asset sale.
- If the transaction involves the formation of a continuation fund, (exiting) investors will again be keen to ensure that the fund as seller is not entering into overly onerous warranties, with the starting point being that they should be in line with those on a traditional PE sale.
- The existing investor giveback obligations will be relevant in both scenarios, either in respect of warranty claims under the sale documents in the case of a purchase of a portfolio by a continuation fund or in respect of historic warranty claims in the case of an LP-tender process, so investors should be clear how the transaction will interact with such provisions. Investors will also need to consider how liabilities relating to events that occurred before the transaction and shared liabilities such as transfer taxes are apportioned under the sale documents and how any claims in relation to such matters will be enforced.

Deal-Specific Considerations

Given the variety of possible options for structuring GP-led transactions, each deal will present its own unique set of challenges and issues which an investor will have to understand and analyse. However, there are a number of common themes that investors should be alive to:

- If a continuation vehicle is being used to acquire fund assets, what are the terms on offer and how does this interrelate with the position of an investor as a participant in the existing structure? For example, to what extent are existing 'rollover' investors required to make new capital commitments to the continuation fund (to allow for further deployment into the assets) and, if there is optionality in this regard, how will they be diluted by any new capital? If additional capital is required to be committed, investors will have to carefully consider whether they want to be on risk for a further number of years, not only in respect of their original commitment but also the additional amounts, when early de-risking is possible in the alternative.
- Depending on the constitutional documents of the fund, there could be a prohibition on selling assets to entities affiliated with the manager on the disclosure of confidential information (thereby preventing effective due diligence by any buyer) or (where this is a component part of the structuring) distributions *in specie* of continuation vehicle interests. Each of these might require engagement with investors to secure the requisite amendments to fund documentation to permit the deal to go ahead

(and the voting thresholds required to approve the amendment may vary depending on the nature of the particular change); therefore the more complex the deal is, the greater the execution risk as there is likely to be a wider engagement with LPs and ultimately an investor or small group of investors could effectively hold a veto right over the consummation of the transaction.

- Are investors confident in the manager's ability to manage the assets to the next stage in their lifecycle and ultimately deliver the growth that underpins projected investment returns? This will be particularly acute where a manager originally sold their expertise in a particular area, for example a specialist venture capital manager who now proposes to manage a company through its growth stage. It may also be the case that a more activist approach to the management of longer-term assets puts pressure on the resources of the manager and dilutes the focus on the core strategy (even if this is not the case, is there an implied cross-subsidy where the core programme will be generating the revenue which allows for certain assets to be held for more extended periods?). On a related note, investors will have to consider whether the holding of one or more companies to a later stage than originally intended impacts their own asset allocations.
- To ensure that investors are receiving fair value for their interests, they will need to ensure that the price calculation methodology in the sale documents works appropriately and that a transparent and effective price discovery process has been undertaken. For example, is the purchase price calculated by reference to NAV at a particular date? If so, is there a revaluation mechanism that takes account of better information being made available after completion about the NAV as at the valuation date? Similarly, is there a price adjustment mechanism for any exits pre-completion or to take account of drawdowns and distributions during the period between the reference pricing date and completion?
- Tax considerations will always be relevant, even for tax-exempt investors. US tax issues in particular can cause unexpected problems, even for funds that themselves hold no US assets following recent changes to the US rules on 'Effectively Connected Income' (ECI). Under these rules, non-US persons must pay US tax when they transfer an interest in a partnership and realise a gain if that partnership would normally generate ECI. Buyers can be required to withhold 10% of the purchase price and the enforcement provisions can impact the sellers, so investors will need to satisfy themselves that the manager and buyer have carried out careful due diligence and have maintained a solid audit trail if this withholding is intended to be avoided.
- Particular difficulties can arise in respect of excused investors. If an investor has been excused from an investment, which looks set to become more common with investors' environmental, social and governance (ESG) programmes and opt-out requirements becoming more robust, how does the manager propose to deal with this? Can investors roll over into the continuation vehicle and maintain their excused position? Even if they are able to do so, how is the excuse quantified and reflected in the purchase price and amounts received by the investors? This is a potentially more difficult issue where, as is often the case, the buyer does not carry out line-by-line pricing. Whether they are excused investors or otherwise, investors will need to ensure that whatever decision is arrived at allocates fairly the purchase price and any adjustments.

Conclusions

There is no doubt that GP-led transactions are a useful element of the toolkit available to managers to drive returns and meet the objectives of their investors. As managers increasingly have to balance the advantages of further developing assets to maximise returns over a longer period with the natural desire to observe the investment horizons which have been agreed with investors, a GP-led transaction provides an obvious route for bridging this gap. Ultimately, for an investor, its view on a particular proposal may simply come down to an analysis as to whether it believes that a better overall outcome would be achieved if the manager was to realise the portfolio on the original timeframe. However, no matter the circumstances of the deal, the key takeaway for investors is understanding the role the LPAC will play in the majority of these transactions and therefore the importance of it: (a) having all the relevant information it needs to assess the transaction; and (b) having access to appropriate professional advice (financed by the fund). Even for investors who are unlikely themselves to be participating as LPAC members, these issues remain vital as each investor needs to be confident that the LPAC is properly equipped to represent and protect the interests of the investor group as a whole.

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Starting with teams of transactional, investment funds and financial services regulatory lawyers dedicated to the private equity sector in the 1990s, Travers Smith now advises many asset owners and asset managers in the private equity, alternative credit, real estate and infrastructure sectors and has a market-leading cross-practice team of 43 partners representing clients in the private capital sector who manage over $4 trillion of assets.
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Bringing Foreign Investment Funds into Japan


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1 Overview of Regulations for Foreign Investment Funds in Japan

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

Foreign unit trust-type investment fund

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

Public offering of a foreign investment trust in Japan

Based on a survey conducted by the Japan Securities Dealers Association ("**JSDA**"), among foreign unit trust-type investment funds that publicly offered units in Japan, those domiciled in Luxembourg or the Cayman Islands had an aggregate market share of more than 80% in the first half of 2020 on a net asset value basis. These are followed by unit trusts domiciled in Ireland.

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

JSDA requirements

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

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

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

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

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

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

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

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

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

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

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

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

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

Disclosure – securities registration statement and prospectus

The issuer of a foreign investment trust, *i.e.*, the management company of the fund, must file a securities registration statement with the regulator in advance of the public offering via EDINET, a web-based disclosure system managed by FSA. The securities registration statement is a disclosure document under the FIEA, for securities that are publicly offered in Japan, and is disclosed to the public through the internet. The securities registration statement becomes effective 15 days after filing. Solicitation of investments in the securities can be made before the securities registration statement becomes effective, but the

investment cannot be made until the securities registration statement becomes effective and a mandatory prospectus (*kofu mokuromisho*) is delivered to the investor.

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

FSA filing

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

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

Private placement of units of a foreign unit trust in Japan

Types of private placement in Japan

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

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

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

No securities registration statement or prospectus

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

FSA filing

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

Registration requirement for self-solicitation

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

Issuer – manager or trustee

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

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

Foreign partnership-type investment fund

Public offering/private placement

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

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

Self-solicitation (*jiko boshu*)

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

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

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

Self-management (*jiko un-yo*)

The management of assets by operators of foreign collective investment schemes, such as limited partnerships, is regulated as self-management (*jiko un-yo*) under the FIEA. A person offering collective investment scheme management services is required to register if the fund to be managed invests more than 50% of its assets in securities or derivatives.

Prior to the enactment of the FIEA, which replaced the Securities and Exchange Act of Japan in 2007, the management

of assets by such fund operators was regarded as management of the operator's own assets, and was outside the scope of the regulation. However, the FIEA recognises this as management of investors' assets, extending the law to cover the management activities of fund operators.

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

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

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

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

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

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

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

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

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

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

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

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

Exception to self-management by delegation of entire management authority

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

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

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

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

2 Taxation

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

Foreign stock investment trust

As to individual investors of a foreign stock investment trust publicly offering units in Japan, distributions paid through a paying agent in Japan are treated as dividend income and subject

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

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

Foreign bond investment trust

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

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

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

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

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

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

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

AIFMD

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

FATCA

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

CRS

A law to implement the reporting requirement under the Common Reporting Standard (the "**CRS**") of the Organisation for Economic Co-operation and Development became effective from January 1, 2017. NTA collects account information of non-residents from Japanese financial institutions pursuant to the law and provides it to the competent foreign tax authorities under the CRS. As Japan is a Model 2 country under the FATCA, Japanese financial institutions are required to provide account information in a bifurcated manner: to the U.S. IRS as to U.S. persons under the FATCA; and to NTA as to non-residents under the CRS. NTA announced that they obtained the information of 2.19 million accounts from foreign tax authorities and provided the information of 0.65 million accounts for foreign tax authorities under the CRS as of March 2021.

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1 Regulatory Framework

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1.7 What service providers are required?

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

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

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

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

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

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

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

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

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

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

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

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

2 Fund Structures

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

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

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

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

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

Investment funds

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

Investment companies

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

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

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

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

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

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

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

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

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

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

Common AIFs have to comply with some diversification requirements:

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

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

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

3 Marketing

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

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

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

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

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

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

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

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

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

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

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

3.4 What restrictions are there on marketing Alternative Investment Funds?

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

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

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

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

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

3.6 Can Alternative Investment Funds be marketed to retail investors?

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

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

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

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

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

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

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

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

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

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

4 Investments

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

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

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

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

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

Please see question 4.1 above.

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

Please see question 4.1 above.

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

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

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

According to Law 10/2008, only Andorran banking entities or authorised credit institutions of EU Member States, OECD Member States or other third countries with prudential standards considered by the AFA as equivalent can hold AIFs' assets.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

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

Such information must be published in accordance with the prospectus.

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

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

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

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

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

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

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

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

5.4 Is the use of side letters restricted?

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

6 Taxation

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

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

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

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

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

This is not applicable in Andorra.

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

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

(b) If the investor is a non-tax resident individual or legal person, Andorra applies neither withholding tax for income from dividends nor capital gains distributed to non-residents.

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

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

No. This is not necessary in Andorra.

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

Andorra itself has not signed any intergovernmental agreements, but all Andorran banks have assumed the commitments through their corresponding registration before the Internal Revenue Service ("IRS").

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

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

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

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

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

No, there are not.

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

No, there are not.

7 Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

According to the last annual report published by the Andorran Banking Association ("Associació de Bancs Andorrans"), sustainability has become part of the core business of the Andorran banking industry. COVID-19 has greatly impacted on investments subject to ESG factors.

To this extent, the commitment to sustainability in the banking sector is inevitably being conditioned by the COVID-19 health crisis.

In Andorra, the most recent initiative undertaken by the Andorran banks has been the launch of their own investment funds, exclusively managed in accordance with these criteria.

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

As stated in question 1.9, the Monetary Agreement sets forth the progressive adoption in Andorra of EU banking/finance legislation, along with respective deadlines.

In this regard, there are specific Directives that will impact on AIFs and their management companies, mainly crystallised through the implementation of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.

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

Moreover, the full implementation of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments ("MiFID II") and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments ("MiFIR") was foreseen by 31 December 2020 as per the latest Annex to the Monetary Agreement. However, due to COVID-19, it has been postponed for this year.

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1 Regulatory Framework

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1.7 What service providers are required?

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

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

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

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

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

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

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

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

2 Fund Structures

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3 Marketing

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

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

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

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

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

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

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

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

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

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

3.4 What restrictions are there on marketing Alternative Investment Funds?

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

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

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

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

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

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

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

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

3.6 Can Alternative Investment Funds be marketed to retail investors?

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

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

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

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

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

There are no additional restrictions.

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

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

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

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

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

4 Investments

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

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

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

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

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

As regards real estate investment funds, they may invest the majority of their assets in real estate, but may also invest in shares of real estate investment companies (*sociedades de investimento imobiliário*), derivatives, mainly for hedging purposes, units/shares of other real estate investment funds and liquidity instruments. The extent to which the investment in the referred assets is limited depends on whether the AIF is closed-ended, open-ended or targeting a specific scope, i.e. real estate investment funds investing in house renting, agriculture, livestock, industrial exploration, etc.

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

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

Loans originating from AIFs are not allowed under Angolan law.

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

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

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

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

The depository is required to register or hold in deposit all assets of the AIF, save for those which, due to their nature, such is not possible, e.g., property or tangible assets.

In case the depository cannot register an asset nor receive it in deposit, it will be required to confirm that the AIF holds valid entitlement of ownership, or other right, over the referred asset, namely by verifying the relevant supporting legal and contractual documentation.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

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

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

There are no developments in respect of disclosures relating to environmental, social and/or governance factors.

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

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

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

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

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

There are no developments in respect of reporting relating to environmental, social and/or governance factors.

5.4 Is the use of side letters restricted?

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

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

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

6 Taxation

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

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

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

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

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

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

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

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

As such, as Angolan-resident entities, they are subject to the general taxation regime: (i) 25% Industrial Tax on income obtained on a worldwide basis deriving from banking activities; and (ii) capital gains, interest and dividends are subject to Investment Income Tax under a withholding mechanism (rates may vary from 5% up to 15%).

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

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

No establishment or transfer taxes are applicable.

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

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

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

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

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

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

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

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

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

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

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

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

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

No, there are not.

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

No, there are not.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

At the time of writing, the Angolan legal UCI framework is in the consolidation stage.

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

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

No reforms in the Alternative Investment Funds space are expected to occur any time soon.

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1 Regulatory Framework

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

The Austrian Alternative Investment Fund Managers Act ("**AIFMG**") is the main legislation that governs the licensing of Alternative Investment Fund Managers ("**AIFMs**") and the establishment and operation of Alternative Investment Funds ("**AIFs**"). The AIFMG has implemented Directive 2011/61/EU ("**AIFMD**").

For AIFMs with a so-called MiFID II top-up licence to provide certain investment services – the individual management of single portfolios, giving investment advice or accepting and transmitting orders relating to financial instruments – certain due diligence provisions of the Austrian Securities Supervision Act 2018 ("**WAG 2018**"), as well as the provisions listed in Art. 1 para. 1 of the Commission Delegated Regulation (EU) No. 2017/565, apply (including keeping records, product governance obligations, prevention of conflicts of interests, obligations to act in the client's best interest, and reporting obligations). In addition, anti-money laundering provisions in line with the EU Anti Money Laundering Directives apply.

The Austrian Financial Market Authority ("**FMA**") issued an FAQ regarding the AIFMG (last update as of 23 November 2020; available in German only).

A special form of open-ended real estate fund that can also be distributed to retail investors (subject to additional requirements) is governed by the Real Estate Investment Funds Act ("**ImmoInvFG**").

Further, Undertakings for the Collective Investment in Transferable Securities (UCITS) managers with an additional licence also may set up an AIF subject to the provisions of the Investment Funds Act ("**InvFG 2011**").

Of course, in Austria, European venture capital funds may also be established pursuant to the EuVECA Regulation (EU) No. 345/2013.

This chapter focuses on AIFs pursuant to the AIFMG.

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

Managing an AIF generally requires a licence from the FMA.

An exemption applies for sub-threshold AIFMs (assets under management of less than EUR 500 million without and EUR 100 million with leverage): they can simply register their services instead of obtaining a licence from the FMA. In general, such registered (sub-threshold) AIFMs are exempted from the AIFMG to a large extent. They cannot obtain an EU passport under the AIFMD.

Investment advisers may, depending on their activities (e.g. investment advice relating to financial instruments), require a licence pursuant to the WAG 2018.

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

Each AIF that is marketed by an AIFM must be notified to the FMA. These AIFs are then listed in the funds database of the FMA: https://webhost.fma.gv.at/FondsSearch.

Registered AIFMs must notify the FMA promptly of each AIF issued and each commencement of the winding-up of an AIF (Sec. 1, para. 5, no. 5 AIFMG).

Licensed AIFMs must submit an application for approval to the FMA for every AIF they propose to market. The application for approval must include specific documentation and information (e.g. statutes of the AIF, name of the depositary, information pursuant to Sec. 21 AIFMG) as stipulated by Annex 3 of the AIFMG. Within 20 working days of receipt of the complete application, the FMA must decide on the permissibility of the marketing of the AIF. In case of a positive decision, the AIFM can start marketing the AIF from the date of the relevant approval. If any material change in the information provided pursuant to the application process occurs, the FMA must be informed at least one month before the change is implemented in case it is a planned change. In case of an unplanned change, notification must take place immediately after the change has occurred.

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

There is no difference under the AIFMG as to whether the AIFM

manages open-ended or closed-ended AIFs pursuant to the definition given in Commission Delegated Regulation (EU) No. 694/2014.

However, the AIFMG includes some provisions that specifically refer to closed-ended types of AIF (e.g. liquidity management or valuation).

Closed-ended AIFs do not qualify as financial instruments (Sec. 1, para. 7, letter c WAG 2018) but instead qualify as investments (*Veranlagungen*) pursuant to the Austrian Capital Market Act 2019 ("**KMG 2019**"). Consequently, closed-ended AIFs can be distributed by financial advisers with a licence under the Austrian Trade Act (GewO). Open-ended AIFs can only be distributed by credit institutions and investment firms.

It should be noted that the strategy of the AIF is relevant for this question regarding whether the fund may be distributed to retail investors (see question 3.6 below).

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

The authorisation process (licensing) of an AIFM with the FMA is rather complex, though the registration of a sub-threshold AIFM is relatively easy.

Basically, the licensing requirements and process follows the requirements of the AIFMD. For AIFMs that already hold a licence to manage AIFs pursuant to the InvFG 2011 or the ImmoInvFG, specific provisions apply.

The FMA must grant the authorisation to the applicant within three months of receipt of the complete application. In practice, AIFMs should expect the licensing procedure to exceed the three-month period.

The applicant must, *inter alia*, provide evidence showing its ability to comply with the conditions of the AIFMG and that it has sufficient initial capital. An internal AIFM must have an initial capital of EUR 300,000 and an external AIFM must have an initial capital of EUR 125,000. The persons managing the business of the AIFM must be sufficiently reliable and have sufficient experience in investment strategies of the AIFs managed by the AIFM ("fit & proper test"). The application must include specific information such as a business plan, the remuneration policy, delegation (sub-delegation), investment policy, information on the depositary, and specific information pursuant to Sec. 21 AIFMG (Art. 23 AIFMD).

Please refer to question 1.3 above regarding the notification of AIFs.

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

The AIFM must have its registered office and the main management in Austria. Thus, although there are no specific local residence requirements, there are substance requirements in Austria.

1.7 What service providers are required?

There must be a depositary for each AIF managed by an authorised AIFM.

An auditor certified pursuant to Directive 2006/43/EG must audit the annual report.

Further, it is necessary to appoint an external appraiser in case the AIFM cannot conduct the valuation on its own.

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

According to Sec. 33 AIFMG (Art. 33 AIFMD), EU AIFMs approved in another Member State can manage EU AIFs either directly or indirectly through a branch in Austria, provided that the EU AIFM is entitled to manage this type of EU AIF. EU AIFMs must follow the procedure laid out by Sec. 33 AIFMG (Art. 33 AIFMD). The information can be submitted in German or English. The competent authority of the EU AIFM's home Member State must submit to the FMA a range of documents/information (e.g. business plan and additional information in case of a branch). If the AIFM intends to offer collective portfolio management of an AIF approved in Austria, the EU AIFM must send an application to the FMA (Sec. 29 AIFMG/Art. 31 AIFMD). If the EU AIFM is already managing AIFs of the same type in Austria, it is sufficient to refer to the documents already submitted.

Delegation of fund management to a foreign manager is possible (see Sec. 18 AIFMG). The AIFM must promptly notify the FMA in writing of the delegation. In case of a delegation to an entity from a third country (e.g. the USA or the UK), cooperation must be ensured between the FMA and the supervisory authority responsible for the third country (see question 1.9 below). In case of a delegation of the management or risk management, the AIFM must inform the FMA.

Investment advisers may require a licence under the WAG 2018 or an EU passport.

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

The FMA has entered into several Memoranda of Understanding ("**MoU**") with regulators of other countries. The list can be found at https://www.fma.gv.at/en/international-affairs/the-financial-market-authoritys-cooperation-with-the-european-supervisory-authorities-and-sister-supervisory-authorities/.

So far, no information has been published on when an MoU with the UK will be established.

2 Fund Structures

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

According to the AIFMG, it is irrelevant whether the AIF is set up as a company, based on a contract, a trust or in any other legal form (Sec. 1, para. 2, no. 2 AIFMG).

AIFs under the AIFMG are often established as a *GmbH & Co KG*. A GmbH & Co KG is comparable to a limited partnership whereby the general partner is a limited liability company. The investors in the AIF are limited partners. Sometimes, a trustee acts as limited partner and holds the participation of investors in escrow.

Further, AIFs under the ImmoInvFG and InvFG 2011 are structured as separate assets that are owned by the investors but do not have legal personality.

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

The liability of investors depends on the legal structure of the AIF. As outlined above, AIFs are often structured as limited partnerships where the investors are involved as limited partners. Limited partners are only liable up to a certain amount registered in the company register and the liability is reduced to the extent such amount has been paid in. However, the limited partner's liability is revived if distributions are not covered by profits.

If the AIF is structured as a corporation (limited liability company or stock corporation), basically the liability is limited to the paid-in capital (in this case, a claw-back of distributions that have not been covered by profits may also occur).

In case of AIFs structured as agreements under the law of obligations (e.g. structures notes), the liability is limited to the investment of the investors.

The liability of investors in funds under the ImmoInvFG and InvFG 2011 is limited to their investment.

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

Most Austrian AIFMs are established as limited liability companies pursuant to the Austrian Limited Liability Company Act (GmbHG). Some Austrian AIFMs are established as stock corporations pursuant to the Austrian Stock Corporation Act (AktG).

The same applies to financial advisors.

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

The definition of open-ended or closed-ended AIFs follows Commission Delegated Regulation (EU) No. 694/2014. An open-ended AIF repurchases or redeems its shares or units with its investors, at the request of any of its shareholders/unitholders, prior to the commencement of its liquidation phase or wind-down. Procedures and frequency are set out in the rules or instruments of incorporation, prospectus or offering documents (see recital 3 of Commission Delegated Regulation (EU) No. 694/2014).

Thus, the possibility to restrict redemption or transfers in open-ended AIFs is very limited and must be in accordance with the provisions of Commission Delegated Regulation (EU) No. 694/2014.

Transfers in closed-ended funds can be restricted.

In case of marketing to retail investors (Sec. 48, para. 10 AIFMG), any temporary suspension of redemption of the share or unit certificates must be reported to the FMA without delay. Such suspension requires extraordinary circumstances. Further, a public announcement must be made to notify the investors when redemption of the shares or unit certificates is both suspended and resumed.

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

Generally, there are no statutory transfer restrictions. However, for funds that may not be distributed to retail investors (see question 3.6), it needs to be ensured that no transfers to such investors are permitted.

The fund rules of special funds according to Sec. 163 InvFG 2011 must stipulate that the transfer of unit certificates of the unitholders require the approval of the management company.

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

The AIFM must manage its funds in accordance with its investment policy.

For AIFs according to the InvFG 2011 and the ImmoInvFG, statutory investment restrictions apply.

If the type of AIF is eligible for marketing to retail investors (see question 3.6 below), the AIFMG stipulates specific investment restrictions based on the specific type of AIF (e.g. an AIF in real estate, *inter alia*, must invest in at least 10 different properties).

The AIFMG stipulates the prohibition of asset stripping. This provision does not apply for registered (sub-threshold) AIFMs. This set of rules is only relevant in case of targets that are not listed on a stock exchange.

3 Marketing

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

The AIFMG provides for specific rules for marketing materials only in case of marketing to retail clients (see question 3.6 below). Besides specific warnings, there must be a reference to the prospectus and to the client information document ("**KID**"). It must be specified in which manner and in which language the prospectus and the KID (which must be in German) may be obtained and made accessible to investors/potential investors.

Advertising must be (i) clearly identifiable as such, (ii) fair, (iii) clear, and (iv) not misleading.

There must not be statements that contradict or diminish the significance of the information contained in the prospectus and the KID. Where there is reference to the historical performance, an indication should be contained that makes clear that the performance record of a fund does not provide any reliable indication as to its future performance.

Cold calling and spam e-mails (or SMS) are prohibited.

Marketing materials for foreign AIFs that are distributed in Austria must include certain disclaimers (e.g. that the AIFM is not supervised by the FMA).

As of 2 August 2021, the "Requirements for marketing communications" according to Art. 4 of Regulation (EU) No. 2019/1156 will be binding and directly applicable in all EU Member States. Consequently, some changes to the AIFMG will follow as well (see section 7 below).

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

Advertising material must be clearly identifiable as such, fair, clear and not misleading. Further, see question 3.1 above.

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

No, there is no requirement for the FMA to approve marketing material.

However, Art. 7 of Regulation (EU) No. 2019/1156 (see question 3.1 above) stipulates "ex-ante verification of marketing communication". According to Art. 7, para. 3, these provisions also apply to AIFMs that market units or shares of their AIFs to retail investors.

3.4 What restrictions are there on marketing Alternative Investment Funds?

In principle, AIFs can only be marketed to professional investors according to Annex II of the revised version of the Markets in Financial Instruments Directive ("**MiFID II**"). Only certain types of AIFs are eligible for a specific notification procedure for marketing to retail investors. Please refer to question 3.6 below.

As outlined, AIFs can only be marketed subject to registration with the FMA. There is no private placement regime available for AIFs.

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

The FMA has not issued any guidelines regarding the "pre-marketing" concept. Since the term "marketing" pursuant to the AIFMG is very broad, "pre-marketing" activity is a grey area. Any "pre-marketing" activities should be considered on a case-by-case basis.

The AIFMG will be revised due to the implementation of Regulation (EU) No. 2019/1156 (see section 7 below).

3.6 Can Alternative Investment Funds be marketed to retail investors?

Basically, AIFs can only be marketed to professional investors. Only certain types of AIFs under the AIFMG may be marketed to retail investors (private clients as defined by the WAG 20218/MiFiD II) subject to a specific registration procedure with the FMA:

- AIFs that invest in real estate;
- managed futures funds;
- private equity funds; and
- private equity funds of funds.

The AIFMG stipulates specific conditions that each of the above AIFs must meet to be eligible for marketing to retail investors (including specific investment restrictions). Certain types of AIFs (e.g. AIFs in private equity) require a minimum investment of EUR 10,000.

In any case, a UCITS-KID is necessary. It should be noted that, as of 1 January 2022, a PRIIPs-KID will be needed since the grandfathering provision of Art. 32, para. 2 Regulation (EU) No. 1286/2014 PRIIPs-Regulation is only valid until 31 December 2021.

For closed-ended AIFs that are marketed to retail investors, in addition to the registration of the AIF with the FMA, a prospectus pursuant to the KMG 2019 must be published (unless an exemption applies, e.g. a minimum investment of EUR 100,000).

Importantly, EU-AIFs (domiciled outside of Austria) may also be marketed to retail investors in Austria in accordance with Sec. 49 AIFMG (Art. 43 AIFMD). The AIF must be admitted for marketing to retail investors in its home Member State and must be admitted for marketing to professional investors in Austria pursuant to Secs 31 or 47 AIFMG (Arts 32 and 42 AIFMD). Further, the EU-AIF must be materially equivalent to the types of AIF that are admitted for marketing to retail investors in Austria (as outlined above). In addition to passporting of the EU-AIF, a specific registration procedure with the FMA is required, too.

Further, AIFMs can market the units of an AIF to so-called qualified retail investors in Austria. A qualified retail investor pursuant to the AIFMG must meet several conditions. *Inter alia*, the qualified retail investor must have unencumbered bank balances and financial instruments valued at more than EUR 250,000. In addition, the investor must invest at least EUR 10,000 in the AIF (unless there is no minimum investment requirement for the relevant type of AIF for retail investors).

An AIFM can market an AIF to qualified retail investors if (i) no leverage is used, or (ii) leverage that does not exceed the net asset value of the AIF by more than 30% is used.

Further, real estate funds pursuant to the ImmoInvFG, and AIFs pursuant to the InvFG 2011, may be distributed to retail clients.

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

Investors must fall within the definition of a professional investor pursuant to MiFID II (for marketing to retail investors see question 3.6 above). Most institutional investors will qualify *per se* as professional investors (e.g. credit institution investment firms, insurance companies). On request, clients may be treated as professionals if they fulfil certain criteria (Annex II, part II, MiFID II).

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

There are no additional restrictions if they qualify as professional investors (which is not always the case). However, public bodies usually must comply with a strict set of investment rules. Therefore, there is only limited possibility to invest in AIFs. Please also refer to question 3.9.

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

Certain regulated investors (e.g. pension funds, investment funds, credit institutions or insurance undertakings) must comply with specific statutory investment provisions that may limit or exclude the possibility to invest in AIFs. This needs to be assessed on a case-by-case basis.

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

There are no specific restrictions pursuant to the AIFMG regarding intermediaries. Based on the actual activity of the intermediary, a licence might be required.

4 Investments

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

Basically, there are no restrictions on the types of investment activities that can be performed by AIFs if they are only marketed to professional investors.

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

AIFs that are eligible for marketing to retail investors must comply with certain diversification requirements depending on the AIF type (see question 3.6 above).

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

Specific local regulatory requirements apply in case of AIFs that will be marketed to retail investors (see question 3.6 above). For example, certain AIFs may only hold derivatives for hedging purposes.

We note that lending activities constitute a regulated banking activity pursuant to the Austrian Banking Act (BWG). However, based on an exemption, AIFMs can conduct lending activities as long as they do not exceed the extent of their authorisation in accordance with the AIFMD.

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

There are specific information requirements for AIFMs that manage leveraged AIFs (see Sec. 23 AIFMG/Art. 25 AIFMD).

For AIFs that can be marketed to retail investors, specific requirements also apply regarding leverage. For example, AIFs in real estate must only use leverage for the AIF with exposure not exceeding twice the AIF's net asset value, calculated according to the commitment method; AIFs in private equity must not use leverage at all.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

Yes, a (licensed) AIFM must appoint a depositary for each AIF (Sec. 19 AIFMG/Art. 21 AIFMD). The depositary must either be a credit institution according to the CRR (Regulation (EU) No. 575/2013), an investment firm having its registered office within the EU that is subject to the capital adequacy requirements pursuant to Art. 92 CRR, or another category of institution that is subject to supervision and constant monitoring (further requirements apply).

In most cases, credit institutions are appointed as depositaries.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

Regulation (EU) No. 2019/2088 ("**Disclosure Regulation**") applies directly in all EU Member States and thus also in Austria.

According to Art. 6, para. 3 Disclosure Regulation, an AIFM must disclose the required information on sustainability risks to investors in the Art. 23 AIFMD document (Sec. 21 AIFMG). The Joint Committee of the three European Supervisory Authorities (EBA, EIOPA and ESMA) on 4 February 2021 published the draft Regulatory Technical Standards ("**RTS**"). The RTS will only apply as of 1 January 2022.

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

The requirement to register beneficial owners depends on the legal structure of the AIF. Based on the 4th and 5th Anti-Money-Laundering Directives of the EU, Austria has adopted the Austrian Beneficial Owners Register Act ("**WiEReG**"). Entities which have their legal registered office in Austria must register their beneficial owners. Therefore, if the AIFM and/or the AIF is established as such an entity (e.g. a limited liability company or stock corporation), registration of the beneficial owners is required. If no individual qualifies as a beneficial owner pursuant to the WiEReG, a so-called "subsidiary notification" becomes applicable. In this case, the managing directors of the legal entity must be registered as beneficial owners. This will be the usual procedure for AIFs.

If the AIF is only established based on contractual arrangements, there is no requirement to register the investors as beneficial owners since contractually established AIFs are not subject to the WiEReG.

AIFMs must comply with the Financial Markets Anti-Money Laundering Act (FM-GwG). Consequently, they must conduct a KYC check regarding investors.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

Thus far there are no Austrian specific requirements regarding sustainability risks (see question 5.1 above).

The AIFMG stipulates different disclosure requirements. The details also depend on the type of AIF and whether the AIF is permitted for marketing to retail investors.

In any case, an annual report pursuant to Sec. 20 AIFMG (Art. 22 AIFMD) must be provided. The AIFM must comply with the information requirements pursuant to Sec. 21 AIFMG (Art. 23 AIFMD). In addition, Sec. 22 AIFMG (Art. 24 AIFMD) stipulates reporting obligations to the FMA.

In case of an EU-AIF that is passported for marketing into Austria, similar information requirements exist.

5.4 Is the use of side letters restricted?

Austrian law does not generally restrict the use of side letters. However, any such letter must not interfere with the obligations of the AIFM under the AIFMG.

To avoid liability issues, it is generally advisable to disclose the material contents of side letters to other investors prior to their investment, if they could interfere with their interests.

6 Taxation

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

As outlined in question 2.1 above, there are different principal forms of AIF in Austria. For tax purposes, they are treated as neutral in terms of their legal form. This means that regardless

of the legal form of an AIF either as a partnership or a corporation, taxation must be carried out in accordance with the special provisions of the InvFG 2011. As the AIF is not regarded as a taxable entity, the taxation follows the fiscal transparency principle. This means that the income of the investment fund is allocated directly to the unitholder. Income at the level of the AIF generally retains its character as interest income, dividend income or capital gains for taxation purposes at the level of the unitholder. For taxation purposes, a distinction is made between income actually distributed and deemed distributions (*ausschüttungsgleiche Erträge*). As a result, all fund income is generally taxable, either because it is actually distributed (distributions) or because it is only deemed to have been actually distributed (deemed distributions). The taxation of income of an AIF furthermore depends on whether the tax data of the AIF is reported by a tax representative with the *Oesterreichische Kontrollbank* ("**OeKB**").

In the case of reinvesting funds (*thesaurierender Fonds*), income is retained and not distributed to the unitholders. For tax purposes, however, this income is treated as if it was distributed to the unitholders once a year after the end of the fund's fiscal year as mentioned above. This income is therefore also referred to as "distribution-equivalent income". As with distributing funds, this income is taxed at 27.5%. However, only 60% of the capital gains income within the fund are taxed at a rate of 27.5%. This reduces the effective tax burden to 16.5% (60% × 27.5%), which has a tax-saving effect in the long term and thus increases returns on investment.

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

The tax treatment of the principal forms of the investment manager/adviser does not differ from the general taxation of the legal structure they use. Austrian limited liability companies (GmbHs) or stock corporations (AGs) are both covered by the Austrian Corporate Income Tax Act (KStG) and are deemed to be a taxable entity. The profits are taxed at a rate of 25%.

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

There are no establishment or transfer taxes levied in connection with an investor's participation in an AIF or the transfer of the investor's interest. Gifts *inter vivos* of participations in an AIF under certain circumstances have to be reported to the tax office if the acquirer or donor is a resident of Austria. Transactions in participations as well as the management of an AIF are VAT exempt.

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

The taxation of the income of an AIF follows the principle of transparency; therefore income is directly taxed at the level of the investor. As a consequence, non-resident investors of an Austrian AIF are generally not taxable in Austria (unless the fund invests in Austrian assets).

With respect to Austrian resident investors, the income of the AIF is basically treated as if the investors held the assets of the fund directly. Hence, the fund's income needs to be broken down into individual income components, i.e. (i) interest income, (ii) dividend income, and (iii) capital gains.

All data relevant to calculate the taxation of actual and deemed distributions have to be reported by a tax representative of the fund to the OeKB. The report has to take into account the different tax treatment of each class of investors (privately held assets, business assets, corporate assets).

Generally speaking, the following tax treatment applies to funds complying with the reporting obligation:

- If fund participations are held as private assets, the dividend and interest income of the fund is taxed at 27.5%. 60% of the capital gains derived within the fund are taxable at a rate of 27.5%. The remaining 40% of the capital gains are only taxable upon distribution to the investor.
- If an investor holds the fund participation as business assets, again interest and dividends are taxed at 27.5%. 100% of the capital gains are taxed at 27.5%.
- If the fund participation is held by a corporation, all of the fund's income is taxed at the 25% corporate income tax rate regardless of the asset class.
- Austrian pension fund investors benefit from a corporate income tax exemption.

If an AIF does not report its income to the OeKB (due to it having no Austrian tax representative), the taxation is based on a very disadvantageous lump-sum calculation.

The basis for this lump-sum taxation is the higher of the following values in each case:

- 90% of the difference between the unit value (*Rücknahmepreis*) at the beginning and the end of the calendar year; or
- 10% of the last unit value (*Rücknahmepreis*) in the calendar year.

The Austrian custodian bank is required to apply a 27.5% withholding tax on the flat-rate distribution-equivalent income of these non-reporting funds on 31 December of each year.

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

Generally speaking, it is not necessary to obtain tax rulings prior to establishing an AIF.

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

The agreement between Austria and the USA on Cooperation for Facilitated Implementation of FATCA was signed in 2014. The present agreement, which corresponds to the U.S. "Model 2", provides for the authorisation and obligation of Austrian credit institutions and other financial institutions to forward summarised information (aggregate data) on the accounts of U.S. recalcitrant account holders (i.e. customers who do not consent to the disclosure of their accounts to the U.S. tax administration) to the U.S. tax authority ("**IRS**") instead of an automatic exchange of information by the tax authorities, which would have corresponded to "Model 1". This aggregated information forms the basis for a subsequent group request to the FATCA partner state (Austria), on the basis of which the competent Austrian authority would forward the required detailed information to the IRS. Such group requests have been expressly declared permissible since the latest commentary extension to Art. 26 of the OECD Model Tax Convention, which was adopted by the OECD Council in July 2012. Under the agreement with Austria, a period of eight months is provided for the response to this group request.

On 1 October 2016, Austria joined the Common Reporting Standard (CRS), the global mechanism of the OECD for the automatic exchange of information (AEOI) in tax matters. From this point onwards, personal data of foreign customers from participating jurisdictions have gradually been reported by the Austrian Federal Ministry of Finance ("**BMF**") to the competent authorities in their respective jurisdictions. *Vice versa*, the BMF has been receiving such data of persons taxable in Austria who maintain financial accounts abroad.

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

The MLI was adopted in 2017 and became effective 1 July 2018. The implementation of DAC 6 led to the introduction of a reporting obligation for cross-border tax arrangements. DAC 6 had to be implemented into national law by the end of 2019 and applied to reportable arrangements as of 1 July 2020 (new cases). Since AIFs are treated as tax transparent, there is not much room for BEPs on the level of the AIF itself.

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

In the case of reinvesting funds (*thesaurierende Fonds*), income is retained and not distributed to the shareholders. For tax purposes, however, this income is treated as if it was distributed to the shareholders once a year after the end of the fund's fiscal year. This income is therefore also referred to as "distribution-equivalent income". As with distributing funds, this income is taxed at 27.5%. However, only 60% of capital gains, i.e. gains from the sale of securities, are taxed within the fund with capital income tax of 27.5%. This reduces the effective tax burden to 16.5% (60% × 27.5%), which has a tax-saving effect in the long term and thus promotes a return on investment. However, finally this untaxed portion (40% of capital gains within the fund) increases the capital gain on the level of the unitholder and will then be taxed at a rate of 27.5%.

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

The tax position of an investor in an Austrian AIF is mainly dependent upon the personal tax profile. Investors should, therefore, always seek independent tax advice on the tax implications.

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

At this point, we do not expect any material changes in the taxation of AIFs in the coming 12 months.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

Due to Brexit, there is an increased interest in the possibility of reverse solicitation. The FMA has not issued any specific guidance in this regard. However, we would expect the FMA to apply a strict approach based on the public statement of ESMA: "Reminder to firms of the MiFID II rules on 'reverse solicitation' in the context of the recent end of the UK transition period" (dated 13 January 2021). There is a possibility that the FMA will focus on reverse solicitation in relation to the UK.

The FMA has issued guidance for Sec. 47 AIFMG (Art. 42 AIFMD). This document (dated 3 November 2020) contains information for non-EU AIFMs regarding the marketing of AIFs in Austria.

Further, loan origination funds have been a topic of practical interest.

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

The harmonised concept of pre-marketing (Directive EU No. 2019/1160; Regulation EU No. 2019/1156) will come into effect as of 2 August 2021. A draft ministerial proposal (67/ME) has been published that, *inter alia*, amends Austrian law in line with these provisions.

It is expected that the rules on pre-marketing will favour cross-border distribution. Although the new rules mean more legal certainty, the new framework will be stricter (e.g. no pre-marketing by non-EU AIFMs; no pre-marketing towards retail investors).

It also remains to be seen how the Disclosure Regulation and the RTS will impact the AIF landscape.

No further reforms have been proposed.

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1 Regulatory Framework

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

The establishment and operation of alternative investment funds (AIFs) in Brazil depends on the strategy envisaged by the investor, and there are specific laws, regulations and types of vehicles for each strategy. For example, *Fundos de Investimento em Participações* (FIPs) for private equity and venture capital, *Fundos de Investimento Imobiliário* (FIIs) for real estate, *Fundos de Investimento Multimercado* (FIMs) for hedge, among others. Note that Brazilian-formed investment funds, including AIFs, are formed as unincorporated pools of assets and are subject to the legal regimes established by the Brazilian Civil Code and the Brazilian Capital Markets Law, which confer authority to the Brazilian securities and exchange commission (*Comissão de Valores Mobiliários* – CVM) to oversee and establish regulations with respect to the establishment and operation of AIFs.

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

Yes. The administration and investment management of investment funds in Brazil, which includes AIFs, 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) The fiduciary administrator (*administrador fiduciário*), the entity in charge of the operation and maintenance of the securities portfolio, is responsible for, among others: (a) legally forming investment funds under its administration and registering them with the governmental authorities (including tax authorities) and the CVM; (b) hiring service providers that are legally required for the operation of securities portfolios and/or investment funds; and (c) treasury, accounting, custody of assets and other back-office activities in relation to the investment fund.

(ii) The investment manager (*gestor de recursos*), the entity responsible for the investment decisions (including purchase and sale) of the securities portfolios and/or investment funds.

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.

In addition to the registration with the CVM, it is a local market standard that an asset manager (whether a fiduciary administrator or an investment manager) must also be registered with the Brazilian Financial and Capital Markets Entities Association (ANBIMA) or the Brazilian Venture Capital and Private Equity Association (ABVCAP), depending on the type of investment funds it intends to work with, in order to perform such activities.

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

Yes. As a rule, Brazilian-formed investment funds like AIFs are required to be registered with the CVM. The rules and requirements for registration are determined by the CVM and are generally based on the types of investment funds, investors and public offerings issued by them.

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

As mentioned in question 1.1 above, the regulatory regime differentiates among different strategies of investment and consequently different AIF vehicles, which are all classified as locally formed investment funds and are formed as unincorporated pools of assets (*condomínios de natureza especial*). In summary, the following are the principal types of AIF funds in Brazil, with their applicable investment strategies: (i) FIM: hedge strategy; (ii) FI-Infra: infrastructure; (iii) FIP: private equity, venture capital and certain strategies of infrastructure; (iv) FII: real estate; (v) FIDC (credit rights investment funds): credit rights, securitisation, distressed debt, legal claims, royalties; and (vi) FIAGRO (agribusiness investment funds): agriculture assets.

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

The formation of AIFs requires prior registration with the CVM through the filing of a minimum set of documents, such as the fund's formation act, certain statements and other ancillary documents, which vary depending on the nature of the AIF. The registration process is generally automatic upon the filing. Note that the marketing of interests in Brazilian-formed AIFs is made through public offerings, that may be registered or exempt from registration (in this case, targeted to a limited number of sophisticated investors only, with certain trading restrictions). Registered public offerings of securities (including interests/

quotas in AIFs) must be approved by the CVM and the authorisation process usually takes three to four months.

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

In general, the local regulations do not impose limitations on international investors investing in Brazilian-formed AIFs. Additionally, local AIFs may, except for certain types of vehicles (FIIs, for example) invest offshore, to the extent the applicable regulations and the applicable AIF's investment policy allows such type of investment. With respect to service providers, Brazilian AIFs are required to be administered and managed by service providers duly licensed by the CVM (see question 1.2 above), which must be necessarily based in Brazil (Brazilian subsidiaries of foreign institutions are allowed) and have locally based structure and investment teams.

1.7 What service providers are required?

AIFs must necessarily have a fiduciary administrator (see question 1.2 above), which may render all the required AIFs' services (such as investment management, custody, treasury, bookkeeping of quotas, etc.), or engage other service providers, the latter being more common in Brazil, mainly for investment management services. Certain types of AIFs may have specific service providers, such as collection agents (in securitisation funds, for example), and investment consultants (in real estate and private equity/venture capital funds, for example). Additionally, all local funds are required to engage an external auditing firm authorised by the CVM to audit the funds' financial statements.

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

As mentioned in questions 1.2 and 1.7 above, AIFs are required to be administered and managed by service providers duly licensed by the CVM (see question 1.2 above), which must be necessarily based in Brazil (subsidiaries of foreign institutions are allowed) and have locally based structure and investment teams.

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

Information exchange and cooperation efforts with foreign regulators are mostly made by the CVM under the arrangements set forth in the IOSCO Multilateral Memorandum of Understanding. But the CVM also maintains bilateral agreements with regulators in many countries, including France, Germany, Hong Kong, Luxembourg, Switzerland, United Kingdom and the USA.

2 Fund Structures

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

In Brazil, AIFs are structured as special unincorporated pools of assets, with the investors participating in the fund through the acquisition of quotas, each of which corresponds to a notional fraction of all the assets held by the fund. As with any Brazilian-formed fund, AIFs 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 being unincorporated pools of assets, AIFs are not considered separate and independent legal entities from their investors (there is no corporate veil between the fund and its investors). As described in question 1.4 above, the Brazilian AIF's regulatory framework differentiates between types of strategies, with specific types of funds (FIM, FIP, FII, FIDC, FIAGRO, among others) for each investment type and nature.

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

Brazilian law allows the possibility to establish that the liability of each AIF quota holder be limited to the amount of its quotas – provided that such limitation is expressly determined by the fund's bylaws. For comparison purposes, this approach is similar to the limited liability of shareholders of corporations and limited liability companies in Brazil. It is worth highlighting that the limitation of liability in an investment fund that was originally formed without such limitation will only cover facts that occurred after the respective change of its bylaws. Although the limitation of liability is provided by a statute enacted by the Brazilian government in 2019, it is still subject to further regulation by the CVM, which has not yet been published.

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

Investment management is a regulated activity and may only be performed by CVM-licensed entities. Investment managers are directly engaged by the AIF administrator. Common structures adopted in the USA, Cayman Islands and other traditional AIF jurisdictions involving limited partnerships, limited partners, general partners and investment advisers do not exist in Brazil.

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

The limits and restrictions with respect to redemption or transfers of quotas are usually determined in each of the AIF bylaws. In open-ended funds, the quotas cannot be transferred to third parties, except in very specific cases, and the investor (not the manager) has the ability to redeem quotas at its discretion.

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

No, but certain requirements may apply depending on the investors' nature. For example, certain types of investors like local pension funds and non-resident investors generally may only trade quotas of Brazilian AIFs in stock exchange or organised market environments. Additionally, it is worth mentioning that quotas of AIFs that were distributed through exempt public offerings are subject to a 90-day lock-up period for trading.

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

Yes. The Brazilian AIF regulatory regime provides for specific limitations, diversification requirements and restrictions for each

type of AIF fund, based on the type of strategy, which tend to limit the manager's ability to structure AIFs with very flexible investment policies and strategies. For example, an FIP is the vehicle usually used for private equity and venture capital transactions, and the applicable regulations for FIPs determines (i) the scope of assets in which the fund may invest (shares, subscription bonus, convertible debentures, etc.), (ii) minimum investment requirements in such assets (90% of the fund's net asset value), and (iii) limitations and restrictions for certain types of investments and transactions (derivative transactions, borrowings and leverages, offshore investments, etc.), to mention only a few. Similar situations are also present in the regulations of other AIF funds, such as FIMs, FIIs, FIDCs and FIAGROs.

3 Marketing

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

The marketing and distribution of quotas of AIFs can only be made by members of the Brazilian 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. The distribution of quotas of closed-ended investment funds requires prior registration with the CVM, except if made through an exempt public offering, which is subject to certain limitations. The preparation and use of marketing materials are regulated by the CVM regulations and ANBIMA guidance applicable for each type of public offering (registered or exempt) and consider the level of sophistication of investors.

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

It depends on the type of public offering used for distribution of AIF quotas, i.e. if it is registered or exempt from registration.

Registered public offerings require the use of prospectus and other marketing materials that must be subject to prior approval by the CVM. The prospectus must contain information about the characteristics of the offering and target public, information about the manager and principal service providers, the AIF's main features, the investment policy, risk factors, taxation and disclaimers, among other requirements set forth in the applicable regulations.

In exempt public offerings, which are necessarily targeted at sophisticated investors, there is no requirement for the preparation of a prospectus or other marketing materials. However, it is a customary practice to prepare short memorandums and/or presentations with a summary of the main terms and conditions of the AIF and offering, service providers, risk factors, etc.

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

Yes. The AIF governing documents must be filed with the CVM and might be subject to comments and requests made by the regulator. Note that, in addition to the fund registration, the public offering of quotas of a certain AIF may be also registered and consequently subject to review and approval by the CVM.

3.4 What restrictions are there on marketing Alternative Investment Funds?

As mentioned above, the distribution of quotas of AIFs is necessarily made through public offerings, whether registered or exempt from registration. Registered public offerings do not have a limitation on the number of investors that may be approached, but the type of investors that may be approached (retail, qualified or professional – see question 3.7 below) depends on the type of AIF vehicle. Most distributions of AIFs in Brazil take place through exempt public offerings, which are subject to certain limitations: (i) they can be offered to professional investors only; (ii) distributors can approach a maximum of 75 professional investors, provided that only 50 can actually invest in the securities being offered; and (iii) AIF quotas offered under an exempt public offering are subject to a 90-day lock-up period for trading.

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

The CVM regulations provide mechanisms for consultation of interest to potential investors, conducted by the distributor and limited to a maximum of 50 potential investors. The consultation must be made on a confidential basis and is of a non-binding nature.

3.6 Can Alternative Investment Funds be marketed to retail investors?

In general, Brazilian AIFs can only be marketed to sophisticated investors (professional or qualified investors), but there are a few types of investment funds that, depending on their investment policy, may be marketed to retail investors. This is the case, for example, for quotas of FIMs (hedge), FIIs (real estate) and FIAGROs (agriculture). Note that 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 such investor might be exposed to and, therefore, less protection may be granted to them. In this sense, AIFs like the FIM, FII and FIAGRO that can be marketed to retail investors have more restrictions and limitations, and less flexible investment policies.

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

Investors are classified 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 AIFs' investment policies and target investors (see question 3.6 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.

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

Yes. In addition to the CVM regulations, managers interested in marketing their AIFs to local government pension funds and/or other similar entities are also required to comply with other specific regulations, which are generally more restrictive and provided by different government authorities such as the National Monetary Counsel (CMN) and PREVIC for closed-ended pension funds (EFPC), and the CMN and Ministry of Social Security for open-ended pension funds (EAPC).

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

No, except for investments in AIFs made by certain types of investors (for example, local pensions funds – see question 3.8 above) which are subject to certain limitations or restrictions.

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

No, to the extent the intermediaries acting in the marketing and distribution of quotas of Brazilian AIFs are members of the Brazilian securities distribution system (in general, financial institutions, brokerage entities, fiduciary administrators) and consequently follow certain requirements and disclosure of information as required by the applicable laws and regulations. Note that investment managers must have an additional licence with the CVM to directly market and distribute quotas of AIFs.

4 Investments

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

As mentioned in questions 1.1 and 1.4 above, the Brazilian AIF regulatory regime is structured on the general basis of specific vehicles for each specific strategy. Then, each type of fund has its own restrictions and limitations, which may also vary depending on the investors' category (retail, qualified or professional investors).

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

As mentioned in questions 1.1 and 1.4 above, the Brazilian AIF regulatory regime is structured on the general basis of specific vehicles for each specific strategy. Note that the CVM regulations tend to be very restrictive with respect to the type and list of assets that can be invested in by each AIF, which are usually provided for in the specific regulations for each type of AIF. In this sense, the use of two or more types of AIFs with the same strategy is not uncommon in Brazil due to restrictions in the regulations. For example, the FIDC is the most common fund that makes use of the special situations strategy, but in case there is an equity component in such strategy, an FIP (equity/convertible investment) may be required.

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

As mentioned in questions 1.1 and 1.4 above, the Brazilian AIF regulatory regime is structured on the general basis of specific vehicles for each specific strategy. Then, each type of fund has its own requirements for derivatives or loans, which may also vary depending on the investors' category (retail, qualified or professional investors). AIFs like FIPs, FIDCs and FIIs can generally enter into derivative transactions for hedging purposes. FIMs (hedge funds) can invest in derivative transactions and leverage, subject to certain restrictions and limitations depending on the target investors.

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

As mentioned in questions 1.1 and 1.4 above, the Brazilian AIF regulatory regime is structured on the general basis of specific vehicles for each specific strategy. In general, except in very specific cases and circumstances involving FIPs, Brazilian AIFs are not allowed to borrow cash. FIMs (hedge funds) can borrow securities in modalities authorised by the CVM as part of their investment strategies, subject to certain restrictions and limitations.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

According to the CVM regulations, the assets of any Brazilian AIFs must be held by the funds directly, except for real estate assets invested in by FIIs (real estate investment funds), which must be owned directly by the FII fiduciary administrator on a fiduciary basis on behalf of the FII.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

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

With respect to the investment manager, it is customary practice to prepare reports about the performance of the assets, perspectives on returns and results, among other relevant information, and make them available to investors in accordance with the frequency set forth in the AIF's bylaws. In general, the current regulations do not impose an obligation on the AIF investment manager to report or disclose ESG practices to investors, but it is becoming customary to include these practices and the related obligations in certain types of AIF funds.

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

Yes. The disclosure of the ultimate beneficial ownership of AIFs and entities doing business in the Brazilian financial and capital markets is generally required by the AIF fiduciary administrators and/or distributors, custodians of non-resident investment accounts, as applicable, as well as by the Brazilian tax authorities, subject to certain conditions and thresholds set forth in the applicable regulations.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

The CVM regulations do not provide for reporting requirements related to ESG matters associated with AIFs or their managers. However, as ESG practices and policies are becoming more common in the Brazilian investment management industry, the inclusion of obligations and reporting requirements in certain AIF bylaws are being increasingly demanded by investors and are expected to become customary.

5.4 Is the use of side letters restricted?

The general rule for Brazilian-formed investment funds is that all the quota holders participating in the fund with a fraction of its assets and holding the same type of quotas must be treated equally, holding the same rights and obligations. In this sense, the use of side letters, depending on their agreed terms and conditions, may represent a violation of the CVM regulations.

6 Taxation

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

Under Brazilian law, AIFs are treated as unincorporated pools of assets (condominiums) and regulated by the CVM as described above and not as taxable legal entities.

Consequently, income and capital gains earned by AIFs will only be subject to taxation, as a general rule, at the level of the quota holders. This is true for the FIP, FIM and FIDC types of AIF mentioned above.

For the FII and FIAGRO, an exception to this general rule applies, as net income and gains obtained by such types of funds with financial investments of fixed or variable income (other than mortgage and real estate bonds for FIIs or agricultural bonds for FIAGROs) are subject to the same income tax regime generally applicable to financial investments in Brazil. However, such tax may be offset against the income tax due at the moment the FII or the FIAGRO transfer such gains to investors.

There is also one exception that applies to FIIs. If the fund invests in real estate ventures in which the developer, constructor or other investor is also an investor of the FII who holds, either severally or jointly with related persons, more than 25% of the quotas of the fund, then the FII will be subject to the same tax regime applicable to Brazilian legal entities.

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

Investment management/advisory is typically provided by licensed individuals through a legal corporate entity formed as a limited liability company (an Ltda) or a corporation (an S.A.) that renders services to the AIF.

The Brazilian tax system does not foresee any special tax treatment for investment managers or advisers. Therefore, management, advisory and service fees earned by the legal entity are generally subject, at the corporate level, to gross revenue taxes (PIS and COFINS that apply at combined rates of 3.65% or 9.25%), corporate income taxes (nominal rate of 34%) and municipal service taxes (ranging from 2% to 5% according to the municipality where the legal entity is located).

Dividends paid out of profits by the legal entity to shareholders are currently exempt from taxes.

There are specific situations, for example, on certain FIP structures as described in question 6.8, in which more complex structures are set up with certain functions, employees or services, and service providers are divided between Brazil and offshore jurisdictions. These structures usually involve separate vehicles onshore and offshore as well as several agreements between Brazilian local entities, the AIF and foreign advisors from the different jurisdictions. For such cases there are additional tax issues that should be considered such as Brazilian controlled foreign company rules, transfer pricing and certain exemptions on the export of services.

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

As a general rule, there are no establishment or transfer taxes applicable to the investor's cash contribution or acquisition of participation in an AIF. The transfer of certain assets (such as shares and financial investments) as an interest contribution by an investor to an AIF, at fair market value, as determined by applicable law, could result in taxation for the investor if any gain is recognised upon such contribution (taxation varies according to the type of investor).

A transfer of the investor's interest to a third party is a taxable event, in general subject to capital gains tax as described in question 6.4 below.

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

As mentioned above, gains and income obtained by AIFs are not subject to taxation. Brazilian income tax is levied at the level of the investors on income or gains arising from the redemption, amortisation or sale of the quotas. Below is a high-level summary on the general taxation applicable to investors in AIFs.

Brazilian residents

As a general rule, for open-ended funds, the redemption or amortisation of quotas is currently subject to withholding income tax (WHT) applied on the positive difference between the redemption or amortisation amount and the cost of acquisition of the quota. WHT applies according to the following regressive rates:

- For short-term, fixed-rate funds:
  - 0–180 days: 22.5%.
  - 181–360 days: 20%.

- For long-term, fixed-rate funds:
  - 0–180 days: 22.5%.
  - 181–360 days: 20%.
  - 361–720 days: 17.5%.
  - More than 720 days: 15%.

During the investment period, a semi-annual Source Income Tax withholding regime (known as "*come-cotas*"), due on the last day of May and November, in an amount equivalent to 20% (for short-term funds) or 15% (for long-term funds) applies on the gains accrued. This is a pre-payment of the WHT due upon redemption or amortisation.

WHT levied on distributions made to Brazilian individuals is considered final. For Brazilian legal entities, the distribution should be considered as financial revenue and taxed according to ordinary corporate taxation.

For closed-ended funds, taxation can apply (i) upon redemption or amortisation (in which case a flat 15% or regressive rates from 22.5% to 15% can apply according to the type of investment fund), or (ii) a sale of the quotas (in which case taxation can vary depending on the taxpayer and if the sale was made in the stock exchange or not).

Non-residents

Non-resident investors are generally subject to the same taxation applicable to Brazilian resident individuals regarding taxation on AIFs.

Distributions made to non-residents as redemption of quotas of open-ended funds, when paid to an investor that carries out financial transactions in Brazil in accordance with the rules and conditions established by the CMN, except in the case of a beneficiary resident or domiciled in a tax haven jurisdiction, are not subject to the semi-annual WHT or to the 15% WHT.

For closed-ended funds, if the above requirements are met, the applicable WHT will be 10% or 15% (depending on the portfolio of the investment fund). An exemption applies to capital gains from the sale of quotas on the Brazilian stock exchange for non-resident investors that carry out financial transactions in Brazil in accordance with the rules and conditions established by the CMN.

Pension funds

The taxation of pension funds varies according to the type of legal entity. However, as a general rule, income or earnings obtained by Brazilian pension funds are exempted from income taxes and any WHT levied on gains (as described above) is considered final.

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

No, it is not necessary to obtain a tax ruling in Brazil. It is also not common practice to request a ruling prior to establishing an AIF.

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

As for FATCA, the Brazilian Congress issued Legislative Act 211/2013, enforcing a bilateral agreement for the exchange of information signed between Brazil and the U.S. on 20 March 2007.

Brazil has also implemented the OECD's Common Reporting Standard (CRS) for the exchange of financial account information. Regulation of such reporting obligation was enacted by the Brazilian Federal Revenue providing the requirements and guidelines for financial institutions to identify and remit information on reportable financial accounts of non-residents, which will be automatically exchanged with other jurisdictions participating in the CRS. The exchange of information is made under the Mutual Assistance Convention and the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information.

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

Brazil has formally expressed the desire to become a member of the OECD. The Brazilian Federal Revenue and OECD have been engaged in several research projects and produced reports on the impacts of the OECD's guidance on BEPS to existing Brazilian rules.

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

There are several structures and classes of assets that provide certain tax advantages. The most widely deployed structures are:

FIPs

As a general rule, distributions made by FIPs are subject to WHT at a rate of 15%.

For non-resident investors in accordance with the rules and conditions established by the CMN, a zero-rate WHT applies if certain requirements are complied with, as follows:

(i) the investor, including related parties, has less than 40% of the FIP quotas or of the right to receive FIP income at the time of the amortisation or sale of the quota;
(ii) the investor is not resident in a tax haven jurisdiction; and
(iii) the FIP does not hold in its portfolio, at any time, debt securities exceeding 5% of the FIP's net equity (except for convertible debentures and government bonds).

FIP-IEs

The FIP-IE was introduced to incentivise investments in new infrastructure projects. Income from the redemption of FIP-IE quotas, including income from the liquidation of the fund, is subject to a 15% WHT on the positive difference between the value of redemption and the cost of acquisition of the quotas.

In the case of a sale of the quotas of the FIP-IE, the gains will be taxed: (i) at a 0% rate, for individuals, in transactions carried out on or off the stock exchange; or (ii) as a net gain, at a 15% rate, when earned by a legal entity in transactions carried out on or off the stock exchange.

For non-resident investors, the sale of the quotas of the FIP-IE is subject to a 0% rate when paid to a beneficiary resident or domiciled abroad, whether an individual or group, that carries out financial transactions in Brazil in accordance with the rules and conditions established by the CMN if certain conditions are met, such as:

(i) it is not a beneficiary resident or domiciled in a tax haven jurisdiction;
(ii) at least 90% of the equity of the fund is invested in shares, warrants, debentures, whether convertible or non-convertible into shares, or other securities issued by special purpose companies that invest in certain sectors provided in law; and

(iii) the fund must have a minimum of five quota holders, each of which may not hold more than 40% of the units issued by the FIP or earn an income of more than 40% of the fund's total income.

Funds for government bonds
The income tax rate on earnings from quotas of non-resident investors in investment funds exclusively for non-Brazilian investors with at least 98% invested in government bonds is reduced to zero.

FIDC structures
The tax rate on earnings from FIDCs for non-Brazilian investors is reduced to zero if (i) the credit rights portfolio originator or assignor is not a financial institution, and (ii) the funds are allocated to investment projects, including research, development and innovation.

FIIs
FIIs are AIFs that can hold in their portfolio real estate assets such as real property, mortgage and other real estate bonds, real estate companies' securities, as well as equity in other investment funds.

Taxation at the investor's level for distributions made by the FII are as follows:

(i) individuals, whether resident or domiciled in Brazil or non-residents, are exempted from income tax, provided that (a) the FII quotas are traded in the stock exchange or an over-the-counter market, (b) such quotas are held by at least 50 investors, and (c) the investor does not hold more than 10% of the FII quotas nor is entitled to more than 10% of the FII's proceeds; and

(ii) legal entities and individuals not entitled to the exemption are subject to income tax at a fixed rate of 20% if the investor is a Brazilian resident and 15% for non-resident investors (in case of amortisation or redemption, only the net gain is subject to taxation).

On the sale of quotas, the applicable rates are: (1) 20% for Brazilian investors; and (2) non-resident investors are (a) exempt if executed on the stock exchange, or (b) taxed at a rate of 15%.

FIAGROs
FIAGROs were recently introduced for investments in (i) rural real estate, (ii) equity in agro-industrial companies, (iii) financial assets, credit securities or securities issued by individuals and companies that are part of the agro-industrial production chain, and (iv) agribusiness securities and receivables (e.g., CRAs, etc.). FIAGRO taxation is similar to that for FIIs as described above. Brazilian tax authorities have not yet issued regulations regarding the FIAGRO.

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

No, there are not. However, the Brazilian tax system is highly complex, subject to frequent changes and it is not uncommon that Brazilian tax authorities take aggressive positions regarding the applicability of taxes.

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

There are no tax changes approved by Congress for the coming 12 months. Nevertheless, the government has filed a tax reform proposition on corporate income taxes, including changes to the taxation on financial investments (such as a flat 15% rate, instead of the regressive rates from 22.5% to 15% for WHT, and annual "come quotas" as opposed to the current "semi-annual come quotas") and AIFs (such as taxation of closed-ended funds and FIPs as well as a change to the current exemption that applies to the FII, amongst others). The tax reform still has to be approved by both Houses of Congress.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

Recently, as of June 2021, the relatively low interest rate environment has driven Brazilian investors to seek higher return investments, including AIFs, mainly in the private equity and venture capital, infrastructure, real estate and special situations strategies. Thanks to recent regulatory reforms, investment alternatives that a few years ago were only available to sophisticated investors are now also available to qualified investors and, in a few cases, to retail investors through registered public offerings.

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

New regulatory regimes for investment funds and, more specifically, FIDCs, are expected to be enacted by the CVM in the last quarter of 2021 or in the first few months of 2022, bringing relevant innovations to the AIFs space, such as the regulation of limitation of liability to investors, clearer rules on the liabilities of service providers, possibility of segregation of assets, among others.

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Maples Group

1 Regulatory Framework

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

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

The Private Funds Act (As Revised) (the "**PF Act**") provides for the regulation of closed-ended investment funds. Responsibility for regulation under the PF Act rests with CIMA.

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

CIMA has also published rules and guidance regarding certain operational requirements for CIMA-registered mutual funds and private funds, including in respect of the valuation of assets, safekeeping of fund assets, cash monitoring and identification of securities.

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

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

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

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

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

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

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

A "Registered Person" includes:

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

(b) a person carrying on SIB exclusively for one or more of the following classes of person:

  (i) a sophisticated person (i.e., a person regulated by CIMA or a recognised overseas regulatory authority or whose securities are listed on a recognised securities exchange or who by virtue of knowledge and

experience in financial and business matters is reasonably to be regarded as capable of evaluating the merits of a proposed transaction and participates in a transaction with a value or in amounts of at least US$100,000 in each single transaction); or

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

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

provided always that such person has a registered office or a place of business in the Cayman Islands provided by a licensed corporate services provider (such as, for example, Maples Corporate Services Limited); and

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

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

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

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

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

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

There are four categories of mutual funds:

1. a licensed fund under section 4(1)(a) of the MF Act;
2. an administered fund under section 4(1)(b) of the MF Act;
3. a registered fund under section 4(3) of the MF Act; and
4. a limited investor fund under section 4(4) of the MF Act.

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

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

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

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

(b) the investments are managed as a whole by or on behalf of the operator of the private fund, directly or indirectly, but does not include:
   (i) a person licensed under the *Banks and Trust Companies Act (As Revised)* or the *Insurance Act (As Revised)*;
   (ii) a person registered under the *Building Societies Act (As Revised)* or the *Friendly Societies Act (As Revised)*; or
   (iii) any non-fund arrangements.

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

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

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

CIMA has established a secure Regulatory Enhanced Electronic Forms Submission (REEFS) web portal, which enables the online

submission of mutual fund and private fund applications and documentation. An application for a section 4(3) mutual fund, limited investor and private fund involves the submission of:

(a) the fund's offering document, other than (i) in the case of a master fund, which will often not have an offering document separate from that of its feeder fund(s), and (ii) in the case of a private fund and a limited investor fund, a summary of terms or marketing materials may be submitted if the fund does not have an offering document;
(b) the relevant statutory application form;
(c) consent letters from the fund's auditor and administrator (except in respect of a private fund that does not engage an external administrator);
(d) the relevant fees (currently a registration fee of US$4,268, initially and annually, and a separate application fee of US$366, other than in the case of a master fund which has a registration fee of currently US$3,049 initially and annually;
(e) for section 4(3) mutual funds only, an affidavit or declaration signed by an operator of the fund relating to the authorisation of submission of the online application; and
(f) a structure diagram for private funds.

CIMA's practice with these funds is to make the effective date of the application the date on which all application requirements have been submitted. For a regulated mutual fund, an application must be completed prior to the fund's launch. For a private fund, an application must be submitted to CIMA within 21 days after its acceptance of capital commitments from investors or, if earlier, prior to the private fund receiving any capital contributions for the purposes of investments.

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

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

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

The Directors Registration and Licensing Act (As Revised) (DRLA) requires that the directors (both natural persons and corporate directors) of a corporate mutual fund regulated by CIMA or a certain type of "Registered Person" registered with CIMA under SIBA be either registered or licensed with CIMA. The registration process is undertaken online at the "CIMA Director Gateway".

1.7 What service providers are required?

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

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

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

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

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

The Cayman Islands has Tax Information Exchange Agreements and similar bilateral arrangements with 36 countries as of May 2021 and is on the OECD "white list" with respect to the exchange of tax information. In addition, CIMA has entered into bilateral regulatory cooperation agreements pursuant to the AIFMD with the competent authorities of 27 of the EU and EEA Member States. Please also see the description of FATCA/CRS under question 6.6.

2 Fund Structures

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

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

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

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

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

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

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

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

The limited liability of investors in a Cayman Islands investment fund depends upon the nature of the vehicle used and whether

the investor has agreed to contribute additional funds to that vehicle pursuant to the terms of the governing documentation.

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

Limited partners ("**LPs**") of an ELP shall not be liable for the debts or obligations of the ELP under the ELP Act, (a) save as provided by the terms of the applicable partnership agreement, and (b) subject to the provisions of the ELP Act (i) providing that an LP who takes part in the conduct of the business of the ELP may lose its limited liability with respect to a third party who deals with that ELP and who reasonably believes such LP to be a GP of such ELP, and (ii) providing for clawback of capital distributions (together with interest) made to an LP within six months of the ELP becoming insolvent where the LP had actual knowledge of the insolvency.

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

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

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

The principal structures are exempted companies and LLCs.

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

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

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

Not as a general matter of Cayman Islands Law, subject to restrictions on the assignment of certain liabilities by LPs pursuant to the ELP Act or the transferee meeting any minimum investment requirements that may apply. Proposed transferees will need to satisfy applicable know your client and anti-money laundering requirements.

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

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

3 Marketing

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

The MF Act requires that every regulated mutual fund issue an offering document which must describe the equity interests in all material respects and contain such other information as is necessary to enable a prospective investor to make an informed decision whether or not to invest. CIMA has also issued a rule relating to the contents of offering documents for all funds licensed or registered under the MF Act.

For private funds registered under the PF Act, to the extent any offering document (or other document that solicits investors to invest in a private fund) is issued to investors, it must comply with CIMA's rule on the contents of marketing materials.

The Japan Regulations also set out additional disclosure requirements for the prospectus of a retail mutual fund, which are more onerous.

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

An offering document of a regulated mutual fund must contain the disclosures set out in CIMA's rule on the contents of offering documents, which include the following:

(a) details of the name of the fund, date of establishment of the fund, its registered office, fiscal year and its operator together with biographies;
(b) a description of the fund's investment objectives, policy, and restrictions;
(c) a description of the fund's investment manager or adviser, together with biographies of the portfolio managers and information regarding remuneration;
(d) the names and addresses of the fund's other service providers, together with details of the services to be performed and remuneration;
(e) the classes of interests available for investment or issue, together with descriptions of any minimum investment, eligibility requirements and subscription procedures;
(f) details of the principal rights and restrictions attaching to the fund's equity interests, including with respect to currency, voting, circumstances of winding up or dissolution and the procedures and conditions for repurchases, redemptions or withdrawals of such equity interests, including suspensions;
(g) the NAV calculation policy; and
(h) details of the fund's material risks and potential conflicts of interest.

Where a private fund has an offering document or marketing materials, CIMA's rule on the contents of marketing materials also applies. A private fund's offer document (if any) or summary of terms (required for registration under the PF Act) should contain, as a minimum, the name and address of the fund, the name and address of the general partner (if the fund is an ELP), the name, address and biographies of the principals of the operators of the fund, the name and address of the manager, the name, address and biographies of the principals/senior officers of the manager, the base currency of offering, the minimum investment, the valuation policy, the applicable audit principles, the financial year end, the term, the investment strategy, applicable risk factors and conflicts of interest, applicable Cayman Islands laws and regulations (including the anti-money laundering

regulations), and the name and address of the administrator (if any), the custodian (if any), the auditor, the Cayman Islands legal adviser and registered office service provider.

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

The offering document of a registered mutual fund must be filed with CIMA as part of the initial application; however, it is not technically subject to approval by CIMA prior to its circulation to prospective investors. An amended offering document or supplement must be filed with CIMA within 21 days in the event of material changes, where there is a continuing offering.

A private fund is required to submit an offer document (if any) or a summary of terms for registration under the PF Act. Details of any material changes to the information submitted on the registration of a private fund must be filed with CIMA within 21 days of such change (or becoming aware of such change).

3.4 What restrictions are there on marketing Alternative Investment Funds?

Generally, no offer or invitation to subscribe for equity interests in a Cayman Islands investment fund may be made to the "public in the Cayman Islands". The range of persons that may be considered excluded from the "public in the Cayman Islands" will depend upon the fund's legal structure and whether or not the fund is regulated under the MF Act or the PF Act, but it is generally likely that Cayman Islands exempted companies, LLCs, ELPs and exempted trusts engaged in offshore business and foreign companies registered in the Cayman Islands will not be considered part of the "public in the Cayman Islands".

Prior to the filing for registration of a private fund with CIMA, the private fund may only be marketed to high-net-worth or sophisticated persons.

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

No, it is not.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes, in respect of section 4(1)(a) or section 4(1)(b) funds under the MF Act. In respect of section 4(3) mutual funds, yes, subject to the US$100,000 minimum investment or the equity interests being listed on a recognised stock exchange. There is no statutory minimum investment amount for a private fund.

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

Potential investors will be subject to due diligence and sanction checks in accordance with the Cayman Islands' anti-money laundering regime.

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

No, there are not.

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

No, there are not.

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

No, there are not.

4 Investments

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

There are no such restrictions on investment strategy subject to applicable local regulatory laws.

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

No, there are not.

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

No, there are not.

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

No, there are no such restrictions (assuming that the fund is not subject to the Japan Regulations).

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

There are no such restrictions on mutual funds regulated under the MF Act. However, regulated mutual funds are required to comply with CIMA's rules relating to Net Asset Value Calculation and the Segregation of Assets.

Private funds regulated under the PF Act are also subject to CIMA's rules relating to Net Asset Value Calculation and the Segregation of Assets. Further, a private fund is required to appoint a custodian unless it has notified CIMA and it is neither practical nor proportionate to do so having regard to the nature of the private fund and the type of assets it holds. If no custodian is appointed, a private fund must appoint an administrator or another independent third party or (subject to disclosing and managing any conflicts) the operator or investment manager/adviser to verify that the private fund holds title to its assets, and to maintain a record of those assets.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

There are no public disclosure requirements for exempted companies or trusts. Although such vehicles are required to maintain statutory registers and make certain filings with the Cayman Islands Registrar and CIMA, those registers and filings are not available to inspection by the general public.

The register of limited partnership interests of an ELP is required by the ELP Act to be open to inspection during all business hours by all partners, subject to any express or implied term to the contrary of the limited partnership agreement, or by any other person with the consent of the GP.

While there is currently no local regulation requiring disclosure for funds engaged in environmental, social and/or governance ("**ESG**") factors, interest from both investors and managers regarding these factors has resulted in additional voluntary disclosure by such funds.

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

The Cayman Islands beneficial ownership regime ("**BOR**") requires certain exempted companies and LLCs (but not ELPs) to maintain non-public registers of beneficial owners at their Cayman Islands registered offices, which are then submitted to a competent authority designated by the Cayman Islands Government. However, BOR does not apply to CIMA regulated mutual funds and entities that are managed, arranged, administered, operated or promoted by an "approved person" (generally a regulated or listed person or subsidiary of such person) as a special purpose vehicle, private equity fund, collective investment scheme or investment fund.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

Regulated mutual and private funds are required to file, in electronic format, audited financial statements, an annual Key Data Elements Form (containing a summary of the basic information about the fund) and a Fund Annual Return ("**FAR**"), in each case within six months of the financial year end. The FAR provides general, operating and financial information relating to such regulated funds. Certain additional requirements apply to funds subject to the Japan Regulations.

A manager registered as a "Registered Person" pursuant to SIBA is required to make an annual filing confirming its status with CIMA but does not otherwise have any reporting requirements.

See question 5.1 regarding ESG factors.

5.4 Is the use of side letters restricted?

No. Side letters are commonly used by Cayman Islands investment funds although certain legal considerations should be borne in mind in order to ensure that such letter agreements are compliant with Cayman Islands law.

6 Taxation

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

The Cayman Islands imposes no taxation on the income or capital gains of investment funds or their investors and no transfer taxes on the transfer of interests in investment funds. As discussed above, "exempted" companies, ELPs, unit trusts and LLCs can obtain undertakings from the Cayman Islands government that if any taxation is introduced during the period of the undertaking, such taxation will not apply to the entity to which the undertaking is given.

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

Please see question 6.1.

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

No, there are none.

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

There is no distinction from a Cayman Islands perspective – please see question 6.1.

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

No, it is not.

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

The Cayman Islands has signed an inter-governmental agreement to improve international tax compliance and the exchange of information with the United States (the "**US IGA**"). The Cayman Islands has also signed, along with over 100 other countries, a multilateral competent authority agreement to implement the OECD Standard for Automatic Exchange of Financial Account Information – Common Reporting Standard ("**CRS**" and together with the US IGA, "**AEOI**").

Cayman Islands regulations have been issued to give effect to the US IGA and CRS (collectively, the "**AEOI Regulations**"). Pursuant to the AEOI Regulations, the Cayman Islands Tax Information Authority (the "**TIA**") has published guidance notes on the application of the US IGA and CRS.

All Cayman Islands "Financial Institutions" are required to comply with the registration, due diligence and reporting requirements of the AEOI Regulations, unless they are able to rely on an exemption that allows them to become a "Non-Reporting Financial Institution" (as defined in the relevant AEOI Regulations) with respect to one or more of the AEOI regimes, in which case only the registration requirement would apply under CRS.

The AEOI Regulations require funds to, among other things (i) register with the Internal Revenue Service ("**IRS**") to obtain a Global Intermediary Identification Number (in the context of the US IGA only), (ii) register with the TIA, and thereby notify the TIA of its status as a "Reporting Financial Institution", (iii) adopt and implement written policies and procedures setting out how it will address its obligations under CRS, (iv) conduct due diligence on its accounts to identify whether any such accounts are considered "Reportable Accounts", (v) report information on such Reportable Accounts to the TIA, and (vi) file a CRS Compliance Form with the TIA. The TIA will transmit the information reported to it to the overseas fiscal authority relevant to a reportable account (e.g. the IRS in the case of a US Reportable Account) annually on an automatic basis.

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

Country-By-Country Reporting

As part of the Cayman Islands' ongoing commitment to international tax transparency, the Tax Information Authority (International Tax Compliance) (Country-By-Country Reporting) Regulations (As Revised) (the "**CbCR Regulations**") were issued on 15 December 2017, with the Department for International Tax Cooperation releasing its Guidance on the Country-by-Country Reporting ("**CbCR**") requirements of entities that are resident in the Cayman Islands on 29 March 2018.

The CbCR Regulations essentially implement in the Cayman Islands the model legislation published pursuant to the OECD's Base Erosion and Profit Shifting Action 13 Report (Transfer Pricing Documentation and Country-by-Country Reporting). The CbCR Regulations also reflect the Cayman Islands' obligations under the OECD Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (the "**CbC MCAA**").

Pursuant to this initiative, qualifying multinational enterprises ("**MNEs**") are required to report annually the information set out in the model legislation for each tax jurisdiction in which they operate. The TIA will automatically exchange such reports prepared by MNE Groups in the Cayman Islands with partner jurisdiction competent authorities in all jurisdictions that the MNE Group operates, provided that the jurisdiction is a co-signatory to the CbC MCAA or a tax information exchange agreement is in place between the Cayman Islands and each relevant jurisdiction. The information reported will be subject to confidentiality restrictions compliant with the requirements of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

Pursuant to the CBCR Regulations, any business unit or permanent establishment of an MNE Group "resident in the Cayman Islands" that are "Constituent Entities" will have registration and/or reporting requirements in the Cayman Islands. An MNE Group means, broadly, with respect to any fiscal year of the Group, a Group that has two or more enterprises for which the tax residence is in different jurisdictions or that has an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax through a permanent establishment in another jurisdiction and, in both cases, that has a total consolidated group revenue of equal to or more than US$850 million during its preceding fiscal year.

Lack of Tax Treaties

As a Cayman Islands fund will not be claiming access itself to a tax treaty, Action 6 is not directly relevant to it. However, a Cayman Islands fund can be set up in a variety of different legal forms, either as legally transparent or opaque, which facilitate cross-border fund structures, whereby either the fund investors may rely on their own treaty or through investment entities that may be able to rely on their own treaty.

Economic Substance

In response to the BEPS standards on geographically mobile activities, on 27 December 2018, the Cayman Islands published The International Tax Co-operation (Economic Substance) Act (As Revised) and The International Tax Co-operation (Economic Substance) (Prescribed Date) Regulations (As Revised) (together, the "**Initial Act**"). The Initial Act was amended by several amendment regulations, which were subsequently consolidated into the International Tax Co-operation (Economic Substance) Act (As Revised) (the "**Economic Substance Act**"). The Economic Substance Act is supplemented by the issuance of the related Guidance on Economic Substance for Geographically Mobile Activities, version 3.0 of which was issued on 13 July 2020.

The Economic Substance Act introduces certain reporting and economic substance requirements for "relevant entities" conducting "relevant activities". Such entities will be required to report certain information on their relevant activities on an annual basis to the TIA, the first such annual report being due no later than 12 months after the last day of the relevant entity's financial year commencing on or after 1 January in the year it commences a relevant activity.

The definition of "relevant entity" is set out in the Regulations. It expressly recognises that, among other things, an entity that is an "investment fund" is not within the classification of a "relevant entity" and therefore not subject to the requirements of the Economic Substance Act.

The definition of "investment fund" includes an "entity through which an investment fund directly or indirectly invests or operates".

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

Not applicable – please see question 6.1.

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

No, there are not.

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

No, there are not.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The number of both regulated mutual funds and private funds has increased significantly during the past 12 months. The number of CIMA regulated mutual funds increased by 1,039 during the course of 2020, from 10,857 in December 2019 to 11,896 in December 2020. With limited investor funds now required to register under the MF Act, 583 such funds registered during 2020. The growth in regulated mutual funds continued to grow into the first quarter of 2021, with an additional 329 regulated mutual funds being registered with CIMA by 31 March 2021.

Following the introduction of the PF Act in 2020, 12,695 private funds registered with CIMA for the first time in 2020. The growth in private funds continued into the first quarter of 2021, with an additional 524 such funds being registered by 31 March 2021.

As a leading domicile for alternative investment funds, the Cayman Islands combines a robust legal and regulatory regime with a pragmatic commercial approach to business.

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

It is anticipated that the economic substance requirements outlined in question 6.7 will be extended to apply to partnerships from mid-2021.

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1 Regulatory Framework

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

There is no specific regulation for Chilean Alternative Investment Funds ('*AIFs*'). Vehicles typically used in our jurisdiction as AIFs are regulated under Law No. 20,712 (the '*Funds Law*'), its internal regulation (Decree No. 129) and, depending on the type of investor the fund is targeted at, Law Decree No. 3,500 (the '*Pension Fund Investment Regime*') could also be applicable.

For the purposes of this chapter, we refer only to onshore structures and exclude requirements, licensing, and the registration process for foreign AIFs to be traded or marketed in Chile.

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

Public investment funds, *i.e.* local closed-ended investment funds with shares listed on a local stock exchange ('*Public Funds*'), and private investment funds, *i.e.* local closed-ended unlisted investment funds ('*FIPs*'), may be managed by so-called 'general funds managers' ('*AGFs*'), special corporations that require prior authorisation of the Chilean Financial Market Commission (*Comisión para el Mercado Financiero* or '*CMF*') to be incorporated and to act as a fund manager. FIPs, however, can also be managed by an unregulated closely held corporation (a '*FIP Manager*'), which does not require prior authorisation, and must only comply with certain reporting obligations in relation to the CMF.

Also, Law No. 21,314, which came into effect in April 2021, regulates investment advisory services, defined as the provision, by any means, of services or the offering of related products to the general public or to specific sectors, where such are related to investment in financial instruments of any kind. This regulation states that investment advisory may only be provided on an ongoing basis by (i) those registered in the registry that the CMF will keep for that purpose, and (ii) those entities that, according to article 3° of Law No. 21,314, are exempted from such registration (banks incorporated in Chile, insurance and reinsurance companies, intermediaries of publicly offered securities, fund managers authorised by law and portfolio managers supervised by the CMF).

Regarding investment advisory services, pursuant to General Regulation No. 412, certain key persons in AGFs, Chilean portfolio managers, placement agents and brokers (among others) need to pass an exam carried out by the stock exchange to evidence their technical knowledge.

Finally, if an entity consistently manages portfolios for more than 50 non-related entities for an amount of over 10,000 *Unidades de Fomento* (around US$400,000) or manages over 500 portfolios, its shall be registered in the CMF and act according to the provisions of Title II of the Funds Law.

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

Funds in Chile do not have a separate legal personality. However, a fund constitutes a separate estate, a pool of assets different to the assets of the management company (the Chilean equivalent of the general partner) and the assets of the individuals or entities that have a participation in it.

Public Funds are overseen by the CMF. Once the AGF's board of directors has passed a resolution approving the bylaws (*reglamento interno*) of the fund, the bylaws, along with other documentation established by CMF regulation, must be deposited in the CMF's 'Public Registry of Funds' Bylaws'. No specific authorisation is required, notwithstanding the CMF's authority to present its observations on the fund's legal documents if they do not fulfil the legal requirements.

FIPs are not subject to licences or authorisations.

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

As mentioned above, the regulation distinguishes between mutual funds, Public Funds and FIPs, disregarding other types of funds or their investment strategy or purpose (subclassifying Public Funds and FIPs into redeemable and non-redeemable).

The exception would be the Pension Fund Investment Regime, which classifies funds into several categories in order for them to be eligible for pension fund resources.

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

See question 1.3 above. Once the Public Fund's bylaws are registered in the CMF, the fund's shares may be placed and will be considered as publicly offered securities for all legal purposes, including marketing (see section 5 below).

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

No; however, FIPs and Public Funds need a registered office or domicile in Chile (which is normally the management company's domicile) and books and records which are kept by the management company. Further, the residence of the contributors and the underlying assets may be of importance when analysing tax benefits and exemptions (see section 6 below).

1.7 What service providers are required?

Other than the fund manager, the fund will need to have a custodian for the assets that are subject to custody. If the fund's bylaws allow it, it may outsource other kinds of services (such as back office or compliance), in which case it must also state who bears such expenses.

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

As mentioned above, Chilean funds may only be managed by FIP Managers or AGFs, and thus foreign managers may not directly manage Chilean funds without incorporating or outsourcing a FIP Manager or AGF, as applicable, that fulfils the local requirements.

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

Chile has multiple co-operation and information-sharing agreements from tax, customs and regulatory standpoints. Notwithstanding that there is no agreement in place specifically for AIFs, the CMF is part of the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), among other bodies, and has multiple co-operation and information-sharing agreements in force with foreign regulatory entities (such as the US Securities and Exchange Commission), which can be found on the CMF's website.

2 Fund Structures

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

The vehicles typically used in our jurisdiction as AIFs are Public Funds and FIPs.

FIPs are different from Public Funds because (i) they are not subject to the CMF's supervision, and (ii) have fewer than 50 shareholders that are not 'members of the same family' ('members of the same family' is defined as those who maintain among them a certain degree of consanguinity or affinity relationship, and entities directly or indirectly controlled by each of those people).

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

In Chile, as a general rule, management companies and fund shareholders are not liable for the fund's obligations. Chilean law does not expressly permit the disregarding of the limited liability of the fund to reach its management company or shareholders. Moreover, the 'piercing of the corporate veil' theory has only been applied by courts in our jurisdiction with respect to corporations, and just in a few exceptional cases (cases of fraud or abuse of rights which have produced damages against a third party). However, since Chile is governed by civil law, such precedents are not binding for any court.

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

As stated in question 1.2 above, fund managers need to be incorporated as AGFs or FIP Managers.

AGFs are subject to the following special rules: (i) AGFs need to be organised as special corporations for the unique corporate purpose of managing third-party funds; (ii) AGFs are subject to the provisions that regulate public corporations and are supervised by the CMF; (iii) AGFs must include in their names the following phrase: '*Administradora General de Fondos*'; (iv) AGFs need to maintain a paid capital of at least 10,000 *Unidades de Fomento* (around US$400,000); (v) AGFs have to issue a guarantee in favour of each of their managed funds to guarantee the fulfilment of their obligations; and (vi) after the lapse of one year starting from the granting of authorisation for incorporation, AGFs must manage at least one operating fund with an equity of at least 10,000 *Unidades de Fomento* (around US$400,000) and have least one institutional investor or 50 shareholders.

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

Funds are either structured as redeemable or non-redeemable. The regulation on redemptions must be included in detail in the fund's bylaws, differentiating between standard redemptions and redemptions of a sizable amount.

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

The Funds Law provides that no shareholder of the Public Fund that is not an institutional investor (such as banks) may directly or indirectly own more than 35% of the funds' shares after one year from the fund's incorporation.

Regarding FIPs, FIP Managers have a shareholding limit of 20% over the FIP's shareholding (which may be lowered to 10% in case the FIP has access to alternatives to Chilean Economic Development Agency (*Corporación de Fomento de la Producción* or '*CORFO*') funding). Further, provided that no shareholder is an institutional investor, one year after the FIP has been incorporated it must have at least eight shareholders, each of them owning less than 20% of the FIP's shareholding (including related parties).

Finally, note that pension funds have specific limits on investment in Public Funds, which are thoroughly detailed in the Pension Fund Investment Regime and the Pension Fund Superintendence Compendium (which does not expressly authorise investment in FIPs).

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

While General Rule No. 365 of the CMF sets forth the requirements of a Public Fund's bylaws (which contain an investment policy, liquidity policy, indebtedness policy and voting policy, among others), Chilean regulation does not impose specific limitations (other than the prohibitions stated in questions 4.1 and 4.2). However, if the AGF pursues the raising of capital from pension funds, additional restrictions may apply to accommodate the policies of the Pension Fund Investment Regime.

Note that FIPs may be subject to some additional requirements if they have obtained access to funding from the CORFO.

3 Marketing

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

The offering of securities is governed mainly by Law No. 18,045 on the Securities Market, the Funds Law and certain general rules issued by the CMF.

There is no definition of 'private offering' in Chilean securities law; however, the CMF has established a safe harbour rule under current regulation through General Rule No. 336.

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

The legal implications and key content of offering securities in Chile changes substantially depending on whether the offer itself qualifies as a 'public offering' or a 'private offering', the main difference between the two procedures being the requirement to register the securities with the CMF.

For public offerings, General Rule No. 365 of the CMF states that, prior to any investment, the AGF must make available to investors: the fund's bylaws; the share subscription agreement and the general share subscription agreement of the AGF (*contrato general de Fondos*), all of which must be in Spanish and in clear language; a copy of the portfolio and the financial statements sent to the CMF; and, in case of non-redeemable Public Funds, the AGF board of directors' meeting minutes agreeing the commercial conditions of the shares. Further, the AGF must provide investors with a copy of the investment brochure, which shall contain in clear language the essential information of the Public Fund that allows investors to understand the nature of the fund and its risks, allowing investor to make an informed decision (*e.g.* the fund's purpose, the targeted type of investor, historical revenues, among others).

Regarding private offerings, every communication must be in Spanish or English and shall express: (i) the date of commencement of the offering and that such offer is subject to the provisions of CMF General Rule No. 336; (ii) that the offering refers to securities that are not registered in the Securities Registry of the CMF and that they are not subject to the CMF's supervision; (iii) that the issuer is not obliged to deliver public information regarding such securities in Chile; and (iv) that such securities cannot be publicly offered while they are not properly registered.

Note that, pursuant to article 93 of the Funds Law, a FIP's shares may not be publicly offered, marketed, advertised, or registered with the CMF (unlike Public Funds' shares), so they must fulfil the process set out by General Rule No. 336, applicable to private offerings expressly stating that they are not regulated or overseen by the CMF.

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

For public offerings only, the securities must be previously registered with the CMF.

3.4 What restrictions are there on marketing Alternative Investment Funds?

There are no additional requirements other than those stated above for the public or private offering of securities.

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

Pre-marketing is not recognised in our jurisdiction.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes, provided they are compliant with the requirements for public or private offerings. Shares of Public Funds may be offered through public offerings since the fund's shares are registered with the CMF. However, as stated in question 3.2, FIP shares may not be publicly offered. Therefore, pursuant to General Regulation No. 336, they may be marketed to up to 50 non-qualified (or retail) investors.

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

There is no qualification requirement *per se*, but the offering mechanics and requirements differ for retail investors and 'qualified investors' (such as banks, financial companies, insurance and national reinsurance companies, fund managers, among others), especially for private offerings.

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

The regulations of public bodies generally differ from each other. As mentioned above, marketing to pension funds is no different than any other 'qualified investor'; however, they are subject to specific limits regarding investments per asset, per issuer, limits regarding commissions, among others.

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

No, provided that if the sponsors carry out regulated activities in Chile, they must be previously approved as such (*e.g.* securities brokers).

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

The use of an intermediate to assist in fundraising is authorised, provided that if they act as stockbrokers or securities agents (*agente de valores*) they must be duly registered with the CMF and comply with their corresponding legal requirements.

Also, as mentioned in question 1.2, investment advisory services are subject to the provisions of Law No. 21,314.

4 Investments

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

Funds cannot directly develop commercial, industrial, real estate, mining, agricultural, exploration, exploitation, or extraction of assets of any kind, insurance, reinsurance or intermediation activities or any other business involving the direct development of an industrial, professional, commercial or construction activity by the fund and in general, any activity directly developed by the fund other than investment or complementary activities.

Further, AIFs have specific restrictions regarding related-party transactions and investments in instruments issued or guaranteed by the fund manager or its related parties.

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

Funds cannot directly invest in water rights, industrial or intellectual property rights, mining concessions, real estate, or vehicles of any kind.

Further, any investment carried out by Public Funds must comply with the basic information, regulation and oversight requirements set out in General Rule No. 376 of the CMF (*e.g.* that the jurisdiction of the investments must be a member of the GAFI-FATF (or an equivalent organisation)).

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

No, provided that they comply with the limits and requirements set forth in the funds' bylaws and the applicable corporate approvals.

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

No, provided that they comply with the limits and requirements set forth in the funds' bylaws and the applicable corporate approvals (except for some very specific limits, such as that mutual funds may not own more than 25% of the debt of the State of Chile or another foreign state).

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

Yes, all assets eligible to be subject to custody must be held by a depository company registered with the CMF called the Central Securities Depository S.A. Foreign assets and assets which are not eligible to be subject to custody are subject to specific regulations (General Rule No. 235 of the CMF).

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

(a) Public Funds

AGFs must disclose material information regarding themselves and the Public Funds they manage (along with information about the main characteristics of the Public Funds and their series of shares) truthfully, sufficiently and promptly, to the Public Fund's shareholders and the public in general. Material information is such information that a person of good judgment would consider important for his/her investment decisions.

This information is delivered to the CMF and automatically posted on the CMF's website. Therefore, it is possible to check Public Funds' bylaws, financial statements, material information, shareholders' registry, etc. online.

Environmental, social and governance ('*ESG*') factors are a relatively new trend in Chile and only referred to in some secondary CMF legislation (General Rule Nos 385 and 386) addressing ESG factors related to certain mandatory reports, which must include information about the adoption of ESG factors. There is no obligation to apply such factors, but it is mandatory for issuers of publicly offered securities (such as a Public Fund) to report whether they have adopted them and their status regarding diversity ratios and the gender pay gap. Such information must be submitted each year through a direct communication to the CMF and must be included in a special section of the companies' annual report.

Entities reporting to the CMF shall address ESG topics by answering a questionnaire on self-regulation policies, good practices and standards, including 19 questions directly related to social responsibility and sustainable development (including risk assessment and control for sustainability and social benefits issues, the adoption of international principles, how the shareholders are informed about the ESG principles that have been adopted, relations with stakeholders, indicators to measure the social and environmental impact of the company, etc.).

There is no obligation to adopt the good practices or guidelines mentioned in the questionnaire or to improve diversity ratios.

(b) FIPs

Although FIP Managers are entities that report to the CMF, they do not have an obligation to disclose information about the FIPs they manage to the public in general. The information they are compelled to send to the CMF is only related to: (i) the identification of the FIP and its shareholders; (ii) the value of the contributions made by the shareholders to the FIP; and (iii) the value of the FIP's assets. Additionally, the CMF may request further information to the management company in order to supervise compliance with the Funds Law in different matters.

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

Yes, AGFs, Public Funds and FIP Managers are registered in the

Financial Analysis Unit (*Unidad de Analisis Financiero* or '*UAF*'). The UAF is an autonomous governmental agency, seeking to prevent the misuse of the financial and other markets for money laundering and/or terrorism financing activities. The UAF is responsible for supervising compliance with the anti-money laundering and counter-terrorism financing ('*AML/CTF*') controls of the AML Act (Law No. 19,913) and the UAF General Instructions. Reporting Entities (including AGFs) are subject to regulation by the UAF in respect of their compliance with all such AML/CTF controls.

On 12 June 2017, the UAF issued General Instruction No. 57, imposing on 'Reporting Entities' (including, but not limited to, banks and financial institutions, representative offices of foreign banks, fund managers, brokerage firms, securities brokers, insurance companies) additional AML/CTF and Know Your Customer controls. Reporting Entities must identify, independently verify and record supporting evidence as to their clients' (legal entities) ultimate beneficial ownership.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

As detailed in question 5.1, AGFs must disclose material information regarding themselves and the Public Funds they manage (along with information about the main characteristics of the Public Funds and their series of shares) truthfully, sufficiently and promptly, to the Public Fund's shareholders and the public in general. Material information is such information that a person of good judgment would consider important for his/her investment decisions.

Further, as mentioned above, AGFs and FIP Managers are overseen by the UAF, and thus are subject to additional reporting obligations.

5.4 Is the use of side letters restricted?

No, provided that the legal documents of the fund itself contain the minimum requirements set forth by Chilean regulation.

6 Taxation

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

Public Funds are an exception to the general tax regime since, among other benefits, they are not subject to corporate income tax ('*CIT*') on profits earned or accrued. Thus, taxation may be deferred until actual distribution is made to Public Fund investors in case they are the final taxpayers. FIPs are subject to the same taxation applicable to Public Funds.

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

Management fees payable to both AGFs and FIP Managers are generally subject to a 19% Value Added Tax ('*VAT*'). However, the Funds Law establishes a VAT exemption for the part of the fee corresponding to non-resident shareholders.

Additionally, income derived from management fees or carried interests are subject to general taxation rules.

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

There are no significant establishment or transfer taxes related to investors' participation in an AIF.

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

Resident investors, either in Public Funds or FIPs, are subject to the following rules: (i) dividend distributions received by Chilean-resident individuals are subject to personal income tax (PIT) (which is applied on an annual basis, at progressive rates ranging from 0% to 40%), with a right to use 65% of the CIT paid over such funds (to the extent those were subject to CIT at the level of the fund's portfolio companies) against the corresponding taxes. Dividend distributions received by corporate taxpayers (*e.g.* Chilean entities) are not subject to CIT; (ii) capital gains obtained from the sale or redemption of quotas are generally deemed as ordinary income subject to capital gains tax; and (iii) the proceeds obtained from a capital decrease or from the redemption of quotas upon the AIF's liquidation should be tax free, as long as they comply with specific imputation rules established in the Income Tax Law (generally, final taxpayers should not be taxed on the proceeds from the capital decrease or liquidation, unless the fund has taxable profits or financial book profits).

On the other hand, non-resident investors in Public Funds are subject to: (i) 10% sole-withholding tax ('*WHT*') on dividends distribution, without any credit for the CIT previously paid over such amounts (if any); (ii) 10% WHT on capital gains derived from the sale or redemption of quotas; and (iii) the same tax regime as residents on the proceeds obtained from capital decrease or redemption of quotas upon the AIF liquidation, unless it has taxable profits or financial book profits, in which case they would be subject to the 10% WHT.

The 10% WHT applicable to dividend distribution and capital gains is not available to non-residents investors in FIPs, which in turn are subject to a 35% WHT with a tax credit for 65% of the CIT paid at the level of the FIPs portfolio companies, if any. Tax credit will not be available in case of capital gains, and in the case of dividend distribution it can be 100% of the CIT if the non-resident investor is resident in a country with which Chile has a valid treaty to avoid double taxation.

Lastly, if the investor is a Chilean pension fund, dividends distribution and capital gains obtained should not be subject to taxes.

Please refer to question 6.8 to obtain more information about certain tax benefits related to AIFs.

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

It is not necessary to obtain a ruling from local tax authorities with respect to the tax treatment of AIFs.

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

Chile has signed an intergovernmental agreement with the United States within the scope of the FATCA (IGA Model 2),

which is currently in force; and has also subscribed the OECD's Common Reporting Standard rules, which are also currently in force in the country.

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

Chile has been active in implementing the BEPS recommendations. In this regard, it has already signed and deposited its Instrument of Ratification, Acceptance or Approval of the MLI, which is currently in force. Furthermore, it has adopted the majority of the changes incorporated in the 2017 OECD Model Tax Convention in its tax treaties and has made changes to internal laws in line with the said recommendations.

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

Besides the 10% WHT to non-resident investors detailed in question 6.4, there are two main tax benefits related to AIFs:

(i) A full tax exemption could be available on the capital gains derived from the disposal or redemption of quotas of a Public Fund or FIP, provided certain requirements related with where the quotas are disposed or redeemed, the investment policies of the funds bylaws, and the market presence of its quotas, are met.

(ii) A full tax exemption could be available to non-resident investors in Public Funds or FIPs, in case 80% of the of the fund investment portfolio is composed by assets or securities located or emitted abroad, and other requirements established in the Funds Law are met. In this case, dividends distributed by the Public Fund or FIP to a non-resident investor and capital gains arising from the redemption of quotas should not subject to withholding tax.

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

There are no such material tax issues.

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

The 'Growth and Equity Tax Commission', a group of tax experts summoned by the Ministry of Finance to review a series of tax exemptions in accordance with the suggestions made by the OECD and the FMI, has suggested the elimination of the 10% WHT benefit for non-resident investors on dividends distribution and capital gains related to Public Funds, and a review of the deferral benefits applicable to FIPs (*i.e.*, consider them as if they were corporations, subject to CIT).

The President has announced a Bill in which several tax exemptions will be limited, and whether or not the Bill will include the modifications proposed by the Commission is anticipated.

Furthermore, by the end of the year, Chile will have presidential elections, and certain presidential candidates have proposed that, if elected, they will propose a Bill to eliminate/modify certain tax benefits associated with AIFs.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

Please see the answer to question 6.10 above.

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

Please see the answer to question 6.10 above.

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1 Regulatory Framework

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

The establishment and operation of Alternative Investment Funds ("AIFs") is governed by the Alternative Investment Funds Law 124(I)/2018 ("AIF Law") as well as any secondary legislation issued in the form of derivatives/circulars by the Cyprus Securities and Exchange Commission ("CySEC"). In addition, and depending on whether an AIF is internally and/or externally managed, the Alternative Investment Fund Managers Law of 2013 ("AIFM Law") and Directive 2011/61/EU ("AIFMD") provide further regulation in relation to this sector.

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

Yes, external managers of AIFs are required to be licensed, authorised and regulated by CySEC. The following entities can take the role of an external manager of an AIF:

(i) an Alternative Investment Fund Manager ("AIFM"), in accordance with the AIFM Law;
(ii) a UCITS management company authorised in accordance with the Open-Ended Undertakings for Collective Investments Law (UCI) Law of 2012;
(iii) a Mini Fund Manager, authorised by Law No. 81(I)/2020 for the management of AIF investments whose assets under management do not exceed the limits laid down by article 4(2) of the AIFM Law or article 3(2) of the AIFMD;
(iv) an AIFM authorised in another EU Member State that is subject to prudential rules under the relevant legislation of its EU Member State of origin; or
(v) a Cyprus Investment Firm, authorised by the Investment Services and Activities and Regulated Markets Law ("MiFID II Law").

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

Yes, CySEC is the regulatory body responsible for the licensing, authorisation and regulatory compliance of AIFs. Registered Alternative Investment Funds ("RAIFs") do not need to receive authorisation from CySEC, they merely need to be registered with CySEC.

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

Yes, the regulatory regime distinguishes between open-ended and closed-ended AIFs. An AIF may be of the open-ended type if its shares or units are, at the request of any of its shareholders or unitholders, repurchased or redeemed prior to the commencement of its liquidation phase or winding up, directly or indirectly, out of the assets of the AIF and in accordance with the procedures and frequency set out in its fund rules or instruments of incorporation, prospectus or offering document. In all other cases they are of a closed-ended type. An AIF is classified as having a particular strategy if it invests more than 60% of its assets in a single category.

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

The authorisation process involves submission of the following information to CySEC:

Common Fund

(i) the name and the data identifying and certifying the appropriateness of the AIF's external manager, as well as the identity of the persons responsible for the risk management and portfolio management functions;
(ii) a statement by the external manager confirming that it agrees to perform the investment management functions for the AIF;
(iii) a statement by the depositary confirming that it agrees to perform the depositary functions;
(iv) the identity of the person or persons appointed by the depositary as responsible for monitoring the activity of the AIF;
(v) a draft of the AIF's fund rules, signed by the AIF's external manager;
(vi) a draft of the AIF's offering document;
(vii) a draft of the AIF's key investor information document; and
(viii) any other information as provided in article 30(1) of the AIFM Law.

Investment Company

(i) in case of a company under incorporation, the persons that will sign the instruments of incorporation; or
(ii) in case of an existing company, the members of the board of directors; and

(iii) when the investment company is externally managed, the following must be submitted to CySEC:
  (a) the name, registered address, and address of the headquarters of the AIF;
  (b) sufficient information and data, including a résumé, of the persons who effectively direct the business of the internally managed AIF;
  (c) the name and the data identifying and certifying the appropriateness of the AIF's external manager, as well as the identity of the persons responsible for the risk management and portfolio management functions;
  (d) a statement by the external manager, where one is appointed, confirming that it agrees to perform the investment management functions for the AIF;
  (e) a statement by the depositary confirming that it agrees to perform the depositary functions;
  (f) the identity of the person or persons appointed by the depositary as responsible for monitoring the activity of the AIF;
  (g) a draft of the AIF's instruments of incorporation;
  (h) a draft of the AIF's offering document;
  (i) a draft of the AIF's key investor information document; and
  (j) any other information as provided in article 30(1) of the AIFM Law.

Limited Partnership

The external manager, or the general partner of the Limited Partnership in case of a self-managed AIF, in addition to the application for authorisation, shall submit the following:

(i) the name, address of the registered office and the place of basic activity of the partnership;
(ii) sufficient information and data, including a résumé, for the persons who effectively direct the business of the internally managed AIF;
(iii) the name and the data identifying and certifying the appropriateness of the AIF's external manager;
(iv) a statement by the external manager, where one is appointed, confirming that it agrees to perform the investment management functions for the AIF;
(v) a statement by the depositary confirming that it agrees to perform the depositary functions for the assets of the AIF;
(vi) the identity of the person or persons appointed by the depositary as responsible for monitoring the activity of the AIF;
(vii) a draft of the AIF's partnership agreement;
(viii) a draft of the AIF's offering document;
(ix) a draft of the AIF's key investor information document; and
(x) any other information as provided in article 30(1) of the AIFM Law.

CySEC shall grant authorisation to the AIF only if it approves:

(i) the relevant application as described above;
(ii) the rules or instruments of incorporation;
(iii) its choice of external manager or, in the case of a self-managed AIF, the persons who effectively conduct the business; and
(iv) its choice of depositary, if one is appointed.

CySEC shall inform the external manager of the AIF or the self-managed AIF of its decision within six months of the submission of a complete application file.

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

AIFs which operate in the form of an investment company must be authorised by CySEC and have their registered office in the Republic of Cyprus.

In the case of an internally managed AIF, the board of directors shall undertake the responsibilities of the external manager, which shall appoint at least one person responsible for the portfolio management who meets the following conditions:

(i) he holds academic qualifications and/or has experience related to the assets in which the AIF is allowed to invest;
(ii) he is certified to provide portfolio management services in accordance with the provisions of the Investment Services and Activities and Regulated Markets Law, as amended; and
(iii) he is registered in the public register kept by CySEC, which lists the persons who have succeeded in CySEC's exams.

1.7 What service providers are required?

This highly depends on structure of the AIF in question. The usual service providers of an AIF are the depositary, the fund administrator and the auditor.

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

An AIFM of another EU Member State which is authorised in accordance with the AIFMD may undertake the following either directly or by establishing a branch:

(i) manage AIFs established in the Republic, provided that the AIFM is authorised to manage that type of AIF; and
(ii) provide in the Republic of Cyprus the services which are covered by the AIFM licence.

An AIFM of another EU Member State which intends to manage AIFs established in the Republic of Cyprus for the first time may start providing its services in the Republic of Cyprus upon receipt of the transmission notification from the competent authorities of its home Member State.

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

CySEC maintains a wide range of co-operation agreements and/or memoranda of understanding with many jurisdictions. For further information on the memoranda of understanding, please refer to: https://www.cysec.gov.cy/en-GB/cysec/INTERNATIONAL-AFFAIRS/MoU/.

2 Fund Structures

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

The legal structures available for AIFs are:

(i) AIFs with an unlimited number of persons (AIFs), which can take the form of a Common Fund or Variable/Fixed Capital Investment Company subject to the Companies Law Cap. 113, or the form of a Limited Partnership with or without legal personality subject to the General and

Limited Partnerships and Business Names Law Cap. 116. AIFs are addressed to both retail and professional and/or well-informed investors with no imposed limit on the number of investors that can participate. The minimum capital requirement is €125,000 at all times both for externally managed and self-managed AIFs.

(ii) AIFs with a limited number of persons (AIFLNPs), which can take the form of a Variable/Fixed Capital Investment Company subject to the Companies Law Cap. 113 or a Limited Partnership with or without legal personality subject to the General and Limited Partnerships and Business Names Law Cap. 116. The minimum capital requirement for a self-managed AIFLNP is €50,000 at all times. If the AIFLNP is externally managed, then no minimum capital requirement exists.
AIFLNPs are addressed only to professional and/or well-informed investors. The number of investors that can participate in this type of fund is limited to 50. Where the AIFLNP is structured as an umbrella fund with multiple investment compartments, the limit of 50 investors applies to the total number of investors and not to each investment compartment separately.

(iii) Registered Alternative Investment Funds (RAIFs), Common Funds or Variable/Fixed Capital Investment Companies, subject to Companies Law Cap. 113, or Limited Partnerships with or without legal personality, subject to the General and Limited Partnerships and Business Names Law Cap. 116.
RAIFs are addressed only to professional and/or well-informed investors. There is no limit on the number of investors that can participate in the fund and there are no minimum capital requirements.

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

The general principle is that the liability of the investors is limited to the amount they have invested via their participation in the particular fund structure.

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

A manager usually takes the form of a private limited liability company pursuant to the Companies Law (Cap. 113). Please also refer to question 1.2 above.

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

The suspension of redemption or repurchase of the units of an AIF, irrespective of whether it is an open- or closed-ended fund, is only allowed in exceptional cases where this is mandated by the circumstances or allowed by the AIF's rules and, in any case, if this is in the best interests of the unitholders. Furthermore, such suspension requires the prior approval of the external manager, or the AIF in case it is internally managed, as well as authorisation by CySEC which is communicated by the external manager, or the AIF in case it is internally managed, to the competent authorities of the other countries in which the units of the AIF are marketed.

The decision on such suspension must also set its timeframe. Any extension of this timeframe is only permitted upon authorisation by CySEC. In addition, CySEC may decide to extend the suspension period where this is justified by the interests of the unitholders of the AIF and where it is necessary in order to ensure the proper functioning of the market.

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

The general rule is that no legislative restrictions exist on the transfer of investors' interests in AIFs subject to any restrictions contained in their rule of operation and/or their constitutional/formation documents.

Please refer to the analysis in question 2.4 above.

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

Other than the investment restrictions and limitations imposed by CySEC as described below in question 4.2, and the limitations imposed by the AIFMD and the AIFM Law relating to asset stripping, there are no limitations on an AIFM's ability to manage AIFs.

3 Marketing

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

The production and use of marketing materials is governed by the AIF Law and the AIFM Law. CySEC also issues detailed domestic guidelines from time to time. In addition, Regulation (EU) No. 1286/2014 ("PRIPS Regulation") governs the production and offering of the key information document (KID) where units are offered to retail investors.

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

Prospective investors are provided with the offering document of the AIF, fund rules or instrument of incorporation and its latest annual and half yearly reports, and disclose to a prospective investor the latest net asset value of the AIF or the latest market price of its units.

The following information is disclosed prior to investment:

(i) a description of:
  (a) the investment strategy and objectives of the AIF;
  (b) the procedures by which the AIF may change its investment strategy or investment policy, or both;
  (c) the main legal implications of the contractual relationship entered into for the purpose of investment;
  (d) how the AIFM is complying with the AIF Law;
  (e) any delegated management functions;
  (f) the AIF's valuation procedure and of the pricing methodology for valuing assets;
  (g) the AIF's liquidity risk management;
  (h) all fees, charges and expenses of the AIF; and
  (i) how the AIFM ensures a fair treatment of investors;

(ii) the identity of the AIFM, the AIF's depositary, auditor and any other service providers and a description of their duties and the investors' rights;

(iii) the procedure and conditions for the issue and sale of units;

(iv) the historical performance of the AIF; and

(v) the identity of the prime broker.

For open-ended AIFs addressed to retail investors, a key investors' information document is also given to the applicant free of charge.

As a general rule, all marketing communications of an AIF to the investors shall be precise, clear and not misleading.

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

Core marketing materials such as those indicated in question 3.2 need to be approved by CySEC.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Marketing of AIF units to another EU Member State or third country

The external manager or the AIF, in case it is internally managed, may market in another Member State or third country the units of the AIF to professional and/or well-informed investors only if this is allowed by the legislation of that Member State or third country, or to retail investors, but in the latter case further notification requirements are applicable. Before the marketing of the units of the AIF in the Member State or third country begins, the external manager or the AIF, in case it is internally managed, shall submit to CySEC a confirmation by the competent authorities of the Member State or third country that the appropriate marketing procedures regarding the marketing of units of the AIF in its jurisdiction, provided by the legislation of the host country, have been followed.

Marketing of AIF units from another EU Member State or third country into Cyprus

An AIF established in another Member State or third country, which is externally managed by an AIFM, may market its units in the Republic of Cyprus in accordance with the provisions of the AIFM Law.

AIFs established in another Member State or third country which do not fall within the scope of the AIFM Law may market their units in the Republic of Cyprus only where they are subject to effective supervision in their home Member State, in accordance with the applicable legislation, to ensure the protection of investors and on the condition that they have been authorised by CySEC for the marketing of their units in the Republic of Cyprus.

AIFLNPs

The marketing of an AIFLNP's units is forbidden prior to the granting of authorisation and notification of authorisation by CySEC.

RAIFs

The marketing of RAIF units to its investors is carried out in accordance with the AIF Law.

Please note that there are further restrictions on marketing to retail and well-informed investors; please see question 3.5 below.

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

Directive 2019/1160/EU of 20 June 2019 on cross-border distribution, which regulates pre-marketing, has yet to be transposed into Cyprus law. EU Member States are required to transpose the Directive by 2 August 2021.

It remains to be seen how this will be implemented into the law of the Republic of Cyprus.

3.6 Can Alternative Investment Funds be marketed to retail investors?

AIFs can be marketed to retail investors in Cyprus provided that the AIF has been granted authorisation by CySEC in accordance with the relevant provisions of the AIF Law and the AIFM Law.

Where the AIF is addressed to retail investors, additional requirements exist as follows:

(i) marketing communications must specify where and in which language the offering document may be obtained by the investors and the authorisation number of the AIF. All marketing communications and every document or message which contains, directly or indirectly, an invitation to purchase units of an AIF, including those posted on the internet, must include in a prominent section that the performance of the investment in units of the AIF is not guaranteed and previous returns do not ensure future ones. In case of an AIF with guaranteed performance, the above reference shall be limited to the fact that past performance does not guarantee the same in future;

(ii) in case an AIF replicates a stock exchange index, all marketing communications must include a specific statement in a prominent section on the attention the investors need to show to the investment policy of the AIF; and

(iii) in case the net asset value of an AIF may have high volatility because of the composition of its portfolio or the management techniques used, all marketing communications shall include a specific statement in a prominent section drawing the attention of the investors to this aspect.

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

Further to question 2.1 above, which specifies what type of investor can invest in which fund under the laws of Cyprus, there is a distinction between: (i) a professional investor (an investor that is considered to be a professional client or may, on request, be treated as a professional client within the meaning of the MiFID II Law); (ii) a well-informed investor (every investor who is not a professional investor as further defined in the AIF Law); and (iii) a retail investor (an investor who does not qualify as a professional investor nor as a well-informed investor).

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

No particular restrictions exist on marketing AIFs to public bodies.

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

There are no restrictions on participation in AIFs subject to the internal on-boarding procedure of each particular AIF and anti-money laundering restrictions.

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

No particular restrictions exist on the use of intermediaries.

4 Investments

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

No particular restrictions exist on the types of investment activities; however, all its investment activities and/or investments must be made in accordance with its defined investment policy as approved by CySEC.

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

AIFs which are addressed to retail investors are allowed to invest in, *inter alia*, one or more of the following:

(a) transferable securities;
(b) money market instruments;
(c) units of collective investment undertakings;
(d) derivative instruments which satisfy certain conditions;
(e) deposits with credit institutions;
(f) immovable property and property related to immovable property;
(g) mortgage-related securities;
(h) securities which encompass claims of up to 30%;
(i) commodities of up to 20%; and
(j) exchanges of up to 20%.

Further restrictions and conditions apply for AIFs addressed to retail investors with respect to investing in shares giving them voting rights in other AIFs, entering into loan agreements secured by assets of the AIF, investing in cash in the same organisation, investing in collective investment funds, investing in securities not admitted or traded on a regulated market and investing in securities of the same issuer, etc.

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

They are allowed to invest subject to certain requirements set out in a domestic directive issued by CySEC.

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

An AIF addressed to retail investors may enter into loan agreements which do not exceed, at any time, 25% of the net asset value of the AIF's assets. No restrictions exist for professional and well-informed investors.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

Under the AIF Law, the assets of the AIF must be entrusted for safekeeping to a depositary which:

(a) has its registered office in the Republic of Cyprus or in another Member State, or a third country provided that:
    (i) in the third country where the depositary is established, depositaries are subject to prudential regulation and supervision, including minimum capital requirements;
    (ii) the third country where the depositary is established is not listed as a Non-Cooperative by the FATF;
    (iii) the third country has signed an agreement with the Republic of Cyprus which fully complies with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements; and
(b) is a credit institution or an investment firm, or another category of institution established in a Member State that is subject to prudential regulation and supervision and which falls within the categories of institutions determined by Member States as eligible to be appointed as depositaries.

Further, if the AIF invests, in accordance with its investment policy, in assets which are not subject to custody, as per the provisions of the AIFM Law, it may appoint as a depositary an entity performing depositary services within the context of its professional or business activities for the performance of which the entity is subject to professional registration recognised by the law, or an administrative authority or by professional conduct rules.

Lastly, the requirement for the appointment of a depositary can be dispensed with for AIFLNPs under certain conditions.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors??

The fund rules or instruments of incorporation of the AIF shall specify the way the net asset value of AIF units, as well as the subscription price and redemption price of AIF units, are disclosed to investors.

The external manager or the AIF, in case it is internally managed, shall prepare and submit to CySEC, without undue delay:

(i) every material change in the offering document of the AIF;
(ii) an annual report for each financial year; and
(iii) a half-yearly report covering the first six months of the financial year. The annual and half-yearly report of the AIF shall be communicated to CySEC by the external manager of the AIF, and made available to the investors by the external manager of the AIF at the points of distribution of its units within the following time limits from the end of the period to which they relate:
    (a) six months in the case of the annual report; or
    (b) two months in the case of the half-yearly report.

The offering documents of the AIF, its fund rules or instruments of incorporation and its latest annual and half-yearly report are provided to any potential investors of the AIF.

The AIF shall provide the investors, free of charge, with its annual report, following a relevant request by them.

RAIFs

The cover of the offering document of the RAIF shall include in a prominent section that:

(i) the RAIF is not authorised by the CySEC;
(ii) the RAIF is addressed only to professional and/or well-informed investors; and
(iii) the registration of the RAIF in the RAIFs Register is not equivalent to authorisation by CySEC.

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

On 18 February 2021, the Republic of Cyprus fully implemented EU Directive 2018/843 of the European Parliament and of the Council of 30 May 2018, which will create three Ultimate Beneficial Owners registers in the Republic of Cyprus, namely:

(i) the Companies Register. This register will be maintained by the Registrar of Companies and Official Receiver and will be open to the public;

(ii) the Express Trusts and Similar Legal Arrangement Register. This register will be maintained by CySEC. It will not be open to the public, but it may be accessible to those persons who can prove a legitimate interest; and

(iii) the Register of Legal Bodies, other than those registered with the Registrar of Companies, such as clubs, foundations, unions and federations. This register will be maintained by the General Commissioner and will be open to the public.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors??

In relation to AIFs with an unlimited number of persons, the annual audited report as well as the half-yearly unaudited report must be submitted to CySEC and made available to investors. In relation to AIFLNPs, the annual audited report must be submitted to CySEC and must be made available to investors. There are no particular reporting requirements for RAIFs; CySEC will rely on the regulated status of the AIFM to ensure both the compliance and supervision of the RAIF.

AIFMs shall regularly report to CySEC the following: (i) the principal markets and instruments in which they trade on behalf of the AIFs they manage; and (ii) the main categories of assets held by each AIF.

For each of the EU AIFs they manage and for each of the AIFs they market in the EU, the following must be disclosed to CySEC: (i) the percentage of the AIF's assets which are subject to special arrangements due to illiquidity; (ii) any new liquidity arrangements of the AIF and results of liquidity stress tests; (iii) the risk profile of the AIF, the risk management systems employed and results of periodic stress tests; and (iv) main categories of assets in which the AIF has invested. The frequency of these reports is dependent on the size of the fund.

5.4 Is the use of side letters restricted?

The use of side letters is not restricted. An AIFM, however, is subject to certain operating conditions including the obligation to treat unitholders fairly and to ensure that no unitholder obtains a preferential treatment unless such preferential treatment is disclosed within the AIF's constitutional documents. This last point is a general principle and thus also applicable to internally managed AIFs.

6 Taxation

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

Standard taxation rules apply.

AIFs, AIFLNPs, and RAIFs which are established in the form of variable capital investment companies benefit from the following standard corporate taxation rules:

(i) corporation tax is set at 12.5%, which is amongst the lowest in the European Union;

(ii) gains from trading in securities are tax exempt;

(iii) profits on sales of securities are exempt;

(iv) Notional Interest Deduction (NID) for new equity may reduce the taxable base for interest received by up to 80% (for company-type funds), reducing the effective tax on interest to 2.5%;

(v) dividends received, capital gains arising from the sale of property abroad as well as capital gains from the sale of shares of foreign property companies are exempt from tax;

(vi) there is no subscription tax on the net assets of the fund;

(vii) fund management services provided to AIFs are not subject to VAT;

(viii) each compartment of an AIF, although legally not treated as a separate entity, is for tax purposes treated as a separate taxpayer; and

(ix) Cyprus tax resident funds can benefit from a wide array of double taxation treaties.

AIFs in the form of a common fund or a limited liability partnership are considered tax transparent funds. In such case, the national tax laws of the investor will be applied.

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

Fund managers:

(i) are usually incorporated in the form of companies and benefit from the standard company taxation rules, set out in the response to question 6.1 above;

(ii) have a 35% cap on personal income tax as well as an option to be taxed at a flat rate of 8% on carried interest for certain employees;

(iii) enjoy a 50% exemption of income earned for a 10-year period from the date of first employment in Cyprus (if emoluments exceed €100,000); and

(iv) subject to certain conditions, fund management services to approved mutual funds and AIFs are exempt from VAT.

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

There is no Capital Gains Tax on the gains arising from the disposal or redemption of units in funds unless the fund owns immovable property in Cyprus. However, even if it owns immovable property in Cyprus, no Capital Gains Tax arises if the fund is listed on a recognised stock exchange.

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

Foreign Investors

- No withholding tax on dividends.

- No taxation on redemption of units.
- No deemed distribution restrictions.

Resident Investors

- Withholding tax on dividends of 17% if the investor is an individual who is both tax resident and domiciled in Cyprus.
- No taxation on redemption of units.
- No withholding tax if the investor is a company.

Resident Investors – Non-Domiciled

- Exemption from 17% withholding tax on dividends.
- No taxation on redemption of units.
- No withholding tax if the investor is a company.

Where the AIF investor is a non-Cypriot resident, and the AIF is in the form of a common fund or partnership, investors are generally exempt from any withholding tax on distributions and from any tax on the redemption of their units in an AIF under Cyprus law since AIFs in such a form are not considered to have a permanent establishment in Cyprus. National tax legislation will apply instead.

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

There is no requirement to obtain advance tax clearance.

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

The Minister of Finance of the Republic of Cyprus signed the FATCA Intergovernmental Agreement between Cyprus and the USA (Intergovernmental Model 1 Agreement Foreign Account Tax Compliance Act) with the US ambassador on 2 December 2014.

On 29 October 2014, the Republic of Cyprus signed, following a Council of Ministers decision dated 22 October 2014, the OECD Multilateral Competent Authority Agreement for the automatic exchange of financial information of financial accounts, which now includes more than 80 signatories.

The Cyprus Government has issued decrees which transpose FATCA and CRS requirements into domestic law.

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

On 5 April 2019, Cyprus voted in the first implementation law of the European Union (EU) ATAD and, more specifically, the interest limitation rule, CFC rule, and GAAR, which are effective for tax years commencing from 1 January 2019.

On 19 June 2020, Cyprus voted in the second implementation law with respect to the remaining measures, provided for in the ATAD effective as follows:

- Exit taxation provisions: 1 January 2020.
- Hybrid mismatch rules: 1 January 2020 (except for specific reverse-hybrid mismatch provisions to be effective as of 1 January 2022).

Cyprus signed the Multilateral Convention to Implement Tax Treaty Related Measures (MLI) to Prevent Base Erosion and Profit Shifting (BEPS) on 7 June 2017. Subsequently, Cyprus ratified the MLI on 23 January 2020. The date of "entry into effect" as regards Cyprus' application of the MLI has been set for 1 May 2020.

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

Cyprus allows tax optimisation for fund structures. Specialised advice needs to be sought depending on the nature of the underlying asset.

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

There are no further material tax issues for investors managers and/or advisers of AIFs.

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

The government will be providing further tax incentives in order to put Cyprus in the forefront of the tax industry sector as one of the most competitive industry players.

7 Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The alternative funds sector has witnessed considerable growth over the last few years. More specifically and according to the Central Bank of Cyprus, the total assets held by investment funds increased significantly – approximately 18.9% to €6,678.4 million in March 2021, compared with €5,616.8 million in December 2020. The main reason for this increase is the inclusion in the data of a number of new relatively larger investment funds, compared to the number of smaller investment funds that were either liquidated or reclassified to another institutional sector. Overall, the number of investment funds in March 2021 stood at 222, unchanged from December 2020.

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

See question 6.10.

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Patrikios Pavlou & Associates LLC is one of the largest law firms in Cyprus, highly recommended for its professional legal services and exceptional client service. With nearly 60 years of experience in the local and international legal market, Patrikios Pavlou & Associates LLC is renowned for its involvement in some of the largest cross-border transactions and complex litigation and arbitration matters.

The team is highly qualified and experienced in offering legal advice in any sphere, while the corporate and M&A department maintains a leading position in Cyprus for its expertise in advising multinational corporations, banks, financial institutions and HNWIs on their high-profile and complex matters, acquisitions, cross-border mergers, reorganisations, and shareholder agreements.

The firm's international profile comprises strong alliances with reputable law firms, particularly in Europe, Russia, USA and Asia, with memberships in various organisations globally and a loyal clientele worldwide.

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1 Regulatory Framework

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

The UK is regarded as one of the leading global asset management centres, with an investment funds industry covering both traditional and alternative asset classes. In the case of funds with alternative investment strategies such as private equity, real estate, alternative credit and infrastructure funds, both the fund manager and the fund itself tend to be domiciled in the UK. The asset management industry is of vital importance to the UK's economy, now more than ever as the economy seeks to recover from the financial impact of the COVID-19 pandemic.

The Alternative Investment Fund Managers Directive ("AIFMD"), supplemented by its Level 2 Delegated Regulation ("Delegated Regulation") and guidelines from the European Securities Markets Authority ("ESMA") ushered in a new regulatory environment for many investment fund managers, including private equity firms and managers of hedge funds. AIFMD offers the lofty ideal of pan-European harmonisation of the regulatory and supervisory framework for the non-UCITS ("Undertakings for Collective Investment in Transferable Securities") fund sector, together with the associated freedom to passport management and marketing activities on a cross-border basis.

Following the end of the Brexit implementation period on 31 December 2020, the UK is no longer treated as an EEA Member State; from the perspective of the EEA, the UK is now a third country. Under the European Union (Withdrawal Act) (2018) all EU law in effect as at 31 December 2020 was, broadly, converted and preserved in domestic legislation (known as retained EU law), with amendments made by way of statutory instruments ("SIs") to correct "deficiencies" in retained EU law. These corrections were designed to ensure that the domesticated and on-shored legislation makes sense and operates properly in the UK: the SIs are not intended to make policy changes other than to reflect the UK's new position outside the EEA.

As such, AIFMD was replicated in the UK's post-Brexit AIFMD legislation ("UK AIFMD"), which sits alongside AIFMD, by way of amendment made by the relevant SIs to the existing Financial Services and Markets Act 2000 ("FSMA") and the Alternative Investment Fund Managers Regulations 2013 (SI 2013/1773). The majority of these measures are contained in the FCA (Financial Regulatory Authority) Handbook. The "FUND" chapter of the FCA Handbook contains most of the FCA's rules and guidance for UK AIFMs, which adds an additional component to the general regulatory framework set out under FSMA. UK AIFMD applies to UK AIFMs and to the managing and marketing of AIFs in the UK. However, whilst UK AIFMD imposes the obligations set out in AIFMD, it does not include its benefits of the managing and marketing passports.

As noted above, AIFMD applies to the non-UCITS sector. Broadly speaking, UCITS funds have not been used to implement alternative investment strategies in the UK and therefore are generally outside the scope of this chapter. Some hedge fund managers may be able to launch products under the UCITS brand if the proposed investment strategy fits into the framework and the UCITS requirements will offer investors greater regulatory safeguards and protections. However, the fact that UCITS funds are subject to mandated investment and borrowing powers means that they are likely to lack the investment flexibility which is available to private funds.

The European Venture Capital Funds Regulation ("VCF Regulation") provides what is essentially "AIFMD Lite" for EU venture capital fund managers. As with AIFMD, the VCF Regulation formed part of the UK's post-Brexit retained EU law. The new UK regime applies to the new "Registered Venture Capital Fund" (RVECA) and applies to UK AIFMs and venture capital funds domiciled in the UK.

The Regulation on cross-border fund distribution ("Omnibus Regulation") and the Directive on the cross-border marketing of funds ("Omnibus Directive") will make a number of important amendments to AIFMD (most notably to the marketing rules) and will apply in individual EEA Member States from 2 August 2021. As the Omnibus Regulation and the Omnibus Directive did not form part of EU law as at 31 December 2020, it does not form part of the post-Brexit EU retained law and will not form part of UK legislation.

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

Many Alternative Investment Funds will be AIFs for the purposes of UK AIFMD. An AIF is a collective investment undertaking which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors. Even if a vehicle does not fall within the definition of an AIF, it may be categorised as a collective investment scheme ("CIS") under FSMA (a CIS is similar, but not identical, to the European concept of a collective investment undertaking). An example of this is likely to be carried interest arrangements structured through a limited partnership, which are unlikely to be AIFs due to the employee participation scheme exclusion from UK AIFMD, but which are likely nevertheless to be unregulated CISs for the purposes of domestic legislation.

The FCA authorises and regulates persons carrying out specific "regulated activities" in the UK. Acting as the manager of an AIF is a regulated activity, as is establishing, operating (which includes managing) and winding up an unregulated collective investment scheme. A suitably authorised person must therefore be appointed to carry out these activities on behalf of an Alternative Investment Fund.

In respect of UK managers of EEA AIFs, UK AIFMs are regarded by the EEA as third country AIFMs. Therefore, if the local law of the EEA AIF's jurisdiction prohibits AIF management without a licence, a UK AIFM will be unable to manage EEA AIFs. UK AIFMs will be required to comply with applicable national rules and may need to apply to the relevant regulator for authorisation.

In the UK, only appropriately authorised persons can carry on a regulated activity by way of business. It is a criminal offence to breach this requirement. Any agreement entered into by a person carrying on a regulated activity in contravention of this provision is unenforceable against the other party and the other party is entitled to recover any money paid and to compensation for any loss sustained.

UK AIFMD contains a partial exemption for AIFMs whose total assets under management do not exceed certain thresholds. These sub-threshold firms will not have to comply with the full provisions of UK AIFMD, unlike those firms which are "full-scope" AIFMs. The relevant thresholds are: (i) €500 million, provided the AIF is not leveraged and investors have no redemption rights for the first five years; or (ii) €100 million (including assets acquired through leverage). The exemptions do not remove the requirement for authorisation, and sub-threshold firms will need to apply to the FCA to become a "small authorised AIFM" or, in certain limited circumstances, a "small registered AIFM". The latter category imposes the lowest regulatory burden on firms but is only available for internally managed AIFs and certain types of real estate scheme.

A regulated entity which conducts all of its activities in its capacity as the manager/operator of an Alternative Investment Fund – whether an authorised AIFM or not – will be exempt from the EU Markets in Financial Instruments Directive ("MiFID"), as replicated in the UK's post-Brexit legislation ("UK MiFID").

Historically, though, many UK resident managers or advisers of off-shore hedge funds would have been subject to MiFID as the manager/operator of the fund was off-shore and the UK regulated entity was merely its delegate in respect of relevant investment management services. This analysis, however, has been somewhat muddied by the "letterbox" test imposed under AIFMD (and now replicated in UK AIFMD). The consequence of this test is that in some cases the entity which is designated as the manager of an AIF under the fund documentation is not regarded as the AIFM for the purposes of UK AIFMD (because it is a letterbox). The exact analysis of the letterbox test applicable to any situation is very fact-specific, but the risk is likely to arise from one of the tests which provides that a manager of an AIF is likely to be deemed a letterbox if it delegates the performance of investment management functions (i.e. investment management and risk management) to an extent that exceeds by a substantial margin the investment management functions performed by the manager itself. The consequence of this is that an on-shore manager of a hedge fund may, depending on the exact structure and division of powers, now find itself as the AIFM for the purposes of UK AIFMD even if it feeds its services into an off-shore manager.

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

Generally speaking, under the current UK framework, an Alternative Investment Fund itself is not required to be authorised or licensed by the FCA. UK AIFMD broadly supports the traditional position that it is the manager (or AIFM), rather than the Alternative Investment Fund, which is subject to regulation. However, whilst historically there have been very few operational requirements imposed at the level of the fund itself, to the extent UK AIFMD applies, the AIFM must now ensure that certain requirements are imposed upon the fund, such as: the appointment of a depositary to have custody of certain assets and/or verify title to privately held assets; organisational controls (relating to risk management, compliance and valuation); conduct-of-business rules (relating to due diligence, execution of orders and reporting); and rules relating to companies in which the fund has a substantial stake.

This will not be the case if the fund manager is looking to implement an alternative investment strategy through a retail fund (meaning those which are approved by the FCA to be marketed to identified categories of investors, including, in the case of UCITS and non-UCITS retail schemes, the general public). In the case of non-UCITS retail schemes, the fund itself, as well as the manager, will require FCA authorisation. Where a closed-ended investment fund is to be launched (such as an investment trust or real estate investment trust) and its shares listed, the listing on the London Stock Exchange of any such fund, as well as the manager, would need to be authorised by the FCA.

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

The UK regulatory regime, broadly speaking, does not differentiate between open-ended and closed-ended private funds, assuming that the fund is domiciled within the UK, although, as noted above in the context of sub-threshold firms, the partial exemption from UK AIFMD will bite at a higher level for non-leveraged closed-ended funds. It should be noted that from 1 January 2021, EEA UCITS funds will fall within the definition of an AIF for the purposes of UK AIFMD, as AIFs are defined as any investment fund that is not subject to the UK UCITS regime.

However, the regulatory categorisation of UK fund managers advising or managing off-shore structures may be different to that which would apply if the entire structure is on-shore.

Other regulatory requirements which might apply to a manager of Alternative Investment Funds are linked with the investment strategy being pursued, rather than whether the fund is open-ended or closed-ended (although the relevant strategy might be linked with a particular type of fund). For example, further requirements of UK legislation which are particularly relevant to hedge funds include: rules relating to market abuse and insider dealing; disclosures of interests in shares and related derivatives above certain levels; and disclosures of net economic short exposures to certain financial-sector companies and companies subject to a rights issue.

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

An application for authorisation under FSMA involves the applicant submitting a considerable volume of information to the FCA. This will include information on the proposed business activities of the applicant, its controllers and individuals who will be undertaking certain core controlled functions, its systems and controls including those relating to the manner in which the applicant monitors its compliance with applicable FCA Rules, its group structure and reporting lines and financial projections for the first year of trading. For those applicants applying for authorisation to manage an AIF, the FCA will require further information about the AIF itself (such as details of the AIF's risk profile and its use of leverage).

Once a complete application has been submitted (together with the requisite application fee), the FCA currently has six months to review the application (this is reduced to three months in the context of applications by AIFMs). During the review process, the FCA is likely to raise additional queries in relation to the information submitted.

The FCA has made available a suite of forms for use by UK AIFMs in order to apply for the various permissions and authorisations required from a UK AIFM. Further applications will also need to be made in relation to any "material changes" to the information submitted as part of the authorisation application.

Following authorisation, a successful applicant will need to comply with the applicable conduct of business and prudential rules of the FCA which are relevant to its business. In the context of AIFMs, particular focus is likely to be given to the capital adequacy requirements of, and remuneration principles imposed by, UK AIFMD.

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

A fund manager applying for authorisation under FSMA (whether or not as an AIFM) must meet certain threshold conditions. One of these is that the head office of the applicant must be in the UK. Although the FCA will judge each application on a case-by-case basis, the key issue in identifying the head office of a firm is the location of its central management and control.

In December 2018, the Department of Business, Energy and Industries Strategy of the UK Government indicated that it will introduce various reforms in respect of UK limited partnerships, following its consultation earlier in 2018. The reforms include requirements for a proposed "principal place of business" ("PPoB") to be included in the application for the limited partnership's registration. On an ongoing basis, the limited partnership will then need to demonstrate that it maintains an ongoing connection to the UK. The UK Government is still considering what evidence will be required to demonstrate the ongoing connection and how these requirements shall apply to existing limited partnerships. In terms of timing, the UK government has only committed to the required legislation "when parliamentary time allows".

1.7 What service providers are required?

Historically, there have been no formal requirements to appoint external service providers to private funds domiciled in the UK (although a manager may have engaged service providers as a matter of choice). However, under UK AIFMD a depositary is required, who will have the responsibilities set out under AIFMD (which include custody, cash movement reconciliations and monitoring certain processes such as issues and redemptions of units and valuations). Under AIFMD, the depositary of an EEA AIF must be established in the home Member State of that AIF. Therefore, EU AIFs will not be able to use UK banks as depositories and UK AIFs will not be able to use EU banks as depositaries. Independent valuers may also be appointed pursuant to the provisions of AIFMD.

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

Following Brexit, EEA AIFMs are no longer able to rely upon the AIFMD managing passport for activities in the UK.

Firms (either EEA or non-EEA) wishing to market AIFs in the UK are required to comply with the National Private Placement Regime (NPPR), as well as the UK's financial promotion rules.

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

One of the key determinants in the context of a UK manager's ability to market a fund (whether EEA or non-EEA) within Europe, or an EEA manager's ability to market in the UK, will be whether information exchange arrangements are in place between the jurisdiction in which the marketing takes place and the jurisdiction in which the fund manager and the fund itself are established. The FCA confirmed in February 2019 that the text of the memorandum of understanding ("MoU") has been agreed with ESMA based on existing precedents and existing MoUs in place for AIFMD, and meets the requirements under the Alternative Investment Fund Managers Regulations 2013 (covering marketing into the UK under the UK national private placement regime). In July 2020, ESMA and the FCA announced that the MoU remains valid and took effect from 31 December 2020. Similarly, regulators in Guernsey and Jersey have announced that they signed MoUs with the FCA which allow Guernsey and Jersey funds to continue to be marketed into the UK.

2 Fund Structures

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

There are a wide variety of fund vehicles available in the UK. Certain of these are only available for retail funds, such as the authorised unit trust and the open-ended investment company. Others, such as the investment trust company, are likely to be used for closed-ended structures implementing a traditional investment strategy.

However, a private fund domiciled in the UK and implementing an alternative investment strategy will usually take one of two forms. Closed-ended private funds (in particular, those investing in asset classes such as private equity, real estate and infrastructure) are most commonly structured as limited partnerships. This is a form of partnership governed by statute under the Limited Partnerships Act 1907 ("LP Act"). In April 2017, the LP Act was the subject of extensive reform by the UK Government in respect of private funds by way of the Legislative Reform (Private Fund Limited Partnerships) Order 2017 ("PFLP Order"). The reforms have been introduced with a view to simplifying the

pre-existing law, reducing uncertainty and administrative costs and burdens, and ensuring that the UK remains an attractive and competitive location for private funds in comparison to other jurisdictions. The reforms apply only to a limited partnership that is "designated" as a Private Fund Limited Partnership ("PFLP"). The new regime is not mandatory: it is open to a limited partnership that satisfies the conditions to be a PFLP to choose not to apply to be designated as a PFLP, in which case the pre-existing limited partnership will apply.

In common with other jurisdictions, the limited partnership (including the PFLP) will have one or more general partners and one or more limited partners. The general partner is responsible for the management of the limited partnership (although whether it fulfils this role will largely depend on the regulatory issues described above), but has unlimited liability for the debts and obligations of the partnership over and above the partnership assets. Conversely, the liability of a limited partner will be limited to the amount of capital it contributes to the partnership (and, in the case of PFLPs, there is no requirement for a limited partner to make a capital contribution), provided such limited partner takes no part in the management of the partnership: to the extent the limited partner does take part in management, it will be treated as a general partner and will lose the protection of limited liability. The LP Act contains a white list of matters ("White List") which limited partners of a PFLP can take part in without jeopardising their limited liability status. A limited partnership (including a PFLP) registered in England & Wales does not have any legal personality separate from its partners and is not a body corporate.

One of the fundamental attractions in the UK of a limited partnership structure for private closed-ended funds is that the limited partnership is a flexible vehicle in terms of internal governance and control. The constitutional document (the limited partnership agreement) is a freely negotiable document between the fund manager and the investors.

The statutory framework in the UK requires that a limited partnership is registered as such. This entails providing an application for registration to the Registrar for Limited Partnerships, providing certain details including the name of each limited partner and the amount of capital contributed by each limited partner. Any changes to these details during the continuance of the limited partnership must be similarly registered within seven days of the relevant change. There are also formalities that must be followed on assignments of limited partnership interests, such as advertising the transfer in specific publications. In respect of the new PFLP regime, either a new or an existing limited partnership may choose to apply for PFLP status if it fulfils the criteria to qualify as a PFLP. Unlike limited partnerships, there is no obligation to provide details of the partnership's general nature, capital contribution amounts or term of the partnership (or to notify of any changes to such details).

It is also possible for a private closed-ended fund in the UK to be structured as a unit trust. The English law concept of a trust has no equivalent in some other jurisdictions. It is a structure under which title to the fund's assets is held by a person with legal personality (the trustee) for the benefit of the fund's investors (the beneficiaries). The document constituting the trust (the trust deed) governs the relationship between the trustee and the beneficiaries and, in addition, strict fiduciary duties are owed by the trustee as a matter of law.

As noted above, although the UK is the primary European hedge fund centre, the usual hedge fund structure will generally not include the actual hedge fund being domiciled in the UK, because to set up the fund on-shore would lead to tax inefficiencies since the fund would be treated as "trading" rather than "investing" for UK tax purposes. Instead, hedge fund structures will invariably include a company or limited partnership established in an off-shore jurisdiction.

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

In respect of funds structured as limited partnerships, under statute the liability of a limited partner for the debts and obligations of the partnership is limited to the amount of capital it contributes to the partnership, subject always to the caveat that the investor does not become involved in the management of the structure.

This does not relieve the investor of its contractual obligation to advance money, and therefore Alternative Investment Funds operating "just-in-time" drawdown structures will be able to draw the full amount the investor has committed to advance to the fund, notwithstanding the statutory limitation on liability. The UK limited partnership will generally be structured so that the commitment of investors comprises a nominal amount of capital contribution, with the balance being advanced by way of a loan. This structure should avoid amounts distributed to investors being subject to return in the event of the insolvency of the limited partnership.

The other fund vehicles available will provide for the limited liability of investors, such that they will not be required to contribute more than the amount which they have committed to invest in the fund.

In respect of PFLPs, as there is no requirement for a limited partner to contribute any capital, the entire funding to be contributed by a limited partner in a PFLP can be in the form of capital which can be contributed and repaid at any time without affecting the extent of the liability. This removes the need for the capital/loan split described above.

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

There are no formal requirements as to the legal structure used for managers and advisers of Alternative Investment Funds. However, the two most common structures seen in the market are the private limited company and the limited liability partnership (LLP). LLPs have been seen as the preferred structure for asset managers for some time now, as they offer the tax transparency of a traditional partnership whilst giving limited liability to the members of the LLP. Although an LLP is a body corporate, it is inherently a more flexible vehicle than a limited company and therefore can be adapted to suit the particular circumstances of the fund manager's business and preferred governance structure. Since April 2016, LLPs (together with UK unlisted companies) are subject to a new requirement to maintain a register of people with significant control; such register is to be available for public inspection at their registered offices.

Historically, each member of an LLP was treated as being self-employed for tax purposes. This meant that LLPs did not need to pay employer's national insurance contributions ("NICs") on the remuneration of members, and it also kept members of an LLP outside of the UK employment-related securities ("ERS") legislation.

However, since the introduction of the "salaried member" rules in 2014, the position has not been quite so straightforward. Under these rules, a member of an LLP will be treated as an employee if, broadly: (a) at least 80% of the amount payable by the LLP for the services they perform for it is "disguised salary" (broadly, remuneration which is not dependent on the firm's profitability); (b) they do not have "significant influence" over the LLP's affairs; and (c) they make a capital contribution to the LLP which is less than 25% of their annual "disguised salary".

If a member meets all three conditions, they will be deemed to be an employee for income tax and national insurance contribution purposes (such that the LLP will need to pay employer's NICs on their remuneration and the member will be brought within the scope of the ERS legislation).

In addition, employees remain outside of the scope of the income based carried interest rules (see question 6.2), whereas self-employed LLP members must consider the potential application of these rules to their carried interest returns.

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

Generally, there are no statutory or regulatory limitations on the ability of managers of private funds to restrict redemptions or transfers in either open-ended or closed-ended funds, although contractual restrictions may be imposed.

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

There are no legislative restrictions on the transfer of investors' interests. However, in the case of UK limited partnerships, certain filing requirements will need to be met, and details of the transfer advertised, before it is deemed to be effective. These filing requirements do not apply to PFLPs.

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

UK AIFMD replicates AIFMD's provisions relating to asset stripping. The provisions cover situations where an AIF managed by an AIFM subject to full authorisation holds a significant proportion of the shares in, or acquires control of, a private company or an issuer of traded securities, imposing requirements relating to the provision of information to the company or issuer, shareholders, employers and employees. The provisions also contain restrictions on distributions, capital reductions, share redemptions and acquisitions by companies or issuers of their own shares for two years after the AIF acquires control.

3 Marketing

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

Marketing restrictions are imposed by UK AIFMD.

AIFMs wishing to market an AIF to retail or professional investors in the UK are required to apply to the FCA to do so. The FCA permits the marketing of a private fund to a wider group of participants than the category of "professional investors" referred to in UK AIFMD, provided the financial promotion rules referred to at question 3.2 below are complied with throughout the entire marketing process.

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

Under domestic legislation, there are limited content requirements applicable to marketing materials, although there is an overarching obligation to ensure that marketing materials are "clear, fair and not misleading". UK AIFMD requires prescribed pre-investment disclosures which must be made to prospective investors. Whilst many of these disclosures are largely consistent with information that has historically been included in marketing materials for private funds, there are specific components of the disclosure regime which were either new or enhanced the level of detail previously provided.

The requirements of the UK's Prospectus Regulation Rules (which, broadly, replicate the EU Prospectus Regulation) which catch "offers to the public" will generally not apply to the marketing of Alternative Investment Funds on the basis that the requirements can be avoided if the total consideration of offers in the UK, calculated over a 12-month period, is below EUR 8 million or the offer is made to fewer than 150 persons in the UK. The UK's Prospectus Regulation Rules will also not catch open-ended vehicles, so most hedge funds, for example, would not be caught in any event.

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

Outside of UK AIFMD, there is no requirement to register marketing or legal documentation with the FCA. However, an AIFM must submit certain marketing information to the FCA 20 working days prior to marketing and must obtain pre-clearance for any material planned changes to the information provided (the AIFM must give at least one calendar month's notice of the changes). Material unplanned changes must be notified to the FCA immediately. The notification must include a declaration from the AIFM that the management of the AIF complies with the relevant conditions in the UK AIFM Regulations. Notifications must be submitted by the AIFM using the FCA's online system, Connect. AIFMs using the online system for the first time must therefore allow for the time taken to set up its online account with the FCA.

3.4 What restrictions are there on marketing Alternative Investment Funds?

For the purposes of UK AIFMD, marketing is a direct or indirect offering or placement at the initiative or on behalf of the AIFM to or with investors domiciled in the UK. This is a narrower concept than that of a financial promotion under domestic regulation, which is an offer or inducement to engage in investment activity. The FCA has provided guidance on when it considers an AIFM to be marketing in the UK; neither pre-marketing (as detailed at question 3.5 below) nor reverse solicitation will be regarded as marketing. In respect of reverse solicitation, the FCA guidance states that a confirmation from the investor that the approach was made at its own initiative should be sufficient to rely on this approach. The guidance, however, also states that it must be received prior to making the offer or placement. In addition, "marketing" does not include general public statements, the issuance of capital calls or secondary trading.

Following Brexit, UK full-scope AIFMs wishing to market within the EEA can no longer rely upon the AIFMD marketing passport, and will instead need to identify on a jurisdiction-by-jurisdiction basis whether local law permits the fund to be marketed.

Under the FCA's temporary transitional powers, a UK AIFM can continue to market an EEA AIF in the UK as if it were governed by the provisions contained in AIFMD, as such provisions had effect immediately before 31 December 2020, until 31 March 2022.

EEA AIFMs will no longer be able to use the AIFMD marketing passport to market into the UK and will need to rely on the UK national private placement regime instead.

Marketing by small AIFMs (i.e. sub-threshold firms) will be subject to a lighter-touch regime; broadly, UK small AIFMs will be able to market all sub-threshold AIFs in accordance with the domestic financial promotion regime.

Off-shore managers of off-shore Alternative Investment Funds may market into the UK on the basis of the financial promotion regime. However, they will be required to comply with the transparency and (if relevant) private equity disclosure requirements imposed under UK AIFMD.

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

In its guidance, the FCA has stated that pre-marketing is not regarded as constituting marketing by an AIFM for the purposes of UK AIFMD. The pre-marketing will be permissible where it is based on draft documentation and the offer document, or other information, is not sufficiently detailed to enable the recipient to make an investment decision or submit a subscription request; for example, a pathfinder document should not amount to marketing. In the EEA, the Omnibus Directive will for the first time, introduce a new definition of "pre-marketing" into AIFMD. The intention of the proposal is that if a promotional activity does not fall within the definition of "pre-marketing", it should be treated as "marketing". These new requirements mean that the circulation of draft offering documents (e.g. draft versions of a limited partnership agreement) will constitute AIFMD marketing. EU AIFMs will be required to send an "informal letter" to their home State regulator notifying it of the pre-marketing within two weeks. Whilst this represents a significant change to the EEA regime, the Omnibus Directive will not be applicable to activities in the UK.

Pre-marketing activities will be subject to the UK's financial promotion regime. Under FSMA, the communication of financial promotions is restricted. Generally, financial promotions are permitted if they are made or approved by an entity authorised by the FCA. However, in the context of unregulated collective investment schemes (which will catch most private funds), there are further restrictions which limit even the scope for authorised persons to make financial promotions.

Units in unregulated collective investment schemes will, to the extent made by an entity which is not authorised by the FCA, need to be marketed in accordance with the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("FPO") or, to the extent made by an entity which is authorised by the FCA, need to be marketed in accordance with either the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) Order 2001 or the provisions of the conduct-of-business rules contained as a component part of the FCA Rules.

3.6 Can Alternative Investment Funds be marketed to retail investors?

AIFMD effectively left the question of marketing to retail investors to the discretion of Member States. The UK retained provisions which allow marketing to retail investors, and this remains the position post-Brexit, as contained in UK AIFMD. If an AIFM is permitted to market to professional investors, it can also market to certain types of retail investors (effectively qualifying high-net-worth or sophisticated investors), provided it does so in accordance with the UK financial promotion regime.

The financial promotion regime has changed recently with the effect that, where the promotion is being made in accordance with the conduct-of-business rules contained in the FCA Rules, in addition to the investors having to fall within the terms of the exemptions themselves, the issuer of the financial promotion must undertake a suitability assessment to ensure that the investment is appropriate for the prospective investor. This suitability assessment needs to be undertaken prior to the point at which the financial promotion is issued.

AIFs being made available to retail investors in the UK must also provide a standardised, short disclosure document – a key information document ("KID") – to investors under the PRIIPs Regulation, as replicated in the UK's post-Brexit regime (the "UK PRIIPs Regulation"). The KID must comply with certain detailed technical standards.

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

There are no "across the board" qualification requirements which apply in relation to prospective investors, although certain bases on which marketing is made under the financial promotion regime (or, where applicable, AIFMD) will require an analysis of the circumstances of the prospective investor.

For the purposes of UK AIFMD, a professional investor is one who could be so regarded under UK MiFID. Although most institutional investors are likely to be professional investors *per se*, it may prove difficult to opt people into professional status (it is a higher bar than most UK managers are used to). Investors who are not professional investors will be retail investors.

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

Under MiFID II, as replicated in the UK's post-Brexit legislation, local government pension schemes ("LGPS") are classified as retail investors which can lead to certain additional restrictions on marketing and distributing interests in such schemes. Following lobbying by the industry, however, LGPS are able to utilise a standardised opting-up procedure, such that LGPS can be opted-up to an elective professional status in a relatively straightforward manner.

There are no additional restrictions to those which otherwise apply under the financial promotion regime.

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

Under the current legislative and regulatory regime, there are no firm restrictions on the participation in Alternative Investment Funds – however, there may be regulatory capital costs to financial institutions in respect of their investment positions.

Under UK AIFMD, AIFMs are limited in terms of the additional activities they are able to undertake, and therefore certain financial institutions may need to restructure their operations to ensure that they are compliant with the provisions of UK AIFMD.

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

There are no restrictions on the use of intermediaries, although if the intermediary is itself carrying on regulated activities for the purposes of the UK regulatory regime, it will need to be authorised by the FCA.

4 Investments

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

Generally speaking, there are no restrictions, although the fund manager will need to ensure that the activities it is carrying out in respect of the Alternative Investment Fund are consistent with the scope of permission it has to carry out regulated activities (and with the contractual investment policy of the Alternative Investment Fund).

However, UK AIFMD does impose certain restrictions relating to asset stripping, as described at question 2.6 above.

In addition, although not restrictions, there are certain deal disclosure requirements under UK AIFMD. From 1 January 2021, UK AIFMs and non-UK AIFMs that have registered their funds for marketing in the UK are subject to UK AIFMD portfolio company provisions only if they acquire a material interest in a UK company (whether listed or unlisted). Prior to Brexit, these requirements would have been engaged on the acquisition of any EEA company. In this regard, an AIFM must notify the FCA when an AIF's voting interest in an unlisted company (being a UK registered company not listed on a UK regulated market) passes through certain thresholds. There are additional disclosure obligations when an AIF acquires "control" of a UK company (the test as to control varies according to whether the investee company is listed or unlisted). Investments by an AIF may also trigger a requirement to make certain information available to the FCA, the investee company and remaining shareholders (including, for unlisted companies, intentions as to the company's future business and the likely repercussions on employees). In the context of unlisted companies, relevant information must be passed to employee representatives (subject to limited exceptions).

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

There are no such limitations.

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

There are no such limitations.

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

In the context of private funds, there are currently no statutory or regulatory limitations on borrowing, although contractual restrictions are common. In the context of AIFs covered by UK AIFMD, certain of the pre-investment disclosures relate to the use of leverage. In particular, an AIFM must disclose: the circumstances in which the AIF may use leverage; the types and sources of leverage permitted and the associated risks; any restrictions on the use of leverage and any collateral and asset re-use arrangements; and the maximum level of leverage the AIFM is entitled to employ on behalf of the AIF.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

UK AIFMD requires full-scope AIFMs to appoint a depositary to have custody of the Alternative Investment Fund's assets, as described at question 1.7 above.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

Alternative Investment Funds structured as limited partnerships will need to comply with the registration requirements under the 1907 Limited Partnerships Act. Limited partnerships designated as PFLPs need only disclose basic details (essentially the fund's name and address). There may be a requirement on the general partner of a UK limited partnership to file the partnership's accounts on the basis of the Partnership Accounts Regulations.

Where an Alternative Investment Fund is to be marketed in a European Member State under national private placement rules, the pre-contractual disclosure requirements set out in the European Sustainable Finance Regulation ("SDFR") must be complied with in respect of products which promote either environmental or social characteristics. Additional (and material) disclosures are required for those Alternative Investment Funds which have "sustainable investment" as an investment objective.

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

From July 2017, fund houses that have any Scottish limited partnerships ("SLPs") in their fund structures (commonly used as feeder and carry vehicles) need to make filings under the Persons of Significant Control ("PSC Regime"). The PSC Regime also applies to SLPs designated as private fund limited partnerships, registered under the Limited Partnerships Act 1907. Failure to comply with the PSC Regime requirements carries criminal penalties. The PSC Regime has applied to LLPs since April 2016. English limited partnerships are not affected by these changes and remain outside the scope of the PSC Regime.

The PSC Regime requires SLPs to deliver to Companies House information relating to people with significant control ("PSCs") in relation to the SLP. The rules are complex but, in broad terms, a SLP's PSCs could include its general partner, any manager/operator and any limited partner whose interest in the partnership represents more than 25% of total interests.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

UK AIFMD requires AIFMs to comply with a range of detailed regulatory reporting obligations. Reporting obligations also apply to AIFMs seeking to market their funds in the UK under its national private placement regime.

Broadly, AIFMs will be required to make periodic reports to the FCA in accordance with UK AIFMD (which replicate those required under AIFMD). In addition to the annual reports in respect of each managed AIF, an AIFM will need to provide periodic reports relating to the AIFM itself and in respect of each AIF that it manages (including information in relation to investment strategies, main instruments traded, principal exposures, risk profiles and (where relevant) leverage).

The FCA has published various guidance papers and Q&As on periodic reporting, setting out what information is required and how, and when, it should be reported. The FCA has an online reporting system, GABRIEL, which assists UK AIFMs with meeting their requirements. The FCA is in the process of phasing out the use of GABRIEL, which is being replaced by a new data platform, RegData.

The UK government has indicated, as part of reforms to the UK limited partnerships regime, that it will introduce a requirement for an annual confirmation statement to be filed, confirming that all information on the register at Companies House is correct. A transitional period will be included for existing limited partnerships to provide additional information to cover all relevant requirements. An original proposal made in April 2018 to require limited partnerships to file annual reports and accounts has been dropped and replaced by the less onerous requirement for an annual confirmation. In terms of timing, the UK government has only committed to introducing legislation "when parliamentary time allows".

Where an Alternative Investment Fund has been marketed in a European Member State under national private placement rules, the website and periodic product disclosure requirements set out in the SDFR must be complied with in respect of products which promote either environmental or social characteristics. Additional (and material) disclosures are required for those Alternative Investment Funds which have "sustainable investment" as an investment objective.

5.4 Is the use of side letters restricted?

There are no firm restrictions on the use of side letters. However, UK AIFMD requires disclosures as to how an AIFM ensures the fair treatment of investors and, if side letters are used to provide preferential treatment to investors, a description of the preferential treatment and the type of investors to whom the treatment is made available will need to be disclosed. If the AIFM operates a general most-favoured nations ("MFN") mechanism, this is unlikely to be an issue; however, if no or a limited MFN process is in place, an AIFM will need to consider its use of side letters in the light of the disclosure requirements under UK AIFMD.

6 Taxation

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

UK limited partnerships are not taxable entities for UK direct tax purposes (although they do submit tax returns) and are instead fiscally transparent. This fiscal transparency means each limited partner is treated for UK tax purposes as owning its proportionate share of the assets of the partnership and is subject to tax on the income and gains allocated to it under the limited partnership agreement (whether or not they are distributed).

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

The tax treatment of the manager or adviser will depend on whether it is constituted as a company or an LLP. If a company, it will be subject to corporation tax on the fees paid by the fund (currently at 19% but the main rate is rising to 25% in April 2023). The management team takes its remuneration in the form of salary (taxed at the highest applicable income tax rates, with national insurance contributions due too) and the excess profit can be extracted as dividend income. If the manager is an LLP, it is fiscally transparent, so the profit arising from the fees paid to the manager is automatically taxable in the hands of its members. As noted above, the salaried member rules will be used to ascertain whether a member should be taxed as a self-employed person or an employee. The apparatus of an LLP is likely to mean that it constitutes a UK permanent establishment of its non-resident members such that all of the members, regardless of where they are resident, must pay UK tax on their share of the LLP's profits arising from its UK trade as an investment manager/adviser.

Under anti-avoidance rules, amounts arising to an individual involved in fund management are taxed as trading income, unless such amounts are already taxed as trading income or employment income or fall into exceptions for carried interest or co-investments. Where amounts from the fund arise to another person – such as a priority profit share/fee income arising to the general partner or manager – these amounts can be potentially imputed to the individual fund managers and taxed in their hands if certain conditions are met.

In terms of funds structured as limited partnerships, where the general partner appoints a manager to manage the partnership, the fee payable to the manager will in principle attract value-added tax ("VAT"). This is most often managed by ensuring that the manager and the general partner are in the same VAT group. The Court of Justice of the European Union ("CJEU") in the *Fiscale Eenheid X* case (C-595/13) outlined broad criteria for what constitutes a "special investment fund" ("SIF") for the purposes of the VAT exemption applicable in relation to SIF management services. It was also strongly suggested by the CJEU that AIFs which satisfy certain qualification criteria can be SIFs. This is a changing area of law and, in March 2020, the UK government announced that it would undertake a review of the VAT treatment of fund management fees. It is therefore possible that the UK's current position on the VAT treatment of management services supplied to AIFs, which satisfy the relevant SIF criteria, will change.

The UK is not typically used as a domicile for hedge funds, but it is a popular location for investment managers of hedge funds, and this is in part because of the Investment Manager Exemption ("IME"). Provided certain conditions are met, the IME ensures that a UK investment manager managing a non-UK fund will not constitute a permanent establishment of the fund in the UK. The IME enables a non-UK resident fund that is trading for UK tax purposes to appoint a UK-based investment manager without the risk of that part of the fund's profit that is attributable to the activity of the investment manager in the UK becoming subject to UK tax.

In relation to the taxation of carried interest, the general "tax transparency" principle is overlaid with: (i) a minimum charge of 28% for carried interest (compared with 20% for most other types of gains); and (ii) rules which can recharacterise carried interest receipts as trading income, taxable at the highest marginal rates, where the fund in question has a short average holding period (the "income based carried interest" rules, or "IBCI"). The IBCI rules are complex, but broadly, where

the average holding period of fund investments is less than 36 months, the carried interest returns will be treated as trading income. Where the average holding period is 40 months or more, the returns will be treated as investment gains or income. Where the average holding period is at least 36 months and less than 40 months, the returns are treated as a mix of investment return and trading income. There is an exception from the IBCI rules for carried interest awarded to employees. These rules relating to the taxation of carried interest do not affect the taxation of the fund itself or external investors.

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

There are no establishment taxes levied in connection with an investor's participation in an Alternative Investment Fund. Stamp duties may be payable on the transfer of limited partnership interests if the partnership property includes stock or marketable securities, although there are a number of methods of mitigating the effect of such taxes. Stamp duty land tax may be payable where the partnership property includes land in England or Northern Ireland (with similar taxes potentially applying in relation to land in Scotland or Wales).

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

The use of tax-transparent limited partnerships as the primary vehicle for Alternative Investment Funds means that income and gains received by the fund are treated as if they had been received by the fund's investors directly. The taxation of the returns depends on whether the fund is treated as trading or investing.

The question of whether or not a fund is carrying on a trade in the UK is largely a question of fact. In practice, this is determined by applying various criteria derived from case law – often referred to as "badges of trade" – to a fund's transactions. For example, churning investments and investing and divesting opportunistically would be likely to be indicative of a trading activity, whereas holding long for income and capital would be more likely to be considered as an investment activity.

Private equity funds (the main users of the limited partnership structure) usually intend to buy and hold securities for the medium to longer term in order to achieve long-term capital appreciation. Consequently, they are more likely to be considered as investing rather than trading.

If the limited partnership is treated as investing then, as a result of its tax transparency, profit distributions from the limited partnership retain their character as capital gains or investment income and are taxed accordingly. The tax payable by a particular investor will depend upon its own tax profile. For example, if the fund receives dividend income, this would be taxed in the hands of a UK-resident individual but a UK pension fund investor should not be subject to UK tax on such investment income. Most non-resident investors will only be subject to UK tax on UK-source investment income to the extent that it is subject to withholding tax or relates to UK land. Withholding taxes are potentially relevant to both UK interest and UK rental income (but generally not dividends), but there are reliefs from withholding. Generally, non-resident investors should not be subject to UK tax on capital gains unless: (i) they hold their interest for the purposes of a UK trade; or (ii) they fall into specific rules relating to UK property (and property-related) holdings (see below).

If the limited partnership is treated as trading for UK tax purposes, UK resident investors and non-UK resident limited partners will be subject to income tax (or corporation tax on trading income) on their share of the partnership's trading profits. This will be of particular concern for UK pension fund investors (who are only exempt from UK tax on investment income and gains). Non-UK resident investors will be caught because the partnership (or the fund manager) will constitute a taxable presence in the UK through which the non-resident is carrying on a trade, but in many cases the IME may be applicable.

The UK regime for taxation of gains arising to a non-resident from interests in UK land has expanded in scope significantly from 6 April 2019. Before that date, the UK only taxed non-residents on gains from UK residential property (subject to important exemptions in the context of investment funds). Broadly, the general position is now that non-resident investors are subject to tax on gains arising from disposals of UK land and also on the disposal of substantial interests in relevant entities that derive at least 75% of their market value from UK land. However, the general position is significantly modified by complex specific provisions relating to collective investment vehicles.

Investors should also be aware of the annual tax on enveloped dwellings ("ATED") and this should be considered carefully when a fund invests in UK residential property.

Where a UK limited partnership receives income from non-UK jurisdictions that levy withholding tax, or receives capital proceeds from the sale of an asset situated in a jurisdiction which might tax that gain, then limited partners may seek to rely on the terms of a double tax treaty in order to obtain relief. Whether such relief is available will depend, in part, upon whether that non-UK jurisdiction treats a UK limited partnership as fiscally transparent.

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

Generally speaking, it is not necessary to obtain tax rulings prior to establishing an Alternative Investment Fund.

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

The UK entered into a Model 1 Intergovernmental Agreement ("IGA") with the US in September 2012 in relation to FATCA and subsequently introduced domestic legislation to implement FATCA reporting. Relevant Alternative Investment Funds established in the UK therefore have to carry out the required due diligence procedures and report prescribed information about relevant investors to Her Majesty's Revenue and Customs.

In addition, the Organisation for Economic Co-operation and Development ("OECD") Common Reporting Standard for Automatic Exchange of Financial Account Information ("CRS") has also been implemented into UK law.

Accordingly, UK funds will need to consider these information reporting rules in order to ensure that they are compliant.

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

Following the publication of the OECD's final BEPS reports

on 5 October 2015, the UK has taken the lead in the development and implementation of new rules relating to BEPS. For example, legislation having effect from 1 January 2017 was introduced in order to neutralise the effect of hybrid mismatch arrangements and legislation to restrict the tax deductibility of corporate interest came into force from 1 April 2017. In addition, the UK has implemented Country-by-Country Reporting.

The UK signed the multilateral instrument ("MLI") in June 2017 and it entered into force for the UK on 1 October 2018. As expected, the UK adopted the principal purpose test in relation to its covered treaties, but did not narrow its definition of an independent agent or extend the definition of permanent establishment, other than adopting the provisions which prevent a permanent establishment being avoided by means of the fragmentation of activities.

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

If there is appetite to establish a listed fund, then a UK investment trust ("ITC") or real estate investment trust ("REIT") should be considered. Provided certain conditions are met, ITCs are exempt from corporation tax on capital gains, can benefit from the general corporation tax exemptions from dividend income and can potentially deduct dividends paid to investors which represent interest income from their interest receipts. Provided certain conditions are met, REITs are exempt from corporation tax on the income profits of their property rental business and on gains arising on disposals of assets used in such business (potentially including interests in certain entities that are UK real estate rich) and can benefit from the general corporation tax exemptions from dividend income.

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

The tax position of an investor in a UK Alternative Investment Fund will inevitably depend upon its own tax profile – accordingly investors should always seek independent advice on the tax implications of participating in the fund, and managers should advise investors of this fact.

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

In March 2020, the UK government announced that it would undertake a review of the UK funds regime, including from a tax perspective. The review is very wide ranging and, as it is still in progress, the full extent to which it will lead to tax changes is not currently known. However, one likely reform is the introduction of a new tax privileged regime for UK holding companies utilised by alternative investment funds, for which legislation is expected to be enacted in 2022.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The UK's Brexit transition period ended on 31 December 2020. The UK now has its own AIFM and PRIIPs regime which sit alongside the European regimes. Whilst the UK and EU rules remain largely aligned, there may be divergence in the longer term.

This has already been indicated in the case of the PRIIPs regime. In 2020, HM Treasury published a policy statement on proposed amendments to the UK PRIIPs regime to improve its functioning in the UK. The changes include clarifying the scope of PRIIPs, giving the FCA power to clarify what information should be provided in the key information document and replacing the "performance scenario" section with "appropriate information on performance", with the FCA amending what information to provide in this section. HM Treasury also intends to conduct a more wholesale review of the disclosure regime for UK retail investors in the longer term.

The UK is not required to implement EU legislation that was not in force before 31 December 2020 but in some instances the UK has indicated that it expects to adopt a similar regime. For example, while the UK is no longer required to implement the EU's prudential regime for MiFID investment firms due to Brexit, the FCA published consultation papers on the introduction of a new UK Investment Firm Prudential Regime (which is expected to come into force in January 2022).

Other regimes will not be adopted, however; for example, the EU cross-border distribution of investment funds legislation, due to come into force in EU Member States in August 2021. That is not to say that such European legislation is no longer applicable; UK fund managers may find that they are affected by consequential amendments that individual EEA Member States may decide to make to their national private placement regimes. A further example is the EU Sustainable Finance Disclosure Regulation, which has applied in EEA Member States since March 2021 and which remains applicable to UK AIFMs to the extent that they undertake marketing of a UK AIF in an EEA Member State under its national private placement regime.

AIFMD now sits alongside its UK counterpart and remains relevant to UK managers managing EEA AIFs, or to the marketing in the EEA. The upcoming revisions to be made to AIFMD, commonly referred to as "AIFMD 2", will therefore continue to be of interest to UK AIFMS and managers of UK AIFs. The timeline for any subsequent legislative proposals remains uncertain for the time being and any concrete changes that may result and impact upon UK firms are (compared to other things) likely to be some considerable way off.

The London Interbank Offered Rate ("Libor") is expected to be discontinued by the end of 2021 and there has been increased pressure from the regulators (including the FCA) to ensure that market participants cease to use this benchmark well in advance of this date. Most funds are likely to be affected by the Libor discontinuation; funds might use Libor as benchmark or performance targets, and its administrators, managers and custodians as an input to their valuations and risk assessments. Also, Libor might feature across a fund's investments, as it is commonly referenced in funding arrangements, interest rate derivatives transactions, as well floating rate notes and securitisations.

The senior domestic managers and certification regime (SMCR), which previously only applied to UK banks, was extended in December 2019 to include all non-bank firms, including UK fund managers, authorised under the Financial Services and Markets Act 2000. The aims of the regime are to ensure greater clarity about the responsibilities of senior individuals within firms, as well as greater individual accountability. Firms had until 9 December 2020 to: (i) complete their fitness and propriety assessments; (ii) to train all those employees (other than ancillary staff) who are not Senior Managers or Certification Staff, but who are nonetheless within the scope of the relevant conduct rules; and (iii) to upload via Connect all the data about individuals that they are required to provide for the purposes of the FCA's new Directory.

Sustainable finance remains a key area of development. In 2020, the UK announced that it will be first jurisdiction in the world to make reporting under the Taskforce on Climate-related Financial Disclosures ("TCFD"), mandatory across the economy, and to develop a UK-specific version of the EU's forthcoming Taxonomy Regulation (a classification system to identify sustainable investments). TCFD-aligned reporting on climate change will be required by almost all UK-regulated asset managers (including alternative investment fund managers).

As to English limited partnerships, the introduction of the PFLP regime has been welcomed as a positive step and should allow the UK to compete with other similar vehicles offered in other jurisdictions. Further (relatively minor) reform proposals for all UK limited partnerships are to be introduced following a response paper published by the UK government in December 2018. The proposals are designed to build in effective controls into the life cycle of a limited partnership to combat such vehicles being used for illegal activities. At the time of writing, no draft legislation has been published, with the government only committing to legislation "when parliamentary time allows".

In short, practitioners within the industry will need to ensure that they keep abreast of developments and consider whether they should be engaging with the industry in lobbying to try and ensure that any proposed regulatory excesses can be curbed.

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

The UK's exit from the EU on 31 December 2020 has created an opportunity to look at the regulation and tax framework of the UK asset management and funds industry in order to create a legal, regulatory and tax regime that remains attractive to fund managers, advisers and other market participants. The UK government is in the middle of a wide-ranging tax and legal review of the UK funds regime, although many of the individual work-streams relating to the review remain at the development stage. The government's primary focus is on identifying options which will make the UK a more attractive location to set up, manage and administer funds, and which will support a wider range of more efficient investments better suited to investors' needs.

Short-term initiatives include the Financial Services Act, introduced to ensure that the UK's regulatory framework continues to function effectively for the UK after leaving the EU. Included in this new piece of legislation is the introduction of a new Overseas Funds Regime to allow overseas domiciled retail funds (and money market funds) to be marketed to investors in the UK.

The government has also launched Lord Hill's review of the UK's listing regime by publishing a policy paper and call for evidence. The review is driven by Brexit and will inform proposals to boost the UK's reputation as a destination for IPOs. In particular, in April 2021, the FCA commenced a consultation on proposed changes to aspects of the UK's Listing Rules that apply to special purpose acquisition companies ("SPACs") which recognised the need to open up the UK markets as a viable listing venue for SPACs.

HM Treasury has published a wide-ranging "call for input" on changes to enhance the UK funds regime. A key option being considered is a flexible, tax-efficient, unauthorised fund structure, capable of investment in alternative asset classes and aimed at professional investors. A review of the VAT treatment of fund management fees is also expected and it is anticipated that a new tax privileged regime for asset holding companies used in alternative fund structures will be introduced (see question 6.10 above). The UK government is also considering various reforms to the UK's REIT regime.

In May 2021, a consultation on a proposed new type of investment vehicle, the long-term asset fund ("LTAF"), was launched, which would create a new, more flexible, open-ended, FCA-authorised fund to invest in long-term assets. The LTAF would make it easier for pension funds – and potentially other investors – to access longer-term, illiquid investments.

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Starting with teams of transactional, investment funds and financial services regulatory lawyers dedicated to the private equity sector in the 1990s, Travers Smith now advises many asset owners and asset managers in the private equity, alternative credit, real estate and infrastructure sectors and has a market-leading cross-practice team of 43 partners representing clients in the private capital sector who manage over $4 trillion of assets.
Through its consolidated approach to providing sophisticated legal services, across asset management, fund formation and fund transactions, regulatory, tax, transactional M&A and private equity, infrastructure, finance, derivatives, structured products, operational risk and sustainable finance (ESG), the team combines cross-disciplinary specialisms to provide holistic support to these clients on important matters both for the funds that they operate and for their own businesses, as well as on the structuring and raising of new funds. The firm's relationships with asset owners, such as pension schemes and family offices, are also very strong.

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Finland

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Olli Kiuru

1 Regulatory Framework

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

All Finnish Alternative Investment Fund Managers ("**AIFMs**") and Alternative Investment Funds ("**AIFs**") are impacted by:

- the Finnish Act on Alternative Investment Fund Managers (162/2014) (the Finnish AIFM Act or "**AIFMA**"), which implemented Directive 2011/61/EU (the AIFM Directive or "**AIFMD**") into Finnish law; and
- the European Commission Delegated Regulation (EU) No. 231/2013, supplementing the AIFMD with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (the "**Commission Delegated Regulation**").

Certain AIFs marketed to non-professional investors are also impacted by the Finnish Act on Common Funds, which implemented Directive 2009/65/EU (the UCITS Directive) into Finnish law.

Finnish AIFs investing mainly in properties are also subject to the Finnish Act on Property Funds (1173/1997).

In addition, other European legislation like the European Venture Capital Fund Regulation and the European Long-Term Investment Fund Regulation (EU/2015/760 – ELTIF) might apply.

Depending on the legal form of the AIF, the AIF might also be subject to, e.g., the Finnish Partnership Act (389/1988) or the Finnish Limited Liability Companies Act (624/2006).

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

Finnish AIFMs managing AIFs established under Finnish legislation are required to be (i) regulated and authorised by, or (ii) registered with the Finnish Financial Supervisory Authority (*Finanssivalvonta* – the "**FIN-FSA**").

An AIF marketed to retail investors requires an authorised AIFM.

Non-Finnish EU AIFMs managing Finnish AIFs must be duly licensed in their home Member State and subsequently passported and notified to the FIN-FSA in accordance with the AIFMA.

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

There are no such requirements. However, an AIFM has the right to market the units of an AIF in Finland only after submitting a notification to the FIN-FSA with information on the AIF it intends to market. Upon receipt of marketing authorisation, the AIF may be marketed either by the AIFM, the AIF or by a duly licensed investment firm or credit institution.

EU-AIFMs may offer EU AIFs to Finnish investors on the basis of the AIFMA and Article 32 AIFMD upon having made the requisite passporting notification. Upon receipt of marketing authorisation, the AIF may be marketed either by the AIFM or by a duly licensed investment firm or credit institution.

AIFs that are also marketed to retail investors are subject to compliance with additional rules on conduct of business and other requirements, which are to be disclosed to the FIN-FSA.

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

The AIFMA distinguishes between open- and closed-ended AIFs.

Closed-ended Finnish AIFs are usually formed as limited partnerships but can also take other forms. Closed-ended AIFs do not have exercisable redemption rights, or only limited rights, for a certain period following the date of initial investment in the relevant AIF.

Special investment funds (*Erikoissijoitusrahasto* – "**ESR**"), as regulated in Chapter 16 b of the AIFMA, are open-ended AIFs that can be marketed to retail investors. Open-ended AIFs and ESRs are subject to stricter rules regarding e.g. redemption rights, risk management and the frequency of valuations.

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

Finnish AIFMs managing AIFs established under Finnish legislation are required to be (i) regulated and authorised by, or (ii) registered with, the FIN-FSA.

The authorisation process of an AIFM, as set out in the AIFMA, follows the AIFMD.

A written application for authorisation is submitted to the FIN-FSA, with supporting documents attached. The supporting documents must contain, *inter alia*, the FIN-FSA

questionnaire and forms, draft articles of incorporation, information concerning shareholders, governing bodies, senior managers, drafts of policies and procedures and service provider agreements.

The application should also consist of information regarding the AIFs the AIFM is managing or intends to manage; *inter alia*, draft constitutional documents of the AIF to be managed.

Application for authorisation must be made either in Finnish or Swedish.

The FIN-FSA has three months from the date of a complete application, including where additional information is requested, to complete its examination process. If, for an essential reason, the FIN-FSA deems it necessary, the FIN-FSA is allowed to extend the examination period by another three months. Although the deadline of three months applies, prospective fund managers should consider the duration of the FIN-FSA authorisation process to be more than six months.

The registration process of an AIFM is set out in the AIFMA. A written application for registration is submitted to the FIN-FSA, with supporting documents attached. The application for registration must be made either in Finnish or Swedish.

Upon receiving the application for registration, the FIN-FSA contacts the AIFM for further information on the process and an estimate of the processing time.

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

Authorisation in accordance with the AIFMA can be granted to Finnish limited liability companies. Furthermore, the registered office and central administration of the AIF/AIFM must be located in Finland to qualify as a Finland-based AIF/AIFM.

In accordance with the AIFMA, an authorised Finnish AIFM must appoint a depositary located in Finland for each Finnish AIF the AIFM manages.

1.7 What service providers are required?

The appointment of an AIFM depository and appointment of an auditor is required under the AIFMA.

If not internally managed, the AIF's appointed external AIFM is entrusted with portfolio and risk management, as well as, potentially, administration and marketing.

The service providers required for an AIF will also depend on:

- the legal structure of the AIF;
- the services which the AIFM will provide (e.g. if it will be necessary to appoint an external valuer, administrator, distributor, etc., if such services are not provided by the AIFM); and
- the investment strategy of the AIF (e.g. where local regulation in the market where the AIF invests requires local brokers).

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

The rules applying to foreign AIFMs depend primarily on whether they are EU- or non-EU (third country)-based.

Non-Finnish EU AIFMs managing Finnish AIFs are not subject to any additional rules and allow for a level playing field with Finnish fund managers.

Non-EU AIFMs intending to manage EU AIFs in Finland acquire prior authorisation by the FIN-FSA in accordance with the AIFMD.

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

The FIN-FSA is a member of the European System of Financial Supervision ("**ESFS**"), created in and with effect from January 2011. The purpose of the ESFS is to contribute to establishing common regulatory and supervisory standards and practices and ensuring that the Member States' supervisory authorities apply a single set of harmonised and consistent supervisory practices.

Finland has also entered a number of information exchange-related agreements on taxation under the OECD and tax treaties, in addition to which Finland is obligated to follow the information-sharing requirements under EU law. In general terms, transparency and exchange of information for tax purposes amongst jurisdictions has increased significantly in recent years.

As one of the recent developments, Finland has implemented Council Directive 2018/822 pertaining to reportable arrangements, which calls for an in-depth review of various cross-border arrangements in anticipation of the applicability of this new regulatory framework, with great relevance also to the activities of AIFs.

2 Fund Structures

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

Under Finnish law, an AIF can be established as a corporate entity or as another type of collective investing where funds are raised from a number of investors in accordance with a defined investment policy.

The most common types of corporate form are limited partnerships and limited liability companies.

The most common type of collective investing is the open-ended ESR.

The choice of legal form depends on, for example, the investor target group, tax and structural reasons as well as requirements set by the FIN-FSA.

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

The limited liability of investors is generally ensured by the legal form of the AIF.

A limited partnership must have at least two partners, one of them being the general partner and one the silent partner. The general partner has the right to contribute to the management's decisions, whereas the silent partner (or partners) has no individual decisional power but does not absorb the losses either. The liability of a silent partner is therefore generally limited to the amount (capital) committed in the AIF.

In a limited liability company, the owners are responsible up to the amount of share capital they possess.

The liability of an ordinary investor in an ESR is generally limited to the amount invested in the fund and the investor has no individual decisional power.

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

The principal form of legal structure for managers of AIFs is the limited liability company.

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

ESRs are generally open-ended but should the investment strategy of the ESR so require, certain restrictions on redemptions are possible within the limits set out in the applicable fund documentation. ESRs may also apply redemption gates if provided for in the applicable fund documentation.

There are no further legislative provisions that limit a manager's ability to restrict redemptions. As a general rule, however, the investment strategy, liquidity profile and redemption policy of the AIF must be consistent with each other and the provided applicable minimum capital requirements must be met. Possible restrictions to redemptions or transfers are generally provided for in the AIF's documents and communicated to investors.

In corporate AIFs, redemption at the request of investors is generally not possible and closed-ended funds have usually availed of the possibility to restrict transfers as well.

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

There are no legislative restrictions on transfers other than those resulting from requirements on investors (see question 3.7) in certain cases.

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

AIFs marketed to non-professional investors are subject to risk diversification provisions.

AIFMs are also subject to asset stripping rules as set out in the AIFMA and AIFMD.

3 Marketing

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

The AIFMA governs the marketing of AIFs in Finland, as well as FIN-FSA regulations and guidelines. AIFs marketed through credit institutions or investment firms licensed to provide MiFID II investment services will also be subject to marketing regulation in accordance with the Finnish Investment Service Act (747/2012, as amended).

Marketing of AIFs will also be subject to the EU Cross Border Distribution of Collective Investment Undertakings Directive 2019/1160, amending Directive 2011/62/EU. The Directive shall be implemented into Finnish law by 2 August 2021.

An AIF marketed to non-professional investors in Finland must comply with the Finnish Act on Consumer Protection (38/1978).

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

The AIFM or the licensed and passported MiFID II investment firm marketing the AIF must in its marketing material make available sufficient information for investors to be able to make an informed judgment on the investment and, in particular, of the risks attached thereto. Further, information presented to the investors must always be fair, clear and not misleading. Also, interests in the AIF may not be marketed by giving untrue or misleading information or by using a procedure that is unfair or otherwise contrary to good practice.

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

The constitutional documents and material contracts of the AIF must be submitted to the FIN-FSA in advance of the marketing of an AIF. Marketing may only commence upon confirmation of receipt from the FIN-FSA.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Under Finnish law, marketing is defined as a direct or indirect offering or placement, at the initiative of or on behalf of the AIFM of units or shares in the AIF, to investors. Therefore, any active marketing activities are covered by the term.

Marketing must as a general rule be targeted to professional clients only. Marketing to non-professional clients is generally allowed only by authorised AIFMs and is subject to compliance with additional disclosure rules, e.g. the requirement to prepare a key investor information document.

Reverse solicitation has generally not been considered marketing and does not trigger AIFMA requirements. According to the draft government proposal implementing the directive on cross-border distribution of funds (EU) 2019/1156, the possibility of invoking the *reverse solicitation* exception in the application of marketing rules will, however, be limited by tightening the conditions for spontaneous contact.

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

The concept of pre-marketing has not been defined in the AIFMA and has mainly occurred in established market practice. This will, however, change as a result of the EU Cross-Border Distribution of Collective Investment Undertakings Directive 2019/1160, amending Directive 2011/62/EU. The Directive shall be implemented into Finnish law by 2 August 2021.

According to the proposal for implementing the Directive into AIFMA, pre-marketing will be defined as the "*provision of information or communication, direct or indirect, on investment strategies or investment ideas by an EU AIFM or on its behalf, to potential professional investors domiciled or registered in the Union in order to test their interest in an AIF which is established, but not yet notified for marketing in accordance with AIFMA in the Member State where potential investors are domiciled or have their registered office, and which in each case does not amount to an offer or placement to the investor to invest in the units or shares of that AIF*".

3.6 Can Alternative Investment Funds be marketed to retail investors?

Authorised EU/EEA AIFMs (and duly licensed investment firms and credit institutions) may market EU/EEA AIFs to non-professional clients subject to compliance with additional disclosure rules and the requirement to prepare a key investor information document.

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

Investments in AIFs are generally reserved for professional investors as defined in the Finnish Act on Investment Services (747/2012).

Only authorised AIFMs are allowed to market EU/EEA AIFs to non-professional clients. The FIN-FSA may grant a non-authorised AIFM the right to market an AIF to non-professional clients that are not retail clients in Finland in the manner referred to in the AIFMA. In order for registered AIFMs to obtain the right to market AIFs to such "well-informed" and wealthy non-professional clients, the AIFM must demonstrate, *inter alia*, that the capital to be invested in the AIF is intended to be collected from professional and non-professional clients who clearly understand the risks associated with the investment, invest on a long-term basis and have sufficient preconditions to bear the investment risk and can make a specified minimum investment.

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

There are no additional restrictions.

However, such public bodies are generally subject to strict internal restrictions on investments and AIFMs are therefore advised to recognise such restrictions at an early stage of structuring an AIF to better meet those restrictions.

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

Finnish law does not provide for any specific restrictions.

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

Provided that they are duly authorised by competent authorities, Finnish or EEA intermediaries may act as distributors for AIFs for which the AIFMD notification process has been duly completed by the relevant AIFM.

4 Investments

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

The eligible assets for AIFs are generally unrestricted.

When investing the assets of an ESR which can be marketed to non-professional investors, the AIFM must diversify the risks of the investment activities of the ESR. Furthermore, if marketed to non-professional investors, the rules of the ESR must specify to what extent the investment activities of the ESR deviates from the provisions of Chapter 13 of the Finnish Mutual Funds Act (213/2019) regulating UCITS funds and how the assets of the ESR are invested and investments diversified.

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

Finnish AIFs are not restricted in terms of types of investments. However, according to the AIFMA, requirements for diversification of risk apply to ESRs marketed to non-professional investors.

Finnish AIFs investing mainly in properties and marketed to non-professional investors are also subject to certain requirements for diversification of investment and risk according to the Finnish Act on Property Funds (1173/1997).

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

There are no local regulatory requirements imposed on Finnish AIFs that invest in derivatives or loans.

However, according to the AIFMA, requirements for diversification of risk apply to open-ended AIFs and AIFs marketed to non-professional investors.

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

The AIFMA does not provide for any restrictions on borrowing. However, The AIFM shall determine and set a maximum level of leverage for each AIF it manages, as well as any rights to re-use collateral or guarantees under the leverage arrangements. AIFs must mention the level of borrowing and leverage in the offering documents and report the same to the FIN-FSA regularly.

Finnish AIFs that mainly invest in properties are also subject to certain restrictions on borrowing according to the Finnish Act on Property Funds (1173/1997).

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

A depositary established in the same EU/EEA Member State as the AIF shall be appointed for the AIF. However, AIFMs subject to registration are not obliged to appoint a depositary for the AIF it manages.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

AIFMs are required to disclose certain prescribed information to prospective investors in advance of any investment and regarding any material changes to such information on an ongoing basis. AIFs marketed to non-professional investors are further subject to additional disclosure requirements, e.g. providing the investor with a key information document in either Finnish or Swedish or other language as approved by the FIN-FSA.

As part of the pre-contractual disclosures, AIFMs shall, subject to the Disclosure Regulation (2019/2088/EU, "**SFDR**"), include descriptions of the manner in which sustainability risks are integrated into their investment decisions and the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available.

In accordance with the SFDR, information on whether the AIF promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, or whether the AIF has sustainable investment as its objective shall also be included in the pre-contractual disclosures.

AIFMs shall also publish on their websites information about their policies on the integration of sustainability risks in their investment decision-making process as well as information on how the AIFM's remuneration policies are consistent with the integration of sustainability risks. Furthermore, AIFMs shall publish on their websites information on where they, on an entity level, consider principal adverse impacts of investment decisions on sustainability factors and a statement on due diligence policies with respect to those impacts; where they do not consider adverse impacts of investment decisions on sustainability factors, they must state clear reasons for why they do not do so. By 30 December 2022, such information shall also be made available for each AIF the AIFM manages.

AIFMs shall, for each EU/EEA AIF that they manage and market in the EU, periodically disclose to investors:

- the percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature;
- any new arrangements for managing the liquidity of the AIF; and
- the current risk profile of the AIF and the risk management systems employed by the AIFM to manage those risks.

AIFMs managing EU/EEA AIFs employing leverage or marketing in the EU AIFs employing leverage shall, for each such AIF, disclose, on a regular basis:

- any changes to the maximum level of leverage which the AIFM may employ on behalf of the AIF as well as any right of the reuse of collateral or any guarantee granted under the leveraging arrangement; and
- the total amount of leverage employed by that AIF.

AIFMs are required to produce and make available an annual report to investors of each AIF they manage within six months of the end of the financial period of the AIF. If mentioned in the documentation, the AIFM must publish the net asset value (or make it available to the investors).

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

AIFMs and AIFs established as corporate entities are subject to corporate laws, obliging the entities to register with the Finnish Trade Register and provide information on the owners and controllers of the entities.

The Finnish Act on Preventing Money Laundering (444/2017), implementing the Fourth EU Anti-Money Laundering Directive (EU 2015/849), as amended by the Fifth EU Anti-Money Laundering Directive (EU 2018/843), also imposes an obligation for corporate and legal entities incorporated in Finland to register details on the beneficial owners in a register held by the Finnish Trade Register.

AIFMs are further required to promptly provide information on any changes in the senior management of the AIFM to the FIN-FSA. Furthermore, any person who intends to directly or indirectly acquire shares exceeding regulated thresholds in an AIFM must notify the FIN-FSA in advance.

ESRs are obliged to keep an updated register with information on the units and unit holders of the ESR.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

A Finnish AIFM must regularly report to the FIN-FSA certain prescribed information in the form of a reporting template as set out in Annex IV of the Commission Delegated Regulation 231/2013, e.g. the principal markets and instruments in which it trades on behalf of the AIFs it manages.

The net asset value per unit or share of AIFs shall be disclosed to the investors at least yearly, unless otherwise regulated in the AIFs documentation. AIFMs are also required to produce and make available an annual report to investors of each AIF they manage within six months of the end of the financial period of the AIF. Authorised AIFMs are required to provide the FIN-FSA with the financial statements within two weeks of the financial statements having been approved.

AIFs promoting environmental or social characteristics and sustainable investments are subject to the reporting obligations set out in the SFDR.

AIFs acquiring or transferring substantial holdings or control of unlisted companies are to report such holdings to the FIN-FSA within 10 days of the transfer.

5.4 Is the use of side letters restricted?

There is no statutory or regulatory restriction on the use of side letters.

However, an AIFM is subject to certain operating conditions, including, *inter alia*, an obligation to treat all AIF unit or shareholders fairly and to ensure that no unit or shareholder of an AIF receives preferential treatment unless such treatment is disclosed in the AIF's constitutional documents.

6 Taxation

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

Under the Finnish tax legislation, AIFs fulfilling the prerequisites for a Finnish tax-exempt investment fund would be tax exempt on profit accrued.

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

As the principal form of investment manager/adviser is the limited company (*osakeyhtiö, Oy*), it is taxed under the general corporate taxation regime on profit accrued, at the currently applicable rate of 20%.

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

No, there is generally no transfer tax payable in connection with the investor's participation in AIFs.

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

Investors are taxed based on their status as individuals, corporates, or transparent entities, whether exempted or not, and depending further on their tax residence, or the tax residence of the ultimate beneficial owner. Accordingly, there is great variance in that regard and each investor/case must be carefully assessed on its own merits, i.e. on a case-by-case basis.

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

An investment structure can often be implemented with reasonable certainty as to its foreseeable tax treatment; however, to avoid all doubt, a tax ruling can be applied for.

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

All the referred regulation platforms are implemented in Finland as appropriate under the Finnish tax and legal framework.

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

All the referred regulation platforms are implemented in Finland, so general assessment of AIFs would accordingly apply, but on a case-by-case basis.

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

There are no specifically tax-advantaged classes or structures available. Generally, however, assuming the prerequisites for a Finnish tax-exempt investment fund are fulfilled, that could be a benefit in itself.

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

VAT liability/compliance should always be confirmed prior to entering into an investment structure. Also, carried interest is still somewhat uncertain under Finnish tax practice and should, therefore, be specifically accounted for, as appropriate.

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

A lot of discussion is still centred around the tax-exempted status of non-Finnish real estate investment structures with AIFs; however, no concrete steps have been taken so far. Further, the specific, yet generally applicable Finnish transfer pricing adjustment rule, aligned with OECD Model Article 9, is being revised, the final content and wording of which, however, is still undefined.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

AIFs investing mainly in different types of properties have been trending on the Finnish market for many years, although the global pandemic slowed the market down for a while in the beginning of 2020. During the ongoing COVID-19 pandemic, in the spring of 2020 some AIFs investing mainly in properties experienced challenges with valuation of assets, and open-ended AIFs in executing redemptions in due time. As a result, AIFMs were forced to take action to improve redemption and valuation procedures to ensure proper procedures during possible unordinary market conditions.

Furthermore, as the market for Finnish AIFs investing mainly in properties has been heated for some time, some AIFs have faced further challenges in finding proper investment objects. As a result, some market participants have found ways to collaborate and join forces.

As a result of the ESG regime, market participants are also looking into the possibilities of marketing "Green" AIFs that fulfil the requirements set out in the Disclosure Regulation and Taxonomy Regulation. Overall, the ESG regime with extended disclosure requirements requires market participants to implement new procedures and assessments into the business activities.

The start-up scene in Finland is strong and new businesses are continuously emerging in, *inter alia*, the gaming, electronics, software, clean & biotech and health industries. As a result, there is a growing interest among investors for possibilities to invest in such start-up companies. AIFMs have started to respond to this demand by developing AIFs investing in start-ups, providing the companies with needed initial capital and making it possible for investors to invest in start-up companies with a more diversified risk than when investing directly in the company.

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

Article 69 of AIFMD requires the European Commission to review the application and the scope of AIFMD after a certain period of the AIFMD entering into force. This entails assessing the Directive's impact on investors, AIFs, AIFMs in the EU and in third countries in order to establish how far AIFMD's objectives have been achieved. The Commission has published a consultation on the areas of "improvement" and harmonisation on areas of detail within AIFMD and the consultation period ended on 29 January 2021.

The Commission's consultation, and the expected revision, should lead, not to major changes, but rather to the definition of a strengthened protective framework for the AIF market, stability and harmonisation of the regimes in force and possible further harmonisation with the UCITS regime. A legislative proposal to amend the AIFMD is expected in the third quarter of 2021.

Marketing of AIFs will also be subject to the EU Cross Border Distribution of Collective Investment Undertakings Directive 2019/1160, amending Directive 2011/62/EU. The Directive shall be implemented into Finnish law by 2 August 2021.

Furthermore, as of 1 January 2022, Regulation (EU) No. 1286/2014, as amended (the PRIIPS Regulation), will govern the production and offering of the key information document (KID) by an ESR where units are to be offered to retail investors.

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Germany

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1 Regulatory Framework

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

The establishment and operation of alternative investment funds is governed by the *Kapitalanlagegesetzbuch* (**KAGB**), which transposes the Alternative Investment Fund Manager Directive (**AIFMD**) into German legislation, introduced in 2013. In addition, the *Investmentsteuergesetz – InvStG* (German Investment Tax Act), substantially revised with effect in 2018, has a substantial impact on the establishment and operation of alternative investment funds.

Certain activities in connection with a fund, like solicitation services, are regulated in the MiFID transposition legislation (*Kreditwesengesetz*, *Wertpapierhandelsgesetz*) or additional domestic law like the *Gewerbeordnung*.

In addition, European legislation such as the European Venture Capital Fund Regulation and the European Long-Term Investment Fund (**ELTIF**) Regulation apply.

Before the introduction of the KAGB, it was possible to establish and operate closed-ended AIFs without triggering regulation in Germany.

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

Following the AIFMD, it is required to register or license an alternative investment fund manager. Germany provides for a small Alternative Investment Fund Manager (**AIFM**) regime with stricter requirements than the AIFMD.

Advisors do not *per se* fall under the KAGB as long as they do not perform outsourcing services, but investment advisory services may fall under the *Kreditwesengesetz* transposing the MiFID rule on such advice into German law.

The supervisory body is in both cases *Bundesanstalt für Finanzdienstleistungsaufsicht* (**BaFin**).

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

AIFs which also address retail investors need several approvals from BaFin to be marketable in Germany.

If the AIFs only address so-called semi-professional and/or professional investors to qualify as a Spezial-AIF, technically no further steps are required, but BaFin requests a(n) (informal) notification on their raising. Professional investors are defined under the AIFMD. Semi-professional investors are defined under domestic law as sophisticated investors with a minimum commitment of EUR 200,000 (with a different threshold of EUR 100,000 under the European Venture Capital Fund Regulation).

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

The KAGB contains substantial distinctions. The definitions of open- and closed-ended follow European regulations.

Before the KAGB, the distinction of open- and closed-ended was decisive on the regulation, as the management of open-ended fund was subject to regulation, whereas closed-ended funds could be managed without regulation.

Nowadays the distinction matters, as it decides:

(1) which regulatory regime the AIFM can be subject to. The small (sub-threshold) AIFM regime is only available to managers of closed-ended funds. All other funds trigger a AIFM licence under the KAGB; and

(2) the KAGB provides for fund-related product regulation on open-ended funds generally, but only for closed-ended funds also addressing retail investors, whereas closed-ended funds addressing semi-professional and professional investors are minimally regulated if they do not provide debt. The KAGB also provides special forms of funds for real estate, hedge and, as of 2021, infrastructure funds.

Besides this Germany-specific legislation, EuVEVA and ELTIF funds can be established.

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

The authorisation process for AIFMs follows the AIFMD. Although the AIFMD deadline of three months applies, prospective fund managers should prepare for the BaFin process duration to exceed three months.

The approval times on AIFs vary as well. The KAGB provides for various deadlines; due to additional demands by and discussions with BaFin, often these deadlines are not met.

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

The local residency requirements under German law follow the AIFMD.

1.7 What service providers are required?

German law does not provide for additional service providers to the AIFMD. A depositary and an external valuer may be required beside an auditor, dependent on the regulatory regime to be applied (with exemptions for small AIFMs).

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

Funds domiciled in Germany can be managed from abroad following the AIFMD cross-border rules. Germany has transposed these, generally following the AIFMD. The regulatory requirements are therefore on a level playing field with domestic fund managers. Please note that in practice these structures are rare due to deficiencies of the German tax system (mainly management fees may be subject to VAT).

The advice to funds domiciled in Germany can be subject to regulation as investment advice (see above).

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

Germany historically has a widespread network of regulatory co-operation or information-sharing agreements with most relevant jurisdictions. In the course of the AIFMD transposition, AIFMD agreements have also been entered into. With some jurisdictions like Mauritius, no agreements exist. For further information, see https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Merkblatt/WA/mb_130722_internat_koopvereinbarungen_kagb_en.html.

2 Fund Structures

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

The fund structures vary on open- and closed-ended funds:

- Open-ended funds are traditionally arranged as *Sondervermögen* (contractual funds), but can also be arranged as investment stock corporations.
- Closed-ended funds are, due to tax reasons, most often structured as limited partnerships. Since 2018, corporate forms are also more tax-efficient and may be used in future more often.

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

Investors' limited liability is generally ensured by the legal form of the AIFs. The German regulator would not allow legal forms with unlimited liability of investors.

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

Traditionally, most firms are established as corporations. Regulatory law also allows the use of limited partnerships which are also sometimes used for tax planning purposes.

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

The closed-ended fund concept also allows a restriction on transfers (redemptions are typically not foreseen).

Open-ended funds generally provide for a regular redemption right which can only be suspended in limited cases defined in the fund agreement and/or legislation, and provided the applicable minimal capital requirements are met. Interests in open-ended funds are generally transferable, but certain restrictions can be implemented. In many cases, investor regulation provides limitations on these restrictions.

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

Yes, the two main restrictions are:

- If a fund qualifies as a Spezial-AIF, the fund agreement needs to contain a transfer restriction to semi-professional and professional investors.
- If a fund qualifies for tax purposes as a *Spezialinvestmentfonds*, a restriction on transfers to individuals must be implemented and the number of investors must be limited to 100.

Please also note that investor regulations may require a more liberal approach to transfers.

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

The KAGB provides for various requirements on the assets to be invested in, which are dependent on the type of fund, which can be categorised as follows:

- Funds also addressing retail investors are subject to detailed asset rules, excluding certain investments.
- The asset allocation rules on open-ended funds focus on ensuring the liquidity of the fund assets and therefore focus on fungible assets and limit other assets. Depending on the investor and fund status (Spezial-AIF), releases can be agreed.
- Closed-ended Spezial-AIFs are generally flexible on assets except for rules on debt investments.
- Germany introduced detailed rules on loan origination which distinguish between open- and closed-ended funds and whether shareholder loans, loan notes or plain loans are issued. Reliefs are granted on secondary loan acquisitions.
- Closed-ended one-asset funds are generally possible, but open-ended funds need to comply with diversification rules.

The KAGB transposed the AIFMD asset stripping rules with the intention of a 1:1 transposition.

3 Marketing

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

The production and offering of marketing materials by the AIFM is governed by the KAGB, which transposes the AIFMD concept in relation to AIFs focused on semi-professional and professional investors. Detailed domestic rules apply to funds that also address retail investors.

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

On funds that also address retail investors, detailed rules on fund terms, as well as on the disclosure of the investment strategy and assets, exist. BaFin has issued certain guidance which needs to be adhered to in order to receive approval.

For Spezial-AIFs, the rules are more liberal. Regarding open-ended funds, the documentation follows standards agreed with the fund industry, whereas for closed-ended funds, a large variety of offering documents can be found on the market. The focus is on disclosure to reduce liability issues.

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

Documents on funds addressing retail investors also need to be approved for marketing. For other domestic funds with domestic managers, no such approval is required.

Please note that cross-border marketing approvals do not technically require a registration or approval of documents, but the documents are to be provided in the marketing approval application.

3.4 What restrictions are there on marketing Alternative Investment Funds?

The restrictions vary depending on the home jurisdiction and the investors to be addressed. To summarise briefly, the main restrictions are:

- Retail investors: Marketing is allowed, but only by licensed AIFMs and subject to compliance with the detailed retail fund rules.
- Semi-professional and professional investors: Marketing is generally allowed, but full AIFMD compliance may be required for funds addressing semi-professional investors.
- Small AIFMs: There is no relief for third country AIFMs. EU AIFMs can be approved if their home jurisdiction also allows marketing by small German AIFMs.

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

Yes, the concept of pre-marketing is acknowledged by way of guidance issued by BaFin and is also mirrored in the AIFMD amendment, now transposed into German law. The pre-marketing definition in the German transposition legislation does not deviate substantially from current practice and the AIFMD amendment. Please note that, as required, Germany has also limited the usage of the investor's initiative argument following pre-marketing.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes, but this is subject to restrictions (see above). Please note that Germany has defined a retail investor as any investor not being a professional investor (the definition of which is based on EU law) or a semi-professional investor (a sub-class of investor defined under German law, which requires, *inter alia*, a EUR 200,000 minimum commitment).

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

These requirements are dependent on the type of fund. Generally, international alternative investment funds can only be marketed to professional and semi-professional investors (see above). Please note that marketing to semi-professional investors generally requires the AIFM to comply with the full AIFMD requirements. If other investors are approached, additional German requirements need to be considered. Semi-professional and professional investors need to be identified, and documents where semi-professional investors are involved also require a constitutive confirmation by the AIFM.

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

There are no particular requirements, but the investor category of these bodies needs to be considered carefully.

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

Banks are subject to the European banking supervisory rules. Germany provides for additional separation rules which in most cases do not apply.

Insurance companies are subject to asset-related requirements under German insurance regulations and Solvency II.

Many pension schemes are subject to asset-related requirements under German domestic law (*Anlageverordnung*).

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

Besides outsourcing cases, intermediaries should consider whether their services are subject to financial market regulation. Solicitation is generally regulated in Germany.

4 Investments

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

Generally, AIFs need to restrict their activities to investing. AIFs other than Spezial-AIFs are subject to detailed product regulation. Debt funds can be established subject to certain restrictions (see question 4.3).

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

Open-ended funds are subject to diversification rules and also limitations on eligible investments. Closed-ended funds can generally be operated as single asset funds. Retail closed-ended funds are subject to restrictions on eligible assets. Specific rules apply on loan origination.

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

Following extensive discussions, in 2015 the regulator acknowledged that the German legislation did not prohibit debt funds from being established (BaFin, *Änderung der Verwaltungspraxis zur Vergabe von Darlehen usw. für Rechnung des Investmentvermögens*, 12.5.2015, WA 41-Wp2100-2015/0001). In 2016, legislative amendments were made. On the one hand, these amendments clarified that debt funds can be established, but on the other hand also implemented certain restrictions on open-ended and closed-ended funds originating debt. While open-ended Spezial-AIFs are further not allowed to originate debt other than shareholder loans, closed-ended Spezial-AIFs are generally allowed to originate debt subject to certain limitations (e.g. they are not allowed to issue consumer loans). Retail funds are also limited on their ability to originate loans.

Spezial-AIFs can invest into derivatives subject to certain restrictions, but retail funds are only allowed to consummate such investments for hedging purposes. Please note that German investor regulation imposes substantial restrictions on derivative investments as well.

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

The KAGB does not provide for a general leverage limit, but special types of funds like retail closed-ended funds are subject to leverage caps. Further, the regulatory status of AIFs and loan originating funds varies in case of leverage.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

Not generally, but please note that German *Sondervermögen* cannot hold a legal title over an asset (in most cases the AIFM is required to hold the legal title).

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

German and foreign AIFMs and their AIFs are subject to the AIFMD reporting and public disclosure requirements if they operate in Germany. German AIFMs are further subject to disclosure requirements to the *Bundesbank* (Federal Bank). In addition, anti-money laundering (**AML**) (transparency register) and tax disclosure requirements (FATCA, CRS, DAC 6) must be complied with.

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

Germany has implemented the transparency register pursuant to AML regulations. In addition, limited partners in a limited partnership must be registered with the commercial register.

In AIFMs, such persons may be disclosed in shareholder lists to be published or via the transparency register. In addition, Ultimate Beneficial Owner controls are implemented under regulatory law.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

German AIFMs and AIFs are subject to the AIFMD reporting and public disclosure requirements. In addition, a report to the *Bundesbank* needs to be made on a monthly basis. Foreign AIFMs and AIFs are subject to the AIFMD reporting requirements. Please also note that cash transfers and the acquisition and disposal of shareholdings can be subject to notification requirements.

5.4 Is the use of side letters restricted?

Within the limits of the AIFMD, the use of side letters is not restricted.

6 Taxation

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

The treatment depends on the legal form of the AIF:

- Partnerships are taxed under the ordinary partnership taxation rules; the fund is generally transparent but can be subject to trade tax if the fund is seen as trading.
- All other AIFs fall under the Investment Tax Act assuming an opaque treatment of the AIF. The AIF is generally taxable, but only with a limited number of income items (e.g. German dividends, German real estate-related income). The income is subject to corporate income tax of 15% and under certain conditions to trade tax as well.

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

A corporation as a management or advisory entity is subject to German corporate and trade tax (a tax burden of up to 33%). Please note that the VAT treatment of management services to other funds than Undertakings for the Collective Investment in Transferable Securities (**UCITS**) and certain real estate funds is subject to debate (German tax authorities claim VAT).

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

No such taxes are levied.

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

Funds falling under the Investment Tax Act:

- Resident investors: Private individuals are subject to the flat tax on investment income (25% plus a solidarity surcharge, plus church taxes; all other investors are fully

taxable); investors need to calculate based on the minimum tax base (*Vorabpauschale*) and taxation on gross amount of distribution.

- Non-resident investors: Not subject to taxation.
- Pension funds: Mostly tax exempt.

Partnerships:

- Resident investors: Subject to taxation on income realised from the fund, but there is a tax exemption on potentially achievable capital gains and dividends.
- Non-resident investors: In case of trading activity, they are taxed like German investors; in case of non-trading, German taxation only occurs in limited cases, subject also to treaty protection.
- Pension funds: In case of trading activity, they are taxed like German investors; in case of non-trading, German taxation occurs only in limited cases, subject also to treaty protection.

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

The German authorities issue relevant rulings, but answer restrictively on certain questions.

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

Germany has concluded a model 1 intergovernmental agreement with the US. CRS was implemented in Germany in 2017.

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

Germany had already implemented anti-abuse provisions in its treaties and domestic law (BEPS Action 6) and limitations on avoiding permanent establishment and profit attributions (BEPS Action 7). The ATAD I/II (BEPS Action 2) transposition was finalised in June 2021.

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

No. Please note that certain asset types require diligent structuring to avoid pitfalls.

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

In certain cases, AIFs can themselves be subject to taxation in Germany and non-German investors can also be exposed to taxation in Germany. The main issue for managers is that management services are not *per se* VAT exempt. Currently, the VAT exemption is only granted with respect to UCITS, certain real estate funds and *Wagniskapitalfonds* (new as of July 2021, the term *Wagniskapitalfonds* not being further defined).

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

There are no concrete plans at the moment, but the new German government (with elections being due in September 2021) may intend to tighten the rules for the taxation of investment income and may also limit the German participation exemption further.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The main trends were a refocusing on German fund structures and further discussions on how to address inefficiencies in German structures.

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

No significant reforms are expected.

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1 Regulatory Framework

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

In Hong Kong, alternative investment funds (**AIFs**) are typically established in the form of companies, limited partnerships and, rarely, unit trusts. AIFs that are operating in Hong Kong comprise funds established in Hong Kong and tax-neutral jurisdictions such as the Cayman Islands and the British Virgin Islands. The Securities and Futures Ordinance (**SFO**) is the primary legislation that governs the operation of AIFs in Hong Kong.

Hong Kong domiciled AIF structures include the following:

(a) the open-ended fund company (**OFC**), which was introduced in July 2018. The establishment and operation of OFCs are subject to the requirements under (i) Part IVA of the SFO, which sets out the legal framework for establishing an OFC, (ii) the Securities and Futures (Open-ended Fund Companies) Rules (**OFC Rules**) and the Code on Open-ended Fund Companies (**OFC Code**), which contain the detailed legal and regulatory requirements for OFCs, and (iii) the Securities and Futures (Open-ended Fund Companies) (Fees) Regulation, which provides for the fees chargeable in respect of OFCs; and

(b) the limited partnership fund (**LPF**), which was introduced in August 2020. The establishment and operation of LPFs are subject to the requirements under the Limited Partnership Fund Ordinance (**LPFO**).

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

Fund managers and advisers to AIFs are required to be licensed by Hong Kong's Securities and Futures Commission (**SFC**) if they carry on or hold themselves out as carrying on the business of any regulated activity in Hong Kong. The SFC is a statutory body governed by the SFO and is responsible for administering the securities and futures markets in Hong Kong. Licences are issued by the SFC based on the type of regulated activity that a person is carrying out. A corporate licence applicant must be either a company incorporated in Hong Kong or a company incorporated overseas and registered in Hong Kong. In practice, corporate applicants are usually Hong Kong companies.

A fund manager operating its business in Hong Kong needs to be licensed for type 9 (asset management) regulated activity, which permits the fund manager to (i) manage securities (including futures contracts) portfolios of an AIF on a discretionary basis, and (ii) market shares/units/interests of an AIF and provide investment advice to an AIF, to the extent that both services are wholly incidental to the portfolio management in (i) above. Depending on its business activities, a fund manager or adviser may need to be licensed for type 1 (dealing in securities) and type 4 (advising on securities) regulated activities. However, if the fund manager or the adviser's activity in Hong Kong can be confined to managing the assets or providing non-discretionary investment advice to members of its wholly owned group, an exemption from licensing may be available.

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

Under the SFO, offering of collective investment funds to retail investors requires the prior approval of the SFC, unless such offering is made in reliance on the relevant exemptions under the SFO or the Companies (Winding Up and Miscellaneous Provisions) Ordinance (**CO**) (for AIFs set up in corporate form).

There are certain situations in which an information memorandum or other document that contains an invitation to subscribe for interests in a fund that will be made available to potential investors in Hong Kong is not required to comply with the requirements of the CO or be authorised by the SFC before issue.

The first situation is known as the **professional investors exception** where the offer to invest in a fund is made to professional investors only, which is defined in the SFO to include (i) institutional investors such as banks, insurance companies, stock brokers, investment managers and licensed financial advisers (but does not necessarily include insurance intermediaries), and (ii) high-net-worth investors, being individuals or corporations, who have a portfolio of cash and securities of not less than HK$8 million or its equivalent in any foreign currency; or corporations or partnerships with total assets of over HK$40 million or its equivalent in any foreign currency; or

trust corporations entrusted with assets of over HK$40 million or its equivalent in any foreign currency. The professional investors exception is the most common exception that is relied on by fund managers of AIFs.

The second situation is known as the "private placement" exception, where the offer to invest in a fund constituted in corporate form is made (i) to no more than 50 persons (**limited offerees exception**), (ii) with a total consideration that does not exceed HK$5 million or its equivalent in any foreign currency, or (iii) with a minimum investment per investor of not less than HK$500,000 or its equivalent in any foreign currency.

It is possible to combine an offer under the professional investors exception with an offer under the limited offerees exception (that is, to offer the AIF to an unlimited number of professional investors as well as to no more than 50 non-professional investors) if the AIF is constituted in a corporate form.

Funds that are offered under the available exceptions are commonly known as "private funds", whereas funds that are offered to retail investors in Hong Kong are commonly known as "retail funds" or "public funds".

Hong Kong domiciled AIFs must be registered in Hong Kong. An OFC must first be registered with the SFC pursuant to the requirements of the OFC Code and the OFC Rules. An LPF must be registered with the Companies Registry pursuant to the requirements of the LPFO.

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

The regulatory regime in Hong Kong does not distinguish between open-ended and closed-ended AIFs.

There may be differences in the SFC licensing requirements for a hedge fund manager and a private equity fund manager, depending on the nature of their businesses.

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

The public offering in Hong Kong of interests in a collective investment scheme is governed by the SFC's Code on Unit Trusts and Mutual Funds (**UT Code**). Retail hedge funds are subject to the further requirements of Chapter 8.7 of the UT Code. Although hedge funds may be authorised for public sale, this route is rarely used, with only one retail hedge fund existing as at June 2021.

The authorisation process involves review by the SFC of the fund itself, its offering documents and its key operators (e.g. the trustee/custodian and investment manager/advisor delegated with investment management powers).

Private funds and their offering documents, which are established in foreign jurisdictions and are offered under the available exceptions noted in question 1.3 above, need not be authorised and approved by the SFC.

An AIF that is structured as a private OFC is required to comply with the requirements set by the OFC Code and the OFC Rules. To initiate an application for a private OFC, the applicant should submit to the SFC a duly completed application form and pay such fees in accordance with the OFC Rules. The application shall be accompanied by all other required documents including the constitutive document of the OFC, namely the instrument of incorporation, and the profile of key operators of the OFC (including directors, the investment manager and the custodian). The SFC should process an application within one month from the date an application is taken up. Once the application is approved by the SFC, the SFC will notify the Companies Registry and the Companies Registry will issue the certificate of incorporation of the OFC. The OFC's offering documents must be filed with the SFC as soon as practicable after its issuance.

An AIF that is structured as an LPF must comply with the requirements under the LPFO. Unlike the OFC, an LPF does not require the prior approval of the SFC. To register an LPF, a duly completed application form must be submitted to the Companies Registry by a solicitor in Hong Kong or a law firm in Hong Kong on behalf of the general partner of the LPF. The application must contain specified information, e.g. proposed name, registered office address, investment scope, principal place of business, name and details of the proposed general partner, investment manager and responsible person to carry out anti-money laundering and counter-financing of terrorism (**AML/CFT**) functions. The Companies Registry will normally issue the registration certificate for the LPF within four working days after receipt of an application. The limited partnership agreement of the LPF is not required to be submitted to the Companies Registry.

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

Except for Hong Kong domiciled AIFs like OFCs and LPFs, there is generally no local residence or local qualification or substance requirements for funds that are offered in Hong Kong.

An OFC must have a registered office in Hong Kong. Whether structured as a public or private OFC, the board of directors of the OFC must delegate its investment management function to an investment manager licensed by the SFC to conduct type 9 (asset management) regulated activity. There is no requirement that the directors of an OFC must be resident in Hong Kong but an overseas director is required to appoint a process agent in Hong Kong to accept service of notices.

For an LPF, it must have a registered office in Hong Kong and the general partner of an LPF must appoint an investment manager to manage the day-to-day investment management function of the fund. The investment manager must be either (i) a Hong Kong resident who is at least 18 years old, (ii) a Hong Kong company, or (iii) a registered non-Hong Kong company. As noted in question 1.2 above, a person is required to be licensed by the SFC if it carries on or holds itself out as carrying on the business of any regulated activity in Hong Kong. Managing a securities portfolio of a fund requires a type 9 (asset management) licence from the SFC. There is also a requirement for the general partner of an LPF to appoint an authorised representative in Hong Kong if the general partner is another LPF or a non-Hong Kong limited partnership without legal personality.

1.7 What service providers are required?

AIFs that are offered in Hong Kong would typically engage an investment manager, an investment adviser (if distinct from the investment manager), a trustee (in the case of a unit trust structure) or a custodian (in case of a structure other than a unit trust), a fund administrator, an auditor, a prime broker (in the case of hedge fund), a fund distributor (if distinct from the investment manager) and a valuation agent (if the valuation of assets is not conducted by the fund administrator).

For OFCs, the SFO requires that an OFC appoint an investment manager licensed by the SFC to conduct type 9 (asset management) regulated activity and a custodian that meets the requirements set out in the OFC Code and an auditor. The board of directors of an OFC must have at least an independent director who must not be a director or employee of the custodian and each director must also meet the requirements set out in the OFC Code.

An LPF is required to appoint an investment manager, an auditor and a responsible person who will be responsible for the anti-money laundering measures under Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance. If the general partner is another LPF or a non-Hong Kong limited partnership without legal personality, it is required to appoint an authorised representative in Hong Kong. The requirements of these service providers are set out under the LPFO. The LPFO also provides that the general partner must ensure that there is proper custody of assets of the LPF.

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

Foreign managers or advisers wishing to manage, advise or otherwise operate a private fund domiciled in Hong Kong need to comply with the requirements under the SFO, the OFC Code and OFC Rules (in the case of an OFC). For LPFs, foreign managers and advisers need to comply with the LPFO.

Fund managers and advisers who are carrying on or holding themselves out as carrying on the business of any regulated activity in Hong Kong need to be licensed by the SFC for such regulated activity under the SFO. Other legal and regulatory obligations that a fund manager licensed by the SFC will need to comply with include (i) the obligations under the SFC's Code of Conduct for Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**), the Fund Manager Code of Conduct (**FMCC**) and the Internal Control Guidelines, (ii) the disclosures of interest in securities obligations under Part XV of the SFO, (iii) anti-money laundering obligations under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance and the SFC's Guidelines on Anti-Money Laundering and Counter-Terrorist Financing, (iv) data privacy obligations under the Personal Data (Privacy) Ordinance, and (v) anti-bribery obligations under the Prevention of Bribery Ordinance.

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

The SFC has entered into various co-operation and information-sharing agreements with local agencies in Hong Kong, Mainland China and regulatory bodies overseas.

Locally, to ensure a consistent regulatory approach, the SFC has entered into memoranda of understanding (MOU) with, amongst others, the Insurance Authority, the Competition Commission, the Hong Kong Monetary Authority, the Independent Commission Against Corruption, the Hong Kong Police Force, the Mandatory Provident Fund Schemes Authority and Hong Kong Exchanges and Clearing Limited.

The SFC has entered into cross-boundary co-operation arrangements with the Mainland securities regulator, the China Securities Regulatory Commission, for mutual investigatory assistance and the exchange of information. The SFC has also entered into co-operation arrangements with the Shanghai Stock Exchange, the Shenzhen Stock Exchange, the State Administration for Foreign Exchange, the China Banking and Insurance Regulatory Commission and the People's Bank of China for exchange of information only.

At the international level, the SFC is a signatory to the IOSCO Multilateral Memorandum of Understanding (**MMOU**) and the IOSCO Enhanced MMOU. These co-operation arrangements facilitate global information sharing among securities regulators for enforcement purposes. The SFC also entered into arrangements for the exchange of information with overseas regulators such as the European Securities and Markets Authority, the Financial Services Agency of Japan, the Monetary Authority of Singapore, the Financial Conduct Authority of the United Kingdom and the United States Securities and Exchange Commission.

2 Fund Structures

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

As noted in question 1.1 above, AIFs in Hong Kong are usually structured as companies or limited partnerships. In addition to Hong Kong domiciled funds such as OFCs and LPFs, AIFs established in other jurisdictions such as the Cayman Islands and the British Virgin Islands are also offered in Hong Kong.

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

Generally, most funds provide for the limited liability of investors. An investor is usually not liable for the debts and liabilities of the fund and is not required to make contributions or payments in addition to their investment in the fund. Such limitation of liability or any exception to the limitation of liability must be clearly set out in the constitutive document of the fund and must be disclosed in the offering documents of the fund.

With the OFC structure, an investor invests as a shareholder of a limited liability company and the SFO provides that a shareholder's liability is limited to any amount unpaid on the shares held as a shareholder.

With the LPF structure, the LPFO provides that a limited partner in an LPF is not liable for the debts or obligations of the LPF beyond the amount of the limited partner's agreed contribution unless such limited partner takes part in the management of the LPF. The LPFO specifically sets out a list of activities (which is non-exhaustive) where a limited partner is not to be regarded as taking part in the management of the LPF and these activities include acting as an agent or employee of the LPF, serving on a board or committee of the LPF, acting as a director, shareholder or employee of the general partner and being involved in the decision-making process in relation to an actual or potential conflict of interest.

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

Fund managers and advisers in Hong Kong are usually companies incorporated in Hong Kong and are licensed by the SFC to conduct the relevant regulated activities. Pursuant to the SFO, an applicant for a licence must be either a company incorporated in Hong Kong or a company incorporated overseas and

registered in Hong Kong as a non-Hong Kong company. Fund managers should have at least a type 9 (asset management) regulated activity licence whereas advisers who provide investment advice on a separate basis should be licensed for type 4 (advising on securities) regulated activity.

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

For private funds, there is no limitation on the fund manager's ability to restrict redemptions or transfers of interest in the fund.

Depending on the offering documents of the fund, fund managers may impose restrictions on redemptions when redemption requests exceed a certain limit of the net asset value of the fund or during the lock-up period. The FMCC requires fund managers who are responsible for the overall operation of the fund to have in place an appropriate liquidity risk management policy for the fund, and shall disclose such policy and provide an explanation of any tools or exceptional measures that could affect redemption rights in the offering document of the fund, or otherwise make such information freely available to the investors. This requirement applies to both open-ended and closed-ended funds.

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

There are no legislative restrictions on transfers of investors' interests in private AIFs in Hong Kong. The transfer of interests would typically be subject to the procedures set out in the constitutive documents and the anti-money laundering laws and regulations applicable to the fund. Any transfer of investors' interests in a private fund would usually be subject to the prior consent of the fund governance body to ensure that the proposed transferee is eligible to hold interests in the fund. Any restrictions on the transfer of interests must be disclosed in the offering documents of the fund.

For the OFC structure, transfers of shares are subject to the prescribed requirements and rules set out in the OFC Rules.

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

The FMCC requires that a fund manager should ensure that transactions carried out on behalf of the fund are in accordance with the fund's stated investment strategy, objectives, investment restrictions and guidelines as set out in the fund's constitutive or offering documents and the fund manager should have in place effective and properly-implemented procedures and controls for complying with such requirement.

3 Marketing

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

The SFO is the main legislation that governs the offering of securities (including collective investment schemes) and the production and use of marketing materials in Hong Kong. AIFs set up as a corporate structure also need to comply with the CO regarding an offer to subscribe for shares in the AIF. AIFs set up as OFCs need to comply with the OFC Code.

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

In the case of a private fund, the FMCC provides that a fund manager should ensure that the marketing materials (a) are not false, biased, misleading or deceptive, (b) are clear, fair and present a balanced picture of the fund with adequate risk disclosures, (c) contain information that is timely and consistent with the fund's offering document, and (d) only contain performance claims that can be verified.

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

The marketing material or offering document of a public fund are subject to the prior approval of the SFC before they can be issued.

As noted in question 1.3 above, an information memorandum or other document which contains an invitation to subscribe for interests in a private fund (other than a private OFC) does not need to comply with the prospectus requirements of the CO or be authorised by the SFC before issue if the fund is offered under an available exception such as the professional investor exception. For private OFCs, the offering documents must be filed with the SFC.

3.4 What restrictions are there on marketing Alternative Investment Funds?

While private funds can be marketed using the exceptions set out in question 1.3 above without any prior authorisation of the SFC, marketing of a fund to the public in Hong Kong can only be conducted after the fund is authorised by the SFC.

Marketing the fund to prospective investors whilst in Hong Kong falls within the definition of "dealing in securities" (type 1 regulated activity) and can only be done by persons who are licensed by or registered with the SFC for type 1 regulated activity. A fund manager holding a type 9 (asset management) regulated activity licence may market funds under its management within the "incidental dealing" exemption.

Under the Code of Conduct, a licensed person who markets a fund to potential investors must determine whether the product that they are selling is a complex product. If a product is a complex product, the licensed person cannot sell the product to an individual investor, whether a professional or not, unless the licensed person is satisfied that the product is suitable for the investor. In making the determination whether a product is a complex product, the licensed person is required to exercise due skill, care and diligence having regard to various factors, including, but not limited to, whether the investment product is a derivative product, whether a secondary market is available for the product at publicly available prices and whether any features or terms of the product could fundamentally alter the nature or risk of the investment or pay-out profile of the investment.

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

There is no concept of "pre-marketing" or its equivalent under the laws of Hong Kong.

3.6 Can Alternative Investment Funds be marketed to retail investors?

The offering of collective investment funds to the public in Hong Kong requires the prior approval of the SFC. An AIF may be offered under the exceptions described at question 1.3 above.

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

The Code of Conduct requires that a licensed person who markets a fund to potential investors should determine the suitability of the product for the relevant potential investor having regard to their needs and circumstances. If the fund is offered in reliance of the professional investor exception, a licensed person would need to put in place appropriate procedures to ensure that the fund is only offered to professional investors and to verify the qualification of the professional investor based on the definition set out in the SFO, as briefly noted in question 1.3 above. Under the Code of Conduct, certain requirements including suitability requirements may be exempted when dealing with certain category of professional investors such as "institutional professional investors" including banks, insurance companies and fund management companies, and consenting "corporate professional investors" which have a dedicated investment function or independent advisor.

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

Under the SFO, any registered mandatory provident fund schemes and their constituent funds, any registered occupational retirement schemes and any governments, central banks and multilateral agencies in Hong Kong fall within the definition of "Institutional Professional Investors". There is no additional restriction on marketing private funds to such entities or bodies.

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

Where an AIF is offered as a private fund in reliance of the professional investor exception, the type of offerees should be restricted according to qualification of the investors as noted in question 3.7 above. Subject to the requirements under the anti-money laundering and counter-terrorist financing regulations, there is no restriction on the participation in the AIFs by any particular type of investors whether as sponsors or investors. Directors, shareholders, employees of the fund or the fund manager or service providers of the fund are not restricted from participating in the AIF provided that any potential or actual conflict of interest is disclosed to investors.

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

Intermediaries assisting in the fundraising process must be properly licensed if they are carrying on or holding themselves out as carrying on a regulated activity in Hong Kong. As noted in question 3.4 above, marketing funds constitutes regulated activity and can only be done by persons who are licensed by or registered with the SFC for type 1 (dealing in securities) regulated activity or by a fund manager licensed for type 9 (asset management) regulated activity in respect of the funds that it manages.

4 Investments

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

For private funds, there is no specific restriction on the types of investment activities that can be performed by a private AIF. The FMCC, however, provides for additional requirements in relation to specific investment activities such as cross trades, investment in financial derivative products, borrowings and investment in securities lending, repurchase (repo) and reverse repo transactions.

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

For private funds, there are no specific limitations on the types of investment that can be included in the investment portfolio of an AIF, whether for diversification reasons or otherwise.

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

Under the FMCC, a fund manager is required to comply with additional requirements if the fund manager engages in the following transactions on behalf of the fund:

(a) securities lending, repurchase (repo) and reverse repo transactions – a fund manager should put in place a collateral valuation and management policy and a cash collateral reinvestment policy governing securities lending, repo and reverse repo transactions and any cash collateral reinvestments in respect of collateral received by the fund. A fund manager should have in place an eligible collateral and haircut policy in determining the types of acceptable collateral and their corresponding haircut in connection with securities lending, repo and reverse repo transactions. If the fund is a security lender, the fund manager should stress test the ability of a cash collateral reinvestment portfolio to meet foreseeable and unexpected calls for the return of cash collateral on an ongoing basis;

(b) cross trades – a fund manager should only undertake sale and purchase transactions between client accounts (cross trades) where: (i) the sale and purchase decisions are in the best interests of both clients and fall within the investment objective, restrictions and policies of both clients; (ii) the trades are executed on arm's length terms at current market value; (iii) the reasons for such trades are documented prior to execution; and (iv) such activities are disclosed to both clients; and

(c) side pockets arrangement – before any side pocket is introduced in a fund (i.e. where certain illiquid or hard-to-value investments of a fund as determined by the fund manager are segregated from other fund assets), a fund manager that is responsible for the overall operation of a fund should disclose to the fund investors: (i) the limit of total assets to be put in the side pocket; (ii) the overall fee structure and charging mechanism (in respect of, among others, any

management and performance fees); (iii) that the redemption lock-up period for a side pocket would be different from that of the ordinary units/shares of the fund; (iv) how the fund manager defines and categorises investment products which are to be put into the side pocket and the policies and rationale for transferring investments in and out of side pockets; and (v) where the assets in side pockets are allowed to be transferred to another investment vehicle, the circumstances under which transfers are allowed and the pricing mechanism for such transfers. Where a fund manager decides to side pocket any fund asset, it should arrange to disclose to the investors of the creation of the side pocket, the asset which has been side-pocketed and how the asset has been valued at the time of side pocketing and the ongoing valuation of the asset.

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

For private funds, there are no restrictions on borrowing. The FMCC, however, provides that where the fund manager is responsible for the overall operation of a fund, it should disclose to fund investors (i) the expected maximum level of leverage which it may employ on behalf of the fund, and (ii) the basis of calculation of leverage which should be reasonable and prudent.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

The assets of an OFC must be entrusted to a separate, independent custodian for safekeeping. The custodian must meet the eligibility requirements set out in the OFC Code.

With respect to other AIFs that are offered as private funds, the FMCC provides that a fund manager should select and arrange for the appointment of, and entrust the fund assets to, a custodian that is functionally independent from it. A fund manager may adopt a self-custody arrangement unless it is subject to a licensing condition that it shall not hold client assets. Where self-custody is adopted, the fund manager should ensure that it has policies, procedures, and internal controls in place to ensure that the persons fulfilling the custodial function are independent from the persons fulfilling the fund's management functions. In selecting a custodian, a fund manager should ensure that the custodian meets the eligibility requirements set out in the FMCC.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

With respect to private funds, the FMCC provides that where a fund manager is responsible for the overall operation of a fund, it should make adequate disclosure of information (as well as any material changes to the information) on the fund which is necessary for fund investors to be able to make an informed judgment about their investment into the fund. The FMCC also requires the fund manager to disclose information such as liquidity management policies, securities lending, repo and reverse repo policies and transactions, valuation policies and side pocket arrangements to the investors.

Please refer to question 7.2 for details on the SFC's Consultation Paper on the management and disclosure of climate-related risks by fund managers.

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

A fund manager in Hong Kong, being a Hong Kong company or a registered non-Hong Kong company, is subject to the requirements under the CO, the SFO, the Code of Conduct and the FMCC. Under the CO, a fund manager needs to file an annual return in a specified form which contains particulars of the company and information in relation to the directors, shareholders and company secretary. Pursuant to the Code of Conduct and the FMCC, a fund manager, being a licensed person, should keep its accounts and records in accordance with statutory requirements and provide appropriate information to the SFC, and access to certain records, upon the SFC's request.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

For private funds, the FMCC requires that an independent auditor be appointed to perform an audit of the financial statements of the fund. The annual report of the fund must be prepared in accordance with generally accepted accounting principles and with the accounting rules set out in the constitutive documents of the fund. The annual report should be made available to investors upon request. The fund manager should also make available the audited accounts of the fund manager to the fund upon request. As noted in question 5.1 above, the fund manager shall have the appropriate policies and shall disclose such policies and information to the investors.

As noted in question 5.2, fund managers are also subject to the reporting requirements under the CO, the SFO, the Code of Conduct and the FMCC.

5.4 Is the use of side letters restricted?

The use of side letters is not restricted. The FMCC, however, states that where a fund manager grants preferential treatment (e.g. side letters) to certain investors, it should disclose such facts and the material terms in relation to redemption in the side letters to all potential and existing investors.

6 Taxation

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

Under the general charging principles set out in the Inland Revenue Ordinance (**IRO**), profits derived from the carrying on of business, trade or profession in Hong Kong are subject to Hong Kong profits tax. A non-resident or overseas company is potentially liable to Hong Kong profits tax if it seen as carrying on a trade or business in Hong Kong and has profits derived from Hong Kong from such trade, profession or business, on its own account or through an agent (e.g., a Hong Kong investment manager). Accordingly, where an AIF derives Hong Kong-sourced profits from carrying on a business in Hong Kong, it may be subject to Hong Kong profits tax.

The Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Ordinance which came into force on 1 April 2019 introduced a "unified profits tax fund exemption regime" (**Unified Regime**), which may allow funds, as defined in the statute, meeting the relevant definition and qualifying conditions to benefit from profits tax exemption even though some or all of its profits may otherwise be taxable. See question 6.8 for further details.

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

The taxation of a Hong Kong investment manager or adviser would be subject to the general charging principles under the IRO. Where management fees are regarded as Hong Kong-sourced (i.e., if the services giving rise to the investment manager's income are performed in Hong Kong), the (net) income will be liable to profits tax in Hong Kong. The current rate is 8.25% on assessable profits up to HK$2,000,000 (subject to certain conditions) and 16.5% otherwise.

On 28 April 2021, the government passed the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance 2021, which provides tax concessions for carried interest distributed by eligible private equity funds in Hong Kong. The concessional tax for carried interest is effective from 1 April 2020 and will provide for a 0% tax rate for qualifying carried interest.

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

Generally, capital gains are exempt from tax in Hong Kong.

Stamp duty is chargeable on transfers of "Hong Kong stock", which includes shares of companies incorporated in Hong Kong.

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

There is no Hong Kong withholding tax on any dividends or distributions or other capital gains to be paid to fund investors, regardless of the category of investors. However, where the payments from the AIFs are considered to be trading gains derived by an investor in connection with any business, trade or profession carried out in Hong Kong, the investor may potentially be subject to Hong Kong profits tax if the gains are Hong Kong sourced.

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

It is usually not necessary to obtain an advance tax ruling from the Inland Revenue Department (**IRD**) for the purposes of establishing an AIF.

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

Hong Kong has signed a Model II Inter-Governmental Agreement with the United States, which forms the necessary basis for Hong Kong to provide for the exchange of information upon requests made in relation to the information reported by financial institutions in Hong Kong to the US under FATCA.

Hong Kong has implemented the Common Reporting Standard (**CRS**) and the automatic exchange of financial account information in tax matters on a reciprocal basis with other CRS partners.

As of June 2021, Hong Kong has concluded avoidance of double taxation agreements with 40 jurisdictions and tax information exchange agreements with seven countries.

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

In June 2017, China, on behalf of Hong Kong, signed the Multilateral Convention to Implement Tax Treaty Related Measures to prevent Base Erosion and Profit Shifting. Hong Kong itself indicated its commitment to the BEPS projects when it joined the BEPS framework in July 2016, and announced that it will focus on implementing the OECD's four minimum standards: countering harmful tax practices (Action 5); preventing treaty abuse (Action 6); country-by-country reporting (Action 13); and cross-border dispute resolutions (Action 14).

On 13 July 2018, the Hong Kong government gazetted the Inland Revenue (Amendment) (No 6) Ordinance 2018. The main objectives of the Amendment Ordinance were to codify certain transfer pricing principles into the IRO and to implement the minimum standards outlined by the OECD. The Amendment Ordinance has empowered the IRD to adjust profits or losses where a transaction between related parties is considered not to be at arm's length. The IRD may also apply the arm's length principle to dealings between different parts of an enterprise, and this may have potential tax implications for AIFs and operators of AIFs.

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

As noted in question 6.1 above, in April 2019, Hong Kong introduced the Unified Regime, a new profits tax exemption regime. Under the Unified Regime, a fund may enjoy profits tax exemption without restriction as to its structure, size or location of its central management and control. Where that fund carries out certain financial transactions in Hong Kong, known as "qualifying transactions", gains arising from those transactions (and transactions that are incidental thereto) are, subject to the rules of the Unified Regime, exempt from Hong Kong profits tax.

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

As mentioned in question 6.7 above, the provisions in the IRO empowering the IRD to make transfer pricing arrangements to transactions which it considers not being at arm's length for Hong Kong profits tax purposes can potentially trigger taxation issues for associated entities within a group of companies, particularly in relation to management or advisory fees paid to a fund manager or advisor of an AIF.

Under the Exemption Amendment Ordinance, there are certain anti-avoidance provisions (the **Deeming Provisions**)

which deem certain Hong Kong residents to have derived assessable profits from a fund, notwithstanding the fund itself being tax exempt and despite no distribution being made by the fund. These Deeming Provisions may apply, where the Hong Kong resident, alone or with his "associates" (as defined in the Exemption Amendment Ordinance), holds 30% or more of the beneficial interest in the fund or where such Hong Kong resident is an "associate" (as defined in the Exemption Amendment Ordinance) of the fund (irrespective of the percentage holding of the beneficial interest in the fund). Should the Deeming Provisions apply, it is generally the Hong Kong resident who will be obliged to report and be subject to Hong Kong profits tax on a deemed basis in respect of his or her share of the tax-exempt profits in the fund concerned. The Deeming Provisions would not apply if the fund is regarded as being *bona fide* widely held.

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

There are no meaningful tax changes anticipated in the next 12 months.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

As part of the Hong Kong government's aim to enhance the competitiveness of Hong Kong in becoming a preferred centre for international asset and wealth managers in Asia, there have been some positive developments for Hong Kong domiciled funds in the past 12 months.

The LPF structure was introduced on 31 August 2020. The LPF structure provides an alternative framework for private equity fund managers in Hong Kong.

For private OFCs, the SFC removed all statutory investment restrictions in relation to the types of assets in which a private OFC is permitted to invest on 11 September 2020. A private OFC is no longer subject to any statutory investment restrictions, except that it must not be a business undertaking for general commercial or industrial purposes. On 10 May 2021, the government introduced a grant scheme for Hong Kong OFCs. Under the grant scheme, a fund manager can apply for government subsidies of up to 70% of the set-up costs of an OFC successfully incorporated in, or a non-Hong Kong fund corporation successfully re-domiciled as an OFC to, Hong Kong on or after 10 May 2021, subject to a cap of HK$1 million per OFC and a maximum of three OFCs per fund manager. The grant scheme will be applied on a first-come, first-served basis with an application period from 10 May 2021 up to 9 May 2024, subject to an earlier end date if the funding under the grant scheme is fully committed. The government has allocated HK$270 million to the scheme.

As mentioned in question 6.2, tax concessions for carried interest distributed by eligible private equity funds were introduced on 28 April 2021.

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

On 29 October 2020, the SFC published its Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers which proposes new mandatory requirements for Hong Kong fund managers of collective investment schemes around climate-related risks. The proposals include amendments to the FMCC. The proposed new requirements cover four areas, namely governance, investment management, risk management and disclosure. The SFC also proposes to impose "enhanced standards" for "Large Fund Managers" (i.e. fund managers with total assets under management of HK$4 billion or above) in areas of risk management and disclosure which require the Large Fund Managers to adopt a more robust approach and make more detailed disclosures. The consultation period closed on 15 January 2021 and the SFC will publish its conclusions in due course.

Pursuant to the consultation conclusions issued by the SFC on 23 December 2020, the SFC will implement a proposal to require OFCs to appoint a responsible person to carry out AML/CFT functions, in line with the Financial Action Task Force's principles and requirements as well as to better align the AML/CFT requirements for different investment vehicles for funds in Hong Kong.

The Hong Kong government also plans to introduce a statutory mechanism to re-domicile overseas funds to Hong Kong to register as OFCs or LPFs. The re-domiciliation mechanism will come into effect upon completion of the legislative process.

Note

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1 Regulatory Framework

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

Irish Funds Legislation, which governs the establishment and operation of Irish AIFs authorised and regulated by the Central Bank of Ireland (the "**Central Bank**"), is set out in question 1.3 below. Additionally, Irish AIFs structured as European long-term investment funds ("**ELTIFs**") are impacted operationally by Regulation (EU) No 2015/760 (the "**European Long-term Investment Funds Regulation**").

The governing legislation of Irish AIFs not subject to authorisation by the Central Bank depends on the legal form of those AIFs; e.g. the Companies Act, 2014 will apply to corporate AIFs established as investment companies with fixed capital.

All Irish AIFs are impacted operationally by:

- the European Communities (Alternative Investment Fund Managers) Regulations 2013 (S.I. 257 of 2013) as amended (the "**Irish AIFM Regulations**"), which transposed Directive 2011/61/EU (the "**AIFM Directive**") into Irish law; and
- Commission Delegated Regulations and Commission Implementing Regulations adopted by the EU Commission in specified areas in order to ensure that the AIFM Directive is implemented consistently across the EU, the principal one of which is the Commission Delegated Regulation (EU) No 231/2013 supplementing the AIFM Directive with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision.

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

AIFMs

Irish AIFMs managing Irish AIFs established under Irish Funds Legislation are required to be authorised under the Irish AIFM Regulations. However, an Irish registered AIFM may manage an Irish AIF marketed to qualifying investors (a "**QIAIF**") for a two-year start-up period during which the Central Bank will not require the QIAIF to have an authorised AIFM. After the start-up period, an authorised AIFM must be appointed.

Non-Irish EU AIFMs managing Irish AIFs are required to be authorised in their home jurisdiction and to have availed of the passporting provisions pursuant to Article 33 of the AIFM Directive.

Although non-EU AIFMs currently have no passporting rights under the AIFM Directive and will not have such rights until such time as they are extended to non-EU AIFMs by the European Commission, non-EU AIFMs may avail of transition benefits allowed by the Central Bank for such entities and consequently may manage an Irish QIAIF, provided they are designated by the QIAIF as the AIFM and certain rules as set out in question 1.8 below are complied with. However, in such circumstances, the non-EU AIFM must be approved by the Central Bank to act as an investment manager of Irish authorised collective investment schemes (see below).

An Irish AIF constituting a collective investment scheme authorised and supervised by the Central Bank under Irish Funds Legislation and marketed to retail investors (a "**RIAIF**") must have an authorised AIFM. Consequently, a non-EU AIFM cannot avail itself of the transition benefits allowed by the Central Bank as referred to above and manage a RIAIF on the basis that it is designated by the RIAIF as the non-EU AIFM.

Non-AIFM Irish Management Companies/General Partners

RIAIFs and QIAIFs, depending on their legal form, may be required to appoint a management company/general partner to carry out the management of those AIFs. Where such a management company/general partner is not acting as the AIFM, it must be approved by the Central Bank and meet the requirements relating to such entities as set out in the Central Bank's AIF Rulebook (the "**AIF Rulebook**"), e.g.:

- a minimum capital requirement of at least EUR 125,000 or one quarter of its total expenditure taken from the most recent audited accounts (whichever is higher);
- organisational requirements such as the appointment of a compliance officer who must be located in the State, policies and systems to identify, control and monitor risk, accounting policies and procedures, maintenance of records, etc.; and
- adequate management resources.

Investment Managers

Investment managers or sub-investment managers, which are one of the following entities, will not usually be subject to an additional regulatory review process by the Central Bank:

- UCITS management companies;
- MiFID investment firms;
- EU credit institutions; and
- externally appointed authorised AIFMs.

Investment managers which are not one of the entities listed above may only be appointed where (i) a Memorandum of Understanding ("**MoU**") is in place between the Central Bank and the competent authority in the home jurisdiction of the investment manager, and (ii) the Central Bank has approved the investment manager following receipt of a completed Investment Manager Clearance Form.

Investment Advisors

The Central Bank does not apply an approval process to investment advisors in order for such entities to provide investment advice in relation to a RIAIF/QIAIF, provided that the managers/directors of the RIAIF/QIAIF confirm that the advisors in question will act in an advisory capacity only and will have no discretionary powers over any of the assets of the RIAIF/QIAIF.

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

Irish AIFs established under "Irish Funds Legislation" as detailed below are required to be authorised by the Central Bank, which has the power to impose conditions on them. The current conditions that the Central Bank imposes are contained in an AIF Rulebook:

(a) unit trusts under the Unit Trusts Act 1990;
(b) investment companies under Part 24 of the Companies Act 2014;
(c) investment limited partnerships ("**ILPs**") under the Investment Limited Partnerships Act 1994 as amended by the Investment Limited Partnership (Amendment) Act 2020;
(d) common contractual funds ("**CCFs**") under the Investment Funds, Companies and Miscellaneous Provisions Act 2005; and
(e) Irish collective asset-management vehicles ("**ICAVs**") under the Irish Collective Asset-management Vehicles Act 2015, (collectively referred to as the "**Irish Funds Legislation**").

In addition, Irish AIFs structured as ELTIFs must be authorised by the Central Bank pursuant to the European Long-term Investment Funds Regulation.

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

The Central Bank allows RIAIFs/QIAIFs to be structured as follows:

(a) Open-Ended
An AIF is considered open-ended by the Central Bank where it:
- provides redemption facilities on at least a (i) monthly basis in the case of a RIAIF, and (ii) quarterly basis in the case of a QIAIF;
- redeems, when requested, at least (i) 10% of net assets in the case of a RIAIF/QIAIF that redeems on a monthly basis or more frequently, or (ii) 25% in the case of a QIAIF that redeems on a quarterly basis; and
- does not impose a redemption fee in excess of (i) 3% of the net asset value per unit in the case of a RIAIF, or (ii) 5% in the case of a QIAIF.

An AIF, which provides for a period of greater than 30 days in the case of a RIAIF and 90 days in the case of a QIAIF between the dealing deadline and the payment of redemption proceeds, will not be subject to the above requirements provided it classifies itself as open-ended with limited liquidity.

(b) Open-Ended with Limited Liquidity
A RIAIF/QIAIF is classified as open-ended with limited liquidity if it does not meet one or more of the requirements for an open-ended AIF but does permit the redemption of units throughout the life of the AIF.

(c) Closed-Ended
The Central Bank considers a closed-ended RIAIF/QIAIF to be one which does not facilitate the redemption of units at the request of the unitholders during the life of the AIF.

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

RIAIFs/QIAIFs

The application for authorisation of a RIAIF/QIAIF must be made by (i) the AIFM, together with (ii) the corporate AIF or management company/general partner in the case of a non-corporate AIF, and (iii) the depositary, in the case of a unit trust or CCF.

All parties to a RIAIF/QIAIF must have been authorised or otherwise deemed acceptable to the Central Bank prior to the application for authorisation (e.g. the management company, general partner, AIFM, directors in the case of a corporate AIF, depositary, other service providers such as the fund administrator, investment manager, etc.).

The directors of any entity authorised by the Central Bank (including, *inter alia*, the directors of a corporate RIAIF/QIAIF) are required to meet certain standards of fitness and probity. As part of the Central Bank's fitness and probity requirements, any director proposed to be appointed must be pre-approved by the Central Bank. In this regard, an individual online questionnaire must be completed by the proposed director and validated and submitted on behalf of the appointing entity by a certain time period in advance of the proposed authorisation date for the RIAIF/QIAIF (i.e. at least 20 working days in the case of a RIAIF and at least five working days in the case of a QIAIF).

A RIAIF/QIAIF is not subject to any minimum capital requirements unless it is internally managed and therefore constitutes the AIFM.

In relation to the authorisation of QIAIFs, there is no prior filing of QIAIF documentation for review by the Central Bank. Instead, there is a self-certification regime (i.e. certification has to be given that the Central Bank's disclosure requirements relating to the QIAIF documentation are met). Because there is no prior review by the Central Bank, the timeframe for authorisation of a QIAIF is within the control of the relevant parties based on the length of time it takes to negotiate and agree the QIAIF documents (subject to the pre-clearance of any persons or parties required by the Central Bank). Once the documentation is filed online by 3pm on the business day prior to the date for which authorisation is sought, a QIAIF will be authorised on the requested date without a prior review. The Central Bank may carry out a "spot check" post-authorisation review.

This contrasts with the authorisation process for RIAIFs, as the Central Bank requires certain documents (e.g. the prospectus) to be submitted for review and cleared of comment by the Central Bank in advance of the formal application for authorisation being submitted. As a result, a RIAIF with an externally appointed AIFM can take approximately eight to 10 weeks to be authorised by the Central Bank from the date of submission of applicable documents for review.

The only exception to the self-certification regime, where no prior filing of QIAIF documentation is submitted to the Central Bank for review, is where the QIAIF has what are in the Central Bank's view one or more features of an unusual nature which

may need to be presented to the Central Bank by way of a written submission and approved in advance by the Central Bank.

Internally Managed RIAIF/QIAIF Constituting the AIFM
Where it is proposed that a RIAIF or QIAIF will be internally managed and constitute the AIFM, a separate application for authorisation of an AIFM must be submitted to the Central Bank (together with other supporting documentation, including, *inter alia*, a programme of activity) and such authorisation must be obtained before formal application for authorisation of the RIAIF/QIAIF may be submitted to the Central Bank.

Any such RIAIF/QIAIF is required to meet the minimum capital requirements of an AIFM as set out in Regulation 10 of the Irish AIFM Regulations (equivalent to Article 9 of the AIFM Directive).

The Central Bank is obliged to inform the AIFM in writing as to whether or not authorisation has been granted, within three months of a complete application. However, the Central Bank may extend this period for another three months where it considers it necessary because of the specific circumstances of the case.

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

Directors/Resources
A minimum of two directors in a corporate RIAIF/QIAIF, or in any entity which is authorised by the Central Bank and provides non-AIFM fund services to such an AIF (e.g. non-AIFM management company, general partner, fund administrator or depositary), must be Irish-resident. In the case of a RIAIF/QIAIF, an Irish resident is a person present in Ireland for the whole of 110 business days per year.

In the case of an Irish AIFM authorised by the Central Bank which has a Central Bank PRISM impact rating of Medium Low or above, the AIFM must have at least:

(i) three directors resident in Ireland or, at least, two directors resident in Ireland and one designated person (i.e. a person designated by the board to carry out one or more managerial functions) resident in Ireland;
(ii) half of its directors resident in the European Economic Area ("**EEA**"); and
(iii) half of its managerial functions performed by at least two designated persons resident in the EEA.

In the case of an Irish AIFM authorised by the Central Bank which has a PRISM impact rating of Low, the AIFM must have at least:

(i) two directors resident in Ireland;
(ii) half of its directors resident in the EEA; and
(iii) half of its managerial functions performed by at least two designated persons resident in the EEA.

In a letter to industry dated October 2020, the Central Bank outlined that all Irish authorised AIFMs should have a minimum of three full-time employees (or equivalent), each of whom should be suitably qualified and of appropriate seniority to fulfil the role. The letter sets out that the requirement is "*a minimum expectation and only relevant to the smallest and simplest of entities*" and notes that other firms "*will be expected to have a level and quality of resourcing determined by the nature, scale and complexity of its operations*".

As part of the Central Bank's fitness and probity requirements, a proposed director/designated person is required to confirm (via the individual questionnaire as referred to in question 1.5 above) his/her time commitment in days that will be provided per year in respect of that directorship or role as designated person. In addition, the appointing entity, in validating the questionnaire, is required to confirm its expectation regarding the proposed director's/designated person's time commitment per year.

Fund Governance Code
Corporate RIAIFs/QIAIFs or the management companies/general partners of non-corporate RIAIFs/QIAIFs are recommended to adhere to a voluntary corporate governance code for funds put in place by the Irish Funds Industry Association at the request of the Central Bank. Such code provides, *inter alia*, for a majority of non-executive directors and at least one independent non-executive director.

Fund Service Providers' Governance Code
Irish fund service providers such as fund administrators and depositaries are recommended to adhere to a voluntary corporate governance code put in place by the Irish Funds Industry Association at the request of the Central Bank. Such code provides, *inter alia*, for at least one independent non-executive director.

Non-Irish Parties
Local requirements regarding the appointment of a non-Irish AIFM, investment manager or investment advisor are detailed in question 1.2 above.

1.7 What service providers are required?

The service providers involved in a RIAIF/QIAIF will depend on:

- the legal structure of the AIF as detailed in question 1.3 above (e.g. a management company/general partner will be required to be appointed in the case of a non-corporate AIF);
- the services which the AIFM will itself provide (e.g. whether it will be necessary to appoint an external valuer, an administrator, transfer agent, distributor, etc., if these services are not provided by the AIFM);
- the investment strategy relating to the AIF (e.g. whether a prime broker is required to be appointed in the case of an AIF with a hedge fund strategy); and
- the marketing strategy relating to the AIF (e.g. any local service providers required to be appointed in the jurisdiction where the AIF is marketed).

The appointment of an AIFM and depositary is required under the Irish AIFM Regulations.

A RIAIF/QIAIF must appoint auditors and a money laundering reporting officer and, if a corporate AIF, will need to appoint a secretary.

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

AIFMs
The rules applying to non-Irish AIFMs depend primarily on whether they are EU- or non-EU (third country)-based.

Non-Irish EU AIFMs managing Irish RIAIFs/QIAIFs are not subject to any additional rules imposed by the Central Bank.

As stated in question 1.2 above, non-EU AIFMs may currently avail of the transition benefits allowed by the Central Bank for such entities and act as AIFMs of QIAIFs. However, the non-EU AIFM and the QIAIF it manages must comply with the

provisions of the Central Bank's AIF Rulebook that apply in the case of QIAIFs with registered AIFMs, e.g. certain provisions of the AIFM Directive relating to delegation, liquidity management, valuation and transparency obligations.

Investment Managers
Non-Irish investment managers approved by the Central Bank to act as an investment manager of RIAIFs/QIAIFs, the process for which is detailed in question 1.2 above, are not subject to any rules imposed by the Central Bank. However, any proposed change in the legal/regulatory status or name of the investment manager must be advised to the Central Bank.

Investment Advisers
Non-Irish investment advisers providing advice in relation to a RIAIF/QIAIF are not subject to any rules imposed by the Central Bank.

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

The Central Bank has entered into numerous national, bilateral and international memoranda of understanding. In particular, the Central Bank has entered into 46 supervisory co-operation arrangements with non-EU competent authorities as part of the implementation of the AIFM Directive. Separately, Ireland has signed comprehensive Double Taxation Agreements with 74 countries, 73 of which are in effect.

2 Fund Structures

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

The principal legal structures of RIAIFs/QIAIFs are set out in question 1.3 above, the main features of which are set out below:

(a) unit trusts are contractual arrangements created under a trust deed made between a management company and a depositary. Unit trusts do not have their own legal personality and contracts are entered into by the management company and, in certain cases, by the trustee. A unit represents an undivided beneficial interest in the assets of the unit trust;

(b) investment companies are public limited liability companies incorporated with variable capital, i.e. the actual value of the paid-up share capital is equal at all times to the value of the net asset value of the company. Shares issued do not represent a legal or beneficial interest in the company's assets;

(c) ILPs are partnerships between one or more general partners and one or more limited partners, constituted by written agreements between the parties known as partnership agreements. A general partner is personally liable for the debts and obligations of the partnership and a limited partner contributes or undertakes to contribute a stated amount to the capital of the partnership;

(d) CCFs are funds constituted under contract law by means of a deed of constitution executed under seal by a management company. The CCF is an unincorporated body and does not have a legal personality and therefore may act only through the management company. Participants in the CCF hold their participation as co-owners and each participant holds an undivided co-ownership interest as a "tenant in common" with other participants; and

(e) ICAVs are corporate bodies with limited liability where the actual value of the paid-up share capital is at all times equal to the net asset value of the ICAV and the share capital is divided into a specified number of shares without assigning any nominal value to them. The assets of the ICAV belong exclusively to the ICAV and no shareholder has any interest in the assets of the ICAV.

Each of the above-referenced AIFs may be established as an umbrella fund with separate sub-funds.

It is also possible to have unauthorised AIFs (i.e. AIFs that are not authorised and regulated by the Central Bank under Irish Funds Legislation), the principal legal structures of which are companies, trusts and limited partnerships.

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

In investment companies and ICAVs, the liability of the shareholders is limited to the amount, if any, unpaid on the shares held by them.

In unit trusts, the limited liability of the unitholders under the trust deed will depend on the contractual provisions in the trust deed.

In ILPs, the liability of the limited partners is limited to the stated amount of capital they have contributed or undertaken to contribute and, except in limited circumstances set down in the Investment Limited Partnerships Act 1994 as amended, does not extend to the debts of the partnership beyond the amount contributed.

In CCFs, the liability of a unitholder is limited to the amount agreed to be contributed for the subscription of units.

The statutory limited liability of investors based on the legal structure of the AIF applies in respect of any fund type established using such legal structure.

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

The principal legal structure used for managers and advisers of RIAIFs/QIAIFs is a private company incorporated with limited liability.

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

Although RIAIFs/QIAIFs may apply redemption gates if provided for in the applicable fund documentation, the Central Bank currently imposes limits on an AIF's ability to restrict redemptions on any one dealing day in the context of open-ended funds. These limits are detailed in question 1.4 above.

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

There are no legislative restrictions on transfers of investors' interests in RIAIFs/QIAIFs other than in ILPs. A limited partner may only assign his partnership interest subject to the consent of all general partners to the assignee being admitted to the partnership as a limited partner.

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

Other than the investment restrictions and limitations imposed by the Central Bank on RIAIFs/QIAIFs as referred to in section 4 below and the limitations imposed under the AIFM Directive (e.g. relating to asset stripping), there are no limitations on an AIFM's ability to manage RIAIFs/QIAIFs.

3 Marketing

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

A new harmonised regime for the cross-border distribution of investment funds has been introduced at an EU level via the EU Cross-Border Distribution of Collective Investment Undertakings Directive 2019/1160 and the EU Cross-Border Distribution Regulation 2019/1156, many of the provisions of which will apply from 2 August 2021.

The Irish Funds Legislation and AIF Rulebook govern the production and offering of a prospectus by a RIAIF/QIAIF. Regulation (EU) No. 1286/2014 (the "**PRIIPS Regulation**") governs the production and offering of the key information document ("**KID**") by a RIAIF/QIAIF where units are to be offered to retail investors in the EU.

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

Pursuant to Article 4 of the EU Cross-Border Distribution Regulation, effective as and from 2 August 2021, EU-authorised AIFMs will be obliged to ensure that all marketing communications addressed to investors of an AIF are identifiable as such and describe the risks and rewards of purchasing units or shares of an AIF in an equally prominent manner, and that all information included in marketing communications is fair, clear and not misleading in accordance with ESMA Guidelines (ESMA34-45-1244) issued on 27 May 2021 and which will apply six months after the date of the publication of the guidelines on ESMA's website in all EU official languages. Such AIFMs must also ensure that all marketing communications indicate that a prospectus exists, where applicable a KID is available and ensure that all information contained in marketing communications does not contradict or diminish the significance of information contained in the AIF's prospectus. Marketing communications must specify where, how and in which language investors or potential investors can obtain the prospectus and where applicable the KID and obtain a summary of investor rights and provide hyperlinks to or website addresses for those documents. Finally, such marketing communications will also need to comply with ESMA's finalised guidelines on marketing communications issued on 27 May 2021 and which will apply six months after the date of their publication on ESMA's website in all EU official languages.

An AIF marketing in Ireland to retail investors must comply with the Consumer Protection Code. In addition, where a non-Irish AIF has been approved by the Central Bank to market in Ireland to retail investors (see question 3.6 below), certain wording prescribed by the Central Bank must be included in the non-Irish AIF's prospectus and in any marketing material distributed in Ireland for the purposes of promoting the AIF to retail investors.

The European Communities (Markets in Financial Instruments) Regulations 2017 (the "**Irish MiFID Regulations**"), which transposed the MiFID II Directive into Irish law, require authorised "investment firms" providing "investment services" (including, *inter alia*, investment advice and certain distribution services) to ensure that information provided to potential clients about, *inter alia*, "financial instruments" (such as units in an AIF) meets certain prescribed requirements.

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

In relation to a QIAIF, a dated prospectus, constitutional document and material contracts must be submitted to the Central Bank for noting in advance of the date of authorisation. In relation to a RIAIF, the prospectus must be submitted for review and clearance by the Central Bank in advance of seeking the authorisation of the RIAIF from the Central Bank.

The prospectus of a closed-ended Irish AIF must be submitted to the Central Bank for approval in accordance with the Irish Prospectus Directive Regulations (where applicable).

The Central Bank does not currently require a KID to be filed with it.

Details of the arrangements for the marketing of shares in Ireland must be submitted to the Central Bank by a non-Irish AIF in support of any application for approval to market in Ireland to retail investors (see question 3.6 below).

3.4 What restrictions are there on marketing Alternative Investment Funds?

Marketing in Ireland to Retail Investors

A non-Irish AIF must be approved by the Central Bank to market in Ireland to retail investors (see question 3.6 below).

Marketing in Ireland to Professional Investors

Notification to the Central Bank pursuant to the Irish AIFM Regulations is required in advance of any marketing in Ireland to professional investors of:

- EU AIFs by Irish AIFMs;
- non-EU AIFs by EU AIFMs; and
- AIFs by non-EU AIFMs.

Marketing may only commence once the Central Bank has informed the AIFM that it may commence marketing and is conditional on the applicable requirements set out in the AIFM Directive having been complied with. For example, a non-EU AIFM must comply with the substantive transparency and other requirements set out under Articles 22, 23, 24 and, for private equity funds, 26–30, of the AIFM Directive:

- Article 22: each AIF must be audited in accordance with the prescribed standards.
- Article 23: sets out disclosure requirements such as disclosing to investors the current risk profile of the AIF.
- Article 24: provides requirements to "regularly" report to each Member State in which the AIF is marketed. Member States may require more information on a periodic as well as an *ad hoc* basis.
- Articles 26–30: set out detailed rules applicable to private equity funds only on the acquisition of control, including rules regarding asset stripping.

Non-Irish EU AIFMs marketing EU AIFs to professional investors in Ireland must only comply with their local rules.

Non-Irish registered EU AIFMs (as opposed to non-Irish authorised EU AIFMs that can avail of the passport pursuant to Article 33 of the AIFM Directive) cannot market AIFs that they manage to professional investors in Ireland.

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

The concept of pre-marketing has not to-date been recognised by the Central Bank in Ireland. However, that will change as a result of a new harmonised regime for pre-marketing AIFs in the EU which has been introduced at EU level via the EU Cross Border Distribution of Collective Investment Undertakings Directive 2019/1160. That Directive, which amends the AIFM Directive, entered into force on 1 August 2019 and must be transposed into law by EU Member States before the 2 August 2021.

In the Directive, pre-marketing is defined as the "*provision of information or communication, direct or indirect, on investment strategies or investment ideas by an EU AIFM or on its behalf, to potential professional investors domiciled or registered in the Union in order to test their interest in an AIF which is not yet established, or in an AIF which is established, but not yet notified for marketing in accordance with Article 31 or 32, or in compartments of such AIFs, in that Member State where the potential investors are domiciled or have their registered office, and which in each case does not amount to an offer or placement to the investor to invest in the units or shares of that AIF or compartment*".

The Directive provides that an authorised EU AIFM engaging in pre-marketing may not present information to investors relating to or containing reference to an established AIF, enabling investors to commit to acquiring units or shares of a particular AIF, or amounting to a constitutional document, a prospectus, a subscription form or similar document whether in a draft or a final form allowing investors to take an investment decision. Any pre-marketing document will have to clearly state that the document does not constitute an offer or an invitation to subscribe to units or shares of an AIF and the information presented in those documents should not be relied upon because it is incomplete and may be subject to change.

AIFMs which engage in pre-marketing must notify their home competent authority in writing within two weeks of engaging in pre-marketing, specifying the Member States, time periods in which the pre-marketing took place, a brief description of the strategies presented and, where relevant, a list of the AIFs which were the subject of pre-marketing. The home competent authority must promptly inform the competent authorities of the Member States in which the pre-marketing took place. AIFMs will no longer be able to rely on reverse solicitation if they have carried out pre-marketing in relation to the AIF in question within the previous 18 months.

3.6 Can Alternative Investment Funds be marketed to retail investors?

RIAIFs/QIAIFs

QIAIFs may be only be marketed to retail investors where they constitute qualifying investors as detailed in question 3.7 below. RIAIFs may be marketed to retail investors.

Non-Irish AIFs

Non-Irish AIFs which propose to market their units in Ireland to retail investors must be authorised by a supervisory authority set up in order to ensure the protection of unitholders and which, in the opinion of the Central Bank, provides an equivalent level of investor protection to that provided under Irish laws, regulations and conditions governing RIAIFs.

A non-Irish AIF which proposes to market its units in Ireland to retail investors must make an application to the Central Bank in writing, enclosing certain prescribed information.

AIFs established in:

- Guernsey and authorised as Class A schemes;
- Jersey and authorised as recognised funds; and
- the Isle of Man as authorised schemes,

will receive approval to market their units in Ireland to retail investors on completion of the information and documentation required by the Central Bank. Other AIFs must demonstrate an equivalent level of investor protection to that provided under Irish laws, regulations and conditions governing RIAIFs.

The marketing of units in Ireland to retail investors is subject to the requirements set out in questions 3.2 and 3.4 above and may not take place until the AIF has received a letter of approval from the Central Bank.

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

RIAIFs

A RIAIF has no regulatory minimum subscription requirement and no investor qualification requirements.

QIAIFs

A QIAIF may only be sold to qualifying investors and a minimum subscription of at least EUR 100,000 applies. A qualifying investor is:

(i) an investor who is a professional client within the meaning of MiFID;

(ii) an investor who receives an appraisal from an EU credit institution, a MiFID firm or a UCITS management company to the effect that the investor has the appropriate expertise, experience and knowledge to adequately understand the investment in the QIAIF; or

(iii) an investor who certifies that they are an informed investor by providing the following:
   - confirmation (in writing) that the investor has such knowledge of, and experience in, financial and business matters as would enable the investor to properly evaluate the merits and risks of the prospective investment; or
   - confirmation (in writing) that the investor's business involves, whether for its own account or the account of others, the management, acquisition or disposal of property of the same kind as the property of the QIAIF.

Qualifying investors must self-certify in writing to the QIAIF that they: (i) meet the minimum initial investment per investor and appropriate expertise/understanding tests; and (ii) are aware of the risk involved in the proposed investment and of the fact that inherent in such investment is the potential to lose all of the sum invested.

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

There are no additional restrictions under Investment Funds Legislation.

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

There are none in the context of RIAIFs/QIAIFs except where participation results in a transaction being entered with the AIF by the AIFM, general partner, depositary, investment manager

or by delegates or group companies of these, in which case the transaction must be negotiated at arm's length and be in the best interests of the shareholders of the AIF.

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

No, there are no such restrictions. However, any intermediaries used to fundraise in Ireland must be regulated where required pursuant to Irish laws. This will depend on the specific activity being carried out by the intermediary in Ireland.

4 Investments

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

The investment activities of a loan originating QIAIF (other than instruments which are held for treasury, cash management and hedging) are limited to the business of issuing loans, participating in loans, investment in debt/credit instruments, participations in lending and to operations relating thereto, including investing in equity securities of entities or groups to which the loan originating QIAIF lends. Such QIAIFs may not originate loans to natural persons, other collective investment schemes, the AIFM or depositary of the QIAIF or delegates or group companies of these, financial institutions or related companies except in the case where there is a *bona fide* treasury management purpose which is ancillary to the primary objective of the loan originating QIAIF, and persons intending to invest in equities or other traded investments or commodities.

Pursuant to the European Long-term Investment Funds Regulation, an ELTIF (which may be structured as a RIAIF or a QIAIF) may not undertake: (a) short selling of assets; (b) taking direct or indirect exposure to commodities; (c) entering into securities lending, securities borrowing, repurchase transactions, etc. if more than 10% of the assets of the ELTIF are affected; and (d) using financial derivative instruments, except where the use of such instruments solely serves the purpose of hedging the risks inherent to other investments of the ELTIF.

A RIAIF/QIAIF may not acquire any shares carrying voting rights which would enable it to exercise significant influence over the management of an issuing body. This requirement does not apply to investments in other investment funds or where the AIF is a venture capital, development capital or private equity AIF, provided its prospectus indicates its intention regarding the exercise of legal and management control over underlying investments.

Investment activities in RIAIFs may be impacted indirectly by concentration rules imposed by the Central Bank (e.g. 20% of net asset value ("**NAV**") issuer limit, 30% of NAV limit on deposits with an acceptable credit institution, 30% of NAV limit in any one open-ended fund, etc.).

In relation to QIAIFs, the Central Bank does not impose any limits on the investment objectives, the investment policies or the degree of leverage which may be employed, except (a) for money market QIAIFs and QIAIFs that invest more than 50% of NAV in another fund, the Central Bank does impose certain requirements in relation to the underlying assets, and (b) a loan originating QIAIF must limit exposure over a specific timeframe to any one issuer or group to 25% of NAV.

Finally, in relation to investment companies authorised as QIAIFs, there is a statutory requirement to spread investment risk.

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

An Irish AIF structured as an ELTIF may only invest in certain eligible investments as prescribed in the European Long-term Investment Funds Regulation. Furthermore, it is subject to portfolio composition and diversification limits as set out in the European Long-term Investment Funds Regulation.

Other than the restrictions referred to in question 4.1 above and the eligible investment requirements of the ELTIF, there are no prescriptive limitations on the types of investments that can be included in an AIF's portfolio. However the liquidity profile of investments is relevant depending on whether the AIF is structured as open-ended, open-ended with limited liquidity or closed-ended.

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

Regulatory Requirements Applicable to Investing in Loans

RIAIFs/QIAIFs

RIAIFs/QIAIFs may invest in loan participations and loan assignments but may not grant loans (except for loan originating QIAIFs). This is without prejudice to the right of such a RIAIF/non-loan originating QIAIF to acquire debt securities and it does not prevent such an AIF from acquiring securities which are not fully paid.

In relation to loan originating QIAIFs, the Central Bank imposes prescriptive requirements in addition to the prescriptive investment activities and persons to whom loans may be issued referred to in question 4.1 above and the issuer diversification limit referred to in question 4.2 above. Such additional requirements include (i) the appointment of an EU authorised AIFM, (ii) must be closed-ended and established for a finite period, (iii) must not be leveraged in excess of 100% of its net asset value, (iv) must have policies and procedures in respect of, *inter alia*: its risk appetite; the assessment, pricing and granting of credit; credit monitoring, renewal and refinancing; collateral management, concentration risk; valuation; and forbearance; (v) must have a comprehensive stress testing programme; and (vi) must ensure that any access to its records/staff given to any one investor for the purposes of a due diligence process has been made available on a non-discriminatory basis to all unitholders.

Regulatory Requirements Applicable to Investing in Derivatives

RIAIFs

RIAIFs may invest in derivatives provided certain prescriptive requirements of the Central Bank are complied with, including implementing a risk management process to ensure that the use of derivatives in accordance with regulatory requirements is monitored, managed and controlled on an ongoing basis. Such regulatory requirements include, *inter alia*: (i) global exposure arising from the use of derivatives using the commitment approach must not exceed 100% of the RIAIF's net asset value; (ii) direct and indirect exposure (through derivatives) to an underlying asset must not exceed issuer regulatory limits; (iii) eligibility criteria for OTC derivative counterparties; (iv) OTC derivative counterparty exposure must not exceed 10% of the RIAIF's net assets in the case of an eligible credit institution and 5% of net assets in all other cases; and (v) sufficient liquid assets must be held to cover any commitments the RIAIF may have in respect of the use of derivatives.

QIAIFs
There are no regulatory requirements imposed by the Central Bank on QIAIFs that invest in derivatives.

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

A RIAIF may not borrow in excess of 25% of its net assets at any time. QIAIFs are not subject to any regulatory borrowing limits.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

In order to act as depositary of an Irish AIF, the relevant entity must be: (i) a credit institution; (ii) a MiFID investment firm which complies with certain capital adequacy rules and is authorised to safekeep assets; or (iii) an Irish company authorised and regulated by the Central Bank under the Investment Intermediaries Act 1995 and either wholly owned by a credit institution or by a third country institution with the liabilities of the company guaranteed by such institution having a minimum share capital.

However, for specific types of Irish AIFs (i.e. those which have no redemption rights exercisable for at least five years from the date of initial investment and which generally do not invest in financial instruments that can be held in custody), an Irish company authorised and regulated by the Central Bank under the Investment Intermediaries Act 1995 may be appointed as the "Real Assets Depositary" (or as referred to by the Central Bank as the "Depositary of Assets other than Financial Instruments") without having to comply with the additional requirements outlined in (iii) above provided such depositary satisfies the Central Bank in relation to its suitability and demonstrates to the Central Bank: (a) its capacity and ability to meet the safekeeping and oversight obligations under the Irish AIFM Regulations; (b) that it has effective policies and procedures to ensure the depositary oversight role is carried out; and (c) how it has the necessary systems access to effectively oversee the AIFM and any of its delegates.

In certain circumstances, it is possible for the depositary to delegate certain of its safekeeping functions to third parties provided there is an objective reason for doing so; however, delegation of the safekeeping function is subject to a number of conditions as provided for in the AIFM Regulations.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

Pursuant to Article 23 of the AIFM Directive, the AIFM of a RIAIF/QIAIF must disclose certain prescribed information to prospective investors in advance of any investment and any material changes to such information on an ongoing basis. Such disclosure requirements are met by including such disclosure in the prospectus of the AIF or in certain cases by referring to where such information may be obtained in the prospectus. In addition, the Central Bank requires additional disclosure in the prospectus of a RIAIF/QIAIF, e.g. disclosure of relevant parties, fees and expenses payable out of the assets of the AIF, maximum remuneration of the AIFM and investment manager (if any), maximum redemption fee, maximum leverage that may be generated, valuation methodologies, dealing arrangements, investment objective, policy and strategy, investment restrictions, ability to create side pockets, etc. Furthermore, there are certain circumstances where investors must be notified of certain incidents, e.g. where there has been a non-material change in investment policy or an increase in the remuneration payable to the AIFM within the maximum amount disclosed in the prospectus, etc.

Pursuant to Article 24 of the AIFM Directive, an AIFM must regularly report to the competent authorities of its home Member State certain prescribed information in the form of a template reporting template as set out in Annex IV of the Commission Delegate Regulation 231/2013, e.g. the principal markets and instruments in which it trades on behalf of the AIFs it manages. In addition, an AIFM must, for each of the EU AIFs that it manages and for each of the AIFs that it markets in the EU, periodically disclose to investors:

(a) the percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature;
(b) any new arrangements for managing the liquidity of the AIF; and
(c) the current risk profile of the AIF and the risk management systems employed by the AIFM to manage those risks.

In respect of environmental, social and governance factors ("**ESG**"), a number of disclosure obligations have been introduced pursuant to Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector ("**SFDR**") and Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (the "**Taxonomy Regulation**").

The SFDR applies different requirements and implementation timeframes in respect of disclosures (i) in the prospectus of the AIF, (ii) on websites of the AIFM, and (iii) in the periodic reports of the AIF.

AIFM Level Requirements: The following disclosure requirements exist at manager level pursuant to the SFDR.

(i) The AIFM must formulate a policy on the integration of sustainability risks in its investment decision-making process and disclose this policy both in the prospectus of the AIF and on its website.
(ii) The AIFM must decide whether to (a) implement a due diligence policy with respect to the principal adverse impacts of its investment decisions on sustainability factors, or (b) provide an explanation as to why it does not consider such adverse impacts. If complying with (a), the AIFM is required to publish a statement on the due diligence policy on its website including information on the identification and prioritisation of adverse impacts, summaries of engagement policies, and adherence to responsible business codes and other internationally recognised standards. If complying with (b), the AIFM must publish on its website its reasons for not considering principal adverse impacts of investment decisions on sustainability factors, including an explanation on whether and when the firm intends to consider such impacts.
(iii) The AIFM must update its existing remuneration policy and disclose on its website how the policy is consistent with the integration of sustainability risks.

All AIFs: The following disclosure requirements apply to all AIFs, irrespective of whether they have an ESG focus pursuant to SFDR.

(i) An AIFM must decide whether to (a) assess the likely impact of sustainability risks on the return of each fund, or (b) provide an explanation for why it does not consider sustainability risks to be relevant to a particular fund. If

complying with (a), the AIF must publish in the AIF's prospectus a description of the manner in which sustainability risks are integrated into investment decisions and the results of the assessment of the likely impact of sustainability risks on the returns of the fund. Where complying with (b), the AIF must publish clear and concise reasons in its prospectus why sustainability risks are not relevant for returns of the fund.

(ii) Where the AIFM is implementing a sustainability due diligence policy with respect to the principal adverse impacts of its investment decisions on sustainability factors, there must be a disclosure in the prospectus of the AIF and on the website of the AIFM as to whether and how each fund considers the principal adverse impacts on sustainability factors. Where a sustainability due diligence policy is not implemented, the AIFM must disclose for each fund in the prospectus of the AIF an express negative statement that it does not consider adverse impacts, and the reasons for not doing so.

(iii) The Taxonomy Regulation further requires that, where a fund is not an Article 8 ESG fund or Article 9 ESG fund, the prospectus of the AIF and periodic disclosures must include the following statement: "*The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities.*"

Article 8 ESG Funds: The following disclosure requirements apply to Article 8 ESG funds or funds which promote ESG characteristics pursuant to the SFDR:

(i) The AIFM must publish on its website: (i) a description of the ESG characteristics that each fund promotes; (ii) information on the methodologies used to assess, measure and monitor the ESG characteristics; (iii) information on how those ESG characteristics are met; and (iv) if an index has been designated, information on how this index is consistent with those ESG factors.

(ii) The AIF must disclose in its prospectus: (i) information on how environmental or social characteristics are met; (ii) if an index has been designated, information on whether and how this index is consistent with those characteristics; and (iii) if an index has been designated, where the methodology used for the calculation of the index is to be found.

(iii) The Taxonomy Regulation further requires that information on the environmental objective or objectives listed under the Taxonomy Regulation to which the underlying investment(s) contributes, and a description of how and to what extent the underlying investments qualify as "environmentally sustainable" for the purposes of the taxonomy, and also the proportion of investments that are environmentally sustainable, be disclosed in the prospectus of the AIF.

Article 9 ESG Funds: The following disclosure requirements apply to Article 9 ESG funds or funds which exclusively pursue a sustainable investment objective pursuant to the SFDR:

(i) The AIFM must publish on its website: (i) a description of the sustainable investment objective; (ii) information on the methodologies used to assess, measure and monitor the impact of the sustainable investments; (iii) if no index has been designated as a reference benchmark, an explanation on how the objective is to be attained; and (iv) if an index has been designated, information on how the index is aligned with the objective and an explanation as to why and how the designated index aligned with the objective differs from a broad market index.

(ii) Where an index has been designated as a reference benchmark, the AIF must disclose in its prospectus information on how the index is aligned with the objective and an explanation as to why and how the designated index aligned with the objective differs from a broad market index. The disclosure must include an indication of where the methodology used for the calculation of the index is to be found. Where no index has been designated as a reference benchmark, an explanation must be provided on how the objective is to be attained.

(iii) The Taxonomy Regulation further requires information on the environmental objective or objectives listed under the Taxonomy Regulation to which the underlying investment(s) contributes, and a description of how and to what extent the underlying investments qualify as "environmentally sustainable" for the purposes of the taxonomy, and also the proportion of investments that are environmentally sustainable, be disclosed in the prospectus of the AIF.

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

Article 30 of the Fourth EU Anti-Money Laundering Directive (EU) 2015/849), as amended by the Fifth EU Anti-Money Laundering Directive (EU 2018/843), obliges EU Member States to ensure details of beneficial owners of corporate and legal entities incorporated within its jurisdiction are held on a central register. Such registers must be made publicly available.

The definition of beneficial owner is set out in Article 3 of Directive 2015/849 and means any natural person who directly or indirectly owns or controls the corporate or legal entity. This can be through having a sufficient percentage of the voting rights, ownership interest, controlling the company by other means such as through a shareholders' agreement, by the exercise of dominant influence, or via the power to appoint senior management.

Article 30 of Directive 2015/849 requires corporate and legal entities to maintain their beneficial ownership details, independent of the central register, and to provide these details to a central register when required.

In Ireland, the Companies Registration Office is responsible for maintaining a central beneficial ownership register in respect of companies such as AIFs established as variable capital companies and the Central Bank is responsible for maintaining a central beneficial ownership register in respect of the following AIF legal structures; ICAVs, Unit Trusts, Common Contractual Funds and Investment Limited Partnerships.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

Annual and Half-Yearly Reports

(a) RIAIFs/QIAIFs

A newly established RIAIF/QIAIF must submit to the Central Bank a set of accounts (whether an interim report or an annual report) within a certain period of the launch date (i.e. within nine months for a RIAIF and 12 months for a QIAIF) and publish it within two months if it is an interim report or six months if it is an annual report. The first annual reports must be made up to a date within 18 months of incorporation/establishment and published within six months.

On an ongoing basis, a RIAIF/QIAIF must publish an annual report within six months of the end of the financial

year. In addition, a QIAIF (established as a unit trust or CCF) and a RIAIF must publish, within two months of the reporting period, a half-yearly report covering the first six months of the financial year.

In respect of ESG, pursuant to the SFDR, the Taxonomy Regulation and regulatory technical standards issued thereunder, AIFs will be required to publish certain disclosures in their annual reports commencing in 2022 with the level of information depending on whether the fund is an Article 8 or Article 9 ESG fund or a non-ESG fund.

(b) AIFMs/Non-AIFM Management Companies/Administrators/Depositaries

Where an AIFM, a non-AIFM management company, administrator or depositary is authorised by the Central Bank, such entity must publish and file with the Central Bank (i) an annual report within four months of the end of the financial year, and (ii) half-yearly reports within two months of the half year end.

However, where an AIFM is an internally managed RIAIF/QIAIF, the annual audited accounts must be published within six months (as opposed to four months) of the year end. Furthermore, internally managed corporate QIAIFs are not required to produce half-yearly financial accounts.

Prudential Reports

(a) RIAIFs/QIAIFs

A RIAIF/QIAIF is obliged to file the following prudential reports with the Central Bank:

- a monthly return setting out prescriptive information relating to the AIF;
- a quarterly Survey of Collective Investment Undertakings returned within 10 working days of the end-quarter to which it refers; and
- a Funds Annual Survey of Liabilities return filed with the latter return.

A RIAIF or a QIAIF structured as a money market fund that meets the definition of a "monetary financial institution" in the Regulation of the European Central Bank (EU) No 883/2011 is also obliged to file statistical information on a monthly and quarterly basis with the European Central Bank.

(b) AIFMs/Non-AIFM Management Companies/Administrators/Depositaries

Where an AIFM, a non-AIFM management company, administrator or depositary is authorised by the Central Bank, such entity must file with the Central Bank a minimum capital requirement report when filing its half-yearly and annual reports.

Other Reports

(a) RIAIFs/QIAIFs

A RIAIF/QIAIF may be obliged to file reports on a periodic basis with the Central Bank depending on the composition of its portfolio, e.g. where the AIF has side pocket assets, an annual report is required confirming whether or not the Central Bank's parameters continue to be respected and the prospects and/or plans for the side pocket assets must be outlined.

(b) Depositary

A depositary of a RIAIF/QIAIF must enquire into the conduct of the AIFM and the management company, investment company, ICAV or general partner in each annual accounting period and report thereon to the unitholders via a depositary report included in the annual report of the AIF.

(c) Irish AIFMs/Non-EU AIFMs Marketing in Ireland

A non-EU AIFM marketing an AIF in Ireland without a passport and an Irish-authorised AIFM are required to file reports with the Central Bank in accordance with Regulation 25 of the Irish AIFM Regulations, e.g. reports on the principal markets and instruments in which they trade on behalf of the AIFs they manage, etc.

5.4 Is the use of side letters restricted?

There is no express statutory or regulatory restriction on the use of side letters. However, a RIAIF/QIAIF is required, subject to certain exceptions as set out in the AIF Rulebook, to treat all unitholders in the same class equally and all unitholders in different classes fairly.

Furthermore, an AIFM is subject to certain operating conditions, including, *inter alia*, an obligation to treat all AIF unitholders fairly and to ensure that no unitholder in an AIF obtains preferential treatment unless such preferential treatment is disclosed in the relevant AIF's constitutional document.

6 Taxation

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

RIAIFs/QIAIFs are not subject to any taxes on their income (profits) or gains arising on their underlying investments. While dividends, interest and capital gains that an AIF receives with respect to its investments may be subject to taxes, including withholding taxes, in the countries in which the issuers of investments are located, these foreign withholding taxes may, nevertheless, be reduced or eliminated under Ireland's network of tax treaties to the extent applicable.

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

Compensation paid to Irish managers and advisors (such as management/advisory fees, as well as performance fees) of RIAIFs/QIAIFs is generally subject to corporation tax at the trading rate (i.e. 12.5%).

With regard to carried interest, aside from a regime introduced in 2009 for certain venture fund managers in respect of qualifying venture capital funds (which must be structured as partnerships and which are quite limited in their activities), Ireland does not have specific legislation dealing with carried interest. Nevertheless, generally speaking it should be possible to structure funds such that carried interest could be treated for Irish tax purposes as a capital gains tax receipt subject to tax at the standard rate (currently 33%) in the hands of an individual manager. It should be noted, the aforementioned venture fund managers regime (where applicable) reduces the capital gains tax rates even further to 15% (as opposed to 33%) for an individual and 12.5% (as opposed to an effective 33% rate) for a company.

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

There are no such establishment taxes. Furthermore, there are no transfer taxes payable in Ireland on the issue, transfer,

repurchase or redemption of units in a RIAIF/QIAIF (aside possibly from units in an IREF, see question 6.4 below). Where any subscription for or redemption of units is satisfied by the *in specie* transfer of securities, property or other types of assets, Irish stamp duty may arise on the transfer of such assets.

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

RIAIFs/QIAIFs are not subject to any taxes on their income (profits) or gains arising on their underlying investments.

RIAIFs/QIAIFs (other than CCFs & ILPs)

Non-Residents

There are no Irish withholding taxes in respect of a distribution of payments by such AIFs to investors or in relation to any encashment, redemption, cancellation or transfer of units in respect of investors who are neither Irish-resident nor ordinarily resident in Ireland, provided the AIF has satisfied and availed of certain equivalent measures or the investors have provided the AIF with the appropriate relevant declaration of non-Irish residence.

Irish Residents

Exempt Investors (which includes pension funds) – Again, no Irish withholding taxes apply in respect of a distribution of payments by the AIF to such investors (which would include approved pension schemes, charities, other investment funds, etc.) or any encashment, redemption, cancellation or transfer of units in respect of investors that have provided the AIF with the appropriate relevant declaration.

Non-Exempt Investors – If an investor is an Irish resident and not an exempt Irish investor, tax at the rate of 41% (25% where the unitholder is a company and an appropriate declaration is in place) is required to be deducted by the AIF on distributions (where payments are made annually or at more frequent intervals). Similarly, tax at the rate of 41% (25% where the unitholder is a company and an appropriate declaration is in place) will have to be deducted by the AIF on any other distribution or gain arising to the investor on an encashment, redemption, etc. of units by an investor who is Irish-resident or an ordinary resident in Ireland. While this tax will be a tax liability of the AIF, it is effectively incurred by investors out of their investment proceeds.

RIAIFs/QIAIFs (established as CCFs or ILPs)

For Irish tax purposes, a CCF and an ILP (authorised on or after 13 February 2013) are treated as "tax transparent". This means that the income and gains arising or accruing to the AIF are treated as arising or accruing to its unitholders/partners either (i) in the case of a CCF, in proportion to the value of the units beneficially owned by them, or (ii) in the case of an ILP, in accordance with the apportionment terms of the partnership agreement. The income and gains are treated as if it did not pass through the hands of the CCF or ILP. Consequently, for tax purposes, the profits that arise to this type of AIF are treated as being profits that arise to the unitholders/partners themselves. Currently, natural persons cannot invest in a CCF without negatively affecting its Irish tax transparent status. This may change in the future.

Irish Real Estate Funds

Ireland has recently introduced a new withholding tax regime in respect of certain Irish property-related distributions and redemptions made by Irish real estate funds ("**IREFs**") to certain unit holders. An IREF is a non-UCITS authorised fund where (i) 25% or more of the market value of its assets is derived from certain types of Irish real estate related assets ("**IREF Assets**"), or (ii) it would be reasonable to consider that the fund's main purpose (or one of its main purposes) was to acquire IREF Assets or carry on an IREF business (that is, activities involving IREF assets the profit or gains of which would, but for the general tax exemptions applied to funds, be within the scope of Irish taxation). Where a fund is an umbrella fund, the new rules will be applied at the sub-fund level. In summary, subject to certain exceptions, a 20% withholding tax will be imposed on distributions and redemptions made out of IREF profits, which are essentially the accounting profits of the IREF with certain exclusions (e.g. distributions/dividends made by unquoted companies which derive the greater part of their value from Irish relevant assets).

The Finance Act 2019 introduced certain anti-tax avoidance measures in respect of excessive debt financing of IREFs and expenses not wholly and exclusively incurred for the purposes of the IREF business (both of which could be used to reduce the profits of the IREF and thus the amount of withholding tax suffered on a distribution). It is important to note that the anti-avoidance provisions do not apply to genuine third-party debt.

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

No. Once a RIAIF/QIAIF has received its authorisation from the Central Bank and for so long as such authorisation remains in place, the taxation treatment detailed above applies.

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

Foreign Account Tax Compliance Act ("***FATCA***") – The Irish and US Governments signed a Model 1 intergovernmental agreement ("**Irish IGA**") on 21 December 2012 and provisions were included in the Irish Finance Act 2013 for the implementation of the Irish IGA and also to permit regulations to be made by the Irish Revenue Commissioners with regard to registration and reporting requirements arising from the Irish IGA. Subsequently, the Irish Revenue Commissioners (in conjunction with the Department of Finance) issued Regulations S.I. No 292 of 2014 which were effective from 1 July 2014. Supporting Guidance Notes have also been issued by the Irish Revenue Commissioners and are updated on an *ad hoc* basis. RIAIFs/QIAIFs that are Irish Reporting Financial Institutions for FATCA purposes will have certain registration, due diligence and reporting requirements. Compliant RIAIFs/QIAIFs will not be subject to, nor will they have to operate, FATCA withholding taxes.

Intergovernmental Agreements – Aside from the Irish IGA, Ireland has not entered into any other IGAs.

*Common Reporting Standards ("**CRS**")* – As Ireland was one of the early adopter countries, the legislation to implement the CRS in Ireland was introduced in the Finance Act 2014 by inserting Section 891F of the Taxes Consolidation Act 1997, and Regulations (Statutory Instrument 583 of 2015) came into effect on 31 December 2015. The legislation to implement the Revised EU Directive on Administrative Cooperation in the

Field of Taxation (DAC2 – which essentially imports the CRS into EU legislation) in Ireland was introduced in the Finance Act 2015 by inserting Section 891G of the Taxes Consolidation Act 1997. Section 891F will not apply where Section 891G applies. RIAIFs/QIAIFs that are Irish Reporting Financial Institutions for CRS purposes will have certain registration, due diligence and reporting requirements.

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

Since the initiation of the BEPS project, the Irish Government has been very active in the area, having launched a consultation in May 2014 and published a detailed paper in the same year, where they explored the potential impacts of the project.

In recent years, it has implemented various domestic tax legislation in line with BEPS and the related EU Anti-Tax Avoidance Directives (as detailed below). They continue to liaise with various interested parties (including the Irish Fund's industry) in relation to the various ongoing "Actions" provided for under BEPS and, indeed, the EU Anti-Tax Avoidance Directives (see below).

EU Anti-Tax Avoidance Directives

The implementation into Irish tax law of Council Directive (EU) 2016/1164 (commonly referred to as the Anti-Tax Avoidance Directive or ATAD), as subsequently amended by Council Directive (EU) 2017/952 (ATAD 2), addresses a number of the BEPS Actions.

Anti-Hybrid Rules – As part of the implementation of ATAD and ATAD 2, anti-hybrid rules have been recently introduced into Irish tax legislation. Broadly speaking, these rules are intended to prevent arrangements that exploit differences in the tax treatment of a financial instrument or an entity under the tax laws of two or more jurisdictions to generate a tax advantage. The new legislation is effective for relevant payments made or arising on or after 1 January 2020 (although the provisions on reverse hybrid mismatches for which implementation can be postponed to 31 December 2021, have not yet been transposed into Irish legislation).

It is important to note that these rules generally only apply to particular cross-border arrangements between associated enterprises and to certain "structured arrangements". Given that AIFs are not subject to any Irish taxes on their income or gains, it is expected that the Irish anti-hybrid rules should have little impact for AIFs.

Interest Limitation Rules – Also as part of the requirements of ATAD, Ireland is currently in the process of developing interest limitation rules which are expected to be implemented into Irish tax legislation from 1 January 2022. As required by ATAD, these rules are designed to limit the ability to deduct borrowing costs when calculating taxable profits. It operates by limiting the allowable tax deduction for 'exceeding borrowing costs' (in broad terms, net interest costs) in a tax period to 30% of Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA).

Nevertheless, Member States may exclude financial undertakings (which in an Irish context would include AIFs) with respect of the aforementioned interest limitation rules and, on that basis, AIFs are not expected to fall within scope.

Multilateral Instrument (Actions 15, 6, 7 and other actions of BEPS)

Ireland signed up to the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**MLI**") which was subsequently ratified by Ireland through the Finance Act 2018 and Ireland formally deposited its Instrument of Ratification with the OECD on 29 January 2019.

In respect of Action 7 (permanent establishments), Ireland has confirmed that it will adopt Option B under Article 13 of the MLI, such that only some of the permanent establishment exceptions listed in Article 5 of the OECD Model Tax Convention must meet the test of being preparatory or auxiliary in character. In line with this, Ireland has also adopted the anti-fragmentation rules in the MLI which are designed to prevent the fragmentation of operations and/or splitting of contracts in order to avail of the permanent establishment exceptions.

The MLI came into force in Ireland on 1 May 2019. The treaties that will be modified by the MLI will be those treaties to which Ireland is a party, and where Ireland's treaty partner has already ratified the MLI.

As a general rule, it will begin to have effect for Ireland's tax treaties (i) with respect to taxes withheld at source, from 1 January 2020, and (ii) with respect to all other taxes levied by Ireland, for taxes levied with respect to taxable periods beginning on or after 1 November 2019.

The Irish Revenue Commissioners have confirmed that they will publish guidance to facilitate the interpretation and application of the treaties as modified by the MLI on an ongoing basis.

The full impact that the MLI may have on QIAIF/RIAIFs going forward remains to be seen.

Mandatory Disclosure Rules (Action 12 of BEPS)

Council Directive (EU) 2018/822 (amending Directive 2011/16/EU), commonly referred to as "DAC6", was enacted in response to Action 12 of BEPS and became effective on 25 June 2018. Relevant Irish tax legislation has since been introduced to implement this Directive in Ireland.

DAC6 creates an obligation for persons referred to as "intermediaries" to make a return to the relevant tax authorities of information regarding certain cross-border arrangements with particular characteristics, referred to as "hallmarks" (most of which focus on aggressive tax planning arrangements). In certain circumstances, instead of an intermediary, the obligation to report may pass to the relevant taxpayer of a reportable cross-border arrangement.

Revenue have issued detailed guidance and this is updated on an *ad hoc* basis.

Country-by-Country Reporting (Action 13 of BEPS)

Ireland introduced Country-by-Country Reporting legislation in the Finance Act 2015, followed by accompanying regulations published on 23 December 2015. The legislation applies for accounting periods commencing on or after 1 January 2016.

Asset managers and AIFs should monitor the potential impact of BEPS/ATAD on their structures.

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

Whether a tax advantage exists for a particular asset class or structure depends on numerous factors, some of which will be non-Irish factors and so in order to obtain the optimum structure for a particular asset type, counsel advice should be sought on a case-by-case basis. That said, there are a few strategies/structures available in Ireland that may assist in obtaining an optimum result.

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

Management fees are generally subject to VAT at the current rate of 23%. However, under the harmonised VAT legislation, an exemption applies to the management of investment funds as defined by the EU Member States which, in Ireland, includes all authorised investment funds. Therefore, the VAT exemptions are wide-ranging with regard to the provision of services to funds (for example, fund administration, transfer agency, investment management, etc.).

RIAIFs/QIAIFs must adhere to the relevant rules on due diligence and information reporting under the CRS and FATCA, for instance (assuming they are Irish Reporting Financial Institutions). Furthermore, RIAIFs/QIAIFs will also need to monitor the OECD BEPS project and its possible effects on their investment structures (see question 6.7 above).

A tax concern which may arise is whether Irish AIFs managed by a non-Irish AIFMs lose their Irish tax residency due to the AIFM being established abroad and are thus taxed according to the laws of the seat of the AIFM. This, however, depends on the content of the laws of the jurisdiction of the AIFM. On the other hand, Irish tax law has provided that a non-Irish AIFM will not be liable to tax in Ireland by reason only of having an Irish AIF.

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

See question 6.7 above with regard to ATAD and also continual monitoring of BEPS and BEPS-related legislation is a necessity.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The main investment trends have been in real estate, private equity, loan origination, private debt and real economy assets. With the enactment of the Investment Limited Partnership (Amendment) Act 2020 in December 2020, the ILP is expected to become the fund structure of choice in Ireland for many international investment managers, particularly those in the private equity and real assets sectors. This updated legislation, together with recent guidance published by the Central Bank relating to closed-ended AIFs, ensures that the regulatory environment in Ireland caters for typical features of limited partnerships, including:

- closed-ended/finite life;
- capital accounting;
- commitments, capital contributions and drawdowns;
- excuse and exclude provisions;
- defaulting investor provisions;
- distribution waterfalls and carried interest arrangements;
- co-investment;
- parallel/alternative vehicles;
- subsidiaries; and
- advisory committees.

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

On 10 June 2020, the European Commission submitted a report to the European Parliament and the Council on the scope and the application of the AIFM Directive. The report concluded that while the AIFM Directive has contributed to the creation of the EU AIF market, provided a high-level protection to investors and facilitated monitoring of risks to financial stability, there are a number of areas where the legal framework could be improved. With this in mind, the European Commission launched a public consultation in October 2020 on the AIFM Directive seeking the views of stakeholders on how to achieve a more effective and efficient functioning of the EU AIF market as part of the overall financial system. The deadline for responses closed on 29 January 2021. A legislative proposal amending the AIFM Directive is expected in the third quarter of 2021.

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Dillon Eustace is one of Ireland's leading law firms, focusing on financial services, banking and capital markets, corporate and M&A, litigation and dispute resolution, real estate and taxation. Headquartered in Dublin, Ireland, the firm's international practice has seen it establish offices in Tokyo (2000), New York (2009) and Cayman Islands (2012) where the firm advises on both Cayman and Irish law matters. In tandem with Ireland's development as a leading international financial services centre, Dillon Eustace has developed a dynamic team of lawyers representing international and domestic asset managers, investment fund promoters, insurers, banks, corporates, TPAs and custodians, prime brokers, government and supranational bodies, as well as newspapers, aviation and maritime industry participants and real estate investors and developers. Dillon Eustace has been the leading Irish legal advisor to Irish domiciled funds for over 20 years as confirmed by Monterey. The Dillon Eustace financial services team is recognised internationally by legal directories *IFLR 1000*, *The Legal 500* and *Chambers* as a top-tier firm in asset management and investment funds.

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1 Regulatory Framework

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

The most relevant provisions regulating the establishment and operation of Italian alternative investment funds ("**AIFs**") are set forth in the following laws and regulations:

- Legislative Decree No. 58 of 24 February 1998 (the "**Italian Financial Act**") (*Testo Unico della Finanza*);
- Ministerial Decree No. 30 of 5 March 2015 ("**Decree No. 30/2015**");
- Bank of Italy Regulation of 19 January 2005 on collective investment management activities (the "**Bank of Italy Regulation**") (*Regolamento sulla Gestione Collettiva del Risparmio*);
- Bank of Italy Regulation of 5 December 2019 on internal governance and organisational requirements applying to AIF managers ("**AIFMs**");
- CONSOB Regulation No. 11971 of 14 May 1999 (the "**Issuers' Regulation**") (*Regolamento Emittenti*);
- CONSOB Regulation No. 20307 of 15 February 2018 (the Intermediaries' Regulation) (*Regolamento Intermediari*); and
- Delegated Regulation (EU) No. 231/2013, implementing Directive No. 2011/61/EU (respectively, the "**AIFMD Delegated Regulation**" and the "**AIFMD**").

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

Italian AIFMs must be authorised by the Bank of Italy and are subject to the regulatory supervision of the Bank of Italy and the Italian Companies and Exchange Commission ("**CONSOB**").

No authorisation is required in respect of AIFMs established in other countries of the European Economic Area ("**EEA**"), which are allowed to manage Italian AIFs under the free provision of services or right of establishment in accordance with the AIFMD passport – see also question 1.8.

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

No authorisation is required for the establishment of "**Reserved AIFs**" (*FIA riservati*), *i.e.* those AIFs whose units or shares can only be offered to:

- professional investors, as defined under Directive No. 2014/65/EU ("**MiFID 2**"); and
- investors qualifying as retail clients under the MiFID 2 who invest at least EUR 500,000 in the AIF – this threshold does not apply to the directors or employees of the AIFM or, in case of Real Estate AIFs (on which see question 1.4), to public institutions contributing their real estate assets in the AIF.

The establishment of "**Non-Reserved AIFs**" (*FIA non riservati*) is subject to the prior approval of the Bank of Italy.

The Bank of Italy's authorisation is also required for the setting up of Italian AIFs in corporate form – see question 2.1.

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

Open-ended *vs* closed-ended AIFs

Under the Italian Financial Act, an open-ended collective investment undertaking (*OICR*) ("**CIU**") is defined as *"any [CIU] whose investors are entitled to ask for the redemption of the units or shares out of its assets in accordance with the modalities and frequency provided for under the rules, articles of association or offering document of the [CIU]"*. Any CIU that does not qualify as an open-ended CIU in accordance with the above definition is a closed-ended CIU.

Open-ended AIFs may only invest in:

- financial instruments negotiated on a regulated market;
- financial instruments that are not negotiated on a regulated market, but only up to 20% (investments in units or shares of open-ended CIUs that are not listed are not considered for the purpose of the 20% limit); and
- bank deposits.

Investors in an open-ended AIFs are entitled to redeem their units/shares at least once a year. The value of such units/shares must be calculated with the same frequency, or in any event when new units/shares are issued by the AIF. The redemption amount must be paid to the investors within 15 days of the date when the redemption request is submitted to the AIFM.

Closed-ended AIFs may invest their capital in a wider range of assets, including the following illiquid assets:

- real estate properties, rights *in rem* on real estate properties (including those deriving from real estate lease agreements providing for the transfer of property or from public concession contracts), shareholdings in real estate companies, units or shares of other Real Estate AIFs (including foreign AIFs);
- credits and debt securities – including credits deriving from the loans originated by the AIF (see below); and
- other assets tradable on a market, and whose value can be determined with certainty at least on a semi-annual basis.

Investors in a closed-ended AIF are not entitled to ask for the redemption of their units/shares. The redemption can occur only at the expiry of the term of the AIF. Early redemptions are permitted (i) upon the initiative of the AIFM, on a *pro rata* basis to all of the AIF's investors, or (ii) upon request of the investors if new shares/units are issued, provided that the aggregate amount of redemptions does not exceed the aggregate amount collected through the issue of the new shares/units (in case of non-listed AIFs, the AIFM can borrow money to pay the amount of redemptions exceeding such limit up to a maximum of 10% of the gross asset value ("**GAV**")).

Real Estate AIFs

"**Real Estate AIFs**" are closed-ended AIFs investing at least ⅔ of their GAV in real estate properties, rights *in rem* on real estate properties (including those deriving from real estate lease agreements providing for the transfer of property or from public concession contracts), shareholdings in real estate companies, units or shares of other Real Estate AIFs (including foreign AIFs).

The ⅔ threshold is reduced to 51% if at least 20% of the AIF's capital is invested in asset-backed securities having as their underlying asset real estate properties, rights *in rem* on real estate properties or mortgage loans.

The requirement referred to above must be satisfied within 24 months of the date when the AIF starts to operate – but special rules apply to AIFs investing in social housing or similar projects.

Reserved *vs* Non-Reserved AIFs

As noted under question 1.3 above, Reserved AIFs can only be marketed to MiFID 2 professional investors and certain other categories of retail investors. The units or shares of Non-Reserved AIFs can be marketed to other categories of investors as well – including, in particular, to retail investors investing less than EUR 500,000 in the AIF.

Non-Reserved AIFs are subject to more stringent requirements in terms of investment diversification, eligible assets, leverage limits, *etc.* These requirements do not apply to Reserved AIFs, which must nonetheless ensure a minimum diversification of their investment portfolio.

The setting up of Non-Reserved AIFs is subject to the prior authorisation of the Bank of Italy. No such authorisation is required for the setting up of Reserved AIFs.

Credit AIFs

"**Credit AIFs**" (*FIA di credito*) are closed-ended AIFs which (i) invest in credits deriving from loans originated by third-party lenders, or (ii) engage in direct lending/loan origination activities. Credit AIFs can be established as Non-Reserved AIFs or Reserved AIFs and can operate only towards non-consumer borrowers.

They are subject to specific rules on leverage and eligible investments even if they are set up in the form of Reserved AIFs. In particular, Reserved AIFs investing in credits or engaging in direct lending activities (i) can only invest in receivables having a maturity not exceeding the term of the AIF, (ii) can borrow money only from banks or other authorised lenders up to a maximum leverage ratio of 1.5.

Credit AIFs that are established in other EU Member States can perform their activities in Italy only if they complete a non-objection procedure with the Bank of Italy.

Simplified Investment Companies

Simplified investment companies (*società di investimento semplici*) are internally managed SICAFs (on which see question 2.1 below) investing their capital in SMEs that are not listed on regulated markets in the form of seed, start-up or early-stage financing. They are subject to a simplified regulatory regime – *e.g.* in terms of minimum capital and organisational requirements – but can only have up to EUR 25 million of assets under management.

EU categories

The following additional categories of AIFs are contemplated under the Italian framework on the basis of the corresponding rules applicable at EU level:

- European Venture Capital Funds (EuVECA);
- European Social Entrepreneurship Funds (EuSEF); and
- European Long-Term Investment Funds ("**ELTIFs**").

Furthermore, special rules apply to AIFs employing leverage on a substantial basis in line with the AIFM framework. According to Article 111 of the AIFMD Delegated Regulation, leverage is employed on a substantial basis if the AIF's exposure calculated according to the commitment method exceeds three times its net asset value ("**NAV**").

Contractual *vs* corporate AIFs

Finally, a key distinction is made under Italian law between AIFs established in contractual (*fondi comuni di investimento*) and corporate (*società di investimento*) form – see question 2.1 for additional details.

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

In order to be authorised to operate as an Italian AIFM, the following conditions must be met:

- The company must be incorporated in the form of an Italian joint stock company (*società per azioni*) and the related name must include a reference to its qualification as "asset management company" (*società di gestione del risparmio*).
- The company must have its registered and administrative office in Italy.
- The company must have a minimum share capital equal to the amount determined by the Bank of Italy – which is currently equal to (i) EUR 50,000 for "sub-threshold" AIFMs (on which see below), (ii) EUR 500,000 for AIFMs managing only closed-ended Reserved AIFs, and (iii) EUR 1 million for all other AIFMs.
- The directors, statutory auditors and general manager(s) of the company must comply with certain fit and proper requirements (*i.e.* integrity, professional experience, independence, no interlocking directorates, *etc.*).
- The relevant shareholders of the company (*i.e.* any person holding 10% or more of its share capital or voting rights, or which may exercise a significant influence over its activity) must comply with certain requirements (*i.e.* integrity, correctness, professional competence, financial soundness, *etc.*).
- The group structure of the company must not hinder the exercise of supervisory powers by, and the transmission of the relevant information to, Italian supervisory authorities.
- The company must file with the Bank of Italy a programme of activity (*programma di attività*) and a report on its organisational structure (*relazione sulla struttura organizzativa*) – along with the other documents that are necessary for the authorisation request.

The additional criteria followed by the Bank of Italy for the purpose of the authorisation and the documents and information to be submitted in connection with the related filing are specified in the Bank of Italy Regulation.

Certain simplifications (*e.g.* in terms of minimum capital, internal organisation, documents/information to be filed, *etc.*) apply to "sub-threshold" AIFMs – *i.e.* those AIFMs managing

only Reserved AIFs whose assets under management do not exceed (i) EUR 500 million, if they manage closed-ended Reserved AIFs which do not employ leverage and whose investors are not allowed to ask for the redemption of their units or shares for a period of at least five years after the date of the initial investment, or (ii) EUR 100 million if they manage closed-ended Reserved AIFs employing leverage.

The authorisation to operate as an Italian AIFM is granted by the Bank of Italy upon consultation with CONSOB. The statutory term of the authorisation procedure is 90 calendar days. The term starts to run from the date when a complete application is filed with the Bank of Italy. The authorisation process is usually suspended by the Bank of Italy in order to ask for the transmission of additional documents or information. As a matter of fact, the overall procedure (excluding the pre-filing preparatory work) normally lasts between four and six months.

Please note that the authorisation procedure referred to above applies to the establishment of an Italian AIFM. The setting up of an AIF is not subject to authorisation requirements, unless in case of Non-Reserved AIFs or if the AIF is established in corporate form (see question 2.1 below).

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

An Italian AIFM must have its registered and administrative office in Italy. It must have its own substance in terms of internal organisation in accordance with the requirements set forth in the regulations issued by the Bank of Italy.

1.7 What service providers are required?

For each AIF it manages, the AIFM must at least appoint:

- a third-party custodian/depositary performing safekeeping and control duties in respect of the assets of the AIF;
- an external auditor; and
- in case of Real Estate AIFs, a third-party independent expert (*esperto indipendente*) performing valuation functions in relation to the real estate assets of the AIF.

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

Italian AIFs can also be managed by companies established in other EEA countries which are authorised to operate as AIFMs in accordance with the national laws of their jurisdiction of incorporation implementing the AIFMD.

EEA AIFMs can manage Italian AIFs by operating on a cross-border basis under the free provision of services, or through an Italian branch under the right of establishment, provided that a "regulator-to-regulator" notification procedure is completed in accordance with the AIFMD passporting rules.

Fund managers or advisers that are not established in the EEA are not allowed to establish or manage Italian AIFs – pending the entry into force of the AIFMD regime applying to third-country AIFMs.

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

The Bank of Italy and CONSOB entered into several information-sharing and other agreements with other regulatory authorities, which are publicly available on their websites.

2 Fund Structures

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

Italian AIFs can be established in the form of:

- contractual funds (*fondi comuni di investimento*); or
- investment companies (*società di investimento*).

Investment companies can be either open-ended (*società di investimento a capitale variabile* – "**SICAVs**") or closed-ended (*società di investimento a capitale fisso* – "**SICAFs**"). The establishment of an investment company requires a specific authorisation by the Bank of Italy.

Contractual funds have no legal personality. They are a separate pool of assets (*patrimonio separato*) pertaining to and managed by the AIFM, which is ring-fenced by operation of law from the assets of the AIFM (and those of the custodian/sub-custodians).

Investment companies are legal entities with their own legal personality established in the form of Italian joint stock companies. They can be either internally managed by their board of directors, or externally managed by an AIFM performing portfolio and risk management functions. Internally managed investment companies must be authorised to operate as AIFMs.

Both contractual funds and investment companies can establish internal compartments/sub-funds, which are ring-fenced from the other compartments/sub-funds of the same contractual fund or investment company.

The majority of Italian AIFs are established in the form of contractual funds.

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

The liability of each investor in the AIF is always limited to the amount of capital that is invested in the AIF. This principle applies regardless of the legal structure that is used to set up the AIF – *i.e.* in case of both contractual funds and investment companies.

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

Italian AIFMs must be established as joint stock companies.

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

Redemptions may be suspended only in the exceptional circumstances specifically indicated in the rules or articles of association of the open-ended AIF. The suspension may last for a maximum period of one month. The AIFM must inform the Bank of Italy and CONSOB of any such suspension promptly.

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

No specific restrictions apply to the transfer of investors' interests in AIFs. However, as a matter of practice, the rules or articles of association of Italian AIFs normally provide that any such transfer must be notified in advance to the relevant AIFM

in order for the AIFM to verify that the transferee is an eligible investor in accordance with the rules applicable to the AIF and to carry out all appropriate checks for the purpose of the applicable anti-money laundering and counter-terrorism financing requirements.

Additional restrictions (*e.g.* for tax purposes) or exemptions (*e.g.* for intra-group transfers) may be specified in the rules or articles of association of the AIF, which can also entrust the other investors with pre-emptive or other contractual rights in respect of any transfer of interests in the AIF.

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

Reserved AIFs are not subject to specific diversification requirements or leverage limits. They must nonetheless achieve a minimum diversification of their investments to optimise their investment portfolio. Specific rules on leverage and eligible investments apply to Credit AIFs – see question 1.4 above.

Non-Reserved AIFs are subject to certain diversification requirements and leverage limits, which differ depending on the nature of the assets in which the AIF invests, and whether the AIF is open-ended or closed-ended.

Italian AIFs are subject to the AIFMD rules on asset stripping and notification obligations in case of acquisition of relevant holdings in listed or non-listed companies.

3 Marketing

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

The rules concerning the marketing documentation of Italian AIFs are set forth in the Issuers' Regulation (on which see question 1.1 above).

AIFs that are marketed to retail investors are also subject to the transparency obligations set forth in Regulation (EU) No. 1286/2014 (the "**PRIIPs Regulation**").

Specific obligations requiring the drafting of a prospectus apply to ELTIFs in accordance with Regulation (EU) No. 2015/760 (the "**ELTIF Regulation**").

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

Italian AIFMs wishing to market AIFs in Italy or in any other EEA Member State must prepare an offering document (*documento di offerta*) drafted in accordance with Annex 1D of the Issuers' Regulation (the "**Offering Document**"). The contents of the Offering Document are those specified at EU level under Article 23 of the AIFMD.

In addition to the above:

- if the AIF is marketed to retail investors, the AIFM must draft a key information document ("**KID**") pursuant to the PRIIPs Regulation;
- if the AIF is marketed to retail investors and none of the exemptions from the relevant prospectus requirements apply, the AIFM must draft an offering prospectus (*prospetto d'offerta*); and
- if the AIF qualifies as an ELTIF, the AIFM must draft a prospectus in accordance with the ELTIF Regulation.

Besides the above requirements, in general terms any marketing communication or material that is used by an Italian AIFM must be clear, transparent and non-misleading. Additional requirements on marketing communications will be introduced as a result of Regulation (EU) No. 2019/1156 – which is part of the so-called "cross-border distribution package", also including Directive (EU) No. 2019/1160 (the "**Cross-Border Distribution Package**"), and will apply starting from 1 August 2021.

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

Unless in case of Non-Reserved AIFs or in the context of the setting up of an Italian investment company, the rules or articles of association of Italian AIFs are not subject to the prior approval of the Bank of Italy. They must nonetheless be filed with the Bank of Italy after they have been approved.

The Offering Document must be filed with CONSOB as part of the AIF marketing notification and is subject to review by CONSOB in the context of such procedure. The KID must also be deposited with CONSOB before the marketing activities are commenced.

Special rules on the approval of the rules or articles of association and the filing of the relevant prospectus apply in case of ELTIFs in accordance with the ELTIF Regulation.

3.4 What restrictions are there on marketing Alternative Investment Funds?

The marketing of AIFs is always subject to the prior transmission of a marketing notification in accordance with the AIFMD regime. In case of AIFs that are managed by an Italian AIFM, such marketing notification must be transmitted to CONSOB. In case of EEA AIFMs, the marketing notification must be transmitted to the competent authority of the home Member State of the AIFM.

AIFs that are established in other EEA countries can be marketed in Italy only to professional investors and other investors that are allowed to subscribe for or purchase units or shares of Reserved AIFs. Marketing to Italian retail investors investing less than EUR 500,000 in the AIF is subject the prior authorisation of CONSOB.

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

No concept of "pre-marketing" is recognised under Italian law. Any promotional or offering activity concerning an AIF is generally considered to amount to a marketing activity under Italian law, thereby triggering the related notification/authorisation requirements.

The Italian rules are, however, expected to be amended as a result of the entry into force of the Cross-Border Distribution Package, which permits pre-marketing activities except if the information presented to potential professional investors: (i) is sufficient to allow investors to commit to acquiring units or shares of a particular AIF; (ii) amounts to subscription forms or similar documents whether in a draft or a final form; or (iii) amounts to constitutional documents, a prospectus or offering document of a not-yet-established AIF in a final form. Additional restrictions and requirements are set out under the Directive (EU) No. 2019/1160, along with the definition of "pre-marketing". The Directive must be transposed into Italian law by 2 August 2021.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Non-Reserved AIFs can be marketed to retail investors.

Reserved AIFs can be marketed only to retail investors investing at least EUR 500,000 in the AIF (or directors or employees of the relevant AIFM). The marketing of EEA AIFs to retail investors that do not satisfy such condition is subject to the prior authorisation of CONSOB.

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

If the AIFMD marketing notification procedure has been completed, the AIF can be marketed to prospective investors that are eligible to invest in the fund.

The qualification of the investor as a professional or retail investor under the MiFID 2 is relevant in order to determine whether such investor may subscribe for or purchase the units or shares of the relevant AIF – *i.e.* depending on whether the AIF qualifies as Reserved AIF or Non-Reserved AIF.

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

There are no specific restrictions on marketing to public bodies – other than the specific rules defining the range of assets in which such public bodies may invest.

Except for the Italian government and the Bank of Italy – which always qualify as professional investors – public bodies may opt in to be treated as professional clients if: (i) their total revenues exceed EUR 40 million based on the latest management accounts; (ii) they entered into transactions on financial markets for a notional value of at least EUR 100 million in the last three years; and (iii) the personnel responsible for their financial management has adequate skills, experience and knowledge in the field of investment services, investment funds and financial instruments.

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

There are no specific restrictions on the participation in AIFs by particular types of investors. However, certain investors (*e.g.* pension funds, public foundations, insurance undertakings, banks, *etc.*) are subject to specific restrictions in terms of eligible investments and/or regulatory capital requirements applying as a result of the investment, which may limit their ability to invest in AIFs.

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

To the extent that such intermediaries are authorised or passported to carry out the relevant investment services (*e.g.* depending on the cases, placement of financial instruments, reception and transmission of orders, *etc.*) or can in any event distribute third-party AIFs in accordance with the EU regulatory framework, no restrictions should apply to the use of such intermediaries in the fundraising process.

4 Investments

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

See question 2.6 – Reserved AIFs are not subject to specific diversification requirements or leverage limits (except for Credit AIFs). Non-Reserved AIFs must comply with the investment restrictions set forth in the Bank of Italy Regulation.

Please note that Italian AIFMs can only manage the categories of AIFs falling within the scope of the licence granted to them – *e.g.* if the licence is limited to the management of Real Estate AIFs, the Italian AIFM cannot manage a Credit AIF, unless it applies for an extension of the scope of its licence.

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

Besides the eligible assets that are specifically contemplated under the applicable regulations (*e.g.* financial instruments, bank deposits, real estate properties, credits and debt securities, *etc.*), the general principle is that Italian AIFs may invest in all types of assets which are tradable on a market and whose value can be determined with certainty at least on a semi-annual basis.

In the light of the above principle, it is currently being debated whether Italian AIFs can be set up in order to invest in cryptocurrencies or digital assets (*e.g.* non-fungible tokens). The same debate arose in the past in relation to investments in paintings, wines or similar goods.

As to the applicable diversification requirements, see question 2.6 above.

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

Specific rules apply to investments made by Credit AIFs – on which see question 1.4 above.

Credit AIFs must comply with the Italian rules on transparency of banking and financial products and services and must report their credit exposures to the Italian Central Credit Register (*Centrale dei Rischi*).

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

No restrictions on leverage apply to Reserved AIFs – except for Credit AIFs, which can employ leverage up to a maximum ratio of 1.5.

The following limits apply in case of closed-ended Non-Reserved AIFs:

- Real Estate AIFs can employ leverage up to a maximum ratio of 2;
- Credit AIFs can borrow money up to 30% of their NAV; and
- other AIFs can borrow money up to 10% of their NAV.

Open-ended Non-Reserved AIFs may borrow money up to 10% of their NAV only for treasury management purposes.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

In case of contractual funds, the assets are legally held by the AIFM as a separate pool of assets (*patrimonio separato*) managed by the AIFM on behalf of the investors. The assets of investment companies are legally owned by such companies.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

The disclosure and transparency documentation which must be prepared for the marketing of AIFs and the requirements applying to marketing materials are described under question 3.2 above.

Italian AIFMs are subject to Regulation (EU) No. 2019/2009 on sustainable finance disclosure and must accordingly give specific indications on environmental, social and governance ("**ESG**") factors, among others, in the marketing materials referred to above.

Italian AIFMs are subject to reporting obligations *vis-à-vis* the Bank of Italy and CONSOB – including *ad hoc* reporting on specific transactions or events, or periodic reporting (*e.g.* on internal compliance matters). These reporting obligations include the AIFMD reporting due in accordance with Article 24 of the AIFMD as well as Article 110 and Annex IV of the AIFMD Delegated Regulation.

For each AIF they manage, Italian AIFMs must prepare annual and semi-annual reports.

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

No, there is no such requirement.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

See question 5.1 above.

5.4 Is the use of side letters restricted?

No, the use of side letters is not restricted. If the side letters provide for a preferential treatment, the related content must be reflected in the rules or articles of association of the AIF.

6 Taxation

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

The tax treatment of the principal forms of AIF is as follows:

- they are not subject to income tax; and
- in case of Italian SICAFs or SICAVs, they are subject to the Italian regional tax on productive activity (*IRAP*) only up to the difference between active and passive commissions.

Withholding tax is limited to certain capital gains.

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

No specific tax regime applies to Italian AIFMs as a matter of Italian law.

As a consequence, Italian AIFMs are subject to the general rules applying to other Italian companies in accordance with the Italian Tax Code (Presidential Decree No. 917 of 22 December 1986 – *TUIR*).

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

No, there are not.

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

The tax treatment of investors differs depending on (i) whether or not the AIF qualifies as a Real Estate AIF, and (ii) the place where the investor is resident, as per the below summary:

(a) **Resident investors holding interests in a non-Real Estate AIF**
The investment is subject to withholding tax on periodic income at a rate of 26%.

(b) **Resident investors holding interests in a Real Estate AIF**
Institutional investors/non-institutional investors with non-qualified investments: withholding tax on periodic income at a rate of 26%.
Non-institutional investors with qualifying holdings: the income received from the AIF contributes to the formation of the investor's income.

(c) **Non-resident investors holding interests in a non-Real Estate AIF**
Non-taxable regime for non-resident persons identified in Article 6 of Legislative Decree No. 239/1996 (*i.e.* persons that are resident in "white list" jurisdictions, international bodies or entities established under international agreements enforced in Italy; foreign institutional investors, even if not subject to taxation, set up in "white list" jurisdictions; central banks or other bodies that also manage foreign States' official reserves).
Withholding tax on periodic income at a rate of 26% for other non-resident investors.

(d) **Non-resident investors holding interests in a Real Estate AIF**
Same regime applying to resident investors holding interests in a Real Estate AIF in case of pension funds, funds established in "white list" jurisdictions, international bodies or entities established under international agreements enforced in Italy, central banks or bodies that also manage foreign States' official reserves.
Withholding tax on periodic income at a rate of 26% for other non-resident investors.

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

A tax ruling is not necessary, but it might be advisable in case of any uncertainties/specific queries concerning the tax treatment of certain investments made in the AIF.

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

The Italian Tax Authority must exchange information on a yearly basis with the tax authorities of other countries, in accordance with the Common Reporting Standard, based on the common rules concerning the automatic exchange of information on financial accounts, including AIFs.

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

Italy implemented the ATAD I and II with Legislative Decree No. 142 of 28 December 2018. Italy is among the countries that signed the MLI on 7 June 2017. However, as of 28 June 2021, the MLI has not yet been ratified.

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

Subject to certain conditions, Italian AIFs may be eligible for the regime applying to individual savings plans (*Piani Individuali di Risparmio*) ("**PIR**") – which allow the AIF's investors to benefit from an exemption from withholding taxes if they comply with certain requirements.

The Italian PIR regime applies to Italian individuals (other than in the context of any business/entrepreneurial activity performed by them) and pension funds or institutions.

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

No, there are not.

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

No, there are not.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

- ELTIFs have become an interesting product to be launched on the Italian market in order to collect capital from high-net-worth individuals or other retail clients – *e.g.* through private banking networks.
- Asset managers have structured several alternative products benefitting from the Italian tax regime applying to PIRs.
- A few SICAFs have been launched in the form of simplified investment companies in accordance with the rules recently introduced by the Italian government.
- The Italian rules on Credit AIFs have recently been amended in order to delete the minimum diversification requirement of 10%, which was also applicable to Reserved AIFs. Following these amendments, the non-objection procedure with the Bank of Italy in order for EU Credit AIFs to perform direct lending activities in the Italian territory has become more attractive for EU asset managers.
- The attention on ESG factors by Italian regulators and AIFMs has increased in the last few months, and asset managers are structuring products that are specifically focused on ESG-compliant investments.
- Credit AIFs have increasingly been used as a means to facilitate the disposal of non-performing loans by Italian banks.

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

- The Cross-Border Distribution Package will amend the rules applying to the marketing of AIFs in Italy and permit pre-marketing activities to be carried out towards Italian clients.
- The Italian government recently proposed to amend the conditions applying to retail investors that are allowed to subscribe for or purchase units or shares of Reserved AIFs. According to such proposal, the following categories of retail investors will be allowed to invest in Reserved AIFs – in addition to those already contemplated under the current rules (*i.e.* retail investors investing at least EUR 500,000 in the AIF, and the directors or employees of the relevant AIFM):
  - retail investors investing at least EUR 100,000 in the AIF, provided that (i) the investment does not exceed 10% of the value of the financial portfolio of such investor (including financial instruments, cash deposits and insurance-based investment products) that is available with the same intermediary or AIFM, and (ii) the investment is made in the context of a MiFID 2 investment advisory service; and
  - MiFID 2-licensed firms which subscribe for or purchase units or shares of the AIF in the context of portfolio management services on behalf of retail investors.

Angelo Messore regularly assists Italian and foreign financial institutions in relation to the regulation of banking, financial, insurance, investment and payment services. He has gained significant experience in the analysis and launching of business projects in the fintech space. Angelo assists clients in the setting up and marketing of alternative investment funds, especially those specialised in private debt, direct lending and non-performing loans. He has also worked on several M&A transactions and capital market deals, with a particular focus on financial institutions and fintech companies.
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LEXIA Avvocati is a leading Italian full-service firm, widely recognised in the Italian legal market for its remarkable expertise in the field of tech, fintech, crypto-assets and blockchain, green energy, financial institutions and venture capital.
The Firm has a specific expertise in the area of asset management and investment funds, and advises foreign and Italian asset managers and investors in the setting up and marketing of Italian AIFs. The Firm has been involved in the establishment of innovative fund structures, such as, for instance, Italian PIR-compliant ELTIFs, direct lending funds and funds specialised in the purchase and restructuring of non-performing loans. The Firm has also assisted several foreign asset managers in the non-objection procedure applicable to EU AIFs in order to engage in direct lending activities in Italy.

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Japan


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1 Regulatory Framework

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

The Financial Instruments and Exchange Act (Act No. 25 of 1948; the "FIEA") and the regulations promulgated thereunder primarily govern the marketing, investment management and disclosure of Alternative Investment Funds in Japan.

Alternative Investment Funds which are categorised as investment trusts or investment corporations are also subject to the Investment Trusts and Investment Corporations Act (Act No. 198 of 1951; the "ITICA") and the regulations promulgated thereunder as well as rules of the Investment Trusts Association, Japan ("ITA"), which is a self-regulatory body for investment managers of investment trusts and investment corporations.

A person engaging in the business of marketing interests in investment trusts or investment corporations is required to be licensed as a Type I Financial Instruments Business Operator ("Type I FIBO") and a person engaging in the business of marketing interests in a collective investment scheme such as a limited partnership ("CIS") is required to be licensed as a Type II Financial Instruments Business Operator ("Type II FIBO") in accordance with the FIEA by the Financial Services Agency of Japan ("FSA"), unless some relevant exemption applies.

A person engaging in the business of discretionary investment management of Alternative Investment Funds is required to be licensed as an investment manager ("Investment Manager") and a person engaging in the business of non-discretionary investment advisory to Alternative Investment Funds is required to be licensed as an investment adviser ("Investment Adviser") in accordance with the FIEA by the FSA, unless some relevant exemption applies.

If interests in Alternative Investment Funds are publicly offered in Japan, certain disclosure requirements including the filing of a securities registration statement, annual securities report and other relevant documents will be triggered under the FIEA.

Please note that if an Alternative Investment Fund is categorised as a CIS which directly (i.e. not indirectly through SPVs or REITs) invests in real estate, the Act on Specified Joint Real Estate Ventures (Act No. 77 of 1994; the "SJREVA") will be applicable instead of the FIEA. We have, however, omitted an explanation of Alternative Investment Funds which fall under this category in the interest of brevity.

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

As noted in question 1.1 above, a person engaging in the business of discretionary investment management, or non-discretionary investment advisory for Alternative Investment Funds is, in principle, under the FIEA, required to be licensed as an Investment Manager or an Investment Adviser respectively by the FSA. However, if both the Alternative Investment Funds and its managers or advisers are domiciled outside Japan, then such managers or advisers will be exempted from such licensing requirements.

It should be noted that if the Alternative Investment Fund is structured as a CIS which invests more than 50% of its assets in securities or derivative transactions, and if any Japanese investor invests in such a CIS, the sponsor (e.g. general partner) of the CIS is, in principle, required to be licensed as an Investment Manager by the FSA unless it delegates all of its investment authority to a locally licensed Investment Manager and meets certain requirements under the FIEA. There are, however, several exemptions to this general principle, which we set out below.

- The general partner will be exempted from the licensing requirement as an Investment Manager if:
  - (i) Japanese investors in the CIS consist of (a) one or more qualified institutional investors as defined under the FIEA ("QIIs"), and (b) not more than, if any, 49 eligible investors other than QIIs as set forth in the FIEA;
  - (ii) none of such QIIs and eligible investors other than QIIs are certain unqualified investors as set forth in the FIEA; and
  - (iii) the general partner has submitted a Form 20 under Article 63 of the FIEA to the relevant Local Finance Bureau prior to the commencement of the management of the assets of the CIS.
- The general partner will be exempted from the licensing requirement as an Investment Manager if:
  - (i) all of the direct investors (i.e., Japanese investors who directly hold interests in the CIS) are either (a) QIIs, or (b) those who satisfy the requirements under Article 63 exemption as summarised above;
  - (ii) if there are indirect investors (i.e., Japanese investors which indirectly invest in the CIS through a Japanese CIS which directly invest in the said CIS) in the CIS, such indirect investors must be QIIs;
  - (iii) the number of Japanese investors in the CIS (including indirect investors) is not more than nine; and
  - (iv) the aggregate amount of investment in the CIS by direct investors is not more than ⅓ of the aggregate amount of all investors' investment in the CIS.

QIIs include: banks; insurance companies; financial instruments business operators registered as Type I financial instruments businesses or discretionary investment management businesses; investment corporations and foreign investment corporations stipulated under the ITICA; the Government Pension Investment Fund; and investment limited partnerships stipulated under the Limited Partnership Act for Investment (Act No. 90 of 1998; the "Limited Partnership Act"). Whether a prospective investor is a QII can be ascertained by looking up the names of the QIIs that are enlisted on the FSA's website.

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

Alternative Investment Funds themselves are not required to be licensed or authorised by a regulatory body. However, in the case of public offering, filing of a securities registration statement is required. Further, if the Alternative Investment Fund is an investment trust or an investment corporation, a notification of an investment trust or investment corporation will be required. For details, please refer to question 3.4.

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

The regulatory regime does not distinguish between open-ended and closed-ended Alternative Investment Funds; provided that in the case of public offering, different rules established by the Japan Securities Dealers Association ("JSDA") (which is one of the self-regulatory bodies in Japan) will apply.

Also, the regulatory regime does not distinguish strategies of Alternative Investment Funds except for CIS's direct real estate investment as noted in question 1.1 above.

The regulatory regime differs depending on the legal structure of the Alternative Investment Funds (i.e. Investment Trusts, Investment Corporations or CIS).

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

Before submitting a formal application for the grant of a licence of an Investment Manager and/or an Investment Adviser, an applicant would be expected to first conduct informal discussions with the relevant Local Finance Bureau concerning the draft application. The duration of this discussion stage will depend on the scope and organisational structure of the applicant's business and the extent to which the relevant application documents have been prepared (including the extent to which the relevant information has been gathered). Once the relevant Local Finance Bureau and the FSA are satisfied with the draft application, a formal application can be submitted. Thereafter, the FSA may seek clarifications or supplements to the formal application. Only after there are no more questions or requests from the regulator will the application be accepted.

The time required for procuring a licence of an Investment Manager and/or an Investment Adviser under the FIEA varies on a case-by-case basis. In general, the process time required for procuring a licence of an Investment Adviser is less than that for the licence of an Investment Manager. In principle, the licence of an Investment Advisor or an Investment Manager, as the case may be, will be issued within two months from the date of filing the formal application.

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

The table below summarises the requirements for a licence of an Investment Manager and an Investment Adviser under the FIEA.

Requirements	Investment Manager	Investment Adviser
Local presence in Japan	Required	Not required
Local representative in Japan	Required (if it is a foreign company)	Not required
Minimum stated capital and net assets requirements	Minimum stated capital: JPY 50 million Minimum net assets: JPY 50 million	None
Organisational requirements	The applicant must be a stock company (*Kabushiki Kaisha*) with a board of directors and a corporate auditor or such committees as prescribed in the Companies Act of Japan (Act No. 86 of 2005; "Companies Act"), or an equivalent foreign company	None
Staff requirements	Key requirements are as follows: ■ Those managing assets of investors must have sufficient knowledge and experience with respect to assets under management ■ There must be separate personnel employed with sufficient knowledge and experience to be in charge of compliance and regulatory matters which is independent of the investment management division	Key requirements are as follows: ■ Those providing investment advice based on an analysis of the value, etc. of securities and other financial instruments must have sufficient knowledge and experience to provide such advice ■ There must be separate personnel employed with sufficient knowledge and experience to be in charge of compliance and regulatory matters

1.7 What service providers are required?

If the Alternative Investment Funds are structured as investment trusts under the ITICA ("Japanese Investment Trusts") or investment corporations under the ITICA ("Japanese Investment Corporations"), then the authority to manage investments must be delegated to a locally licensed Investment Manager pursuant to the ITICA. Further, if the Alternative Investment Funds are structured as Japanese Investment Corporations, they are also

required to appoint a custodian and an administrator. There are no such requirements for foreign investment trusts, foreign investment corporations or CIS under Japanese laws.

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

If foreign managers or advisers are licensed as Investment Managers or Investment Advisers under the FIEA, they must comply with certain codes of conduct for protection of investors under the FIEA. If foreign managers or advisers are not licensed as Investment Managers or Investment Advisers under the FIEA, no such regulations apply. For details, please refer to question 4.1.

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

The Asia Region Fund Passport ("ARFP") formally launched on 1 February 2019 is an international initiative enabling cross-border offerings of eligible investment funds to retail investors, with investor protection in economies participating in the ARFP. Initial participating economies are Australia, Japan, the Republic of Korea, New Zealand, and Thailand.

Under the ARFP, a fund may be "exported" to another participating economy if that fund complies with the regulations of the home economy in which the fund is registered, applicable regulations relating to the offer in the host economy and the ARFP passport rules.

2 Fund Structures

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

The principal legal structure used for Alternative Investment Funds is Japanese Investment Trusts formed under the ITICA. Japanese Investment Trusts are formed by entering into a trust agreement between an Investment Manager and a trustee whereby investors will acquire divided beneficiary interests from such trusts.

Whereas, Japanese real estate trusts ("J-REITs") are structured as Japanese Investment Corporations under the ITICA.

Alternative Investment Funds structured as foreign investment trusts or foreign investment corporations are also offered to Japanese investors.

CIS – more specifically, Japanese and foreign limited partnerships – are commonly used for private equity funds. Typically, a Japanese limited partnership (*toshi jigyo yugen sekinin kumiai*) is formed pursuant to the Limited Partnership Act ("Japanese Limited Partnership"). A Japanese Limited Partnership must consist of at least two partners: a general partner as a sponsor of the partnership; and a limited partner as an investor in the partnership.

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

The liability of investors who hold interests in Japanese Investment Trusts, Japanese Investment Corporations and Japanese Limited Partnerships is limited to the amount of money invested by such investors.

It is possible for a Japanese Limited Partnership to operate on a capital call model where a limited partner owes obligations to make capital contributions up to the amount of its capital commitment in the limited partnership agreement.

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

As noted in question 1.6 above, it is a legal requirement for an Investment Manager to be a stock company (*Kabushiki Kaisha*) with a board of directors and a corporate auditor or such committees as prescribed in the Companies Act or an equivalent foreign company with a branch office in Japan.

There is no legal organisational requirement for an Investment Adviser; however, it is common for an Investment Adviser to be structured as a stock company (*Kabushiki Kaisha*) or a foreign company with a branch office in Japan.

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

There are no legal limitations on the manger's ability to restrict redemptions unless the constitutional documents of the Alternative Investment Funds restrict redemptions; provided that a limited partner of a Japanese Limited Partnership may withdraw if there are unavoidable grounds regardless of the restrictions under the limited partnership agreement.

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

There are no legislative restrictions on transfer of investors' interests in Alternative Investment Funds unless the constitutional documents of the Alternative Investment Funds restrict such transfers.

As noted in question 3.3 below, if Alternative Investment Funds are marketed to Japanese investors by way of a private placement, certain transfer restrictions must be imposed. Further, as noted in question 1.1 above, if the sponsor (e.g. general partner) of the CIS relies on certain exemptions from the licensing requirement, the transfers that result in not meeting the exemption requirements cannot be carried out.

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

Please refer to section 4 below.

3 Marketing

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

In Japan, the FIEA and the regulations promulgated thereunder primarily govern the production and offering of marketing materials of Alternative Investment Funds.

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

If interests in an Alternative Investment Fund are to be publicly offered, an offering memorandum (which should include but not

be limited to, the investment objectives, the investment policy, the investment restrictions, the investment risks, all of the costs borne by investors and an outline of the investment management company) is, in principle, required to be delivered to investors.

In the case of private placement, an offering memorandum or any other marketing material is not legally required to be delivered to investors. However, it is common practice in Japan to provide investors with a private placement memorandum including description on transfer restrictions applicable to interests in an Alternative Investment Fund voluntarily. A private placement refers to an offering: (i) with respect to interests of investment trusts or investment corporations only to (a) an unlimited number of QIIs', and (b) less than 50 persons (excluding QIIs) subject (in both instances) to certain conditions including restrictions on transferability of interests of the fund; and (ii) with respect to interests of a CIS, resulting in less than 500 persons (including QIIs) subscribing to such interests.

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

If interests in an Alternative Investment Fund are publicly offered, a securities registration statement including more detailed information in relation to the Alternative Investment Fund than those required to be described in an offering memorandum needs to be filed with the FSA prior to commencement of marketing of interests in the Alternative Investment Fund pursuant to the FIEA.

If marketing of interests in an Alternative Investment Fund is made by way of a private placement, no registration with the FSA is required under the FIEA (please note, however, that in the case of investment trust or investment corporation, filing of a notification under the ITICA is required as mentioned below).

In addition, if the Alternative Investment Fund is categorised as an investment trust, regardless of the type of marketing (i.e., even in the case of private placement), a notification of investment trust needs to be filed with the regulator prior to its establishment (in the case of those established under Japanese law) or commencement of solicitations of its units (in the case of those established under foreign law) pursuant to the ITICA. If the Alternative Investment Fund is categorised as an investment corporation, regardless of type of solicitation (i.e., even in the case of private placement), a notification of investment corporation needs to be filed with the regulator prior to its establishment (in the case of those established under Japanese law) or commencement of solicitations of its shares (in the case of those established under foreign law) pursuant to the ITICA.

3.4 What restrictions are there on marketing Alternative Investment Funds?

An Investment Manager and a business operator who filed a Form 20 with the regulator pursuant to Article 63 of the FIEA ("Article 63 business operator") (i.e., a general partner of a CIS) are, when marketing Alternative Investment Funds, subject to certain codes of conduct for protection of investors, such as refraining from the delivery of false information to investors and refraining from compensating investors for their losses. If interests in Alternative Investment Funds are marketed to investors who are not categorised as Professional Investors (*tokutei toushika*) as defined in the FIEA, more stringent codes of conduct for protection of investors, such as delivery of statutory documents and advertisement regulations, apply to such marketing activities. Professional Investors include QIIs, listed companies, stock companies whose stated capital is expected to amount to 500 million yen or more, financial instruments business operators (other than those who are categorised as QIIs) and foreign entities.

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

Under Japanese law, there is no concept of pre-marketing or equivalent conduct in the context of marketing of interests in Alternative Investment Funds. Pre-marketing activities are not regulated unless such activities amount to solicitation of interests in Alternative Investment Funds.

Please note that the FIEA has no clear definition of "solicitation", and it is a matter of factual observation made by considering all circumstances to determine whether an activity falls within the purview of the term "solicitation". However, generally speaking, providing information about a specific fund would amount to an act of "solicitation". According to the policies of the FSA, the concept of "solicitation" is construed very broadly.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Alternative Investment Funds can be marketed to retail investors. However, if such marketing is implemented by way of a private placement, the number of investors (excluding QIIs) solicited to invest in Alternative Investment Funds must be less than 50 (in the case of interests of investment trusts or investment corporations) or the number of investors (including QIIs) investing in Alternative Investment Funds must be less than 500 (in the case of interests in CISs), as mentioned in question 3.3 above.

It should be noted, however, that if the sponsor (e.g. general partner) of a CIS relies on certain exemptions from the licensing requirement, the type and number of investors may be restricted to meet the requirements of such exemptions as noted in question 1.1 above.

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

Where interests in Alternative Investment Funds are marketed by way of a private placement only to QIIs, it must be ensured that the prospective investor is categorised as a QII.

It should be noted, however, that if the sponsor (e.g. general partner) of a CIS relies on certain exemptions from the licensing requirement, the type and number of investors may be restricted to meet the requirements of such exemptions as noted in question 1.1 above.

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

There are no additional restrictions.

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

There are no restrictions on participation in Alternative Investment Funds.

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

There are no restrictions on the use of intermediaries. However, in principle, intermediaries may not engage in solicitation of investments in interests in Alternative Investment Funds without registering themselves as a Type I or Type II FIBO depending on the type of interests. Specifically, intermediaries that engage in solicitation of investments in interests of investment trusts or investment corporations are, in principle, required to be registered as a Type I FIBO. On the other hand, intermediaries that engage in solicitation of investments in interests of CISs are, in principle, required to be registered as a Type II FIBO.

4 Investments

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

An Investment Manager and an Article 63 business operator (i.e., a general partner of a CIS) are subject to certain codes of conduct for protection of interests of investors when carrying on its discretionary investment management business for Alternative Investment Funds. In this regard, they are generally prohibited from managing assets of an Alternative Investment Fund for the purpose of conducting a transaction involving such assets and themselves, or their officers, or other assets managed by them for avoidance of conflict of interest.

In addition, the ITA provides for the rules that are applicable to Japanese Investment Trusts and Japanese Investment Corporations whose interests are publicly offered. These rules restrict certain activities such as short selling of bonds whose aggregate market value exceeds the amount of net asset value of the Japanese Investment Trust or the Japanese Investment Corporation.

The ITA's rules above do not apply to investment trusts and investment corporations established in foreign jurisdictions. However, JSDA provides for rules that would apply to investment trusts and investment corporations established in foreign jurisdictions whose interests are publicly offered in Japan. These rules would restrict certain activities such as short selling of securities whose aggregate market value exceeds the amount of net asset value of the investment trust or the investment corporation.

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

Japanese Investment Trusts and Japanese Investment Corporations are obliged to invest more than 50% of their assets in "specified assets". Such "specified assets" include, but are not limited to, securities, rights pertaining to derivative transactions, real properties, rights of lease of real properties, superficies rights, promissory notes, monetary claims, and commodities.

Japanese Investment Trusts and Japanese Investment Corporations are prohibited by the ITICA from acquiring a certain percentage of shares of an entity. Investment trusts and investment corporations established in foreign jurisdictions whose interests are publicly offered in Japan are also subject to a similar limitation imposed by JSDA.

In addition, ITA's rules provide certain limitations on investment objectives that Japanese Investment Trusts and Japanese Investment Corporations may acquire. These rules do not apply to investment trusts and investment corporations established in foreign jurisdictions.

CISs are not subject to any limitations on the types of investments; provided that where an Alternative Investment Fund is structured as a Japanese Limited Partnership, 50% or more of its contributed money may not be invested in foreign shares, etc.

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

If Alternative Investment Funds directly invest in real estate or commodities (not through any fund), the following regulatory requirements apply depending on the legal structure of the Alternative Investment Fund (i.e., whether it is an investment trust, an investment corporation or CIS).

A locally licensed Investment Manager who intends to invest assets of a Japanese Investment Trust or a Japanese Investment Corporation in real estate must obtain an approval from the FSA pursuant to the FIEA. The Investment Manager also needs to be licensed as a real estate brokerage business as well as obtain an approval from the Ministry of Land, Infrastructure, Transport and Tourism pursuant to the Real Estate Brokerage Act (Act No. 176 of 1952) to conduct transactions in real estate on behalf of the Japanese Investment Trust or the Japanese Investment Corporation.

A general partner who intends to invest assets of a CIS in real estate is, in principle, required to be licensed as a specified joint real estate venture (*hudousan tokutei kyoudou jigyou*) pursuant to the SJREVA. A general partner locally licensed as an Investment Manager also needs to file a certain notification with the relevant Local Finance Bureau pursuant to the FIEA.

A locally licensed Investment Manager who intends to invest assets of a Japanese Investment Trust or a Japanese Investment Corporation in commodities or commodities derivatives must obtain an approval from the FSA pursuant to the FIEA.

A general partner who intends to invest assets of a CIS in commodities or commodities derivatives must delegate its authority to make investment decisions to a locally licensed commodities investment manager pursuant to the Act on Regulation of Business Pertaining to Commodity Investment (Act No. 66 of 1991). A general partner locally licensed as an Investment Manager also needs to file a certain notification with the relevant Local Finance Bureau pursuant to the FIEA.

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

Pursuant to ITA's rules, Japanese Investment Trusts and Japanese Investment Corporations may, in principle, borrow money only for the purposes of (i) payment of cancellation money, (ii) distributions for certain investment trusts, or (iii) financing for handling of any accident (excluding borrowings where the investment trust or the investment corporation bear interest on such borrowings).

In addition, JSDA provides for rules applicable to investment trusts established in foreign jurisdictions which are publicly offered in Japan (excluding investment trusts investing in real estate trust beneficiary rights), under which the amount of its borrowing cannot exceed 10% of the net assets value of the investment trust; provided, however, that this restriction does not apply if such amount temporarily exceeds 10% for a reason such as a merger.

CISs are not subject to any restrictions on borrowing unless the constitutional documents of the CIS restrict borrowing.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

There are no restrictions on who holds the Alternative Investment Fund's assets.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

If interests in an Alternative Investment Fund are publicly offered, a securities registration statement which contains, (including but not limited to), the investment objectives, the investment policy, the investment restrictions, the investment risks, all of the costs borne by investors and an outline of the investment management company, needs to be filed with the FSA before commencement of such public offering, which is also publicly disclosed through the "Electronic Disclosure for Investors' NETwork" (so-called, "EDINET"). The Alternative Investment Funds which have filed the securities registration statement must file an annual securities report and semi-annual securities report periodically, which are also publicly disclosed on the EDINET.

In addition, an Investment Manager and an Article 63 business operator (i.e., a sponsor (e.g. general partner) of a CIS) needs to annually prepare an explanatory document describing certain information about its businesses and publicly disclose it at their business offices or through their website.

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

An Article 63 business operator (i.e., a sponsor (e.g. general partner) of a CIS) needs to specify the names of prospective QIIs (to whom the Article 63 business operator will market interests in the CIS) in a notification of Article 63 business (Form 20) which is required to be filed with the relevant Local Finance Bureau prior to commencement of the Article 63 business. An Article 63 business operator also needs to provide the names of QIIs (who have actually invested in the CIS) and the amount of contributions by such QIIs in an annual business report to be filed with the regulator.

An Investment Manager and an Article 63 business operator are required to describe the names of their shareholders in an annual business report to be filed with the regulator.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

An Investment Manager and an Article 63 business operator (i.e., a sponsor (e.g. general partner) of a CIS) are, in principle, required to provide investors with a management report describing certain matters such as status of assets of the Alternative Investment Fund periodically pursuant to the FIEA or the ITICA depending on the types of Alternative Investment Funds.

Also they need to file an annual business report in relation to their business with the regulator after the end of each fiscal year.

5.4 Is the use of side letters restricted?

The use of side letters is not restricted. However, as a financial instruments business operator registered as an Investment Manager and an Article 63 business operator (i.e., a sponsor (e.g. general partner) of a CIS) are in principle prohibited from compensating customers for their losses or making a promise to do so, they would not be permitted to execute a side letter for the purposes of providing such compensation. In addition, an Investment Manager and an Article 63 business operator are subject to a duty of loyalty to its investors, and all the investors of the same Alternative Investment Fund are required to be treated fairly and equally.

6 Taxation

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

An investment corporation is subject to corporate tax. While calculating corporate tax on an investment corporation, dividends to investors can be treated as deductible expenses, if the conduit requirements are satisfied (so-called "pay-through taxation"). Conduit requirements are, among other things, that the amount of payment such as the amount of dividends for the fiscal year exceeds the amount equivalent to 90/100 of the amount of distributable profits.

With regard to investment trusts, there are two types of taxations. First, with respect to collective investment trusts, i.e., securities investment trusts, domestic public offering investment trusts and foreign investment trusts, the trust will not be required to pay Japanese corporate tax but the beneficiaries are taxed when they actually receive the income from such trusts. On the other hand, for investment trusts other than collective investment trusts, the income arising from the property of the trust is subject to corporate tax and the trustee of the trust is the taxpayer.

Vehicles to be used for collective investment schemes (other than investment corporations and investment trusts) include partnerships formed under the Civil Code of Japan (Act No. 89 of 1896) ("NKs"), limited liability partnerships formed under the Limited Liability Partnership Act (Act No. 40 of 2005) ("LLPs"), Japanese Investment Limited Partnerships ("LPSs"), those similar to these in foreign countries (together with NKs, LLPs and LPSs, referred to as "NKs etc.") and silent partnerships ("TKs"). With regard to NKs etc., these entities are fiscally transparent and therefore their assets/debts and profits/losses are treated as being attributed to the members. The subject of direct tax liability is not NKs etc. themselves, but the members of them (so-called pass-through taxation). On the other hand, in the case of TKs, the contribution belongs to their business operator, and not the silent partners. Hence, the TKs themselves are not subject to be taxed, but the business operators are. When calculating the taxable income of the business operator, the amount of losses or profits distributed to its silent partners are treated as gross revenue or deductible expenses, respectively.

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

Investment managers/advisers are usually formed as a stock company or a branch of foreign company. Their fees derived from managing/advising are subject to corporate tax. In the case of an investment trust which is subject to corporate tax, the trustee is obliged to pay corporate tax levied on the trust property. As for TK, the business operator is also subject to corporate tax on income derived from the TK's business.

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

In general, there is no establishment tax or transfer tax levied in connection with an investor's participation.

On the other hand, in the case of transfer of interest in investment corporations and investment trusts, capital gains derived from such transfers are generally subject to corporate or income tax.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

(1) Investment corporations

(a) Resident investors

- Closed-ended investment corporations
  Dividends of closed-ended investment corporations, i.e. not assuming a refund, are subject to withholding tax at the rate of 20.42% and to comprehensive taxation for resident individuals in general.
  If the equity of an investment corporation is listed, dividends are subject to 15.315% withholding tax (plus 5% of local tax levied in the case of resident individual investors) and it is not necessary to file a tax return.
- Open-ended investment corporations
  Dividends of open-ended investment corporations, i.e. assuming a refund, are taxed generally same as dividends of unlisted equity of close-ended investment corporations.
  As for dividends from specified investment corporations, i.e. a domestic public offering investment corporation that assumes a refund in terms of conditions that meets certain requirements, are generally subject to withholding tax at the rate of 15.315% (plus 5% of local tax levied in the case of resident individual investors) when such dividends are paid to resident investors. If the tax is withheld at source, resident investors may select not to file a tax return or file a tax return under comprehensive taxation or separate self-assessment taxation.

(b) Non-resident investors
Concerning non-resident individuals or foreign corporations, who do not have a PE in Japan, dividends are subject to 20.42% withholding tax and it is not necessary to file a tax return.
Dividends of specified investment corporations are subject to 15.315% (plus 5% of local tax levied in the case of non-resident individual investors) withholding tax and it is not necessary to file a tax return.

(c) Pension fund investors and other common types of investors
Dividends received by a pension fund investor are not subject to tax, as long as the pension fund investor constitutes a public corporation or a public interest corporation as defined in the Corporation Tax Act (Act No. 34 of 1965; "Corporation Tax Act"). The majority of financial institutions and stock companies do not fall within the category of these corporations and are taxed according to (a) or (b) above depending on their residence.

(2) Investment trusts

(a) Resident investors
Income withholding tax at the rate of 15.315% and local withholding tax at the rate of 5% will be imposed on profit distributions (to be treated as interest income) from investment funds that only invest in public and corporate bonds (Bond-Related investment funds).
Income withholding tax at the rate of 15.315% and local withholding tax at the rate of 5% will be imposed on profit distributions (to be treated as dividend income) from investment funds that are Securities-Related investment funds other than Bond-Related investment funds (Equity-Related investment funds), where such investment funds publicly offer their shares or units in Japan.
Profit distributions from other investment funds, with some exceptions, will be subject to income withholding tax at the rate of 20.42% (but no local withholding tax).

(b) Non-resident investors
Income tax will only be imposed on non-resident investors with regard to income classified as domestic source income.

(c) Pension fund investors and other common types of investors
Profit distributions are not subject to tax, as long as the pension fund investor constitutes a public corporation or a public interest corporation as defined in the Corporation Tax Act. The majority of financial institutions and stock companies do not fall within the category of these corporations and are taxed according to (a) or (b) above depending on their residence.

(3) NKs etc.

(a) Resident investors
For resident members of NKs etc., as stated in question 6.1, these entities are fiscally transparent and therefore its members are subject to the direct tax liability (so-called pass-through taxation).
Distribution of profit from TKs is subject to 20.42% withholding tax. In addition, as to individual investors, the distribution will be subject to income tax under comprehensive taxation. As to corporate investors, the distribution will be subject to corporate tax. The withholding tax amount paid can be deducted in calculating the tax amount of both.

(b) Non-resident investors
Distributions of profits from the businesses through PE based on contracts of NKs, etc. are generally subject to withholding tax at the rate of 20.42%.
In the case of TKs, those who do not have a PE are subject to withholding tax at the rate of 20.42%, and it is not necessary to file a tax return.

(c) Pension fund investors and other common types of investors
Profit distributions are not subject to tax, as long as the pension fund investor constitutes a public corporation or a public interest corporation as defined in the Corporation

Tax Act. The majority of financial institutions and stock companies do not fall within the category of these corporations and are taxed according to (a) or (b) above depending on their residence.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

It is possible to apply for a tax ruling in Japan, but the Japanese tax authorities are not obliged to issue a tax ruling.

In the case of partnerships, it may be worthwhile to consult in advance if it is identified as a TK or an NK to make sure whether pass-through taxation is available.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

With respect to FATCA, a statement has been issued in 2013 that the government of Japan and the United States will cooperate with each other to implement FATCA in Japan. Based on this, the Japanese authorities have asked domestic financial institutions to register with the IRS and provide information on the targeted accounts to the IRS.

With respect to CRS, based on the Act on Special Provisions of Income Tax Act, Corporation Tax Act, and Local Tax Act Incidental to Enforcement of Tax Treaties (Act No. 46 of 1969), the system for financial institutions based in Japan to report the information of non-resident's accounts to the head of the corresponding tax office has been introduced.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

In cases where a Japanese corporation holding 25% or more of the issued shares in a foreign company receives dividends from the company, 95% of the dividends are excluded from treatment as the corporation's gross revenue. However, the relevant rules concerning this treatment were revised, based on recommendations from Action 2, in the 2015 tax reform. Commencing from the fiscal year beginning 1 April 2016, dividends from a foreign company which are included as deductible expenses in that country (in whole or in part) are now, in principle, treated as the corporation's gross revenue under the Corporation Tax Act.

In relation to Action 6, Japan has been introducing Principal Purpose Test (PPT), Limitation on Benefit clauses and Anti-conduit rules in tax treaties. By these, unfairly obtained treaty benefits are avoided. Also, on the protocol attached to the tax treaty executed with the United States, it has been stated that income arising from TKs can be taxed in accordance with domestic law in both countries in order to prevent tax avoidance.

In accordance with Action 7, the scope of PE under Japanese tax law has been revised in order to prevent artificial avoidance of PE status.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

There are no special tax-advantaged asset classes or structures available in Japan.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

There are no other material tax issues.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No, we do not anticipate any meaningful tax changes in the coming 12 months.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

In 2020, market trends in Alternative Investment Funds changed due to the impact of COVID-19 on market environments. At the beginning of 2020, "balanced funds" that invest in diversified asset classes, such as equities and bonds, in a well-balanced manner, attracted investors from 2019. However, most balanced funds fell as risk assets in general suffered sharp declines because of fears about the spread of COVID-19. This trend might continue to suppress investors' appetite for balanced funds. As a result, global equity investment funds attracted investors as the US equities market turned over and maintained an upward trend toward the end of 2020, mainly led by a rally around hi-tech stocks.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

On 23 December 2020, the "Working Group on Capital Market Regulations" of the Financial System Council of the FSA published its first report ("Capital Market Report"). Based on the recommendations of the Capital Market Report, a bill was submitted to the Diet, which contains two proposals aimed at improving the business environment for foreign financial institutions ("Bill"). One of the proposals would ease the licence requirements for foreign investment managers.

As a general rule, any entity engaging in an investment management business in Japan must be registered as an investment manager under the FIEA. The Bill creates two exemptions to this general rule:

- Under the "Foreign-Licensed Investment Manager Temporary Exemption", a foreign-licensed investment manager will be permitted to establish its office and engage in an investment management business in Japan for up to five years by submitting a notification to the regulator without the registration. The foreign-licensed investment manager must comply with certain requirements to rely on this exemption, including limiting its clients to "foreign investors" (as defined in the Bill and the Cabinet Order to be amended) and investing more than 50% of its clients' assets in "foreign securities", the scope of which will be determined by the Cabinet Order that will be amended. This exemption is designed for foreign-licensed investment managers that wish to expand their business into Japan, so they are normally expected to build a track record in Japan in the initial five-year period and then complete the investment management registration under the FIEA.

- Under the "Foreign Fund Manager Exemption", which is similar to the current Article 63 exemption, an entity (domestic or foreign) will be permitted to: (i) manage its clients' money by forming a collective investment scheme (typically, a limited partnership-type investment fund) and investing such money in securities and derivatives; and (ii) offer the collective investment scheme interests to investors after submitting a notification to the regulator. The entity must comply with certain requirements to rely on this exemption, including limiting its clients to "foreign investors" (as defined in the Bill and the Cabinet Order and the Cabinet Office Ordinance that will be amended; also including certain domestic investors such as qualified institutional investors) and ensuring that more than 50% of the money invested in the collective investment schemes is sourced from non-residents of Japan.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Two categories of legislation that are relevant for Luxembourg-based alternative investment funds ("**AIFs**") should be distinguished. The first category covers the managers of AIFs, and consists principally in the law dated 12 July 2013 ("**AIFM Law**") which transposes the alternative investment fund managers directive 2011/61/EU ("**AIFMD**") into Luxembourg law.

The second category relates to the AIFs themselves, and due to the fact that Luxembourg AIFs existed a long time before the AIFMD was conceived, there are several laws covering specific types of AIFs:

- AIFs established pursuant to part II ("**Part II Fund**") of the law dated 17 December 2010 on undertakings for collective investment ("**Law of 2010**");
- specialised investment funds ("**SIFs**") pursuant to the law dated 13 February 2007 ("**SIF Law**");
- investment companies in risk capital ("**SICARs**") subject to the law of 15 June 2004 ("**SICAR Law**");
- reserved alternative investment funds ("**RAIFs**") pursuant to the law of 23 July 2016 ("**RAIF Law**"); and
- AIFs that are not established under any specific investment funds law and therefore only subject to the law of 10 August 1915 on commercial companies ("**Law of 1915**").

In addition, the establishment and operation of AIFs is governed by a significant number of supranational rules (such as EU regulations) and guidelines (such as ESMA guidelines), but also local administrative regulations such as circulars issued by the Luxembourg regulator, the *Commission de Surveillance du Secteur Financier* ("**CSSF**").

While, in principle, any AIF established in Luxembourg must be managed by an alternative investment funds manager ("**AIFM**") and is therefore at least indirectly impacted by the AIFM Law, there exist investment funds that invest into alternative asset classes but are not considered as an AIF as they benefit from an exemption set out in the AIFMD (e.g. funds with a single investor). Such funds are only subject to one of the above-mentioned product laws.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Any Luxembourg AIF must appoint an AIFM, and this rule applies to all AIFs that qualify as such pursuant to the AIFM Law, irrespective of which of the different laws set out under question 1.1 they are subject to. In principle, AIFMs have to comply with all rules of the AIFM Law, and must be licensed and supervised by a regulatory body. Such an AIFM does not have to be located in Luxembourg: the passport regime introduced by the AIFMD also allows an AIFM to be appointed to a Luxembourg AIF which is located in another EU Member State.

The AIFM Law, however, allows for an exemption in case of Luxembourg domiciled AIFMs with smaller assets under management. These are only subject to a simple registration with the CSSF and a duty to report the size of their assets under management. Such exemption for these so-called registered AIFMs is available if they manage AIFs with less than EUR 100 million (if using leverage) or less than EUR 500 million (AIFs that are closed-ended for at least five years and do not use leverage). This exemption is not available for RAIFs, which must always be managed by a fully licensed AIFM.

Entities that provide only investment advice to a Luxembourg AIF (as opposed to taking the investment decisions) and which are located in Luxembourg are subject to the law dated 5 April 1993 on the financial sector. In principle, they must apply for a licence to provide such services and are supervised by the CSSF. However, exemptions exist for entities that only provide services to a limited number of AIFs. Advisors that are not located in Luxembourg and do not provide services in Luxembourg are not subject to these requirements, and none of the specific investment fund laws requires such entities to be under regulatory supervision.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Part II Funds, SIFs and SICARs must be authorised by the CSSF before they start operating. RAIFs and AIFs that are established pursuant to the Law of 1915 are not subject to any prior authorisation and are not directly supervised by the CSSF.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

All Luxembourg AIFs can be structured as an open-ended or closed-ended fund.

There are currently no rules relating to specific asset classes, and Luxembourg AIFs can therefore invest into any type of assets and pursue any type of strategy: plain vanilla stocks and bonds; private equity; venture capital; real estate; infrastructure; hedge; or the fast-growing segment of private debt including loan origination and syndication. Within one umbrella structure, several of these strategies can even be pursued within different dedicated and segregated compartments (see below question 2.1).

The only exception to such rule is the SICAR. It is limited to investments in risk capital as such term is defined in CSSF Circular 06/241, and is mainly used in the venture capital space.

At the level of an AIFM, however, the CSSF indeed grants licences based on the asset class of the AIFs that are intended to be managed.

1.5 What does the authorisation process involve and how long does the process typically take?

Only Part II Funds, SIFs and SICARs require the conducting of an approval process with the CSSF. The relevant filing must be made in writing, and for new AIFs and AIFMs (as opposed to existing AIF or AIFMs), it is mandatory to use the regulator's electronic platform "eDesk" for such purpose.

The main documents to be filed with the CSSF are the following:

- draft articles of incorporation, limited partnership agreement or management regulations (as the case may be);
- draft offering document;
- draft agreements with the main service providers;
- engagement letter of an independent auditor;
- documentation of the proposed members of the board of the AIF or its general partner (as the case may be);
- various CSSF questionnaires (concerning the investment policy, KYC information, etc.); and
- business plan and structure chart.

The approval process for a fully licensed AIFM is significantly more complex, and should at least include the following documents:

- draft articles of incorporation;
- draft agreements with the main service providers;
- documentation of the proposed members of the board of the AIFM and its senior management;
- draft internal policies relating, among others, to conflicts of interest, liquidity management, risk management, AML/KYC, remuneration rules, etc.;
- information on the shareholding structure;
- information and documents in relation to the AIF(s) to be managed;
- various CSSF questionnaires; and
- business plan including capital requirements and structure chart.

The CSSF can (and frequently does) request additional information and documents in relation to any approval procedure.

In terms of timing, on average three to four months should be expected between the filing and the approval of an AIF, and six to nine months for the procedure with respect to an AIFM. Any amendment of an AIF's documentation or a licence extension for an AIFM, however, are usually significantly less time consuming.

Once approved, the AIFM and the AIF will be entered onto an official list kept by the CSSF and which can be consulted on the regulator's website.

For each approval process, fees have to be paid to the CSSF. Their amount is set out in a Grand Ducal Regulation of 21 December 2017, and are split into a one-off fee and an annual fee.

1.6 Are there local residence or other local qualification or substance requirements?

The registered office and the central administration of any AIF or AIFM must be established in Luxembourg in order to qualify as a Luxembourg-based entity.

In terms of residency of the members of the managing body of any AIF or AIFM, there are no specific rules that require any of them to reside in or around Luxembourg. It is, however, recommended for the majority to be local in order to avoid foreign tax administrations challenging the nationality of the relevant entity.

In addition, the CSSF expects that, in principle, the staff of an AIFM that runs the day-to-day business (the so-called "conducting officers") has to reside in or around Luxembourg.

1.7 What service providers are required?

An AIF must at least appoint the following service providers:

- AIFM;
- management company (in case of an AIF established in the form of a *fonds commun de placement* ("**FCP**"));
- depositary and paying agent;
- central administration agent (typically includes registrar and transfer agent and domiciliation agent); and
- auditor.

In case of an AIF with a registered AIFM (see question 1.2), a depositary is not required.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

AIFMs established in the EEA may be appointed as AIFMs of Luxembourg AIFs, provided that they are authorised in their home jurisdiction as such. Similarly, portfolio managers located in the EEA can manage Luxembourg AIFs as delegates of the AIFM by using their MiFID passport.

For third-country managers, there are a number of conditions in order to manage Luxembourg AIFs: (i) it has to be authorised in its home jurisdiction; (ii) it must be subject to the supervision of a regulatory authority; (iii) there must be a cooperation between the CSSF and such regulator ensured by a Memorandum of Understanding ("**MoU**"); and (iv) the supervisory regime needs to be considered as equivalent to the EU regime. For the AIFs under its supervision, the CSSF verifies these conditions as part of the approval process.

For investment advisors, please refer to question 1.2.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

Concerning AIFMs, and with the approval of the European Securities and Markets Authority ("**ESMA**"), the CSSF has

entered into MoUs with 46 non-EU authorities. ESMA has published a list of such MoUs (https://www.esma.europa.eu/document/aifmd-mous-signed-eu-authorities).

The CSSF furthermore entered into several MoUs with supervisory authorities defining the terms of the cooperation between the authorities with respect to prudential supervision. The list of MoUs signed with EU and non-EU authorities is available on the CSSF's website (https://www.cssf.lu/en/european-and-international-cooperation/#memorandum-of-understanding).

Additionally, the CSSF entered into an MoU on the cooperation between the financial supervisory authorities, central banks and finance ministries of the EU on cross-border financial stability (https://www.cssf.lu/wp-content/uploads/MoU_2008_Final_1_June_2008.pdf).

Luxembourg also has a wide network of 83 double tax treaties, most of which include provisions of the Organisation for Economic Co-operation and Development (OECD) model agreement on exchange of information between tax authorities.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

Except for SICARs, all AIFs subject to specific product laws (Part II Funds, SIFs and RAIFs) can be established as a corporate vehicle or in a contractual form (FCP). The latter is similar to a trust structure and does not have a legal personality, therefore requiring a management company (typically its AIFM) to represent it. Investors in an FCP typically do not have voting rights, and FCPs are mostly considered tax transparent.

Several different corporate forms can be chosen: public limited company (*société anonyme* or "**SA**"); limited liability company (*société à responsabilité limitée* or "**Sàrl**"); partnership limited by shares (*société en commandite par actions* or "**SCA**"); special limited partnership (*société en commandite spéciale* or "**SCSp**"); or simple limited partnership (*société en commandite simple* or "**SCS**"). The choice between them depends on several factors such as investor participation, initiator control over the structure or investor tax status. The most frequently chosen types for AIFs are partnerships, either the SCA or SCSp.

AIFs that are not subject to specific product laws are typically established in the form of an SCS or SCSp, as these are usually considered to be tax transparent.

Additionally, Part II Funds, SIFs, SICARs and RAIFs can make use of a so-called umbrella structure, independently of whether they are intended as a corporate vehicle or FCP. This enables such AIF to be established as one single vehicle, but with several segregated pools of assets: so-called compartments. Each of these can pursue its own investment strategy, acquire its own assets and have its own distinct investors, and due to the segregation that is provided for by the relevant law, the performance of one compartment has no impact on the others. While the AIFM and depositary have to be appointed for the entire structure, each compartment can choose a different portfolio manager or advisor. The economies of scale and advantages in terms of time to market for adding further compartments have resulted in approximately 50% of Luxembourg funds choosing an umbrella structure.

Over the last few years, the majority of AIFs are established in the form of a RAIF or as a partnership (SCS/SCSp) that is not subject to a specific product law.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

The liability of the investors in an AIF is generally limited to the amount they have invested or committed to invest.

In case of a partnership, the liability of the general partner is unlimited. However, typically corporate entities such as an Sàrl are chosen to act as general partner, so that the liability is limited to the share capital of such company.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

The majority of AIFMs and investment advisors that are located in Luxembourg are established in the form of an SA or Sàrl.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

There are no legal or regulatory restrictions for an AIFM or delegate portfolio manager (or general partner) to limit redemptions in open-ended funds. The conditions under which investors can request a redemption of their shares is set out in the fund documentation and must therefore be appropriately disclosed to investors. In particular, for AIFs investing into illiquid assets, it is market practice to provide for restrictions (in time and volume) of redemptions.

The relevant AIFM or manager should establish a liquidity policy adapted to the AIF, in order to avoid a mismatch between investor expectations and the liquidity of the AIF. In its report dated 10 January 2020, ESMA indicated that the assets and the fund structure have to be aligned, and both ESMA and the CSSF recently indicated that this topic will be among their supervisory priorities in the future.

Similarly, there exist no restrictions in relation to transfers in open-ended or closed-ended funds.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There exist no legal or regulatory restrictions in this respect. The only exception is that for SICARs, SIFs and RAIFs, only well-informed investors can invest into such funds.

In view of the fact that the AIFM marketing passport is restricted to professional investors, the fund documentation of AIFs frequently sets out that non-professional investors are excluded.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

Part II Funds, SIFs and RAIFs (except for a RAIF with a SICAR regime) must comply with risk diversification requirements.

In principle, the maximum exposure to a single asset is limited to 20% in case of a Part II Fund, and 30% for a SIF or a RAIF. For AIFs with an umbrella structure, the risk-spreading requirements must be respected within each compartment. For AIFs investing into illiquid assets, a ramp-up phase is permissible during which diversification rules do not apply.

SICARs are not subject to any risk-spreading requirements.

AIFs that are established without using one of the abovementioned specific product laws are not subject to any legal or regulatory diversification requirements, but can define such rules themselves in their fund documentation.

All AIFs are subject to asset stripping rules as set out in the AIFM Law.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The main framework on how AIFs can be distributed in Luxembourg or in other EEA countries is set out in the AIFM Law. In addition, from 2 August 2021, EU Regulation 2019/1156 defines further rules for the marketing of AIFs.

Luxembourg is the largest investment fund hub for AIFs in Europe. As a consequence, most of the AIFs domiciled in Luxembourg are distributed within the EEA, but also abroad in the US or Asia.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The AIFM Law sets out the information every AIFM must disclose to potential investors for each AIF that it manages and markets. Such disclosure document must include the information necessary for investors to be able to make an informed judgment, which includes, *inter alia*, the following information:

- description of the investment strategy and objective of the AIF, including the procedures by which the AIF may change its investment strategy;
- description of the maximum level of leverage which the AIFM is entitled to employ on behalf of the AIF;
- description of the main legal implications of the contractual relationship entered into for the purpose of investment;
- identity of the main service providers of the AIF;
- description of all fees, charges and expenses and the maximum amounts thereof which are directly or indirectly borne by the investors;
- the latest net asset value of the AIF; and
- the latest annual report of the AIF.

In addition, further marketing material can be provided to investors. From 2 August 2021, such documents need to be identifiable as such, describe the risks and rewards of the AIF and have to be fair, clear and not misleading. It also must not contradict the abovementioned disclosure document.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

There is no registration or approval requirement for any marketing in Luxembourg for those AIFs that are not subject to CSSF supervision (RAIFs and AIFs under the Law of 1915). However, if any AIF is intended to be marketed in other EEA countries based on the AIFMD marketing passport, a notification procedure needs to be initiated. In the course of such notification procedure, a number of documents such as the investor disclosure document will need to be provided to the CSSF in order to be sent on to the relevant foreign regulators.

For Part II Funds, SIFs and SICARs, please refer to question 1.5 for the documents that have to be approved.

3.4 What restrictions are there on marketing Alternative Investment Funds?

SIFs, SICARs and RAIFs can only be marketed to "well-informed investors". Such term is understood to include institutional investors, professional investors within the meaning of MiFID II or any other investor that has either invested a minimum amount of EUR 125,000 or received an assessment from a bank or other financial service provider that confirms its expertise, experience and knowledge for the relevant investment.

Part II Funds are not restricted to well-informed investors and can therefore also be marketed to retail investors in Luxembourg.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

Currently, there are no rules on pre-marketing in place in Luxembourg. The CSSF does not review any such material either.

However, a pre-marketing regime will be introduced by the implementation of Directive (EU) 2019/1160 on cross-border distributions of collective investment funds into Luxembourg law, which should enter into force on 2 August 2021. Henceforth, pre-marketing will be defined as providing information or communication, direct or indirect, on investment strategies or investment ideas by an AIFM or on its behalf to investors to test their interest in an AIF which is not yet established. Such pre-marketing will be subject to a notification requirement by the relevant AIFM to the CSSF within two weeks of it having begun pre-marketing. In addition, such pre-marketing cannot be a substitute for marketing in that it must not amount to distributing subscription documents or be sufficient to allow investors to commit to acquiring shares of the relevant AIF. Furthermore, if draft offering documents are provided, it has to include a note that it should not be understood to be an offer to subscribe, and that its content is preliminary and cannot be relied upon.

It is not necessary for the relevant AIFM to notify the competent authorities in the countries where such pre-marketing takes place of the content or of the addressees of pre-marketing.

Any subscription by professional investors within 18 months of the start of such pre-marketing will automatically count as the result of marketing, thereby excluding the possibility of reverse solicitation for such time.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Part II Funds can be marketed to retail investors in Luxembourg. They may also be marketed to retail investors in other jurisdictions, subject to compliance with the applicable local rules.

SIFs, SICARs and AIFs are restricted to well-informed investors. These could also be individuals, if they comply with the definition of such term. However, as any cross-border marketing based on the AIFMD marketing passport is restricted to professional investors, any such marketing to such individuals would need to comply with the applicable local rules.

3.7 What qualification requirements must be met in relation to prospective investors?

Please refer to question 3.4 above.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no restrictions on marketing to public bodies in Luxembourg. It should, however, be mentioned that if an investment fund is exclusively marketed to such bodies, it would not qualify as an AIF and therefore be exempted from the provisions of the AIFM Law.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

There exist no restrictions on participation in AIFs by particular types of investors.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

In case such intermediaries act as distributors, they must have a licence to provide such services from the competent regulator.

With respect to pre-marketing on behalf of an AIFM, from 2 August 2021 onward, only MiFID investment firms, credit institutions, UCITS management companies or other AIFMs are allowed to perform such services.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Part II Funds, SIFs and RAIFs with a SIF strategy can invest in any type of assets, subject to risk-spreading requirements (see question 2.6 above).

SICARs and RAIFs with a SICAR strategy must invest their funds in risk capital as such term is defined in CSSF Circular 06/241.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Please refer to question 2.6 above.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Please refer to question 4.1 above.

With regard to loans, Luxembourg AIFs can grant such loans (loan origination), syndicate these or otherwise invest in loans, without requiring any additional banking licence.

There are a number of specific risk diversification requirements for Part II Funds investing into derivatives, which are set out in CSSF Circular 02/77.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

There are no provisions in Luxembourg law which restrict borrowing by AIFs.

Pursuant to the AIFM Law, the level of borrowing as well as the maximum level of leverage calculated pursuant to the commitment method and the gross method must be disclosed to investors. In addition, AIFMs managing AIFs with substantial leverage have specific reporting duties to the CSSF in this context.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

No such restrictions exist in Luxembourg.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

For investment funds managed by a fully licensed AIFM, disclosures as described in question 3.2 need to be made. Furthermore, the agreement with the AIF's service providers and its constitutional documents (articles of incorporation or limited partnership agreement) are usually made available to investors.

AIFs that are managed by a registered sub-threshold AIFM are not subject to such disclosure requirements, even though in practice such documents are often produced.

Since the entry into force of Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial sector ("**SFDR**"), additional disclosure requirements on the webpage of the AIFM and the pre-contractual documents of the AIF (i.e., the offering document) have to be respected.

The following information must be disclosed on the AIFM's webpage:

- information about the AIFM's policies on the integration of sustainability risks in its investment decision-making process; and
- a statement on whether the AIFM considers principal adverse impacts ("**PAIs**") of investment decisions on sustainability factors and, in case PAIs will not be considered, clear reasons why the AIFM does not consider PAIs.

Furthermore, the pre-contractual documents (i.e., offering document) must include a disclosure on how sustainability risks are integrated in the investment decisions.

Additional disclosure requirements become applicable as from 2022.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

The Luxembourg law dated 13 January 2019 requires that information on the beneficial owners of every entity registered with the Luxembourg Trade and Companies Register must be published in the register of beneficial owners. This also applies to AIFs established in the form of FCPs, despite their lack of legal personality.

For those AIFs under direct supervision of the CSSF, the regulator requires knowledge of the owner, controller and initiator of such AIFs.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

Registered AIFMs only need to report to the CSSF information on the main instruments in which they are trading and on the principal exposures and most important concentrations of the AIFs that they manage.

Authorised AIFMs must ensure that an annual report with a number of financial and other details is made available for each financial year for each AIF that they manage and market. It must be provided no later than six months from the end of the financial year to investors upon request and to the CSSF, plus the home Member State of the AIF.

Authorised AIFMs are furthermore subject to regular reporting requirements to the CSSF, which include (i) the principal instruments and markets in which they trade, (ii) the principal exposures and most important concentrations, (iii) the main categories of assets, and (iv) the risk profile and risk management systems employed.

AIFs that are exclusively subject to specific product laws are also required to produce an annual report and make it available to investors. Part II Funds must additionally provide an unaudited semi-annual report to investors.

For AIFs that either promote environmental or social characteristics or that have sustainable investments as their primary investment objective, AIFMs must, as from 1 January 2022, include in their periodic reports the following information:

- the extent to which environmental and social characteristics are met; and
- the overall sustainability-related impact of the financial product by means of relevant sustainability indicators.

5.4 Is the use of side letters restricted?

The use of side letters is not restricted by Luxembourg law. However, the provisions of the fund documentation with respect to the use of side letters and the principle of equal treatment of investors must be respected, as provided for by the AIFM Law (if the relevant AIF is subject to such law).

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

In general, Luxembourg provides favourable tax treatment for AIFs.

Part II Funds

Part II Funds are not subject to income tax or net wealth tax. Furthermore, distributions of Part II Funds to its investors are not subject to Luxembourg withholding tax and are not taxable if received by non-residents.

Part II Funds are subject to an annual subscription tax of 0.05% calculated on the aggregate net assets as valued on the last day of each quarter. The Law of 2010 provides for a number of exemptions from the subscription tax, for instance in case the Part II Fund holds its assets in another Luxembourg fund which was already subject to the subscription tax. Furthermore, the Law of 2010 provides for reduced rates of the subscription tax ranging from 0.04% to 0.01%. The reduced rates depend on specific circumstances and thresholds with respect to sustainable economic activities.

SICARs

A SICAR incorporated in the form of a joint stock company (i.e., Sàrl, SA or SCA) is fully taxable as an ordinary company at standard rates (i.e., 24.94% for Luxembourg City). As a result, it may benefit from applicable double tax treaties and domestic exemptions. The SICAR, however, benefits from an exemption on income from risk capital securities, as well as income from the transfer, disposal contribution or liquidation of such securities. Other kinds of income remain fully taxable at the level of the SICAR. The SICAR is subject to the minimum net wealth tax.

SIFs and RAIFs

A SIF is not subject to any income tax or wealth tax, so that the income and assets of a SIF are tax exempt in Luxembourg. Distributions by a SIF to its investors are not subject to withholding tax. A SIF is liable to an annual subscription tax at the rate of 0.01% on its net assets. Such tax is payable quarterly on the basis of the net consolidated asset value as of the end of the preceding calendar quarter.

In certain cases, an exemption from the subscription tax may apply. In this respect, (i) assets invested in other Luxembourg-based UCIs, SIFs and RAIFs subject to the subscription tax, (ii) certain institutional cash funds, (iii) microfinance funds, and (iv) pension pooling funds should be exempt.

In principle, the tax regime applicable to a RAIF, in whatever corporate form, is the same as that applicable to a SIF.

In specific cases and if the RAIF qualifies as a vehicle investing exclusively in risk capital, it can be subject to a different tax regime. RAIFs opting for this regime are subject to the same tax regime as SICARs, i.e. fully subject to corporate income tax and municipal business tax as well as the minimum net wealth tax (see above). It should be noted that the option for the SICAR regime applies to the RAIF at the fund level. Consequently, all compartments of a multicompartment RAIF are subject to the same tax regime and it is not possible to apply the SIF regime to some compartments, whereas others would benefit from the SICAR regime.

VAT Treatment of AIFs

In accordance with ECJ case law, the Luxembourg tax authorities have expressly recognised that all investment funds are in general VAT-able persons. However, Luxembourg AIFs do not have an input VAT deduction right with regard to their fund management activities.

A VAT exemption applies for services qualifying as fund management services. As further detailed by ECJ decisions and Circulars from the Luxembourg VAT administration, this exemption covers administrative services outsourced to third-party providers, to the extent they are specific to and essential for the management of the funds.

Other services supplied to Luxembourg AIFs could potentially trigger VAT and require the VAT registration of the AIF in Luxembourg so as to self-assess the VAT regarded as due in Luxembourg on taxable services (or goods to some extent) purchased from abroad. Such VAT is a final cost at the AIF's level as the fund has no right to deduct input VAT.

No VAT liability in principle arises in Luxembourg in respect of any payments by the AIF to its shareholders to the extent such payments are linked to their subscription to the AIF's shares and therefore do not constitute the consideration received for any taxable services supplied.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

Investment managers established in Luxembourg are not subject to any specific tax regime. If incorporated as a standard joint

stock company (i.e., an Sàrl), they are subject to income tax and municipal business tax at standard rates (i.e., a combined rate of 24.94% for Luxembourg City). Furthermore, they are subject to net wealth tax of 0.5% on their net assets (0.05% applicable on the portion of the net assets exceeding EUR 500 million). Depending on the level of intra-group fees linked to the managers' activities, transfer pricing considerations would need to be factored in.

Private portfolio managers and investment advisers are professionals and fall under the rules of individual taxation for independent activities.

A special tax regime applicable to carried interest was introduced by the AIFM Law. In general, the share of profits paid by an AIF and received by AIFM employees is taxable as miscellaneous income, i.e. either as ordinary income (with a tax rate up to 45.78% for 2021), or as extraordinary income (with a tax rate up to 22.89% for 2021). However, if the employee satisfies certain conditions, the carried interest would be taxable at ¼ of the global tax rate only.

Fund management services supplied in Luxembourg are in principle exempt from VAT (please refer to question 6.1 above).

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

No such taxes are applicable in Luxembourg.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

Distributions by Part II Funds, RAIFs and SIFs are in general not subject to withholding tax regardless of investor type. Also, distributions by a corporate AIF in the form of an SCS/SCSp are not subject to withholding tax based on the tax transparency of an SCS/SCSp.

Under the current legislation, non-resident investors are not subject to any capital gains, income, estate, inheritance or other taxes in Luxembourg. The exception thereto is for non-residents who, either alone or together with their spouse, partner and/or minor children, directly or indirectly, at any time within the five years preceding the disposal, hold more than 10% of the shares or units of a Luxembourg AIF and who dispose of all or part of their holdings within six months from the date of acquisition; or in some limited cases, non-residents who have been residents for more than 15 years and have become non-residents less than five years before the disposal of the shares or units of the AIF who, either alone or together with their spouse, partner and/or minor children, directly or indirectly, at any time within the five years preceding the disposal, hold more than 10% of the shares or units of a Luxembourg AIF.

Luxembourg resident individual or corporate investors have to declare income received from a Luxembourg AIF in their annual tax return.

Dividends and other payments derived from a Luxembourg AIF received by resident individuals, who act in the course of either their private wealth or their professional/business activity, are subject to income tax at the progressive ordinary rates. A gain realised upon the sale, disposal or redemption of shares or units in a Luxembourg AIF by Luxembourg resident individuals acting in the course of the management of their private wealth is not subject to Luxembourg income tax, provided this sale, disposal or redemption took place more than six months after the shares or units were acquired or the disposal of the shares or units did not precede the acquisition and provided the shares or units do not represent a substantial participation.

Dividends received and capital gains realised by Luxembourg corporate investors on shares or units in a Luxembourg AIF should be subject to corporate income tax.

The SIF Law and the RAIF Law provide for exemptions from the subscription tax in case the shares or units of the Luxembourg AIF are reserved for institutions for occupational retirement provisions, or similar investment vehicles, established on the initiative of one or more employers for the benefit of their employees, and companies of one or more employers investing funds they hold in order to provide retirement benefits to their employees.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

It is not required or advisable to obtain a tax ruling from the Luxembourg tax administration before establishing an AIF. The Luxembourg ruling regime provides for the option to receive a confirmation at the request of the taxpayer of the correct application of the Luxembourg tax laws, and therefore to provide certainty to the taxpayer with respect to its future tax liability. The ruling cannot by itself, however, provide for an exemption or reduction of the taxes due.

Further, the Luxembourg indirect tax administration in charge of levying the subscription tax does not deliver advance tax agreements.

Finally, the number of rulings filed in Luxembourg has significantly decreased. This is a general downward trend that continues to be confirmed year after year.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

On 28 March 2014, Luxembourg signed an intergovernmental agreement regarding the automatic exchange of information between the Luxembourg and US tax administrations within FATCA, Model 1 ("**IGA**"), in order to implement FATCA in Luxembourg. The IGA was transposed by the Luxembourg Parliament on 1 July 2015 into Luxembourg domestic law.

Luxembourg is signatory to the Common Reporting Standard (CRS) and has implemented the automatic exchange of information in tax matters as of 1 January 2016.

Luxembourg implemented the fifth amendment to the Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements with the law of 25 March 2020 ("**DAC 6 Law**"). The DAC 6 Law is largely based on the Directive.

As per the DAC 6 Law, all transactions the first steps of which have been implemented after 25 June 2018 are in the scope of a potential reporting obligation. Such reporting would, however, only need to take place in case of cross-border transactions, specifically transactions involving more than one EU Member State or transactions involving an EU Member State and a third country.

Furthermore, transactions that fall within the scope of at least one hallmark as provided for in the Appendix to the DAC 6 Law will need to be disclosed to the tax authorities by the relevant intermediary or taxpayer. Hallmarks A to C1 are subject

to an additional main benefit test. However, very little guidance is given as to the interpretation of a "main tax benefit", thus giving room to different application of these Hallmarks between Member States.

The first reporting date of cross-border reportable transactions was set on 1 July 2020. However, with regard to the COVID-19 pandemic, Luxembourg opted to defer reporting obligations to 1 January 2021 as provided for by the European Commission.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Luxembourg implemented various changes to align its laws with the BEPS Action Plan. It implemented ATAD 1, which deals with controlled foreign companies, anti-hybrid and interest deduction limitation rules, into Luxembourg tax law on 1 January 2019.

The hybrid rules under ATAD 2 were transposed in Luxembourg national law with effect as of 1 January 2020, extending anti-hybrid mismatch rules to certain arrangements. The rules with respect to reverse hybrid mismatches under ATAD 2, which specifically have a certain relevance for unregulated AIF structures involving transparent company forms such as an SCS/SCSp, will enter into force as of 1 January 2022.

Luxembourg has signed and ratified the MLI. For Luxembourg purposes, the MLI entered into force on 1 August 2019. Henceforth, each tax treaty signed with Luxembourg will have to be interpreted in conjunction with the MLI provisions in case the countersigning country has also ratified the MLI.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

In general, and independently from a specific asset class or specific structure, Luxembourg AIFs have a rather favourable tax regime. The tax treatment of individual structures should be analysed on a case-by-case basis and depends on several factors such as the underlying assets and the investor's status and residency.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Access to double tax treaties entered into between Luxembourg and other countries by AIFs is not always straightforward, and a case-by-case analysis should be performed. The Luxembourg tax administration issued a Circular on 8 December 2017, establishing a list of double tax treaties where Luxembourg fund structures can – expressly or implicitly – claim a treaty benefit.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

There are currently no major tax changes anticipated that will impact Luxembourg AIFs directly.

However, the 2021 Budget Law introduced a new special 20% tax (*prélèvement immobilier*), which applies as of 1 January 2021 on all income derived by tax-opaque Luxembourg funds from domestic real estate assets. This new tax regime is aiming to align the Luxembourg tax treatment with the tax regimes applicable in other EU countries. It is to be noted and underlined that Luxembourg funds which do not invest in Luxembourg real estate will not be affected by the newly introduced regime.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

Luxembourg remains the top investment fund centre in Europe with more than EUR 5,300 billion of assets under management. More than 62% of the world's cross-border funds are located in Luxembourg. As a consequence, interest in the market for AIFs and AIFMs, and in particular the RAIF as well as unregulated partnerships (i.e., SCS and SCSp), remains very high. Both products have a short time to market and offer great flexibility in terms of structuring.

In terms of asset classes, debt funds in particular have continued to grow over the last few years. Due to the growing reticence of banks, resulting from their capital requirements, to finance SMEs, an increased need for alternative financings can be observed.

Since the entry into force of the SFDR, there has been a notable increase in the number of ESG and impact funds. As a result of pressure from both investors and legislators, it appears certain that sustainable finance products will become a major trend in the investment funds industry in general.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

Directive (EU) 2019/1160 on cross-border distributions of collective investment funds and its Luxembourg implementation, which will enter into force on 2 August 2021, will harmonise the provisions and reduce the restrictions and costs for cross-border distribution of investment funds within the European Union (see also section 3 above).

In addition, the review process of the AIFMD is currently ongoing and is likely to be finalised in early 2022. It can therefore be expected that some amendments to such directive (and subsequently to the AIFM Law) will be introduced, although no fundamental changes should be made to such a well-functioning regime.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Activity involving the management, investment and marketing of Alternative Investment Funds (AIFs) is mainly regulated by: the Undertakings for Collective Investment Law, enacted by Decree no. 54/99 of 8 September 1999 and amended by Decree no. 36/2005 of 29 August 2005 (the UCI Law), which sets out most of the rules relating to AIFs; Law no. 15/99 of 1 November 1999, amended from time to time, which implemented the Credit and Financial Institutions Regime (Banking Law); Decree no. 56/2004 of 10 December 2004, as amended by Decree no. 31/2006 of 30 August 2006 and by Decree no. 30/2014 of 5 June 2014, which implemented the Regulation on Credit and Financial Institutions (Banking Law); Decree-Law no. 4/2009 of 24 July 2009 (Mozambique Securities Market Code); and Ministerial Ordinance no. 10/99 of 24 February 1999 (Financial Intermediation Activities Regulation).

The Bank of Mozambique (BoM) is the relevant supervisory authority.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Yes. Fund managers, as financial institutions, are subject to the BoM's supervision; accordingly, the relevant authorisation procedure shall be filed with the BoM.

The UCI Law does not foresee any *de minimis* exception or fast-track authorisation procedure; therefore, all fund managers, regardless of the type of assets under management, will need to comply, in general terms, with the same requirements.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Yes. The setting up of AIFs is subject to authorisation from the BoM, which is the competent regulator to conduct the supervision of AIF management activity and ancillary service providers as well as distribution and compliance with the general rules applying to AIFs, notably in connection with the protection of investors' interests.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes. In general terms, the UCI Law distinguishes between AIFs investing in (i) securities or financial assets, and (ii) real estate (real estate investment funds). Both AIF types may be open- or closed-ended.

In general terms, open-ended AIFs target the retail market and closed-ended AIFs target high-net-worth or professional investors; thus, in open-ended AIFs, scrutiny by the BoM tends to be tighter.

1.5 What does the authorisation process involve and how long does the process typically take?

In a nutshell, the authorisation request for setting up AIFs is filed with the BoM, and the relevant AIF manager must provide the BoM with the relevant AIF documentation, notably the regulation and a copy of the agreement to be executed between the fund manager and the depositary.

Furthermore, the BoM may request further information from the fund manager.

If applicable, authorisation should be given within 45 days of receipt of either the relevant documentation or any supplementary information or amendments to the documents required by the BoM. If at the end of such period the applicants have not been notified of the authorisation, this means it has been tacitly refused.

However, considering that the BoM has discretion to request further information, which will halt the term for granting authorisation, and that few AIFs are being constituted in Mozambique, the term for completing the process may vary significantly from case to case.

The marketing of the AIF's units shall begin within 90 days of the granting of the relevant authorisation.

1.6 Are there local residence or other local qualification or substance requirements?

No, there are not.

1.7 What service providers are required?

In Mozambique, an AIF is legally required to have a fund manager, a depositary, an auditor and, in the case of real estate AIFs, real estate appraisers.

It should be noted that the UCI Law does not expressly foresee the existence of an auditor and, in the case of real estate AIFs, real estate appraisers; however, the existence of two such entities in the case of real estate assets is fundamental in light of the fact that the AIF itself will need to be assessed and is subject to accounting control.

Furthermore, the AIF may also have, but is not legally compelled to have, distributors or entities that will market its units, although such entities are more common in open-ended AIFs.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

In accordance with the Banking Law, the same rules established for national managers will apply to foreign managers.

However, the foreign managers will need to be properly authorised to conduct their activities in Mozambique and will need to have a local establishment.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

We are not aware of any specific protocol or sharing agreement having been signed by the BoM with other governments or regulators in respect of the Alternative Investment Fund Managers Directive (AIFMD) or AIFs. However, Mozambique signed a cooperation protocol with the Portuguese Securities Market Commission (CMVM).

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

Under the UCI Law and subject to the licensing procedures described in question 1.5 above, an AIF may only adopt the contractual structure with no legal personality. This is the classic structure and requires that the AIF be managed by a separate fund manager. The investors' or unitholders' interests in such funds are called units (*unidades de participação*).

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

The assets of an AIF are only liable for its debts. Accordingly, the AIF will not bear liability for the debts of investors, fund managers, depositaries, distributors or other AIFs. Likewise, the investors are not personally liable for the debts of the AIF.

The statement of the preceding paragraph does not expressly stem from the UCI Law, but rather from general legal principles applicable to investment in AIFs.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

An AIF must be managed, depending on its scope, by a:

- fund manager (financial institution), which may only manage AIFs investing in securities and other financial assets;
- real estate fund manager (financial institution), which may only manage AIFs investing in real estate funds; or
- commercial or investment bank, but only in the case of closed-ended AIFs.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

The UCI Law is silent in respect of the fund manager's ability to limit redemptions in open-ended funds, but considering that such type of AIFs is, in general, targeted towards retail investors, the BoM will most certainly scrutinise this matter. In fact, such possibility would need to be clearly set out in the AIF's regulation, which is analysed throughout the authorisation procedure.

Moreover, the draft AIF regulation, approved by the UCI Law, includes a field where conditions set out for redemptions must be described, but only refers to applicable fees, settlement dates and the criteria for the determination of which units will be redeemed.

The fund manager may suspend the units' redemption, in the case of an abnormal situation that may impact the usual running of the market or jeopardise the interests of the unitholders, provided the BoM is immediately informed of said suspension.

As far as restriction of transfers in open-ended funds is concerned, the same rationale as described above in respect of redemptions is applicable.

Conversely, in the case of closed-ended AIFs – mainly those targeting professional investors – it should be considered that it is possible to establish, in the AIF's regulation, restrictions on the transfer of the units from investors to third parties.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

No. However, it is important to bear in mind the limitations established on foreign investment, which place constraints on transfers abroad of profits or dividends obtained in Mozambique. Therefore, prior to an investment in a Mozambique AIF being performed, the thresholds and requirements to be met by such an investment shall be assessed on a case-by-case basis, as well as the provisions applicable to the transfer abroad of the profits or dividends obtained pursuant to the redemption of the units/shares or liquidation of the AIF.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The ability of the manager to manage its funds will be mainly limited by the investment policy established in the AIF's prospectus or regulation, as applicable, by the general investment limits by type of AIF, if any, established in the UCI Law and by the obligation to conduct its activity in the best interest of the investors.

The UCI Law has a list of acts that a manager cannot carry out, such as granting loans, executing certain transactions on its own account, executing transactions relating to the assets held by the AIF with related parties, e.g. entities of its group, the depositary, etc.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Please refer to question 1.1 above, as well as to the Consumer Law, approved by Law no. 22/2009 of 28 September 2009, and the Advertising Code, approved by Decree no. 38/2016 of 31 August 2016.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

There are no drafts available, nor does the UCI Law set out express provisions addressing marketing materials. However, providing information on the investment policy, markets targeted, main features (identification of the relevant entities, terms and conditions of the investment, links to the legal documents) and historic returns of the AIF is perceived as common practice for fund managers and other distribution entities.

However, the law states that marketing material must observe the need to be offered investors' explanations for a careful decision of investment. If marketing material contains projections of future outcomes of the investment, it shall state what the base of that projection was and if the outcome is certain or uncertain, among other legal requirements.

Lastly, as a general note, the information contained in the marketing materials must comply with the following principles: legality; identifiability; truthfulness; objectivity; adequacy; opportunity; and clarity.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Yes. AIFs' prospectuses, as well as their amendments, are subject to prior BoM authorisation.

Furthermore, all marketing actions in respect of an AIF shall inform the addressee of the existence of the prospectus and the place where it may be consulted.

3.4 What restrictions are there on marketing Alternative Investment Funds?

The concept of marketing or distribution of AIFs is not defined in the UCI Law. Nevertheless, it should be construed as comprising all activity directed towards investors with a view to promoting or proposing the subscription of the relevant AIF's units, regardless of the means of communication used.

Nonetheless, the general principles laid down in question 3.2 above in respect of marketing will be equally applicable to all marketing activities and materials.

Furthermore, attention is drawn to the fact that the reverse solicitation is not officially recognised or defined under Mozambican law and it is thus not an official exemption expressly foreseen in the applicable legal framework, but rather a tolerated practice. Such practice consists of an investor, on its own initiative and without having been engaged for such purpose by the distributor, requesting information on a specific AIF. However, a case-by-case assessment must be conducted, considering that the use of the reverse solicitation exemption may come under the BoM's scrutiny.

Lastly, the requirements and principles laid down in the Consumer Law and Advertising Code in respect of investors, who are deemed consumers, shall also be observed.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

Similar to that of marketing, the concept of pre-marketing is not expressly recognised in the UCI Law (please refer to question 3.4 above).

Nevertheless, if the pre-marketing has only a general nature, i.e. it seeks to present to the investor the existence and activity carried out by the fund manager or an overall look at the market, without recommending or referring to any investment opportunity in particular, there are grounds to sustain that it will not be facing marketing activity subject to the UCI Law requirements.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes, they can.

3.7 What qualification requirements must be met in relation to prospective investors?

There is no particular requirement to be fulfilled in relation to investors in AIFs. However, every marketing material must make reference to the existence of the AIF's prospectus and the place where it may be consulted by the investor.

Nonetheless, the fund manager shall ensure that the "know your customer" and investment adequacy analyses are properly carried out in relation to the investor, and that the procedures against money laundering and the financing of terrorism are closely respected.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

No, there are no additional restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

No. However, the holding of AIFs' units may have an impact on credit institutions' and financial institutions' own funds, which must be assessed on a case-by-case basis.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

No. However, the relationship established between the intermediaries and the AIF shall be laid down in a written agreement and disclosed in the AIF's legal documents.

Furthermore, the intermediary, when carrying out the fundraising process, must act within the scope of activities that it is authorised to conduct, i.e. if the fundraising process corresponds to AIF marketing, the intermediary will need to be an authorised institution under the applicable legal terms in order to carry out the distribution of securities.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Yes. AIFs may only focus on investment activities and their investments must comply with the general rules applicable to financial instruments markets.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Yes. The assets eligible for the portfolio of an AIF will depend on its specific type.

In general terms, an AIF cannot hold in its portfolio: (i) units from a UCI managed by the same fund manager; (ii) assets encumbered with *in rem* security, liens or precautionary proceedings; (iii) securities issued or held by its fund manager; (iv) securities issued or held by entities that hold more than 10% of the fund manager share capital; (v) securities issued or held by entities 20% or more of whose share capital is held by the fund manager; (vi) securities issued or held by entities that are members of the management body of the fund manager; (vii) securities issued or held by entities 20% or more of whose share capital is held by members of the management body of the fund manager; (viii) securities issued or held by entities whose management bodies are comprised of one or more directors of the fund manager; (ix) securities issued or held by entities, pursuant to a placement agreement, by the fund manager, depositary or entities which hold 10% or more of the share capital of the fund manager, save for public subscription offers targeting securities envisaged to be admitted to trading in a stock exchange; and (x) real estate assets in co-ownership.

The prohibitions laid down in points (iv) to (viii) do not apply if the securities at stake are admitted to trading in the Mozambique Stock Exchange.

Moreover, in general terms, an AIF investing in securities or financial assets may have on its portfolio securities as defined in the Mozambique Securities Code, which comprise shares, bonds, participation titles in public funds, units and any other similar instruments, as well as instruments stemming from rights detached from the previous securities, provided that they are exchangeable in a secondary market.

An AIF investing in real estate may hold in its portfolio real estate assets registered in the Land Registry Office as pertaining to an investment fund, and holdings of 50% or more in companies listed in a stock exchange and whose scope consists of acquiring, selling, renting and exploring real estate assets.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

As a matter of principle, the investment in derivatives by AIFs is generally limited to risk management purposes.

Loans originated by AIFs are not permitted under Mozambique law.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Fund managers may obtain loans on behalf of AIFs under their management, but the loan period cannot exceed 120 days, consecutive or not, within a period of one year and up to a maximum of 10% of the AIF's global value.

Moreover, the assets of the AIF can only be encumbered, in any way whatsoever, in order to obtain loans within the conditions referred to in question 4.2 above.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

As per the UCI Law, AIF's assets must be entrusted to a single depositary, namely commercial banks and investment banks operating in Mozambique. That notwithstanding, the Mozambican Minister for Planning and Finance, in consultation with the Governor of the Bank of Mozambique, may determine that other financial institutions, other than those mentioned above, may exercise the functions of a depositary.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

AIFs' legal documents and their updates shall be made available to investors, in the premises of the fund manager, the depositary and, if applicable, the distributor.

Considering that legal documents must describe the identity of the fund manager, depositary, auditor, distributors and other AIF services providers, the majority of data in connection with the AIF will be made available to the public.

However, the identity of the investors in the AIF is not mandatorily subject to public disclosure.

There are no developments in respect of disclosures relating to environmental, social and/or governance factors.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

The fund manager shall implement anti-money laundering/counter terrorist financing (AML/CTF) proceedings in respect of the investors and their beneficial owners, and the relevant authorities may request information on the fund manager's compliance of its obligations in this regard. However, there is no public record-keeping or register of beneficial owners.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

Fund managers must prepare annual accounts of the AIFs under management by 31 December of each year. In the following four months, the fund manager shall publish the balance sheets and profit and loss accounts.

The fund manager shall also prepare biannual accounts after the end of the relevant semester.

The annual and biannual accounts shall be made available to investors, as they become ready, in the premises of the fund manager, the depositary and, if applicable, the distributor.

Additionally, with regard to such data, the fund manager shall publish a report containing the activities carried out during the last term, which shall comprise information on the units, transactions, portfolio evaluation and evolution, etc.

In cases where the marketing entity of the AIF is also a bank of which the investor is a client, it can provide the above information together with the investor's bank statement.

The fund manager shall publish in the Mozambique Stock Exchange's official journal, on a monthly basis with reference to the last day of the immediately preceding month, an inventory of the AIF's asset portfolio, its global net value and the number of units currently in circulation. The fund manager shall remit this information to the BoM within three days after its publication.

Lastly, the fund manager shall submit to the BoM its monthly trail balances, by the 15th day of the following month.

There are no developments in respect of reporting relating to environmental, social and/or governance factors.

5.4 Is the use of side letters restricted?

The use of side letters that set out particular terms and conditions in respect of governance, investment, etc. of an AIF is not specifically addressed by the UCI Law.

However, in the case of open-ended AIFs, considering that they usually target retail investors and/or a broader unrestricted scope of investors, the use of side letters that alter any relevant provision of the legal documents shall be deemed illegal, considering that fund managers need to abide by the AIF's legal documents as a general principle during the provision of its activity.

In closed-ended AIFs, notably in AIFs targeting only professional investors, we trust that there is a wider margin to set out specific provisions, namely through a side letter, in respect of certain matters. However, in general terms, as the provisions of the UCI Law are imperative, any side letter providing for actions in breach of such legal provisions will be deemed illegal and may subject the fund manager to administrative offence proceedings.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Considering there is no special tax regime applicable to Collective Investment Vehicles, the general tax regime applies, under which Mozambican-resident entities are subject to corporate income tax (CIT) at the rate of 32% (*Imposto sobre o Rendimento das Pessoas Coletivas* – IRPC) to be levied on taxable profits obtained on a worldwide basis (including income obtained abroad).

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

There is no special tax treatment or rules applicable in Mozambique for investment managers or advisers. Therefore, as Mozambican-resident entities, they will also be subject to the general taxation regime referred to in question 6.1 above (32% IRPC rate to be levied on taxable profits obtained on a worldwide basis).

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

No establishment or transfer taxes are applicable.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

For tax purposes, income deriving from a fund's units is qualified as investment income, while income deriving from the sale of said units is qualified as capital gains.

Resident investors

Personal Income Tax (*Imposto sobre o Rendimento das Pessoas Singulares* – IRPS): investment income earned by resident beneficiaries is subject to final withholding tax at a 20% rate.

The positive difference between capital gains and capital losses assessed by resident beneficiaries on the sale of fund units is included in the taxable income of the beneficiary and subject to taxation at progressive income rates (currently between 10% and 32%). Such balance may be partially exempt according to the holding period of fund units.

IRPC: investment income payments to a resident entity are subject to withholding tax at a rate of 20% (to be paid on account of the final CIT bill). Such income will subsequently be included in the entity's final IRPC tax result.

Capital gains earned on the sale of fund units are also included in the final IRPC tax result of the resident entity and are subject to IRPC at a 32% rate.

Non-resident investors

IRPS: investment income earned by non-resident beneficiaries is subject to a final withholding tax at a rate of 20%.

As a rule, capital gains taxation on the sale of fund units is similar to that which is set out above for resident individuals. Nevertheless, capital gains obtained by non-resident investors do not benefit from partial exemption according to the fund units' holding period and are fully taxed.

IRPC: investment income paid to a non-resident entity is subject to a 20% final withholding tax rate.

As a rule, capital gains taxation on the sale of fund units is similar to that which is set out above for resident corporate beneficiaries, with the exception that capital gains obtained by non-resident investors do not benefit from partial exemption according to the fund units' holding period and are fully taxed.

Pension funds

Pension funds established and operating according to Mozambique law are subject to a similar tax treatment to that mentioned above for resident investors subject to IRPC.

Pension funds established and operating according to the laws of a foreign jurisdiction are subject to a similar tax treatment to that mentioned above for non-resident investors subject to IRPC.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

Mozambique legislation provides for a tax ruling system in which tax authorities may provide a binding ruling by request. In this respect, since there is no specific tax regime for investment funds, we would recommend the request for a tax ruling in order to obtain more certainty on the taxation that will be applicable. This results from the fact that, after the ruling is issued, the decision obtained by the taxpayer (which it may request previously to a potential transaction or the setting up of a fund) is binding on the tax authorities and may only be amended or changed by a court decision.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Mozambique has not entered into any treaty or adhered in any way to any mechanism in order to implement either FATCA or the Common Reporting Standard and, to the best of our knowledge, no initiative has been undertaken by the Mozambique authorities regarding this matter.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Mozambique is not an OECD Member State and we are not aware of any initiative by the Mozambican tax authorities regarding this subject.

However, the OECD's Commissioners General and Heads of Delegations of the Revenue Authorities of Botswana, Lesotho, Mozambique, Namibia, South Africa, Swaziland and Zambia gathered in Pretoria, South Africa on 16 July 2015 in order to discuss BEPS, among other matters. No further relevant developments have occurred so far on these topics.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

No, there are not.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

No, there are not.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No, there are not.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The Mozambique capital markets framework has been subject to several updates in recent years. However, at the present date, the UCI Law remains in urgent need of a complete revamp in order to address its shortfalls and increasing market needs, particularly as far as real estate AIFs are concerned.

Nonetheless, we are not aware of any legislative initiatives aimed at amending or updating the UCI Law currently in effect.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

No reforms in the Alternative Investment Funds space are expected to occur any time soon.

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VdA

1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Activity involving the management, investment and marketing of Alternative Investment Funds (AIFs) is mainly regulated by: the Undertakings for Collective Investment Law (*Regime Geral dos Organismos de Investimento Coletivo*), enacted by Law no. 16/2015 of 24 February 2015 (the UCI Law), which implemented, in Portugal, Directive 2009/65/EC on undertakings for collective investment in transferable securities (UCITS) (UCITS Directive), as amended from time to time; Directive 2011/61/EU on Alternative Investment Fund Managers (the AIFMD), which sets out most of the rules relating to AIFs; CMVM Regulation no. 2/2015 on Undertakings for Collective Investment (Regulation no. 2/2015), which sets forth more specific rules regarding certain aspects of the UCI Law; and the Portuguese Securities Code (*Código dos Valores Mobiliários* or PSC), enacted by Decree-Law no. 486/99 of 13 November 1999, as amended from time to time, which entered into force on 1 March 2000.

The Portuguese Securities and Exchange Commission (*Comissão do Mercado de Valores Mobiliários* or CMVM) is the competent regulatory body in relation to the aforementioned matters.

In addition, it should be noted that, in Portugal, the AIFMD has been partially implemented by Law no. 18/2015 of 4 March 2015, relating to venture capital, social entrepreneurship and specialised investment (the Venture Capital Law).

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Yes. Fund managers are also subject to the CMVM's authorisation and supervision in what concerns the rules governing their management of AIFs' activity.

Therefore, the fund managers' authorisation procedure will be conducted before the CMVM.

The UCI Law did not implement, in Portugal, the *de minimis* exemption foreseen in the AIFMD. As a result, all fund managers, regardless of the asset under management, will need to comply, in general terms, with the same requirements.

Nonetheless, considering the type of AIFs the fund manager intends to manage, i.e. AIFs investing in securities or financial assets, non-financial assets or real estate, there will be some specific requirements to be met, notably as regards investment policies and contracts with service providers.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Yes. The setting up of AIFs is subject to authorisation by the CMVM, which is the competent regulator to undertake the supervision of AIF managers, ancillary service providers, AIFs' distributors and compliance with the general rules applicable to AIFs, notably those relating to the protection of investors' interests.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes. In general terms, the UCI Law distinguishes between AIFs investing (i) in securities or financial assets, such as undertakings for collective investment in transferable securities that do not comply with the UCITS Directive limits and are thus classified as AIFs which invest in securities, (ii) in real estate (real estate investment funds), and (iii) in long-term non-financial assets with a determinable value.

Furthermore, Regulation no. 2/2015 allows AIFs investing in securities to adopt the branding of an AIF investing in bonds, shares, index trackers, money-market funds, etc., provided that its investment policy complies with certain criteria.

The AIFs described in points (i) and (ii) above may be open- or closed-ended, but the type referred to in point (iii) shall be closed-ended.

The UCI Law does not contain any specific provisions regarding private equity or hedge funds; thus in principle they will be encompassed by the regime of the AIFs investing in securities. Nevertheless, the Venture Capital Law contains a specific regime applicable to funds investing in equity instruments for a limited period of time, as well as in other structures, which, despite having similar features to the undertakings for the collective investment (UCI) framework, are perceived under Portuguese law as being an autonomous subject. That being said, the Venture Capital Law falls outside the relevant scope of this chapter.

In general terms, open-ended AIFs are addressed to the retail market and closed-ended AIFs target affluent or professional investors. As a result, the CMVM's scrutiny over open-ended AIFs tends to be tighter.

Furthermore, depending on the type of AIF at stake and whether it is open or closed-ended, different investing limits will apply, notably in respect of leverage and asset allocation.

1.5 What does the authorisation process involve and how long does the process typically take?

In a nutshell, the authorisation for the setting up of an AIF must be filed with the CMVM. In requesting such authorisation, the relevant AIF's manager must provide the CMVM with the AIF's documentation, notably the Key Investor Information Document (KIID) and the full prospectus of the AIF (if applicable), which must also include the AIF's regulation.

In addition, the CMVM must also be given copies of the agreements to be executed between the management company and (i) the depository, (ii) the distributors or entities that will market the AIF, and (iii) any other entities that will render services to the AIF or the AIF manager.

Documents evidencing the acceptance of the rendering of the relevant services by all entities involved in the AIF's activities must also be provided to the CMVM.

An authorisation is given within 20 days (or three months, extendable for another three by decision of the CMVM, in the case of self-managed collective investment companies) of the receipt of either the fully documented application or of any supplementary information or amendments to the documents required by the CMVM. If at the end of such period the applicants have not yet been notified of the deferral of their application, the authorisation is considered to have been tacitly granted.

The CMVM may refuse the authorisation if the applicant does not submit the required documentation or if the AIF manager at stake engages in irregular management of other investment funds.

After the authorisation has been granted, an AIF will be fully set up from the moment the first subscription is settled or the from the moment the articles of association are registered with the Commercial Registry Office, depending on the AIF being set up, respectively, under the contractual form or as a company.

1.6 Are there local residence or other local qualification or substance requirements?

Considering that the vast majority of AIFs in Portugal have been set up under the contractual form with no legal personality, they ought to be managed by a separate fund manager.

The fund manager may be a Portuguese incorporated entity or an entity providing services on a cross-border basis under the AIFMD passport legal framework, either through the free provision of services or the freedom of establishment.

As regards Portuguese incorporated fund managers, they shall have a board of directors comprising at least two members.

Moreover, pursuant to Law no. 148/2015 of 9 September (Auditing Supervision Framework), the fund manager shall also have an audit board comprising at least three members (the majority of which need to be considered independent) plus a sole auditor.

The members of the board of directors and audit board of the fund manager need to be previously authorised by the CMVM, being subject to a thorough suitability assessment during such a procedure.

Furthermore, the fund manager shall have in place several internal policies aiming to address the risk of its activity, remuneration issues, outsourcing, internal control, evaluation of the assets pertaining to the AIFs under management, anti-money laundering, selection of the members of the boards of directors and audit board, all subject to the control of the CMVM and to a certain extent of the depository, and entailing permanent record-keeping by the fund manager.

1.7 What service providers are required?

An AIF is legally required in Portugal to have a fund manager (if it is not endowed with legal personality), a depository, an auditor and, in the case of real estate AIFs, real estate appraisal experts.

Furthermore, the AIF may also have, but is not legally compelled to have, distributors or entities that will market the AIF, which is standard practice in the case of open-ended AIFs.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

The same rules established for national managers will apply, in addition to the harmonised rules for requesting a passport to carry out the management of AIFs' activity in Portugal.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

In accordance with the information currently available on the CMVM's website, the CMVM has signed memorandums of understanding with the competent regulators of other non-EU Member States, namely Abu Dhabi, Algeria, Angola, Cabo Verde, China, Israel, Malaysia, Mozambique, the USA (SEC), etc.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

An AIF may take one of two forms or structures, both subject to the licensing procedures described in question 1.5 above:

- Contractual structure with no legal personality. This is the classic structure and requires that the AIF be managed by a separate fund manager. The investors' or participants' interests in these funds are called units (*unidades de participação*).
- Collective investment company endowed with legal personality (*sociedade de Investimento coletivo*). They may be self-managed or have appointed a third party as their manager, which must be a duly authorised investment fund manager. Participants in these collective investment companies will hold shares (*ações*).

In Portugal, besides two collective investment companies endowed with legal personality that have been set up to date, all AIFs are usually set up under the contractual structure with no legal personality.

In an overall assessment of the pros and cons of both structures, it should be taken into account that the contractual structure has a long track record in Portugal, being the preferred choice for setting up AIFs, as it offers an affordable, simple and well-known model for AIFs.

Conversely, the collective investment company endowed with legal personality and being self-managed is clearly a more complex model that allows, however, greater control for the investors over the management of the AIF. Nonetheless, the lack of a decisive incentive to change the current *status quo* in respect of the way AIFs are usually set up in Portugal may be deemed as holding back a better use of the opportunities offered by this structure.

Recently, we have also been assisting in a market trend based on the transformation of non-AIF companies into collective

investment companies endowed with legal personality, but externally managed by a fund manager. This model does not differ significantly from a contractual structure, given that it needs to have a fund manager in place complying with the aforementioned requirements.

Lastly, real estate investment trusts (SIGIs) are not subject to the UCI Law nor do they need to be managed by a fund manager. Even though SIGIs are qualified as real estate collective investment companies endowed with legal personality, they are only subject to the SIGIs Framework, the Portuguese companies code and certain provisions of the PSC regarding publicly traded companies.

SIGIs' main activity is the acquisition of rights in real estate, leases or other forms of economic exploitation of real estate, the acquisition of holdings in companies with similar purposes and under equivalent requirements and the acquisition of units or shares in real estate AIFs, whose profit distribution policy is equal to the one provided for in the SIGIs Framework. The shares of SIGIs are traded on a regulated market or multilateral trading facility. In addition, SIGIs are subject to specific requirements regarding the dissemination of their share capital, asset allocation and profit distribution to investors.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Legally, the asset of an AIF is only liable for its debts, thus it will not be liable for investors, the fund manager, depository, distributors or other AIFs' debts. Likewise, investors are not personally liable for the AIF's debts and will under no circumstances be burdened by any debt of the AIF.

Notwithstanding, in the case of closed-ended real estate AIFs, the UCI Law allows for the AIF's regulation to establish that, following a resolution of the investors' assembly, the investors in a privately subscribed real estate AIF will take over the debts of the AIF, provided that the creditors agree so and that it is ensured that the debts arising after the extinction of the AIF will be taken over by the fund manager.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

An AIF, which is not self-managed, will need to be managed by a fund manager authorised to manage AIFs (*sociedade gestora de organismos de investimento coletivo*).

Considering that it is unusual for an AIF to be self-managed in Portugal, almost every AIF is managed by fund managers as described in the paragraph above.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

The UCI Law is silent in respect of the ability of the fund manager to restrict redemptions in open-ended funds but considering that such types of AIFs in general target retail investors, the CMVM will most certainly closely scrutinise this matter. In fact, such possibility would need to be clearly set out in the AIF's regulation, which is analysed during the authorisation procedure.

Moreover, the layout of the AIF regulation, approved by Regulation no. 2/2015, contains a field where the conditions set out for redemptions must be described, but only as regards the applicable fees, settlement dates and the criteria for the determination of which units/shares will be redeemed. Likewise, Regulation no. 2/2015 only seems to foresee conditions under which redemptions may be suspended, but not restricted.

As regards the restriction of transfers in open-ended funds, the same rationale described above in respect of the redemption applies.

Conversely, regarding closed-ended AIFs, mainly those targeting professional investors, it is possible to establish in the AIF's regulation restrictions on the transfer of units from investors to third parties.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no legislative restrictions.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The ability of the manager to manage its funds will be mainly limited by the investment policy established in the AIF's prospectus or regulation, as applicable, by the general investment limits by type of AIF, if any, established in the UCI Law and by the obligation to conduct its activity in the best interest of the investors.

The UCI Law has a list of acts that a manager cannot carry out, such as granting loans, executing certain transactions on its own account, executing transactions relating to the assets held by the AIF with related parties, e.g., entities of its group, the depository, etc.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Please refer to question 1.1 above. In addition, marketing materials are also subject to the general provisions regarding marketing of products to the public, such as the Marketing Code, etc.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

Regulation no. 2/2015 provides minutes for the AIF's legal documents (KIID, prospectus and regulation).

On the contrary, there are no minutes available in respect of marketing materials. Nonetheless, it is common practice for the fund manager and other distribution entities to provide information on the investment policy, markets targeted, main features (identification of the relevant entities, ISIN Code, terms and conditions of the investment, links to the legal documents) and historic returns of the AIF.

Pursuant to Regulation no. 2/2015, if the marketing materials disclose return figures, they shall also contain, at least:

- The identification of the AIF and fund manager.
- The reference "the disclosed returns represent past data and do not guarantee future returns".
- The identification of the reference period for return figures indicated.

- Confirmation on whether or not the return figures disclosed already include the applicable taxation.
- Information on where and how the KIID and other legal documents may be obtained.
- In cases where the AIF's units/shares are admitted to trading on a regulated market, identification of the market at stake and if the values disclosed are calculated on the basis of the asset value or on the market value of the units/shares.
- The warning that investment in the AIF may lead to the loss of principal invested, in cases where the AIF does not guarantee payment of the principal invested.
- If the figures disclosed are annualised, but have a reference period greater than one year, the information disclosed shall also contain the reference according to which the reference return could only be obtained if the investment was performed during the entire period of reference.
- The risk level, with identical emphasis of the return figure, for an identical period of reference.

Lastly, as a general note, in accordance with the PSC, the information contained in the marketing materials shall be prepared in Portuguese or followed with a duly legalised translation, and must be complete, true, updated, clear, objective and licit.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Marketing materials in respect of AIFs do not need to be registered or authorised by the CMVM.

However, an AIF's legal documents, namely the KIID, the full prospectus of the AIF and/or the AIF's regulation, as well as any further amendment to them, need to be registered with the CMVM and publicly disclosed through the CMVM's website.

3.4 What restrictions are there on marketing Alternative Investment Funds?

The marketing or distribution (*comercialização*) of AIFs is very broad, being defined as the activity directed towards investors with a view to promoting or proposing the subscription of units/shares, regardless of the means of communication used.

The entities that are legally permitted to market AIFs are (i) AIF managers, (ii) depositaries, (iii) financial intermediaries registered or authorised by the CMVM to perform the relevant activities, namely those of placement or reception and transmission of orders on behalf of third parties, and (iv) other entities as foreseen in Regulation no. 2/2015 and subject to its authorisation.

Furthermore, the concept of reverse solicitation is not an official exemption from the UCI Law requirements, but rather a tolerated practice, which consists of an investor, on its own initiative and without any previous engagement on the part of the distributor, requesting information on the AIF at stake. However, a case-by-case assessment needs to be conducted, considering that the new AIFMD framework has induced a greater use of the reverse solicitation expedient, which may come under the CMVM's scrutiny.

Virtually every type of marketing falls into the category of distribution (*comercialização*); thus if such is not carried out by a duly licensed entity or under the reverse solicitation exemption, it will be in breach of the UCI Law.

A clear distinction must be drawn regarding pre-marketing. If such marketing is conducted in relation to a specific AIF with the intention of triggering a future solicitation by the addressee to receive more information and subscribe the AIF, it is rather likely that the CMVM will consider it to fall within the concept of actual marketing. Conversely, if the pre-marketing has only a general nature, there are grounds to sustain that it does not constitute a marketing activity subject to the UCI Law requirements.

An AIF may only be marketed in Portugal after its constitution has been authorised by the CMVM and, in any case, the marketing material may contradict or diminish the importance of the AIF's prospectus or regulation and KIID.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

The concept of pre-marketing is not expressly recognised in the UCI Law and is generally viewed by the CMVM as being encompassed in the concept of marketing itself (please refer to question 3.4 above).

Nevertheless, if the pre-marketing has only a general nature, i.e. it seeks to present to the investor the existence and activity carried out by the fund manager or an overall look at the market, without recommending or referring to any investment opportunity in particular, there are grounds to sustain that it does not constitute a marketing activity subject to the UCI Law requirements.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes. However, AIFs passported under the AIFMD can only be marketed in Portugal to professional investors.

In order for the AIF to be marketed to retail investors in Portugal, the fund manager will need to obtain an authorisation of the CMVM, to be granted after the conclusion of a registration procedure in Portugal of the AIF.

3.7 What qualification requirements must be met in relation to prospective investors?

There is no particular requirement to be fulfilled in relation to investors in AIFs.

Nonetheless, the fund manager shall ensure that the "know your customer and investment suitability analysis" is properly carried out in relation to the potential investor, as well as ensure that the anti-money laundering and terrorism financing procedures are respected.

We stress that in the case of AIFs exclusively targeting professional investors, the fund manager shall guarantee that the investors that do not meet such eligibility criteria cannot invest in the AIF.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no additional restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

No. However, the holding of units/shares in AIFs may have an impact, that needs to be assessed on a case-by-case basis, on the own funds and reserves of the credit and financial institutions.

Regarding the Portuguese pension funds sector, there are limits relating to the representation of technical provisions with interests in AIFs, as well as to the asset allocation of pension funds, which restricts the exposure to a single AIF or the investment in AIFs in excess of a certain percentage of the portfolio, which will vary in accordance with the entity at stake.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

No. However, the relationship established between the intermediaries and the AIF shall be put in a written agreement and disclosed in the AIF's legal documents.

Furthermore, the intermediary, when carrying out the fundraising process, needs to act within the scope of activities that it is authorised to conduct, *i.e.* if the fundraising process corresponds to marketing of the AIF under the UCI Law, the analysis carried out in respect of question 3.4 above will be entirely applicable herein.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Yes. AIFs can only focus on investment activities and their management and investment shall comply with the general rules applicable to the financial instruments markets, notably those resulting from the implementation carried out in Portugal of the MiFID II by the PSC, with the due adaptations in accordance with their specific nature.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Yes. The assets eligible for the portfolio of the AIF will depend on its specific type.

Therefore, AIFs investing in securities or financial assets, such as undertakings for collective investment in transferable securities that do not comply with the UCITS Directive limits, may also invest up to 10% of their net asset value (NAV) in units/shares of real estate AIFs. Moreover, the AIF's regulation shall set out the other relevant limits, otherwise the limits established in the UCITS Directive, as implemented by the UCI Law, shall apply.

Real estate investment funds shall invest the majority of their assets in real estate, but may also invest in shares of real estate investment companies (*sociedades imobiliárias*), derivatives, mainly for hedging purposes, units/shares of other real estate investment funds and liquidity instruments. The extent to which the investment in the referred assets is limited will depend on whether the AIF is closed-ended or open-ended, and privately or publicly subscribed. Either way, the real estate investment fund cannot invest in assets encumbered, with liens or charges that may render its future disposal more difficult, such as *in rem* security.

AIFs that invest in long-term non-financial assets with a determinable value need to hold at least 30% of their NAV in long-term non-financial assets with a determinable value and may invest up to 25% of their NAV in real estate, units/shares in real estate investment funds and shares in real estate investment companies.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

As a matter of principle, the investment in derivatives by AIF is generally limited to risk management purposes, save for specific cases where they may be used of leveraging purposes and if that is specified in the AIF's constitutional documents.

Loans originating from AIFs are not allowed in general terms under Portuguese law. Nevertheless, a recent amendment to the Venture Capital Law created a new type of AIF, the loan originating fund, which may extend loans, subject to the limitations established in CMVM Regulation no. 3/2015, as amended; namely, it cannot extend credit to natural persons or credit institutions and the maturity of the loans shall not exceed the maturity of the AIF.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Yes. In respect of real estate AIFs, the borrowing limits are 25% of the asset for open-ended AIFs and 33% of the asset for closed-ended publicly and privately (by more than five investors, which are not exclusively qualified as professional investors) subscribed AIFs. Closed-ended AIFs which are privately subscribed by five or fewer retail investors or whose investors are exclusively qualified as professional investors are not subject to any borrowing limit.

As regards AIFs investing in securities or financial assets and AIFs investing in long-term non-financial assets with a determinable value, their regulations shall set out the limits for borrowing.

4.5 Are there any restrictions on who holds the Alternative Investment Fund's Assets?

The depository is required to register or hold in deposit all assets of the AIF, save for those that due to its nature such is not possible, e.g., property or tangible assets.

In case the depository cannot register an asset nor receive it in deposit, it will be required to confirm that the AIF holds valid entitlement of ownership, or other right, over the referred asset, namely by verifying the relevant supporting legal and contractual documentation.

Regarding the bank accounts of the AIF, in case they are not opened with the depository, the latter will be required to set up a system to monitor the cash flow and transaction involving all accounts of the AIF.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

Besides the reporting obligations referred to in question 5.3 below, the elements that are made available to the public on the CMVM's website and the identity of the persons/companies holding qualifying shareholdings (10% or more) in the fund manager shall also be publicly disclosed.

Furthermore, the legal documents of the AIFs and their updates shall also be made available on the CMVM's website. Considering that the legal documents shall describe the identity

of the fund manager, depository, auditor, distributors and other services providers to the AIF, the majority of the data in connection with the AIF will be made available to the public.

However, the identity of the investors in the AIF is not mandatorily subject to public disclosure.

Additionally, under Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, AIFs, or their managers, as applicable, must publish on their websites their sustainability statement and remuneration policies, including information on how those policies are consistent with the integration of sustainability risks, as well as make available to potential investors pre-contractual information on sustainability.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

The implementation in Portugal of the Fourth Anti-Money Laundering Directive set out a broad range of administrative measures to prevent and tackle breaches of the applicable AML/CFT framework. Within this context, the Ultimate Owner Central Registry (*Registo Central do Beneficiário Efetivo*) was created, in order to collect and centralise the data provided by entities subject to this framework.

AIFs and fund managers or any other entity established in Portugal or possessing a Portuguese taxpayer number will need to provide information to the Registry, and keep it permanently updated, on their ultimate beneficial owners, which, depending on the specific case, may include details on the investors and their shareholders or controllers.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

The fund manager must prepare and publish annual and biennial accounts. These must be made available free of charge at the investors' request.

The marketing entity must send or make available to the investors a statement informing them of:

- the number of units such investor holds; and
- their value and the aggregate value of the investment.

In addition to this information, the marketing entity may provide any additional information regarding the investor's financial situation. For example, if the marketing entity is a bank of which the investor is a client, it could provide the above information together with the investor's bank statement.

Any information published pursuant to the requirements set out below is available to investors, usually through the CMVM's information diffusion system (website).

Moreover, the fund manager must publish and send to the CMVM:

- The annual accounts within four months after the end of the financial year.
- The biennial accounts within two months after the end of the relevant semester.
- An inventory of the fund's asset portfolio, its global net value, any responsibilities not found in the balance sheet and the number of units currently in circulation, on a monthly basis.

The fund manager as a regulated entity shall also, in respect of its activities, prepare and submit its accounts and financial statements and internal control report to the CMVM.

Lastly, the fund manager needs to provide the CMVM with continuous regulatory reports on its activities and the funds under management, in accordance with the CMVM's instructions.

Regarding environmental, social and/or governance factors, please refer to question 5.1 above. Currently, the reporting obligations on this matter are pending the entering into force of the relevant regulatory technical standards.

5.4 Is the use of side letters restricted?

The use of side letters that set out particular terms and conditions in respect of governance, investment, etc. of the AIF is not specifically addressed by the UCI Law.

However, in the case of open-ended AIFs, considering that they tend to target retail investors and/or a broader unrestricted scope of investors, the use of side letters that alter any relevant provision of the legal documents, shall be deemed illegal, considering that, as a general principle, the fund manager needs to abide by the AIF's legal documents during the provision of its activity and treat equally all investors.

In closed-ended AIFs, notably those that are privately subscribed or targeting only professional investors, we trust that there is a wider margin to set out, namely through a side letter, giving specific provisions in respect of certain matters. However, in general terms, the provisions of the UCI Law are imperative; therefore any side letter providing for actions in breach of such legal provisions will be deemed illegal and may subject the fund manager to administrative offence proceedings.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

AIFs are subject to corporate income tax (CIT) at the general rate (currently set at 21%) but are exempt from municipal and state surcharges. Taxable income corresponds to the net profit assessed in accordance with an AIF's accounting standards.

However, passive income, such as investment income, rental income and capital gains (except when sourced in a tax haven) are disregarded for taxable profit assessment purposes. Costs incurred in connection with such income (including funding costs) are also disregarded for profit assessment purposes. The following are also disregarded for taxable profit assessment purposes: (i) non-deductible expenses under the CIT Code; and (ii) income and expenses relative to management fees and other commissions earned by AIFs.

An AIF's income is not subject to withholding tax. However, autonomous tax rates established in the CIT Code will apply.

AIFs that are exclusively investing in money market instruments and bank deposits will also be subject to stamp duty calculated on their global net asset value at a rate of 0.0025% (per quarter). Other AIFs will be subject to stamp duty to be levied on their global net asset value at a rate of 0.0125% (per quarter).

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

In the case of AIFs endowed with legal personality that are self-managed, the tax regime referred to in question 6.1 above applies.

On the contrary, in the case of AIFs managed by a third party, income obtained by such an AIF manager (including capital gains earned on the transfer of fund units) is subject to CIT at a rate of 21% to which a municipal surcharge of up to 1.5% may be applicable on taxable profits, depending on the municipality of where the AIF manager is established (the municipalities have the right to decide if the municipal surcharge is levied and at which rate).

Taxable profits are also subject to a progressive state surcharge which has the following applicable rates: (i) 3% on the part of the taxable profits exceeding €1.5 million up to €7.5 million; (ii) 5% on the part of the taxable profits exceeding €7.5 million up to €35 million; and (iii) 9% on the part of the taxable profits exceeding €35 million.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

Establishment taxes are not applicable in Portugal to the mere holding of a participation in an AIF. Please note in this regard that the acquisition of an AIF's units of a privately subscribed closed-ended real estate AIF, as well as operations of redemption, capital increase or reduction, which results in a single investor or two spouses holding more than 75% of the units representing the assets of such AIF, property transfer tax should apply proportionally at the applicable rate (up to 7.5%) to the taxable value or the total value of the assets, as the case may be, but in each case with preference to the evaluation report of the investment fund manager, if higher.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

(a) Resident investors

The taxation of resident investors is as follows:

Personal income tax (PIT): Income distributed or derived from redemptions to Portuguese individuals (outside their commercial activity) is subject to a 28% final withholding tax. If the investor opts to aggregate the income received, it will be subject to progressive income tax rates of up to 48%. In the latter circumstance, an additional income tax will be due on the part of the taxable income exceeding €80,000 as follows: (i) 2.5% on the part of the taxable income exceeding €80,000 up to €250,000; and (ii) 5% on any taxable income exceeding €250,000.

Income payments to omnibus accounts are subject to a final withholding tax rate of 35%, unless the relevant beneficial owner of the income is identified, in which case the tax rates applicable to the beneficial owner apply. Capital gains arising from the transfer of units are taxed at a special tax rate of 28% on the positive difference between capital gains and losses or the above progressive income tax rates and additional income tax rates, if the investor opts to aggregate the income received.

Corporate income tax (CIT): Income payments to a resident entity are subject to withholding tax at a rate of 25% (to be paid on account of the final CIT due) and are qualified as income or gains for CIT purposes. Income payments to omnibus accounts are subject to a final withholding tax rate of 35%, unless the relevant beneficial owner of the income is identified, in which case the standard tax rates applicable to the beneficial owner apply.

A resident entity is subject to CIT at a rate of 21% (if the taxpayer is a small or medium-sized enterprise as established in Decree-Law no. 372/2007 of 6 November 2007, the rate is 17% for taxable profits up to €25,000 and 21% for taxable profits in excess thereof). A resident entity may also be subject to a municipal surcharge (*derrama municipal*) of up to 1.5% on taxable profits, depending on the municipality where it is established (the municipalities have the right to decide if the municipal surcharge is levied and at what rate). Taxable profits are also subject to a progressive state surcharge (*derrama estadual*) which has the following applicable rates: (i) 3% on the part of the taxable profits exceeding €1.5 million up to €7.5 million; (ii) 5% on the part of the taxable profits exceeding €7.5 million up to €35 million; and (iii) 9% on the part of the taxable profits exceeding €35 million.

Capital gains earned on the transfer of fund units are fully included in the taxable income of the resident entity and are subject to the same rates and surcharges as above.

(b) Non-resident investors

Non-resident investors are taxed as follows:

PIT: Income payments and capital gains derived from units in a securities AIF are exempt from PIT provided that the evidence of non-resident status required by the tax law is timely delivered by the beneficiary of the income to the AIF. A refund procedure is available within a two-year period in cases where a 28% withholding tax was applied for failure to timely deliver the documentation. The refund procedure requires the certification of a special form by the competent authorities of the state of residence. Non-resident investors domiciled in a blacklisted jurisdiction listed in Ministerial Order 150/2004 of 13 February, as amended from time to time, are not able to benefit from income tax exemptions and, in addition, will be subject to an aggravated 35% withholding tax. Income payments to accounts opened in the name of one or more account holders acting on behalf of one or more unidentified third parties are subject to a final withholding tax rate of 35%, unless the relevant beneficial owner of the income is identified, in which case the tax rates applicable to the beneficial owner apply.

Non-resident individuals who obtain income distributed by a real estate AIF or through the redemption of such AIF units shall become subject to withholding tax at the final rate of 10% provided the non-residence evidence in Portugal has been obtained in due time. Capital gains deriving from the sale of said units are taxed autonomously at a 10% rate.

If the exemptions or reduced withholding tax rates do not apply, the general rules and tax rates (28% or 35%, as the case may be) will apply.

CIT: A CIT exemption applies where income arising from the units of a securities AIF is distributed or made available to a non-resident entity without a permanent establishment in Portugal. Capital gains arising from the transfer of the said units are also exempt from CIT.

In order to benefit from such exemptions, adequate evidence of non-resident status must be timely provided.

Non-resident corporate investors who obtain income distributed by a real estate AIF or through the redemption of units on such AIF are subject to withholding tax at the final rate of 10%. Capital gains deriving from the sale of units in a real estate AIF are taxed autonomously at a rate of 10%.

However, non-resident investors cannot benefit from the exemptions or the reduced withholding tax rates, as the case may be, pursuant to the characteristics of the AIF, if: (i) the non-resident entity is domiciled in a blacklisted jurisdiction listed in Ministerial Order 150/2004 of 13 February, as amended from time to time; (ii) more than 25% of the capital of the non-resident entity is held, directly or indirectly, by resident legal entities except when such entities are resident (a) in a Member State of the

EU other than Portugal or in a Member State of the European Economic Area provided, in this case, that such a State is bound to cooperate with Portugal under an administrative cooperation arrangement in tax matters similar to the exchange of tax information existing within the EU Member States, or (b) in a State with which Portugal has a double tax treaty in force or a tax information exchange agreement in force; or (iii) non-resident investors have not timely provided non-residence evidence in Portugal.

If the exemptions or reduced withholding tax rates do not apply, the general rules and tax rates (25% or 35%, as the case may be) will apply.

(c) Pension fund investors

Pension fund investors are taxed as follows:

(1) Pension funds that are established and operate in accordance with Portuguese law are taxed as follows:
   - (i) In the event of income deriving from AIFs distributions, pension funds are exempt from CIT and are exempt from withholding tax.
   - (ii) In the event of income deriving from the redemption of the units or liquidation of the AIF, pension funds are subject to withholding CIT at a 25% rate, which will be refunded upon submission of the annual income tax return, since pension funds are exempt from CIT.

(2) Pension funds that are established and operate in accordance with the law of a Member State of the EU other than Portugal or in a Member State of the European Economic Area are taxed as follows:
   - (i) In the event of income distributed by real estate AIFs or through the redemption of the units or liquidation of such a real estate AIF, the pension funds are subject to withholding tax at a final rate of 10%.
   - (ii) In the event of income deriving from securities AIFs, including income deriving from distributions and from the redemption of the units or liquidation of the AIF, pension funds should be exempt from CIT. In order to benefit from such exemptions, adequate evidence of non-resident status must be timely provided.
   - (iii) However, non-resident pension funds cannot benefit from the exemptions or the reduced withholding tax rates, as the case may be, pursuant to the characteristics of the AIF if: (i) the non-resident pension fund is domiciled in a blacklisted jurisdiction listed in Ministerial Order 150/2004 of 13 February, as amended from time to time; (ii) more than 25% of the capital of the non-resident pension fund is held, directly or indirectly, by resident legal entities except when such entities are resident in a Member State of the EU other than Portugal or in a Member State of the European Economic Area provided, in this case, that such a State is bound to cooperate with Portugal under an administrative cooperation arrangement in tax matters similar to the exchange of tax information existing within the EU Member States or in a State with which Portugal has a double tax treaty in force or a tax information exchange agreement in force; or (iii) non-resident pension funds have not timely provided non-residence evidence in Portugal.
   - (iv) If the exemptions or reduced withholding tax rates do not apply, the general rules and tax rates (25% or 35%, as the case may be) will apply.

(3) In addition, pension funds that are established and operate in accordance with the law of a Member State of the EU other than Portugal or in a Member State of the European Economic Area are exempt from CIT, provided, in this case, that such Member State is bound to cooperate with Portugal under an administrative cooperation arrangement in tax matters similar to the exchange of tax information existing within EU Member States that are also exempt from CIT, provided the following cumulative requirements are met:
   - (i) the pension fund covers exclusively the payment of retirement benefits for old age or disability, for survival, for early retirement, post-employment healthcare benefits and, where they are supplementary to those benefits and are provided on an ancillary basis to the previously mentioned benefits, the attribution and death grants;
   - (ii) the pension fund is managed by institutions for occupational retirement, as provided by Directive no. 2003/41/EC, of the European Parliament and of the Council, of 3 June;
   - (iii) the pension fund is the ultimate beneficial owner of the income; and
   - (iv) with respect to income distributions made by AIFs, the corresponding participation in the share capital is held, continuously, for at least one year.

   In this case, however, it is not clear if the applicable exemption for CIT purposes at the level of the pension funds enables either (i) the operation of a withholding tax exemption upon payment of income from the AIF to the pension fund or, alternatively, (ii) the attribution to the pension funds the right to claim a refund of the CIT withheld. To the best of our knowledge, the tax authorities have not provided any public guidance in this respect up as of the time of writing.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

Portuguese taxpayers may request advance rulings regarding specific tax situations. When advance rulings are issued, the tax authorities may not derogate from such rulings in relation to the taxpayers that requested it, except pursuant to court decisions.

Subject to the payment of a fee (which may range from €2,550 up to €25,500), an advance ruling may be provided urgently, provided that such request by the applicant is accompanied by a tax framework proposal, reasons raised for urgency and the amount to be determined by the tax authorities according to the complexity of the topic is paid.

If the tax authorities accept the urgency of the matter, the binding ruling will be issued within 75 days from the date of presentation of the request, and in the event that the tax authorities do not issue the ruling in such a time frame, it is considered that the tax treatment presented by the taxpayer is agreed to by the tax authorities. Non-urgent rulings are delivered within 150 days, although this deadline is merely indicative.

Unless the new law does not provide a clear answer on any particular topic that might be raised by an investor, it is not necessary to obtain a tax ruling from the tax or regulatory authorities prior to establishing an AIF.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Portugal has implemented, through Law no. 82-B/2014 of 31 December, the legal framework based on reciprocal exchange of

information on financial accounts subject to disclosure in order to comply with FATCA. Portugal signed an Intergovernmental Agreement with the US on 6 August 2015, which has been in force since 10 August 2016 and, as such, Portuguese financial institutions (funds and fund managers) have implemented procedures to fully comply with the legal reporting and compliance rules.

In addition, the Common Reporting Standard (CRS) has also been enacted, through Decree-Law no. 64/2016, of 11 October 2016, as amended, which implemented the legal framework based on reciprocal exchange of information on financial accounts subject to disclosure in order to comply with CRS and, as such, Portuguese financial institutions (funds and fund managers) have implemented procedures to fully comply with the legal reporting and compliance rules.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

There have been several amendments to the Portuguese legislation in connection with the recommendations of the Base Erosion and Profit-Shifting (BEPS) action plan, issued by the OECD.

The transposition of the ATAD 1 into the domestic legislation enacted through Law no. 32/2019 determined a broader scope of financial costs and a different concept of EBITDA (taxable income or loss not exempt, adjusted by the net financial expenses and by the as the depreciations and amortisations tax deductible).

The missing anti-hybrid mismatch arrangement rules in Portugal were transposed into the domestic legislation by Law no. 24/2020.

Although the rules for reverse hybrid mismatch arrangements will only be effective from 1 January 2022, this new legislation entered into force as of 1 January 2020. Portugal has opted to exclude from the scope of the new legislation, until 31 December 2022, some intra-group financial instruments issued with the purpose of meeting the issuer's loss-absorbing capacity requirements.

The transposition of the anti-hybrid mismatch arrangement rules was made without any significant differences from the wording of ATAD2.

In what regards the interest limitation rule, Law no. 24/2020 has only amended it by removing securitisation companies from the category of entities that are not subject to interest barrier rules. This exemption continues to apply to supervised banking entities, insurance entities, pension funds, branches located in Portugal of credit institutions, other financial institutions and insurance companies.

Law no. 32/2019 introduced significant changes to the general anti-abuse clause and to its application procedure in order to facilitate the application of the general anti-abuse clause, ensuring a higher level of protection against abusive planning and fiscal avoidance schemes.

The main amendments were (i) the extension of the controlled foreign corporation (CFC) rules' scope, now being applicable to entities subject to a clearly privileged tax regime and to entities whose tax effectively paid in their State of residence is less than 50% of what would be due if calculated in accordance with the Portuguese Corporate Income Tax Code (instead of being applicable to entities subject to a tax rate below 60% of its statutory rate), and (ii) the allocation ceases to be made with reference to the accounting profit of the CFC determined according to the accounting standards in force in the State of residence and to start being implemented with reference to the tax profit assessed under the Portuguese CIT rules.

Portugal is also a signatory of the Multilateral Convention for the implementation of measures related to tax treaties, being in force in Portugal since 1 June 2020.

The Portuguese State Budget for 2021 has also implemented substantial amendments to the concept of permanent establishment, by broadening the domestic concept in order to bring it closer to recent developments at OECD level. Notably, the permanent establishment concept covers now also (i) a person who only habitually exercises a determining role in concluding contracts routinely and without substantial change, or (ii) a company providing services in the Portuguese territory and for a period (or periods) exceeding 183 days in total in a 12-month period, by employees of the non-resident entity, as well as other persons contracted by the company.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

There are some types of investment funds that benefit from a tax-advantaged treatment, namely: (a) Real Estate Investment Funds on Forest Resources; (b) Residential Letting Real Estate Investment Funds; (c) Real Estate Investment Funds on Urban Rehabilitation; and (d) Venture Capital Funds.

(a) Real Estate Investment Funds in Forest Resources

Real Estate Investment Funds in Forest Resources (REIFFR) incorporated under Portuguese law are exempt from CIT when at least 75% of their assets are allocated to exploitation of forest resources according to approved forest management plans, provided they are carried out according to the applicable regulations and are subject to the legal forest certification proceedings.

Investors who obtain income distributed by a REIFFR are subject to withholding tax at the rate of 10% unless: (i) the investors are entities exempt from CIT on capital income; or (ii) the investors are non-resident entities with no permanent establishment in Portugal to which the income can be attributed and that do not reside in a blacklisted jurisdiction or that are not more than 25% held by resident entities.

Individual investors subject to PIT who opt to aggregate the income received may deduct 50% of the distributed income that concerns to dividends, as a means of eliminating economic double taxation.

Capital gains deriving from the transfer of units are taxed at a 10% rate if the investors do not benefit from the specific exemption applicable to capital gains obtained by non-residents (foreseen in Article 27 of the Portuguese Tax Benefits Code) or if they are individual investors who do not obtain this income under their professional activity and that do not opt to aggregate the income received.

Whenever the conditions above described regarding the composition of the fund's assets cease to be met, the investment fund and its investors shall be taxed according to the regime described in questions 6.1 and 6.4.

For contributions in kind made for the subscription of units made by resident or non-resident individuals, no income is assessed from the transfer of rural properties intended for forest exploitation, and the acquisition value of such properties is considered as the acquisition value of those contributions for tax purposes.

Also, the acquisitions by REIFFR of rural properties intended for forest exploitation or parcels of the ownership right relating to these rural properties are exempt from stamp duty.

(b) Residential Letting Real Estate Investment Funds

Residential Letting Real Estate Investment Funds (RLREIFs) incorporated between 1 January 2008 and 31 December 2015 are exempt from CIT, Property Transfer Tax and Stamp Duty levied on the transfer of the immovable property to the RLREIF when the previous owners become the tenants or when they opt to purchase the immovable property, in accordance with the lease contract.

Investors who obtain income deriving from these funds are exempt from CIT and PIT, except with regard to capital gains earned on the transfer of fund units.

These benefits shall apply if certain conditions are met, such as the RLREIF's portfolio being composed of a minimum of 75% of real estate located in Portugal and used for residential letting purposes.

Whenever the legally required conditions cease to be met, the investment fund and its investors shall be taxed according to the regime described in questions 6.1 and 6.4.

(c) Real Estate Investment Funds for Urban Rehabilitation

Real Estate Investment Funds for Urban Rehabilitation (REIFURs) incorporated between 1 January 2008 and 31 December 2013, of which 75% of their assets are immovable property subject to urban renewal and located in urban renewal areas, are exempt from CIT on income of any type. This exemption is only applicable if urban renewal interventions were initiated after 1 January 2008 and concluded up to 31 December 2020.

Income distributed by the REIFUR is subject to withholding tax at the rate of 10% unless: (i) the investors are entities exempt from CIT on capital income; or (ii) the investors are non-resident entities with no permanent establishment in Portugal to which the income can be attributed and that do not reside in a blacklisted jurisdiction or that are not held in more than 25% by resident entities. This withholding tax becomes final when the investors are non-resident and have no permanent establishment in Portugal or when they are individual investors who earn this capital gains irrespective of their professional activity and that do not opt to aggregate the income received.

Individual investors subject to PIT who opt to aggregate income received may deduct 50% of the distributed income corresponding to dividends, as a means of eliminating the economic double taxation.

Capital gains deriving from the transfer of units are taxed at a 10% tax rate if the investors do not benefit from the specific exemption applicable to capital gains realised by non-residents (foreseen in Article 27 of the Portuguese Tax Benefits Code) or if they are individual investors who do not obtain this income under their professional activity and that do not opt to aggregate the income received.

Whenever the conditions above described regarding the composition of the fund's assets cease to be met, the investment fund and its investors shall be taxed according to the regime described in questions 6.1 and 6.4.

(d) Venture Capital Funds

Venture Capital Funds constituted under the Portuguese law are exempt from CIT on any type of income.

Investors who obtain income deriving from the distribution of income by a venture capital investment fund or from the redemption of units on such funds are subject to withholding tax at the rate of 10% unless: (i) the investors are entities exempt from CIT on capital income; or (ii) the investors are non-resident entities with no permanent establishment in Portugal to which the income can be attributed. This exception does not comprise investors that reside in a blacklisted jurisdiction or that are more than 25% held by resident entities. This withholding tax becomes final when the investors are non-resident and have no permanent establishment in Portugal or when they are individual investors who earn this capital gains irrespective of their professional activity and that do not opt to aggregate the income received.

Capital gains deriving from the transfer of units are taxed at a 10% rate if the investors do not benefit from the specific exemption applicable to capital gains obtained by non-residents (foreseen in Article 27 of the Portuguese Tax Benefits Code) or if they are individual investors who do not obtain this income under their professional activity and that do not opt to aggregate the income received.

(e) Real Estate Investment Trust

Real Estate Investment Trusts are subject to the same tax regime as Real Estate Investment Funds and Real Estate Investment Trust investors are subject to the same tax regime as Real Estate Investment Fund investors.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

The acquisition of real estate by an AIF is subject to Property Transfer Tax (up to 7.5%) and stamp tax (0.8%) and each applicable tax rate will be levied either on the purchase price or the tax value of the property if higher.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

To the best of our knowledge, we are not aware at this stage of any proceedings or actions taken or proposed to be taken by the Portuguese Authorities that consist of meaningful tax changes in the coming 12 months.

7 Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The COVID-19 pandemic outbreak has led the Portuguese government to adopt a comprehensive set of relief programmes, mainly directed at consumers and the working population affected by the disease and the successive lockdowns.

We highlight the moratoriums on loans and rents, which are supporting the economy and keeping people and businesses afloat, and that had, until now, a mild effect on investment funds. Likewise, fund managers were able to adapt to the new environment and keep their business going, including in what concerns the regulatory obligations towards the CMVM.

However, the end of the moratoriums in the near future may unleash the full effects of the pandemic on the economy and lead to an increase in unemployment, bankruptcy and payment defaults. We anticipate that real estate funds may be more susceptible to the direct impacts stemming from the end of the moratoriums, but other types of investment funds will likely be indirectly impacted as well, if businesses in which they invest are affected by the worsening of the economy.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

It is expected that the UCI Law will be subject to further amendments and that more regulations may be published by the CMVM.

Regarding Brexit, Portugal published at the end of 2020 a Decree-Law establishing contingency measures for investment funds and fund managers, basically providing for a phasing out period until 31 December 2021 or, alternatively, a grace period during which UK fund managers may continue doing business in Portugal, provided that they file an application with the CMVM by 30 June 2021 to be authorised under the UCI Law as a third-country fund manager.

Moreover, UK investment funds distributed in Portugal prior to Brexit may continue to be distributed herein, but the fund manager needs to have filed by 31 March 2021 a simple notice with the CMVM, the template for which is provided under Annex III of Decree-Law no. 106/2020 of 23 December.

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Andrew Akintewe

1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The primary legislation that governs the establishment and operation of Alternative Investment Funds (AIFs) in Scotland is:

- the Financial Services and Markets Act 2000 (FSMA) and related orders;
- the Limited Partnerships Act 1907 (LPA 1907); and
- the Companies Act 2006.

In general, the relevant provisions of the above legislation apply on a UK-wide basis; however, many AIFs are structured as Scottish Limited Partnerships (SLPs), which benefit from particular provisions of the LPA 1907 that do not apply to limited partnerships governed by English law. This is discussed further in section 2 below.

The rules which implement the Alternative Investment Fund Managers Directive (AIFMD) in the UK, including retained legislation following the UK's withdrawal from the European Union, apply in Scotland. These rules affect the AIFs managed by managers within the scope of the AIFMD.

SLPs are the main focus of this chapter. However, some consideration is also given to other AIF structures which have been used in Scotland.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

The management and operation of an AIF in Scotland will normally involve regulated activities that are required to be carried out by persons authorised by the UK Financial Conduct Authority (FCA). The exact scope of regulated activities will depend on factors such as (i) the assets under management, and (ii) the structure of the fund; however, regulated activities that are typically considered during the fund structuring process are:

- establishing and operating a collective investment scheme (CIS);
- managing investments;
- managing an AIF;
- arranging transactions in investments; and
- advising on investments.

In cases where the manager and operator do not have the required FCA authorisations, it is usually possible to structure the AIF so as to outsource these activities to authorised service providers.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

AIFs that are structured as SLPs under the LPA 1907 are generally classed as unregulated collective investment schemes (UCIS) and are not themselves required to be authorised or regulated by the FCA or any other regulatory body. Registration with the Registrar of Limited Partnerships in Edinburgh is required.

The vast majority of AIFs registered in Scotland utilise the SLP structure. However, in terms of market practice, other AIF structures have been used in Scotland and two examples are considered below.

AIFs can be structured in Scotland (as they can in England) using certain forms of authorised fund structures, for example, qualified investor schemes (QISs) which take the form of an open-ended authorised unit trust (AUT) or open-ended investment company (OEIC). In general, the same regulatory regime applies to these funds irrespective of whether they are domiciled in England or Scotland. QIS structures are required to be authorised by the FCA, but can only be marketed to certain categories of eligible investor. AIFs that are structured as QISs benefit from investment and borrowing powers that are very flexible, for example, compared with UCITS and other authorised funds designed for retail investors. QISs are required to achieve a basic spread of risk consistent with the investment objective and policy. QIS structures can also be used for non-retail fund of funds structures, facilitating indirect investment exposure to, for example, private equity, hedge funds, and real estate funds. These are referred to as "Funds of Alternative Investment Funds" (FAIFs) and are subject to specific rules in relation to matters such as concentration, liquidity and due diligence, valuation and audit of the underlying funds. FAIFs may also be structured as "non-UCITS retail schemes" (NURSs) to facilitate marketing to a wider range of investors.

In addition, there has been a trend for certain retail funds using authorised UCITS structures to adopt investment strategies similar to those used by some hedge funds. As with QIS structures, the same regulatory regime applies to these funds irrespective of whether they are domiciled in England or Scotland.

Listed AIFs have also been created using Scottish companies with securities admitted to trading on a securities market such as the Main Market or the Alternative Investment Market (AIM) or the Specialist Fund Market (SFM) of the London Stock Exchange. Historically there have been many examples of Scottish investment companies of this type, designed to facilitate indirect investment into alternative asset classes such as real estate and other asset classes. In these cases, the company

becomes subject to regulation by the FCA and the London Stock Exchange, in respect of compliance with applicable provisions of FSMA, the Disclosure and Transparency Rules, the Admission & Disclosure Standards of the London Stock Exchange and, as applicable, the Prospectus Regulation Rules and/or AIM Rules for Companies.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The table below sets out the key features of the three main examples of AIF described above:

Key Features	Scottish Limited Partnership	Authorised Unit Trust or OEIC (for example: Qualified Investor Schemes)	Investment Company Admitted to Trading on a Securities Market
Legal structure	Partnership	Trust or Company	Company
Separate legal personality	Yes	Yes	Yes
Open-/ closed-ended	Either	Open-ended	Closed-ended
Is the Fund/ Manager/ Trustee/ Depositary regulated?	Manager and/or operator (FCA)	Manager or Authorised Corporate Director, Trustee/ Depositary and Fund (FCA)	Manager and Custodian (FCA), Fund (Companies Act, FCA listing rules or AIM rules)
Admitted to trading on a securities market?	No	Not in practice, with the exception of those Exchange Traded Funds (ETFs) that use these fund structures	Admitted to trading on a securities market, for example, the Alternative Investment Market, Main Market or Specialist Funds Market of the London Stock Exchange
Collective Investment Scheme?	Yes	Yes	No
Pricing	Bespoke valuation provisions in fund documentation	NAV of fund	Determined by market

1.5 What does the authorisation process involve and how long does the process typically take?

AIFs structured as SLPs

No authorisation is required at fund level. As indicated in question 1.3 above, the manager and/or operator will typically be required to be authorised by the FCA. Where not already authorised prior to the launch of the fund, the manager or operator will be required to apply to the FCA for authorisation to conduct the expected range of regulated activities. This will require the production of a detailed business plan, including proposed internal controls and outsourcing, a staff organisational chart including all those individuals who are seeking approved person status and relevant reporting lines, a compliance monitoring programme, details of IT systems as well as numerous other pieces of information. A typical, straightforward application would normally be processed within three months. More complex applications can take longer. As indicated in question 1.2 above, where the manager and operator do not have the required FCA authorisations, it is usually possible to structure the AIF so as to outsource these activities to authorised service providers.

AIFs structured as QISs or NURSs

An application for authorisation of a QIS or NURS must be submitted to the FCA. This involves submission of a structured application form, constitutional documents and prospectuses which comply with the detailed requirements of the FCA Collective Investment Schemes sourcebook (COLL), and a solicitor's certificate. A typical application would normally be processed within two months.

AIFs structured as public companies admitted to trading on AIM or SFM

The company must be registered as a public limited company and obtain a trading certificate. A prior requirement is that the nominal value of the company's share capital is not less than £50,000. At least one quarter of the nominal capital and the whole of any premium must be paid-up.

The process of applying for admission to AIM includes (i) the production of a detailed AIM admission document (which complies with the AIM Rules for Companies and the AIM Rules for Investing Companies), and (ii) the appointment of a nominated adviser (nomad) and broker. A nomad is usually a corporate finance firm, investment bank or a broker that has been approved by the London Stock Exchange. The nomad is responsible to the London Stock Exchange for assessing the appropriateness of a company for an application to AIM and for advising the company on the admission process and its continuing obligations under the AIM Rules for Companies.

The process of applying for admission to the SFM is a two-stage process. The requirements include (i) the approval of a prospectus by the UK Listing Authority, and (ii) following approval of the prospectus, application to the London Stock Exchange for admission to trading on the SFM. Applicants will require specialist advice.

1.6 Are there local residence or other local qualification or substance requirements?

Basic formation requirements for SLPs

Some market practice for the formation of SLPs is outlined below. Where the separate legal personality of the SLP is required for the operation of the fund (which is often the case with AIFs, particularly in the case of fund of funds, feeder

funds and other vehicles), some of these steps are of particular importance:

- It is fundamental that the partnership agreement be written so as to be governed by Scots Law, specifically stating that the partners intend the partnership to be a Scottish partnership.
- The SLP is generally required to have a principal place of business in Scotland. This is often an address provided by the lawyers advising on the SLP formation.
- It is recommended that the general partner is a Scottish entity. This is most usually a Scottish special purpose private limited company. The general partner will be responsible for any day-to-day management of the SLP; however, this is normally delegated to an authorised manager. The registered office of the general partner is normally the principal place of business of the SLP.
- The partnership agreement is usually signed in Scotland. This is often undertaken by an attorney for the partners, who do not have to be physically present in Scotland to sign documents.

In addition, an occasional meeting, for example, an annual review meeting, is sometimes held at the SLP's principal place of business address in Scotland.

1.7 What service providers are required?

In the case of SLPs, the service providers required will vary depending on the activities of the fund. As indicated above, the management and operation of a typical AIF SLP will be undertaken by manager and operator, which may be the same entity, authorised by the FCA to carry out the regulated activities involved. However, operator services are often provided by specialist fund administration businesses, which will often also provide ancillary services such as fund accounting.

The rules implementing the AIFMD in the UK, including retained legislation following the UK's withdrawal from the European Union, apply in Scotland. These rules introduced requirements for specific service providers, such as depositaries, for AIFs managed by managers within the scope of the AIFMD.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

As indicated in question 1.2, the management and operation of an AIF in Scotland will normally involve regulated activities that are required to be carried out by persons authorised by the FCA. The exact scope of regulated activities will depend on factors such as (i) the assets under management, and (ii) the structure of the fund.

In cases where the manager and operator do not have the required FCA authorisations, it is usually possible to structure the AIF so as to outsource these activities to authorised service providers.

These rules apply to foreign managers or advisers. Specific advice should be taken on whether the relevant regulated activities are within the UK regulatory perimeter or not.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

Co-operation or information sharing agreements are entered into at the UK level and there are currently no separate agreements applicable to Scotland. Please see the England & Wales chapter of this publication for an overview of those agreements entered into at the UK level.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

As indicated in question 1.3 above, the vast majority of AIFs registered in Scotland utilise the SLP structure. However, in terms of market practice, some other structures have been used, for example, QIS structures and listed investment companies (described in questions 1.3 and 1.4 above).

As indicated in question 1.1 above, the focus of this chapter is on SLPs.

SLP key features include (i) flexible terms of management and operation, (ii) tax transparency, (iii) separate legal personality, (iv) limited liability for investors, and (v) the possibility of multiple passive investors (limited partners). For these reasons, SLPs are frequently used as AIF vehicles, particularly as private equity funds, real estate funds (including their feeder funds and carried interest vehicles), and fund of funds structures.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Investors participate in SLPs as limited partners. Provided it does not involve itself in the management of the SLP, a limited partner's liability for the debts and obligations of the SLP is limited to the amount of its capital contribution. It is normal for AIF SLPs to be structured so as to ensure that this capital contribution is a nominal amount. For example, "capital contribution" is often defined in the partnership agreement as a fraction (e.g. 0.01%) of a limited partner's commitment to the SLP. The rest of the limited partner's commitment to the SLP will comprise a loan.

If the partnership is wound up, for example, on an insolvent basis, the limited partner will normally rank as an ordinary creditor for sums advanced above the nominal capital commitment.

With effect from 6 April 2017, most AIF SLPs can apply to be treated as Private Fund Limited Partnerships (PFLPs). Limited partners in PFLPs are not required to contribute capital and any capital contributed can be repaid at any time without affecting the limited liability status.

The general partner of the SLP, which (subject to any delegation arrangements) is responsible for the management and operation of the SLP, has unlimited liability.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

The principal legal structures used for managers and advisers of AIFs in Scotland are limited companies and limited liability partnerships (LLPs).

LLPs are tax-transparent, which may assist efficient structuring of the management vehicle.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

AIF SLPs can be either open- or closed-ended.

Subject to the point below about the restriction on distributions of capital by SLPs, a manager may restrict redemptions or transfers, generally in accordance with the terms of the fund documentation.

The LPA 1907 restricts distributions of capital by SLPs during the life of the partnership. This makes the redemption of an investor's capital commitment difficult. However, as described in question 2.2 above, this capital commitment is usually a nominal amount, with the rest of an investor's commitment comprising a loan. This means that in practice there is no legal impediment to structuring an SLP as an open-ended vehicle. In addition, with effect from 6 April 2017, most AIF SLPs can apply to be treated as PFLPs. Limited partners in PFLPs are not required to contribute capital and any capital contributed can be repaid at any time without affecting the limited liability status.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

In the case of SLPs, transfers of partnership interests are required to be advertised in the Edinburgh Gazette and, for the purposes of the LPA 1907, do not take full effect until publication of the advert. Publication of the advert is a simple administrative procedure.

With effect from 6 April 2017, the requirement to advertise in the Edinburgh Gazette has been removed for PFLPs.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The UK AIFMD rules regulating the acquisition of substantial stakes in UK companies apply in Scotland as in the rest of the UK. These rules impose disclosure obligations on the acquisition of major holdings (starting at 10% of voting rights) in non-listed UK companies as well as restrictions on "asset stripping". These rules impose certain limitations on distributions, share redemptions or buybacks and capital reorganisations during a period of 24 months following the acquisition of control.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

As indicated in question 1.3 above, for regulatory purposes, AIF SLPs are generally classified as UCIS.

The marketing and promotion of UCIS is regulated by the FSMA and related orders, and the AIFMD-driven rules where the manager is within their scope.

In very general terms, these regulations mean that, as is the case with AIFs in many other jurisdictions, AIF SLPs cannot be freely marketed to the public, but only to certain categories of eligible investor (such as "investment professionals" and "sophisticated investors").

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

Key content requirements for AIF SLP marketing materials are similar to those used in many other jurisdictions and, typically, details include:

- investment objectives and strategy;
- investment process;
- management personnel;
- summary of key fund terms;
- risk disclosures;
- disclosure of UK tax treatment of the fund and investors and, if the fund is being distributed on a cross-border basis, disclosure of the tax treatment of the fund and investors in other key jurisdictions; and
- regulatory statements and disclosures required by the FSMA and other securities laws in the UK and, if the fund is being distributed on a cross-border basis, regulatory statements and disclosures required by securities laws in other key jurisdictions.

This content is required by a combination of market practice and certain provisions of the FSMA and related orders, the common law of Scotland and the securities laws of other jurisdictions in which the fund may be being promoted. The AIFMD-driven rules apply where the manager is within the scope of the AIFMD.

In addition, the Packaged Retail and Insurance-based Investment Products Regulation as implemented in the UK (PRIIPS Regulation) requires product manufacturers to prepare Key Investor Documents (KIDs) for all Packaged Retail and Insurance-Based Investment Products (PRIIPS) that are offered to sale to retail investors in the UK. This includes AIFs sold to retail investors.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

SLPs are required to be registered with the Registrar of Limited Partnerships in Edinburgh. This requires the filing of a form at registration, containing basic details of the partnership, the partners and capital contributions. There are limited continuing obligations to notify the registrar of various changes relating to the partnership, its business and capital. There is no registration requirement in respect of an SLP's marketing document.

3.4 What restrictions are there on marketing Alternative Investment Funds?

As indicated in question 3.1 above, most AIF SLPs are classified as UCIS. The marketing and promotion of UCIS is regulated by the FSMA and related orders.

In very general terms, these regulations mean that, as is the case with AIFs in many other jurisdictions, AIF SLPs cannot be freely marketed to the public, but only to certain categories of eligible investor (such as "investment professionals", "high-net-worth individuals" and "sophisticated investors").

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

There is currently no formal concept of pre-marketing in the AIFMD rules as implemented in the UK including Scotland. Pre-marketing is, however, possible under the existing regulatory framework and the FCA has indicated in its Perimeter Guidance manual that, in its view, draft documentation does not fall within the meaning of an offer or placement for the purposes of the AIFMD, because an AIFM cannot apply for

permission to market an AIF at that point. On that basis, it is possible under existing rules to conduct pre-marketing activities using an advanced draft of an information memorandum or prospectus.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Yes, AIFs can be marketed to some investors classed as retail investors subject to the restrictions described under question 3.4 above and compliance with suitability assessment rules.

3.7 What qualification requirements must be met in relation to prospective investors?

A range of qualification requirements for eligible investors are set out primarily in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (FPO), the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (CIS Promotion Order) and specific FCA conduct of business rules. The specific rules that apply will depend on factors such as whether the promoter of the AIF is authorised by the FCA or not. Some commonly used categories of eligible investors are noted below:

- investment professionals;
- certified high-net-worth individuals; and
- certified sophisticated investors.

These categories are specifically defined in the applicable legislation.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

No; public bodies will often fall within one of the categories of eligible investor, such as "investment professional", but this should be specifically checked as certain local government pension schemes may be categorised as retail investors.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

Generally, and subject to the points made above (see questions 1.2, 3.4 and 3.7 in particular) on authorisation and marketing, there are no restrictions on the participation in AIFs by particular types of investors.

Some qualifications apply to this. For example, Scottish local government pension schemes (LGPS) are subject to the restrictions set out in the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, which contains concentration limits for various classes of investments. LGPS, together with other types of pension funds, will also be subject to the terms of their internal investment policies.

Certain types of retail investment funds (for example, UCITS funds) also have to comply with investment restrictions, which may limit their exposure to AIFs.

In addition, investments by financial institutions in AIFs may impact their regulatory capital requirements.

The rules which implement the AIFMD in the UK apply in Scotland. These significantly restrict the range of activities which managers within the scope of the AIFMD can undertake.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

The restrictions on marketing that apply to the manager or promoter will also apply to intermediaries.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

In general, no. However (as described in question 1.2 above), the management and operation of an AIF in Scotland will normally involve regulated activities that are required to be carried out by persons authorised by the FCA. Such persons will be authorised to conduct a specific scope of activities.

The rules that implement the AIFMD in the UK also restrict certain activities, for example, where an AIF acquires control of a non-listed company. These restrictions relate to matters such as distributions, capital reductions and share buybacks.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

No such limitations apply to AIF SLPs, although it is common for fund documentation to limit the types of investments held.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

No such restrictions apply to AIF SLPs, although it is common for fund documentation to limit exposure to specific instruments, such as derivatives, by the fund.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

No such restrictions apply to AIF SLPs, although it is common for fund documentation to limit borrowing by the fund.

The rules implementing the AIFMD in the UK require managers within the scope of the AIFMD to specify leverage limits.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

For AIFs that are within the scope of the AIFMD, a depositary must hold in custody all "AIF custodial assets" (broadly: (i) financial instruments belonging to the AIF or to the AIFM acting on behalf of the AIF which are not able to be physically delivered to the depositary where such securities are (a) transferable securities including those which embed derivatives, money market instruments or units of collective investment undertakings, and (b) financial instruments that are capable of being registered or held in an account directly or indirectly in the name of the depositary; and (ii) financial instruments belonging to the AIF or the AIFM acting on behalf of the AIF which are able to be physically delivered to the depositary).

For assets of the AIF that are not "AIF custodial assets", a depositary must: (i) verify that the AIF, or the AIFM acting on behalf of the AIF, is the owner of the assets based on information or documents provided by the AIF or the AIFM and, where available, on external evidence; and (ii) maintain, and keep up to date, a record of those assets for which it is satisfied that the AIF, or the AIFM acting on behalf of the AIF, is the owner.

The depositary may delegate this safekeeping function to a third-party custodian, provided specific rules are complied with, including rules relating to the selection and appointment of the custodian, periodic review and ongoing monitoring.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

The registration and disclosure requirements, including those contained in the LPA 1907, that apply to AIF SLPs are set out in questions 3.2 and 3.3 above.

In addition, the Partnerships (Accounts) Regulations 2008 (as amended) require the annual accounts of certain SLPs to be filed.

The EU Regulation on sustainability-related disclosures in the financial services sector (SFDR) and the disclosure obligations of the EU Regulation on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation) have not been implemented in the UK following its withdrawal from the EU.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

With effect from 26 June 2017, SLPs were brought within the scope of the UK rules that require UK companies and all LLPs to keep a register of "persons with significant control" (PSC) and file their PSC information with Companies House.

The purpose of the PSC regime is to improve transparency and identify those individuals who ultimately own and control UK companies, LLPs and SLPs.

A person will be a PSC if they meet one or more of the following conditions:

- holding, directly or indirectly, the right to more than 25% of any surplus assets in the partnership on a winding up;
- holding, directly or indirectly, more than 25% of the voting rights in the partnership;
- holding the right, directly or indirectly, to appoint or remove the majority of the persons who are entitled to take part in the management of the partnership;
- having the right to exercise, or actually exercising, significant influence or control over the SLP; and
- having the right to exercise, or actually exercising, significant influence or control over the activities of a trust or firm (which is not a legal person) where the trustees or members of that firm meet any of the above conditions in relation to the partnership.

There are complex rules for applying these conditions, for example, if rights or interests are held or exercised indirectly or jointly with others.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

The rules which implement the AIFMD in the UK introduce various reporting requirements. These involve periodic reports to the FCA using an online reporting system.

The EU Regulation on SFDR and the disclosure obligations of the Taxonomy Regulation have not been implemented in the UK following its withdrawal from the EU.

5.4 Is the use of side letters restricted?

A requirement to disclose preferential terms, such as side letters, was introduced by the AIFMD. Other than this, the use of side letters is not restricted by current legislation. As is common in other jurisdictions, investors will often seek to negotiate "most favoured nation" provisions.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Although SLPs have separate legal personality (which is why they are often used in fund of funds structures, feeder funds, and similar vehicles), they are tax-transparent for most UK taxes. This means that no income, corporation or capital gains tax is payable by the SLP itself. Instead, the UK tax authorities look through the partnership structure and partners are taxed on their share of partnership income arrived at in accordance with their profit-sharing ratios (which can be different from the ratios in which capital has been contributed). For capital gains tax purposes, partners are treated as owning fractional shares in the underlying assets.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

The tax treatment of the principal forms of investment manager/adviser will vary according to the structure used, for example, a company or LLP. LLPs are often used as management vehicles, as they are tax-transparent corporate vehicles, offering limited liability, with no restrictions on members participating in management. VAT on management fees is often a key tax consideration, as is the use of the Investment Manager Exemption, which allows a non-UK resident fund that is trading for tax purposes, such as a hedge fund, to appoint a UK-based investment manager without creating a permanent establishment in the UK.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There are no establishment taxes levied in connection with an investor's participation in an AIF. Stamp duty may be payable on the transfer of an investor's interest in an SLP if the SLP's property includes stock or marketable securities. In practice, transfers of interests are often structured so as to mitigate stamp taxes. Stamp duty land tax or land and buildings transaction tax may apply where the SLP's property includes land.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

As indicated above, although SLPs have separate legal personality, they are generally tax-transparent and the UK tax authorities look through the partnership structure. Partners are taxed on their share of partnership income in accordance with their profit-sharing ratios (which can be different from the ratios in which capital has been contributed). For capital gains tax purposes, partners are treated as owning fractional shares in the underlying assets. The tax profile of individual investors determines their tax liability.

AIF SLPs are generally operated so that they are not treated for UK tax purposes as carrying on a trade, the result of which is that non-resident investors should not be subject to UK tax on gains from the SLP. Non-resident investors may, however, be subject to UK tax on investment income, although this is likely to be restricted to UK tax that is withheld at source (for example, by a portfolio company in a private equity fund). Withholding tax on UK investment income would be subject to the relevant double taxation treaty between the UK and the investor's jurisdiction of residence. It should be noted that some SLP- or LLP-based funds may be treated as trading if they invest directly in relevant activities such renewable energy operations.

Non-resident investors who hold their interest in the AIF SLP as part of their trade (for example, financial traders such as banks) are likely to be treated as carrying on part of that trade in the UK through a permanent establishment, branch or agency which is a UK representative (for example, the general partner or manager of the fund). The UK-resident general partner would then be treated as the investor's UK tax representative, and would share responsibility with the investor for submitting UK tax returns and paying any UK tax due on the investor's partnership income. In these circumstances, the manager will often be authorised to retain an amount equal to such investor's liability to UK corporation or income tax and pay such amounts to the UK tax authorities. These tax liabilities can usually be mitigated by the use of special purpose vehicles established for the purpose of participating in the AIF SLP.

In addition, non-UK jurisdictions may apply or withhold tax on income or gains receivable by the AIF SLP from investments in those jurisdictions. In these circumstances, investors will normally seek relief under applicable double tax treaties, and the availability of relief may depend on whether the SLP is treated as fiscally transparent in the overseas jurisdiction.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

This is not generally necessary.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

FATCA and other Automatic Exchange of Information (AEOI) compliance is currently coordinated at the UK level. The use of AIFs domiciled in Scotland should not ordinarily introduce any additional material factors relevant to FATCA or compliance with similar information reporting regimes.

It is to be noted that SLPs often elect to be treated as corporations for US tax purposes. Where that is the case, it may be relevant for FATCA compliance purposes (for example, when considering which entity may become liable for FATCA withholding tax).

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Implementation of the OECD's Action Plan on BEPs is being dealt with at UK level.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Other than SLPs, which are described above and are generally tax-transparent, the tax and regulatory regime applicable to tax-advantaged fund structures and asset classes generally applies on a UK-wide basis.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Individual investors, managers and advisors who are classed as Scottish tax payers for income tax purposes will be liable to pay the Scottish rates of income tax on any non-savings non-dividend income. For example, management fees or trading income treated as arising from an SLP could be subject to the Scottish rates.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

On 15 December 2020, the UK tax authorities (HM Treasury) published a second-stage consultation on taxation of asset holding companies in alternative fund structures, setting out proposals for changes to the UK tax treatment of such intermediate vehicles in investment fund structures. The consultation also includes a review of VAT on investment management fees. This is part of a wider review, aiming to make the UK competitive with other investment fund formation and asset holding company jurisdictions.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

Three key trends over the past 12 months are:

- linked to an increase in demand for strategies involving sustainable assets, an increased focus on careful articulation of investment policies, disclosure and reporting;
- continued review of pan-European distribution strategies by UK managers, following the UK's withdrawal from the EU; and
- consideration of special purpose acquisition companies (SPACs) as an alternative to a classic private equity fund strategies.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

As noted above, the SFDR and the disclosure obligations of the Taxonomy Regulation have not been implemented in the UK following its withdrawal from the EU. However, an alternative set of UK rules has long been anticipated and, on 22 June 2021, the FCA published a consultation paper on enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers (CP21/17).

CP21/17 sets out the FCA's proposals to introduce climate-related financial disclosure rules and guidance. These will include (i) entity-level disclosures, including annual reporting on how climate-related risks and opportunities are assessed in managing or administering investments, and (ii) product or portfolio-level disclosures, including annual disclosures for products and portfolios. The FCA intends to introduce a new Environmental, Social and Governance (ESG) sourcebook to set out its proposed rules and guidance.

It is intended that the FCA's proposals would not apply to firms with less than £5 billion in assets relating to relevant activities. The FCA's final policy on climate-related disclosures should be confirmed by the end of 2021.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The legislation governing the establishment and operation of an Alternative Investment Fund ("**AIF**") will depend on the structure the AIF takes. AIFs are usually formed in South Africa as a company, *bewind* trust (a form of trust where the assets are owned by the beneficiaries but administered by the trustees) or an *en commandite* partnership (a form of limited partnership in South Africa).

If the AIF is structured as a company, the Companies Act, 2008 will apply. If the AIF is structured as a trust, the trust will be governed by the Trust Property Control Act, 1988, and the trust deed will need to be registered with the Master of the High Court in the jurisdiction where the trust's assets are situated. If the AIF is structured as an *en commandite* partnership, there is no specific legislation governing the establishment of the partnership and the AIF will be established and operated in terms of the partnership agreement constituting the AIF.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

The Financial Advisory and Intermediary Act 37 of 2002 ("**FAIS**") provides that no person may act or offer to act as a financial services provider ("**FSP**") unless such person has been issued with a licence from the Financial Services Conduct Authority ("**FSCA**") under FAIS. An FSP is effectively defined to mean any person other than an employee or agent of an FSP, who as a regular feature of the business of such person, furnishes advice (i.e. investment recommendations but not factual advice) and/or renders any intermediary service (which includes non-discretionary investment management) to clients in respect of financial products (defined to encompass a broad range of local and foreign securities and financial instruments). Accordingly, any person who manages the assets of an AIF, or who advises an AIF on the management of its assets, will be required to obtain an FSP licence. Advisors will be required to obtain a Category I FSP licence, discretionary managers a Category II licence, and hedge fund managers a Category IIA FSP licence.

A manager of a registered collective investment scheme ("**CIS**") is required to be authorised as a CIS manager under the Collective Investment Schemes Control Act 45 of 2002 ("**CISCA**"), rather than licensed as an FSP under FAIS (although in practice managers will be authorised under both CISCA and FAIS if they conduct financial services business other than the management of the CIS).

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

This is dependent on the type of AIF. Generally, partnerships and trusts are regarded as CISs, but not companies. The promotion of local and foreign CISs in South Africa is regulated by the CISCA. If the AIF is a CIS, it will be regulated under the CISCA and will be required to be registered with the FSCA. An AIF will only qualify as a CIS if members of the public are invited to invest in the AIF.

CISCA currently recognises five categories of CIS, being: (i) a CIS in securities (listed securities); (ii) a CIS in property; (iii) a CIS in participation bonds; (iv) retail hedge funds; and (v) qualified hedge funds. Currently, private equity funds do not fall within any of the categories of CIS and accordingly are not registered with the FSCA. This means that private equity funds may not be offered to members of the public in South Africa, unless such offer is made by way of private placement.

A foreign CIS that is carried on outside South Africa, which will be promoted in South Africa, must be registered under CISCA as an approved foreign CIS.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The regulatory regime does not distinguish between open-ended and closed-ended AIFs. However, it does distinguish between types of strategies (see above). Currently, private equity funds are not registered under CISCA and, as such, interests in a private equity fund may not be offered to members of the public, but only through a private placement. There are two types of hedge fund that may be registered under CISCA: qualified investor funds and retail funds. Qualified investor funds are hedge funds that only permit investment by investors who have demonstrable knowledge and experience in financial and business matters that would enable them to assess the merits and risks of a hedge fund investment (or are advised by an FSP having such knowledge) and who initially invest at least R1 million. A retail fund does not have any such restrictions but retail funds must comply with more onerous regulatory and prudential requirements.

FAIS also recognises separately managed accounts or segregated accounts, which are usually structured as investment management agreements executed between the investor and the manager on the basis of a segregated mandate.

1.5 What does the authorisation process involve and how long does the process typically take?

The prior approval of the FSCA is required to establish a CIS under CISCA or to form a new portfolio of the CIS in which investors participate. As part of the authorisation process, CISCA (and the regulations promulgated thereunder) prescribes various requirements in relation to the authorisation of both the CIS manager who administers the scheme and the trustee or custodian who holds the assets and oversees compliance with CISCA, the formation of the CIS itself and the creation of each portfolio. The FSCA will generally take up to nine months to approve the application.

There are no registration requirements for AIFs that are not offered to members of the public; however, the manager or advisor of such AIF must be registered as an FSP under FAIS. An application for an FSP licence by the manager of, or advisor to, an AIF involves filling out the prescribed application forms and submitting the applicant's financial statements, business plan and organisational chart. The key individuals of the FSP that will be responsible for managing and overseeing the activities of the FSP must also be approved by the FSCA. Key individuals must meet the fit and proper requirements of honesty and integrity, demonstrate that they have appropriate management and financial product experience, have a recognised qualification and pass regulatory exams. The FSCA will generally take around five months to approve the application and grant the FSP licence.

1.6 Are there local residence or other local qualification or substance requirements?

If the AIF is a registered CIS in South Africa, the CIS manager must be a company registered in terms of the Companies Act, 2008 and the trustee of the CIS must be a South African public company, a South African bank (or South African branch of a foreign bank) or a South African-registered long-term insurer. In order for any of the above institutions to qualify as a CIS manager, the institution must maintain capital and reserves amounting to a minimum of R10 million and be registered by the registrar as a trustee or custodian, which registration will only be granted where the institution is not a holding company or subsidiary in relation to the manager and where the general financial and commercial standing, as well as the independence of the institution, is fit for it to perform the functions of trustee or custodian. As such, the institution must be sufficiently experienced and equipped to perform such functions by virtue of the nature of its business. A foreign CIS that is carried on outside South Africa, which will be promoted in South Africa, must be registered under CISCA as an approved foreign CIS. A foreign manager may not perform management activities for a South African CIS without prior authorisation from the FSCA and would require an appropriate licence in South Africa to authorise it to carry out any outsourced services in South Africa.

By law, there are no local resident or local qualification requirements for any manager or advisor of an AIF that wishes to apply for an FSP licence under FAIS – although the FSCA appears to require registration as an external company in South Africa.

1.7 What service providers are required?

A registered CIS must have an approved CIS manager who administers the scheme and an approved trustee or custodian who holds the CIS assets and oversees compliance with CISCA.

There are no required service providers for AIFs that are not registered under CISCA, although such AIFs will generally have an investment manager or advisor that will then need to be licensed under FAIS.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Foreign FSPs may not render financial services in or into South Africa without a FAIS licence. Such licence is obtained in the same manner as a local FSP licence (depending on its level of activity in South Africa, the foreign applicant may have to register as an external company with the Company and Intellectual Properties Commission), and foreign licensees will be subject to the same regulatory framework (including in respect of fitness and propriety, as South African licensees).

A foreign CIS that is carried on outside South Africa but which will be promoted in South Africa must be registered under CISCA as an approved foreign CIS. The requirements for such approval include that the foreign scheme must be carried on in a regulatory environment of at least the same standing as the South African regulatory environment and may not offer investments with a significantly higher risk profile than investments that may be offered by any local CIS. The foreign scheme must either establish a representative office in South Africa or enter into a representative agreement with a local CIS manager.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The Convention on Mutual Administrative Assistance in Tax Matters, various bilateral Tax Information Exchange Agreements and international tax compliance agreements, including the USA FATCA Intergovernmental Agreement, Common Reporting Standards ("**CRS**") and the Organisation for Economic Co-operation and Development – Base Erosion and Profit Shifting.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

AIFs that are registered under CISCA are usually formed by a trust agreement entered into between an authorised manager and a registered trustee. The CIS then creates portfolios, subject to approval from the FSCA, in which investors purchase participatory interests. While CISCA permits other legal structures, in practice only these forms of unit trusts are used.

The most common structure in South Africa for a private equity fund is the *en commandite* partnership, which is equivalent in all material respects to a limited partnership or limited liability partnership as seen in other jurisdictions. There is no statute in South Africa governing the establishment and management of *en commandite* partnerships, which are created through written agreement between the partners. In its simplest form, an *en commandite* partnership comprises two categories of

partner, a disclosed or general partner, whose liability is unlimited, and one or more *commanditarian* partners (limited partners), whose liability is limited.

Another type of structure sometimes used for private equity funds is a *bewind* trust. A *bewind* trust is a type of trust vehicle governed by the Trust Property Control Act, in terms of which the assets are owned by the beneficiaries of the trust but the trustee of the trust holds and manages such assets on their behalf. Each investor is a beneficiary of the trust and the investors own the assets of the trust jointly in undivided shares in proportion to their respective contributions. The trust deed must be registered with the Master of the High Court.

AIFs may also be structured as companies. However, whilst the legal status of companies is well established and the limited liability position of shareholders is clear, companies are separate taxpayers in their own right. This makes them unattractive vehicles for investors that are otherwise tax exempt. The exception to this is venture capital companies, where investors have been provided tax relief in terms of which, subject to certain conditions being met, investors may deduct 100% of their investment in the venture capital company in that year of assessment.

Long-term insurance companies may also market investment exposure in respect of asset portfolios to investors through the issue of linked investment policies.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

For AIFs established as *en commandite* partnerships, the investors are limited partners who occupy the role of partners only insofar as their co-partners are concerned but not with respect to third parties or outsiders. Each limited partner will enjoy limited liability and will not be liable to creditors of the partnership for more than their capital commitments to the partnership, provided that they are and remain limited partners. A limited partner's limited liability is compromised if it holds itself out publicly as an ordinary partner or participates actively in the management or operation of the partnership. The general partner will have unlimited liability to third parties for the partnership's debts. An advisory board, also called a limited partner advisory committee, is typically established in respect of private equity funds structured as *en commandite* partnerships, to represent the interests of limited partners. Since the limited partners are not entitled to participate in the management or operation of the partnership, as this would compromise their limited liability status, limited partner oversight and governance of the partnership is achieved through the advisory board. The advisory board will, in general, serve to provide guidance to the private equity fund and will enable the limited partners to exercise governance in respect of certain limited matters such as conflicts of interest, valuation methodologies, as well as consents and approvals required to be given by the advisory board as pre-defined in the governing documents of the partnership.

From a liability perspective, there is little difference between an *en commandite* partnership and a *bewind* trust; both forms of entity afford limited liability for investors.

For AIFs incorporated as companies, the limited liability of shareholders is clear and is not dependent on the role that the shareholders may play in the management of the company.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

The principal legal structures used are private limited companies incorporated under the Companies Act, 2008.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

For AIFs that constitute CISs (which are authorised under CISCA), there are certain liquidity, leverage and valuation requirements for investors prescribed under CISCA, with CISs in securities typically allowing for daily dealing. There are no such statutory limits for any other form of AIFs (other than as contractually agreed with investors).

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no such legislative restrictions, other than for a hedge fund which is registered as a qualified investor fund under CISCA, where all investors must meet the prescribed qualifying criteria.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

For AIFs that are authorised under CISCA, CISCA places significant restrictions on the asset classes in which a CIS can invest, as well as concentration limits on CIS portfolio exposure. There are no such statutory limits for any other form of AIFs.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

For AIFs that constitute CISs (which are authorised under CISCA), CISCA prescribes comprehensive requirements relating to the documentation used to market the AIF. These requirements will also apply to any foreign CIS that is carried on outside South Africa and which is also registered under CISCA as an approved foreign CIS for marketing in South Africa. The manager of the local or foreign CIS must lodge copies of all advertisements and marketing material with the FSCA (including fund fact sheets and relevant investor application forms) before publication or use of the material.

There is no specific legislation governing the marketing of interests in private equity funds in South Africa and other AIFs that are not offered to members of the public that do not fall to be regulated under CISCA.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

For AIFs that are authorised under CISCA, CISCA requires the CIS manager to disclose to each investor (prior to any investment) information about the investment objectives of the CIS, the calculation of the net asset value and dealing prices, charges, risk factors and distribution of income accruals. CISCA also prescribes various particulars that must be included in any price list, brochure or similar document published for the purpose of soliciting investment in a CIS. These particulars include details of charges levied by the manager and the basis on which the manager will undertake the repurchase of interests, as well as a clear and unambiguous statement to the effect that the value of participatory interests in a portfolio is subject to fluctuation

from time to time. The same requirements will apply to foreign CISs authorised under CISCA to be promoted in South Africa.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

For AIFs that are authorised under CISCA, the manager of the local or foreign CIS must lodge copies of all advertisements and marketing material with the FSCA (including fund fact sheets and relevant investor application forms) before publication or use of the material.

3.4 What restrictions are there on marketing Alternative Investment Funds?

An AIF may not be marketed to members of the public in South Africa without first being registered as a CIS under CISCA or, in the case of a foreign AIF, as a foreign collective scheme.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

CISCA makes no distinction between pre-marketing and marketing activities. Accordingly, any advertising, including bringing to the attention of all or a part of the members of the public the existence or identity of the CIS manager, shall be subject to the requirements under CISCA.

There is no specific legislation governing pre-marketing activities of interests in private equity funds in South Africa and other AIFs that are not offered to members of the public and which do not fall to be regulated under CISCA.

3.6 Can Alternative Investment Funds be marketed to retail investors?

An AIF may not be marketed to retail investors without first being registered as a CIS under CISCA or, in the case of a foreign AIF, as a foreign collective scheme. Hedge funds that are registered as qualifying investor funds may only accept investments from qualifying investors.

3.7 What qualification requirements must be met in relation to prospective investors?

There are no qualification requirements except for the case of an AIF registered under CISCA as a qualified investor fund (hedge fund), where the manager may only permit investment by investors who have demonstrable knowledge and experience in financial and business matters that would enable them to assess the merits and risks of a hedge fund investment (or are advised by an FSP having such knowledge).

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no additional marketing restrictions.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

South African pension funds and financial institutions can invest in AIFs in accordance with their statutorily prescribed prudential limits. For example, South African pension funds are permitted to invest up to 10% of their assets in private equity funds, with a 2.5% limit per fund and a 5% limit per fund of funds. These limits are currently under review and are anticipated to change in due course.

A registered CIS in securities may not itself invest in a private equity fund or hedge fund (other than a listed fund) as it is restricted from investing in unlisted securities.

South African exchange control regulations also determine the extent to which South African residents may invest in AIFs established outside of South Africa.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

AIFs may be marketed by any person having an appropriate FSP licence under FAIS. There are restrictions relating to the fees that intermediaries may charge. Intermediaries may earn fees expressed as a percentage of the net value of a financial product (such as an investment in a CIS) only on condition that if such fees are deducted from the investment, the client must specifically agree to this in writing and must have the power to stop the payment of fees.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

For AIFs that are authorised under CISCA, CISCA places significant restrictions on the asset classes in which a CIS can invest, as well as concentration limits on CIS portfolio exposure. There are no such statutory restrictions for an AIF that is not open to investment by members of the public and which do not fall to be regulated under CISCA (although investment restrictions are commonly provided for contractually).

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

For AIFs that are authorised under CISCA, CISCA places significant restrictions on the asset classes in which a CIS can invest, as well as concentration limits on CIS portfolio exposure.

There are no such statutory restrictions for an AIF that is not open to investment by members of the public and which do not fall to be regulated under CISCA, subject to compliance with exchange control requirements. An AIF that wishes to invest outside of South Africa but in Africa can obtain an upfront exchange control approval to invest 100% of its commitments in other jurisdictions in Africa. For investments outside of Africa, exchange control approval will generally need to be obtained for each such investment.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

For an AIF manager that is authorised under CISCA, as a CIS in securities, may not lend or advance any money. However, a manager, other than a manager of a CIS in securities, may for the account of a portfolio borrow money for the purposes and subject to the limits and conditions determined in the deed.

There are no regulatory restrictions for an AIF that is not open to investment by members of the public and which do not fall to be regulated under CISCA, other than the investment guidelines for the AIF that is contractually agreed by the parties to the partnership, which forms part of the governing documents of the AIF.

South African pension funds and financial institutions can invest in AIFs in accordance with their statutorily prescribed prudential limits as set out above, namely that South African pension funds are permitted to invest up to 10% of their assets in private equity funds, with a 2.5% limit per fund and a 5% limit per fund of funds.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

For an AIF that is authorised under CISCA as a CIS in securities, such AIF may not borrow any funds, save where the manager must repurchase participatory interests but insufficient liquidity exists in a portfolio or assets cannot be realised. In such circumstances, the manager may borrow the necessary funds for such repurchase from registered financial institutions at the best commercial terms available, provided that the maximum amount borrowed may not exceed 10% of the market value of such portfolio at the time of borrowing.

For an AIF that is authorised under CISCA as a retail hedge fund, a manager may borrow up to 10% of the value of the portfolio for liquidity purposes in respect of the repurchase of participatory purposes. In addition, CISs may enter into eight-day loans for purposes of bridge funding in order to acquire assets.

There is no limitation on borrowings by an AIF that is not open for investment by members of the public (other than as contractually agreed with investors).

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

For an AIF that is authorised under CISCA as a CIS, the Financial Institutions (Protection of Funds) Act 28 of 2001 applies and prescribes that assets acquired are the property of the trust and the manager is designated as the authorised agent, trustee or custodian, who is tasked with dealing with the assets in accordance with the law, deed and in the best interests of investors.

There is no statutory limitation on who the holder of AIF assets should be in the case of an AIF that is not open for investment by members of the public (other than as contractually agreed with investors). However, assets are typically held in the name of the AIF or alternatively through an alternative investment or special purpose vehicle which may be established for the purpose of holding certain assets of the AIF.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

AIFs that are structured as companies are required, in terms of the Companies Act, 2008, to file a copy of their annual audited returns with the Companies Office.

AIFs that are structured as trusts are required to register their trust deed with the Master of the High Court in the jurisdiction where the trust's assets are situated.

Advisors and managers licensed in terms of FAIS are also required to make limited disclosures in respect of the investment into an AIF.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

AIFs that are structured as trusts are required to disclose the beneficial owners of the trust upon registration of their trust deed with the Master of the High Court.

For AIFs that are authorised under CISCA, there are no requirements to disclose the details of the participants in an AIF; however, a manager must publish on its website quarterly a general investor report which must also be available to investors on request, that details the number of participatory interests.

In terms of FAIS, an FSP is required to notify the FSCA within 15 business days of a change in its shareholders or its board of directors. If the FSCA is of the view that the new shareholder or board member does not comply with the requirements relating to fitness and propriety, the FSCA is entitled to suspend or withdraw the licence of that FSP.

In terms of CISCA, the prior consent of the FSCA is required for any change in shareholding of a CIS, a change of directors or a change of name.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

For an AIF that is authorised under CISCA, the manager of the AIF must report to investors at least on a quarterly basis, must submit quarterly reports to the FSCA relating to all assets in the portfolios administered by them and must annually submit to the FSCA their audited financial statements, together with audited financial statements for each portfolio, certain prescribed information and a compliance report.

In terms of FAIS, a manager of an AIF that is an authorised FSP must maintain a register of representatives, and key individuals of those representatives, which must be regularly updated and be available to the FSCA for reference or inspection purposes and within five days after being informed by the Authority of the debarment of a representative or key individual by the FSCA, remove the name of that representative or key individual from the register.

There are no statutory reporting requirements for AIFs that are not open to investment by members of the public, save that AIFs that are structured as companies are required, in terms of the Companies Act, 2008, to file a copy of their annual audited returns with the Companies Office.

Advisors and managers licensed in terms of FAIS are required, on a biannual basis, to submit financial reports in the prescribed form to the FSCA.

5.4 Is the use of side letters restricted?

There are no restrictions on the use of side letters by AIFs. However, AIFs that are authorised under CISCA will need to disclose the nature and scope of side letters to investors.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

In general, AIFs that are structured as trust vehicles and authorised under CISCA are treated as conduit vehicles in relation to income amounts and, accordingly, if the income amounts are distributed within 12 months of their accrual, such amounts will retain their nature and are taxed in the hands of the investors in accordance with their tax profile.

South African partnerships are fiscally transparent. Partnership income and capital gains are taxed in the partners' hands. Foreign partners are only taxed on South African-sourced income and capital gains derived in respect of certain "land-rich" assets.

Ownership of fund assets of a *bewind* trust resides in the investors' hands, with the trustees merely administering such assets on their behalf. *Bewind* trusts are therefore fiscally transparent and treated on the same basis as partnerships as above.

South African companies are taxpayers in their own right and are taxed at the current company rate of 28%. A withholding tax is levied on the declaration of a dividend by a company, which is a tax borne by investors (this may be reduced for foreign investors in terms of applicable double tax treaties).

Section 12J of the Income Tax Act offers tax relief to investors in venture capital companies by allowing investors to deduct 100% of their investment into such company in that year of assessment, provided that the investor holds their interest in the company for a minimum of three years. The types of assets that a section 12J company can invest in are regulated by statute.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

South African companies are taxed at the current company rate of 28%.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

There will only be securities transfer tax if the AIF is structured as a company, which will be levied at a rate of 0.25% of the market value of the shares transferred.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

South Africa has a residence-based tax system, which means residents are, subject to certain exclusions, taxed on their worldwide income, irrespective of where their income was earned. By contrast, non-residents are taxed on their income from a South African source. South African pension fund investors do not pay tax on their investment.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

There are general AIF structures with established laws regulating these structures and, as such, it is not necessary to obtain a tax ruling from the South African Revenue Service ("**SARS**"), unless an exceptional circumstance exists or arises, such as an entirely new transaction or form of legal entity.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

SARS imposes sanctions for the non-compliance with FATCA. In maintaining records and collecting the information, financial institutions must comply with the due diligence requirements as mandated by the Tax Administration Act and set out in the prescribed *Business Requirement Specification: Foreign Account Tax Compliance Act Automatic Exchange of Information (BRS: FATCA AEOI)* return required under Public Notice 509. SARS will exchange information with the U.S. Treasury through an automatic process.

The Tax Administration Act 2021 was amended in order to implement a mechanism in terms of which SARS may require South African Financial Institutions to collect information under the OECD Standard for Automatic Exchange of Financial Account Information in Tax Matters, which encompasses the Common Reporting Standard, which regulations have been effective from 1 March 2016.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

The OECD has contemplated 15 BEPS actions to be implemented according to various deadlines, which will have an implication on policy.

The objective of Action 2 (hybrids) is to counterbalance hybrid mismatch arrangements by amending tax convention and providing recommendations on domestic rules in order to avoid double non-taxation for hybrids. In South Africa, a final report on Action 2, providing final measures, was published on 5 October 2015. It is recommended by the Davis Tax Committee ("**DC**"), that legislation dealing with hybrid instruments be simplified, as it is still behind the G20, in order to focus on legal principles as opposed to instruments or transactions, as well as to align the rules with international best practice to avoid double taxation or double non-taxation of income.

The purpose of Action 6 is to prevent treaty abuse by developing a model treaty framework regarding the manner in which domestic rules are designed to prevent treaty benefits being granted in inappropriate circumstances. The DC's recommendation on Action 6 is that South Africa should categorically preserve the utilisation of domestic anti-avoidance provisions in tax treaties, in order to ensure it complied with the OECD's placement of onus on countries to preserve these provisions. The DC further recommends that renegotiation of older treaties should be undertaken or the execution of protocols to amend titles and preambles of older treaties to the extent that they prevent creation of opportunities for non-taxation or reduced taxation through avoidance or evasion.

Action 7 deals with re-evaluating thresholds for creating permanent establishment status to prevent profit sharing and base erosion, with a focus on commissionaires and exemptions on specific activities. South Africa may, going forward, consider

incorporating changes to all of its double taxation agreements by incorporating beneficial provisions that deal with the Action 7 changes to the definition of permanent establishment contained in the OECD Model Tax Convention, in order to address strategies which are utilised to avoid being taxed in a country in terms of tax treaties.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Section 12J of the Income Tax Act offers tax relief to investors in venture capital companies by allowing investors to deduct 100% of their investment into such company in that year of assessment. The types of assets that a section 12J company can invest in are regulated by statute.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

No, there are not.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

Following the 2021 Budget review, we can expect changes to the strengthening anti-avoidance rules in respect of loan transfers between trusts, to curb the transfer of growth assets to trusts using low-interest or interest-free loans, where it is proposed that further changes be made to these anti-avoidance rules.

We anticipate an amendment purposed to limit potential for double taxation under the hybrid debt anti-avoidance rules, where it is proposed the rule on unfair use of hybrid debt instruments or hybrid interest to gain tax benefits be amended to ensure that instruments that exhibit equity features or returns that exhibit dividend features do not benefit from interest deduction, as the Income Tax Act deems any returns to be *in specie* dividends paid by the issuer on which the issuer must pay dividends tax if no dividends tax exemption applies. However, the provision does not deem the return to be an *in specie* dividend for the recipient of the return. As such, these anti-avoidance rules may be overreaching as the return would be regarded as interest and thus also be taxable for the recipient, leading to economic double taxation.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The impact of the novel coronavirus (COVID-19) and the consequent curtailment of economic activity has had significant ramifications for South Africa's economy. Over the past 12 months, managers in the capital-raising cycle have faced challenges of limited partners delaying and, in some instances, reducing commitments in the wake of the economic fallout, causing fund managers to redirect their attention to the long-term nature of their investments.

For AIFs where commitments were already in progress, we witnessed a shift to due diligence processed through virtual data rooms and video facilities for the completion of in-person due diligences that were required.

New opportunities also arose, including an increase of funding in the healthcare, pharmaceutical, urban development and technology sectors. Foreign development finance institutions have also dedicated larger amounts of funding toward impact investing in the African market.

For AIF managers in the investment cycle, market instability, lower valuations and a decrease in interest rates gave rise to significant capitalisation opportunity. Extension periods were more readily considered to alleviate long-term pressure and allow portfolio investments time to recover from the decline in value. Certain funds considered amendments to their investment guidelines to redirect the focus of the AIF toward sectors that were less impacted by the pandemic.

AIFs during the harvest period of the AIF lifecycle saw a tendency toward development of contingency plans assessing workforce considerations, mitigation of supply chain disruptions and business continuity, in an effort toward financial stability.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

The introduction of the draft Conduct of Financial Institutions Bill ("**COFI**") and the ongoing Retail Distribution Review ("**RDR**") may have an impact on the operation of AIFs. COFI is intended to focus on the conduct of financial institutions. It will replace the conduct provisions of most existing financial sector laws, including the licensing regime, in order to streamline the market conduct framework for all financial sector institutions. In essence, this aims to replace multiple standards of legislation. The second draft of COFI was published for public comment in 2020 and proposed a specific category of financial product for AIFs, namely "*participatory interest in an alternative investment fund*". The regulation of rendering of financial services in respect of AIFs (including in respect of those regulated by CISCA) will thus be streamlined under COFI.

The RDR has also published an update on its status of implementation – noting that the final stages of RDR will be given effect to in COFI. The RDR proposed a number of regulatory reforms related to the distribution of financial products and the provision of financial advice, including to:

- Support delivery of suitable products and advice.
- Allow customers to make informed decisions.
- Enhance professionalism in the financial services industry.
- Promote fair competition.
- Promote sustainable business models, including those of financial advisory services.

Nicole Paige, co-head of Webber Wentzel's Private Equity Sector, specialises in the formation of alternative investment funds. She has advised and acted for local and international private equity and venture capital houses looking to raise funds for deployment in South Africa as well as in Africa generally and also for limited partners looking to invest in those funds. Her experience in fund formation, which has been recognised by various international research organisations including *Chambers Global* and *The Legal 500*, includes the full spectrum of generalist and sector funds, including buyout, real estate, debt, housing, healthcare, infrastructure and renewable energy funds. She also advises on all regulatory aspects of investment funds. She continues to lead her team through numerous significant transactions and award wins, like the Funds Legal Advisor of the Year award from *Private Equity Africa Awards* for 2015, 2017, 2019 and 2020. The team has also received the Best Legal Services: Investment Funds award from *African Global Funds Awards* for 2017 & 2019.

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With over 150 years of experience and industry knowledge, Webber Wentzel is the leading full-service law firm on the African continent. We combine the collective knowledge and experience of our firm to provide clients with seamless, tailored and commercially minded business solutions within record times. We value excellence and innovation and we work with our clients to help them achieve success in whatever they do.

We have a full-service team providing advice on the complete package of services in relation to the establishment of, and investment in, private funds across all asset classes, including regulatory, fund formation, tax, corporate and domiciliation advice. We act on behalf of fund sponsors, limited partners and institutional platforms and partner with our clients in achieving their commercial objectives.

Our fund formation and international tax experts work together to ensure the most efficient structuring for funds investing across Africa, taking into consideration all relevant legal, risk, tax and exchange control considerations. We are experienced in fund restructurings and secondary transactions, and our team has particular expertise with the complexities involved in structuring carried interest and spinout arrangements.

The team has developed and refined fund structures which have become accepted best practice in the private equity market. Consequently, we have been consistently involved in the highest-profile private equity transactions in Southern Africa.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

For the purpose of this chapter, an Alternative Investment Fund (hereinafter, "AIF") means a collective investment scheme undertaking, including investment compartments thereof, which: (i) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (ii) does not require authorisation pursuant to article 5 of Directive 2009/65/EC.

Spanish legislation distinguishes between closed-ended and opened-ended AIFs.

Spanish closed-ended AIFs are governed by *Law 22/2014, of 12 November 2014, regulating private equity entities, venture capital entities and other closed-ended collective investment entities and the management companies of closed-ended collective investment entities, and amending the Collective Investment Schemes Act* ("Law 22/2014"), which involves the transposition into Spanish law of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers ("AIFMD") applicable to companies managing AIFs. The main purpose of Law 22/2014 is the establishment of the applicable rules for the authorisation and supervision process and governance of management companies managing AIFs, rather than the particular requirements of closed-ended AIFs for which Law 22/2014 is very flexible.

Spanish open-ended AIFs are governed by *Law 35/2003, of 4 November, on Collective Investment Schemes* ("Law 35/2003"), which has been modified by the aforementioned Directive relating to fund management companies of alternative funds, and *Royal Decree 83/2015, of 13 February, amending Royal Decree 1082/2012, of 13 July, approving the Regulation for the Development of Collective Investment Schemes Law* ("RD 83/2015"). The current Spanish legal framework transposes Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("UCITS").

Regulatory authorities and investors, both in the European Union and Spain, have discussed the possibility of reforming the regulatory framework to democratise alternative investments. In the European Union, an alternative investment fund has already been authorised, offering units of EUR 10,000.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Yes, management companies of open-ended AIFs (under the regulation of UCITS regime) ("*Sociedad Gestora de Instituciones de Inversión Colectiva*" or "*SGIICs*", in Spanish official terminology) are governed by Law 35/2003. For additional information, please review the Spanish chapter of *ICLG – Public Investment Funds 2020*.

Management companies of closed AIFs ("*Sociedad Gestora de Entidades de Inversión Colectiva de Tipo Cerrado*" or "*SGEICs*" in Spanish official terminology) are governed by Law 22/2014. SGEICs are regulated by the Spanish National Securities Market Commission ("CNMV") and require its prior authorisation; although it has to be noted that non-Spanish Alternative Investment Fund Managers ("AIFMs") already authorised in other EU Member States can be passported with no need of obtaining further authorisation or any other additional requirements, and can thus operate with the freedom to provide services with or without a branch office.

Management companies from non-EU countries providing marketing services in Spain are not required to obtain prior authorisation by the CNMV, although a prior authorisation of the AIF is required prior to its marketing in Spain. This process is governed by the reciprocity principle, and the following conditions shall be evidenced to the CNMV prior to its marketing among Spanish investors:

- The existence of cooperation agreements between the CNMV and the home country regulator of the management company, with the purpose of ensuring proper exchange of information.
- The home country of the management company shall not be listed as a Non-Cooperative Country and Territory ("NCCT") by the Financial Action Task Force on anti-money laundering and terrorist financing.

Please note that SGIICs, management companies for UCITS funds, can also carry out activities for closed-ended AIFs. When managing AIFs, SGIICs must comply with the provisions of Law 22/2014.

The CNMV, as the supervisory authority, has created a special register where AIFMs must register prior to the start of their activities. However, depending on the type of AIF, the requirements and timeline will vary and Spanish AIFMs must be registered in the Commercial Registry ("*Registro Mercantil*") and must have obtained prior authorisation from the CNMV after the approval of their application (demonstrating that they meet the regulatory criteria, including: equity requirements; suitable risk management and investment selection procedures; suitability requirements of the shareholders, managers, directors and other key persons; and, if any, applicable exemptions). Consequently, any AIFM which does not appear to be registered in the special CNMV registry is not able to perform management activities.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Yes, AIFs themselves must obtain authorisation from the CNMV, since it is the authorising, supervisory and control authority. For EU management companies, the cross-border marketing of an AIF duly authorised in an EU country is free once the regulator's home country notifies the management company that it has sent the notification letter to the CNMV including information required pursuant to the EU Passport Regime. In case an EU management company intends to market an AIF not registered in an EU country, it will be necessary to demonstrate to the CNMV that the following conditions are met:

- A cooperation agreement exists between the CNMV and the home country regulator of the management company, with the purpose of ensuring proper exchange of information.
- The AIF's home country shall not be listed as a Non-Cooperative Country and Territory ("NCCT") by the Financial Action Task Force on anti-money laundering and terrorist financing.
- The AIF's home country has signed a tax agreement with Spain according to the principles stated in article 26 of the Organisation for Economic Co-operation and Development ("OECD") regulation for the exchange of tax information.

Authorisation is not automatic, but depends on the criteria of the CNMV, which may refuse it in any case for prudential reasons.

Non-EU management companies intending to market AIFs are also required to comply with the aforementioned conditions.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes. As set out in question 1.1 above, the Spanish legal system distinguishes between open-ended and closed-ended AIFs, regulated, respectively, by Law 35/2003 and Law 22/2014. Each law establishes different types of structures and, among others, the requirements, aspects and procedures of each of these entities. Neither the Spanish regulator (the CNMV) nor Law 22/2014 (AIFs) nor Law 35/2003 (UCITS) have included a specific definition of an Alternative Investment Fund, which is provided for by the AIFMD. In our understanding, all collective investment schemes which are not UCITS should be classified as AIFs; venture capital entities should be added to this category.

Open-ended AIFs are those whose object is the collective investment of the funds raised from the public and whose operation is subject to the principle of risk sharing, and whose units, at the request of the holder, are repurchased or reimbursed, directly or indirectly, out of the assets of these undertakings. Open-ended AIFs may adopt the form of either an investment fund or an investment company, and can be financial or non-financial, depending on their purpose and on whether or not they invest in financial instruments or assets.

Closed-ended AIFs are those collective investment entities that, lacking a commercial or industrial goal, raise capital from investors, through an advertising activity, to invest in all types of financial and non-financial assets, according to a defined investment policy.

Law 22/2014 designates closed-ended AIFs as "*Entidades de Inversión de Capital Cerrado* or "*EICC*", establishing the following types: (i) closed-ended investment funds ("*Fondos de Inversión de Capital Cerrado*" or "*FICC*"); and (ii) closed-ended investment companies ("*Sociedades de Inversión de Capital Cerrado*" or "*SICC*"). In addition, Law 22/2014 establishes two types of closed-ended entities focused on private equity activity: "*Entidades de Capital Riesgo*" or "*ECR*"; and companies ("*Sociedades de Capital Riesgo*" or "*SCR*").

1.5 What does the authorisation process involve and how long does the process typically take?

Given the difference of treatment between open-ended and closed-ended AIFs, the authorisation process will depend on the type of fund and, in addition, on whether it is already authorised outside or within the EU.

Those AIFs authorised within the EU will not require specific authorisation by the CNMV and are enabled to operate in the country through the EU passport. However, non-EU AIFs shall be required to obtain prior authorisation by the CNMV in order to carry out any activity in Spain.

An AIF seeking to set up in Spain shall submit its application and draft constitution documents for approval by the CNMV. The authorisation request must, in all cases, include the following documents: (i) a report; (ii) accreditation of the good reputation and professionalism, in the terms stated in the regulations, of those who hold a position of fund administrator; (iii) in general terms, any data, reports or records deemed appropriate to verify compliance with the conditions and requirements legally established; (iv) the prospectus and the key investor information document; and (v) the rules of management.

In the case of both AIFs and investment companies which designate an AIFM already authorised by the CNMV as their management company, they are obliged to notify such appointment to the CNMV.

AIFs cannot start their activity until they are registered in the special CNMV register.

The resolution of the CNMV shall be notified within two months of submitting the authorisation request or having presented all the required documentation. If no management company has been appointed, the resolution will be notified within three months of submitting the authorisation request or having presented all the necessary documentation. The resolution shall be considered denied if it has not been resolved five months after having submitted the application or all the needed documents.

Regarding the formal authorisation of a "*Sociedad Gestora de Entidades de Inversión Colectiva de Tipo Cerrado*" or "*SGEIC*", the final resolution of the CNMV must be made and shall be notified within the three months following the initial submission by the management company of its application.

In February 2017, the CNMV published a welcome programme for investment and management firms; although this dossier is for informational purposes only and does not entail any legal or administrative responsibility for the CNMV, it highlights that the CNMV will try to complete its authorisation process within two months, provided that the applicant meets the mandatory requirements and the required documentation has been substantially presented. This initiative was mainly due to the still ongoing Brexit process.

1.6 Are there local residence or other local qualification or substance requirements?

Local residence and other local qualification requirements only apply for Spanish-based AIFs or AIFMs registered in Spain and for those foreign AIFs intended to be marketed in Spain.

Thus, those AIFs or AIFMs which carry out their activities in Spain will be subject to local residence or qualification requirements, except in those cases where the AIFM is authorised to carry out its activities in Spain on a cross-border basis through the EU passport, as noted in question 1.2 above.

Foreign AIFs marketed in Spain shall designate a legal person responsible for complying with the general provisions of disclosure of information and communication of any change affecting the essential elements in its offering to investors or data registration with CNMV. In addition, all foreign AIFs will be required to submit to the CNMV statistical data on a regular basis.

Management companies operating with the freedom to provide services in Spain will be obliged to appoint a representative with tax residence in Spain for the purpose of complying with any tax obligations that may arise.

1.7 What service providers are required?

In addition to the management of an AIF, the "*Sociedad Gestora de Entidades de Inversión Colectiva de Tipo Cerrado*" or "*SGEICs*" can perform duties of an administrative, distribution or fiduciary nature. Furthermore, different types of ancillary services, such as: maintenance of a discretionary management of investment portfolios, including those of pension funds and employment funds; investment advice; and reception or transmission of client orders can also be handled by SGEICs.

The applicable law and regulations set out that there shall be a depositary institution in which: (i) securities, cash or any other products; and (ii) management companies (in case of investment funds) need to be deposited.

Although SGEICs are allowed to outsource certain functions, they must retain ultimate responsibility over their functions, establishing reasonable controls over any such outsourced functions. The information related to the outsourcing of functions shall be at the disposal of the CNMV.

In addition, please note that AIFs may be marketed by financial intermediaries, which mainly tend to be banks, securities firms or securities agencies.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Under Law 35/2003, foreign managers or advisers wishing to manage, advise or operate open-ended funds domiciled in Spain can do so if they have been authorised by Directive 2009/65/EC, 13 July 2009, in another Member State. If they have been authorised in another Member State, they can operate in Spain either through a subsidiary or under the free provision of services regime. As established in article 55.2 of Law 35/2003, under any circumstances the establishment of subsidiaries or the free provision of services can be conditioned to the acquisition of an additional authorisation or contribute to an endowment fund or any measure of equivalent effect.

Under Law 22/2014, foreign managers or advisers wishing to manage, advise or operate closed-ended funds domiciled in Spain can do so by filing a request for authorisation before the CNMV if they have been authorised in another Member State under Directive 2009/65/EC.

According to article 82 Law 22/2014, EU management companies are also allowed to manage closed-ended AIFs domiciled in Spain, as well as to provide services in Spain either through a subsidiary or under the free provision of services regime with similar procedures to those mentioned in Law 35/2003 for open-ended AIFs.

For foreign management companies to be registered in Spain, article 49 of Law 22/2014 establishes the obligation for the CNMV to, prior to authorisation of the manager, consult with the national authority of the Member State where the manager was authorised if:

- The manager wishing to operate in Spain is a subsidiary of another manager company authorised under Directive 2009/65/EC in another Member State.
- If the manager company is the subsidiary of the parent company of another managing company authorised under Directive 2009/65/EC, an investment services company, a credit entity, or an insurance or reinsurance company authorised in another Member State.
- If the managing company is under the control of the same natural or legal persons as another managing company authorised under Directive 2009/65/EC or Directive 2011/61/EU, an investment services company, a credit entity or an insurance or reinsurance company authorised in another Member State.

Please note that Directive (EU) 2019/1160, amending Directives 2009/65/EC and 2011/61/EU on cross-border distribution of collective investment undertakings, has included additional information obligations to be fulfilled by UCITS in each Member State where they intend to market their units.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The CNMV, within the EU supervisory framework, has entered into many information exchange agreements with other jurisdictions and supervisory bodies from within the EU and abroad; for example: Argentina; Australia; Belgium; Bolivia; Brazil; Canada; Chile; China; Colombia; Costa Rica; the Czech Republic; the Dominican Republic; Ecuador; El Salvador; France; Germany; Hong Kong; Italy; Mexico; Panama; Peru; Portugal; Romania; Taiwan; the United Arab Emirates; and the USA.

Specifically with regard to information-sharing agreements, these include, amongst others: (i) the European Union Agreement on Cooperation Between the Financial Supervisory Authorities, Central Banks and Finance Ministries – On Financial Stability in the European Union; (ii) the International Organization of Securities Commissions ("IOSCO") Multilateral Agreement; (iii) the European Securities and Markets Authority ("ESMA") Multilateral Agreement for the Exchange of Information and Supervision of Securities Activities; (iv) the Co-operation Framework Agreement for Mutual Assistance in the Supervision and Monitoring of an AIFM, its Delegates and Depositaries; (v) the Securities and Exchange Commissions ("SEC") and Committee of European Securities Regulators ("CESR") (currently ESMA) Work Plan; and (vi) the exchange of confidential information between the SEC and the CNMV, in accordance with International Financial Reporting Standards ("IFRS"), on companies issuing securities in both markets.

All information regarding sharing agreements is available on the CNMV's website.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

Essentially, AIFs can be constituted through either an investment fund or an investment company. However, investment

funds can only be managed by a management company since they have no legal personality, whereas an investment company can be managed directly (by its own board of directors), or by delegating management to an authorised institution.

The main legal structures for open-ended AIFs are investment funds whose objective is to obtain the highest possible return using all the investment opportunities available to the manager ("hedge fund" or "*Instituciones de Inversión Colectiva de Tipo Libre*" or "*IICIL*"), funds of hedge funds ("*Fondos de Instituciones de Inversión Colectiva de Tipo Libre*" or "*IICIICIL*"), as well as real estate CIIs and non-UCITS open-ended CIIs other than those mentioned above.

The main legal structures for closed-ended AIFs are: private equity entities (which can take the form of funds or companies); and other types of entities (i.e. closed-ended collective investment entities, which can be either funds or companies, as noted in question 1.4 above). The Spanish legislator requires that closed-ended collective investment entities do not have a "commercial or industrial purpose", and does not impose a specific investment regime, allowing investment in all types of assets, including non-financial assets. To sum up, Law 22/2014 distinguishes between two types of open-ended investment schemes:

- "*Sociedades de Inversión de Capital Cerrado*" or "*SICC*" (Spanish terminology), a closed-ended collective investment scheme in company form.
- "*Fondos de Inversión de Capital Cerrado*" or "*FICC*" (Spanish terminology), a closed-ended collective investment scheme in funds form.

Other AIFs include the European Venture Capital Fund, regulated by Regulation (EU) No. 345/2013 of 17 April 2013, and the European Social Entrepreneurship Fund, regulated by Regulation (EU) No. 346/2013 of 17 April 2013.

On the other hand, there are other types of funds, such as:

- "*Fondos de Emprendimiento Social Europeos*" or "*FESE*", which refers to European social entrepreneurship funds.
- "*Fondos de Inversión a Largo Plazo Europeos*" or "*FILPE*", which refers to European Long-Term Investment Funds.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

The investors (i.e. participants of the AIF) will be responsible up to the limit of their contributions to the AIF.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

As mentioned, managing both investment funds, being either UCITS or AIFs, is a regulated activity, limited to licensed institutions. Any legal persons whose regular business is to manage one or more closed-ended AIFs must be registered at the CNMV under the official name of "*Sociedad Gestora de Entidades de Inversión Colectiva de Tipo Cerrado*" ("*SGEICs*"). Consequently, the name of SGEICs can only be used by any legal person with this sole purpose. All SGEICs must vest the form of public limited company whose corporate purpose is the managing of AIFs.

Please take into account that management companies managing UCTIS or open-ended AIFs ("*Sociedad Gestora de Instituciones de Inversión Colectiva*" or "*SGIICs*", in Spanish terminology) can also manage closed-ended AIFs complying with Law 22/2014. The legal status of SGIICs is similar to SGEICs.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

The management companies of open-ended AIFs issue and redeem shares at the same intervals as net asset value calculations upon the request of any participant, under the terms established in the relevant regulations. Notwithstanding the foregoing, AIFs do not have to grant the requested redemption on a net asset value calculation date set by the participant, and so it does not constitute any right by itself and shall be expressly stated in the prospectus. However, in the CNMV, on its own initiative or upon the request of the management company, this may temporarily suspend the subscription or redemption of units when it is not possible to determine its price or concur on other *force majeure* events. In principle, subscription or redemption of shares may only be restricted or suspended if there is just cause or in cases of *force majeure*.

Closed-ended AIFs can establish restrictions on redemptions and will be subject to their own ruling provisions.

Furthermore, please note that Law 22/2014 was amended by means of the Royal Decree-Law 22/2018, of 14 December, establishing macro-prudential tools ("*Real Decreto-ley 22/2018, de 14 de diciembre, por el que se establecen herramientas macroprudenciales*") ("RD-Law 22/2014"). Namely, based on the stability and integrity of the financial system, the CNMV is entitled to demand AIFM to reinforce the level of liquidity of their portfolios and, particularly, to increase the percentage invested in especially liquid assets, as defined by the CNMV itself. This order may be justified on necessity and proportionality ground and must be adopted for a specified timeframe.

In fact, due to the public health emergency caused by COVID-19, a series of economic measures have been approved in Spain, among which is the modification of Law 35/2003, which establishes that: (i) AIFMs will be required to reinforce the level of liquidity of the portfolios of the managed IIC and, in particular, to increase the percentage of investment in liquid assets, as defined by the CNMV; and (ii) AIFMs may establish notice periods for redemptions managed by them without applying the requirements of time, minimum amount and prior notice in the management regulations. Such notice periods may also be established by the CNMV.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

No, there are no specific legislative restrictions. However, general principles of public order and company law may apply.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

As mentioned, for closed-ended AIFs, Law 22/2014 focus mainly in the authorisation process of management companies ("*SGEICs*"), considering that this type of fund is more flexible than UCITS and there are no significant requirements for their investment and liquidity structure.

It is worth noting the liquidity enhancing requirements that may be ordered by the CNMV to the AIFM as provided by RD-Law 22/2014 (please see question 2.4).

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Legislation governing the production and the offering of marketing materials of investment funds will depend on whether it is a closed-ended or open-ended fund, based on the "advertising activity" concept.

Thus, Law 35/2003 and Regulation No. 1082/2012 on Collective Investment Entities apply to open-ended AIFs; and Law 22/2014 to closed-ended funds.

However, there is a common generic regulation for both types of AIF, which consists of: (i) the revised text of the Securities Market Law 4/2015, which states, in general terms, the basic conditions for marketing materials, as well as Act 34/1998, of 11 November 1998, on General Advertising; and (ii) Royal Decree 217/2008, of 15 February 2008, on investment firms.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

For retail investors, the new legislation of Packaged Retail Investment Products ("PRIIPS") came into force in January 2018. SGIICs currently providing Key Investment Information Document ("KIID") are exempt from applying the new PRIIPS regime until 2022, following the vote to postpone the PRIIPS application to UCIT funds issued by the Committee on Economic and Monetary Affairs ("ECON") of the European Parliament (although an in-depth review of PRIIPS regime is expected by European industry funds in the short term). Moreover, on 3 February 2021, EIOPA (the European Insurance and Occupational Pensions Authority) accepted the new PRIIPs RTS, enabling the introduction of PRIIP KIDs by the end of the year. The fund shall not carry out their activities until the current KIID and information brochure is registered in the relevant CNMV's administrative register.

The KIID shall include information containing the essential characteristics of the fund. The words "key investor information" shall appear prominently at the top of the first page of the document in Spanish or another language that accepts the CNMV. Specifically, information shall include the following data: (i) identification of the AIF; (ii) a brief description of its investment objectives and investment policy; (iii) a presentation of the historical returns or, where appropriate, profitability scenarios; (iv) costs and associated expenses; and (v) risk/reward investment, with appropriate guidance and warnings in relation to the risks associated with investments in the Council of Institutional ("CII") considered warnings profile.

The KIID will be drafted in concise, non-technical language and presented in a common format, allowing for comparison, and must be easily analysable and comprehensible to the average investor in order that he/she is reasonably able to understand the essential characteristics, nature and risks of the investment product that is offered and make investment decisions without recourse to other documents. The document must be continuously updated and any amendments thereto should be sent to the CNMV.

Regarding closed-ended AIFs, upon the entry into force of PRIIPS a KIID is required to be delivered to any retail investor. Additionally, there are pre-investment disclosure obligations for each closed-ended fund (e.g. strategy and investment policy), as well as periodic reporting requirements to investors and the CNMV.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Yes, the CNMV establishes the standard model applicable to all the documentation to be submitted to investors. In this sense, it keeps a record of brochures, documents with key investor information, and annual and quarterly reports on the AIF, to which the public will have free access.

All documents published in the public domain will be forwarded simultaneously to the CNMV in order to keep the above-mentioned records updated.

In the case of the dissemination of the prospectus and the document containing key investor information, prior registration by the CNMV is required. Registration of the prospectus and the document containing key investor information will require prior verification by the CNMV.

3.4 What restrictions are there on marketing Alternative Investment Funds?

From a client perspective, there is a very relevant distinction between the marketing of UCITS and AIFs. UCITS can be marketed both to retail or professional investors. However, as a general rule, AIFs are to be marketed to professional clients, as defined in the Spanish Securities Market Act. The marketing to retail clients is an exception limited to those retail clients who commit to invest a minimum of EUR 100,000 and acknowledge in writing that they understand the risks of the fund being marketed.

AIFs and their management companies must respect, in any event, the regulations concerning marketing and advertising in Spain. The CNMV monitors compliance with these obligations.

It is especially relevant that authorisation is required for marketing in Spain. The CNMV monitors compliance with these obligations. Authorisation for marketing in Spain may be refused due to prudential reasons, specifically: (i) not being treated in an equivalent manner to investment funds in the respective country of origin; (ii) non-compliance with the rules of order and discipline in the Spanish securities markets; (iii) not sufficiently ensuring the adequate protection of investors resident in Spain; or (iv) the existence of disruption in the conditions of competition between AIFs authorised outside Spain and those authorised in Spain.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

There is no express legal definition of "pre-marketing" (or equivalent) recognised under the laws of Spain as of today. Please note that in this sense Directive (EU) 2019/1160 is complemented by Regulation (EU) No. 2019/1156 of the European Parliament and of the Council.

Both the Directive and the Regulation are aimed to establish uniform rules on the publication of national provisions concerning marketing requirements for UCITS and AIFMs in relation to their cross-border activities. In particular, the Regulation further strengthens the principles applicable to marketing communications governed by UCITS Directive and extends the application of those principles to AIFMs, thereby resulting in a high standard of investor protection, regardless of the type of investor. As a novelty, these pieces of regulation introduce a harmonised definition of "pre-marketing", whose rules on pre-marketing will only apply to authorised EU AIFMs.

These rules must be addressed to potential professional investors and will need to be considered as from 2 August 2021. This introduces an additional burden, especially for non-EU AIFMs, and will have a big impact around reverse solicitation insofar as any subscription within 18 months of the AIFM, having begun pre-marketing activities, shall be considered to be the result of marketing and therefore subject to the applicable notification procedures.

Please note that the new regime on pre-marketing introduced by Directive (EU) 2019/1160 has not yet been transposed in Spain, the deadline being 2 August 2021.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Please see the answer to question 3.4.

According to AIFMD and MiFID, AIFs managed by AIFMs regulated by AIFMD may be marketed and advertised to retail investors but subject to enhanced investment requirements set forth in the Spanish legislation in order to ensure protection for such retail investors.

Accordingly, open-ended funds can be marketed to retail investors provided the following conditions are fulfilled: (i) an investment of, at least, EUR 100,000; and (ii) a written declaration from the retail investor confirming that it is aware of the associated risks.

Despite the fact that the advertising of closed-ended AIFs is targeted to professional investors, this does not preclude the possibility for retail investors to invest in closed-ended funds, provided they fulfil the conditions mentioned above.

Additionally, and without prejudice to the obligations aforementioned, the Directive (EU) 2019/1160 introduces a new Article 43 a) to Directive 2011/61/UE setting out additional information obligations for AIFM to be made in each Member State where it intends to market units or shares of an AIF to retail investors.

3.7 What qualification requirements must be met in relation to prospective investors?

Prior to investment, investors shall declare, in writing, that they acknowledge the investment risks.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

The legislation does not provide any additional restrictions on marketing to public bodies.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

No, other than in relation to pension funds, there are no general restrictions in the applicable laws or regulations. However, we would recommend that an in-depth analysis be carried out, on a case-by-case basis, on the individual restrictions resulting from legal or statutory provisions of the relevant sponsor or investor.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Financial intermediaries, which can be banking or non-banking entities, shall perform activities related to the selling, buying, transferal or subscription of participations in AIFs. Investors cannot buy and sell securities listed on organised markets on their own, it being necessary to turn to financial intermediaries for such activities.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Compared to UCITS, AIFs have lower investment rules and the possibility to have a higher leverage ratio. Their investment object can consist of either financial or non-financial activities. The distinction between open-ended and closed-ended funds is explained in question 1.4.

Closed-ended funds are subject to different restrictions regarding their object, as this cannot constitute a commercial or industrial purpose. The object of closed-ended funds must be related to a predefined investment policy.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Law 35/2003 states that requirements for financial UCITS are applicable to open-ended AIFs.

To comply with the principle of risk diversification, AIFs must comply with the limitations that are imposed regarding the minimum percentage of the assets which shall be invested (in some cases, investment in assets and financial instruments may not exceed certain thresholds).

In both open-ended and closed-ended AIFs, a minimum of 60% of their assets shall be invested. However, open-ended AIFs cannot invest more than 10% of their assets in another hedge fund. In the case of closed-ended funds, the aforementioned minimum of 60% of their assets must be invested in financial instruments as shares or profit-participating loans.

Those AIFMs authorised within any Member State of the EU or in those countries not included in the Financial Action Task Force ("FATF") list of countries not co-operating in the exchange of information, are able to invest up to 100% of their assets in other ECRs.

As mentioned, Law 22/2014 mainly focuses on the requirements for management companies (SGEICs). Compared to UCITS, Law 22/2014 establishes only high-level principles regarding due diligence procedures that the SGEIC need to perform in managing closed-ended AIFs, especially regarding conflicts of interest, valuation procedures and risk and liquidity levels. Also, SGEICs shall establish a maximum level of leverage to which they may recourse. SGEICs have to disclose sufficient information regarding the main characteristics of every single fund, level of risks and leverage limits to the potential investors.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

There are no additional requirements for AIFs in any particular investments beyond those stipulated in Law 35/2003; more specifically, AIFs will be authorised to invest in the assets listed in Article 30 of the same without any limitations other than those explained in previous questions, as well as the limitations established by the statutes of each of the entities involved.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

According to Art. 30(7) Law 35/2003, in the case of financial open-ended AIFs, their debt may not exceed 10 times the value of their assets. Likewise, investment companies, when indebted for the acquisition of immovable assets which are essential for the direct pursuit of the business, may not exceed this limit. In such cases, financial open-ended FIAs' debts may not exceed 15 times the value of their assets. In both open-ended and closed-ended funds, the cap on borrowing shall be specified in the prospectus.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

Securities and assets comprising open-ended AIFs portfolios must be held in custody under a regulated depositary.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

In general, AIFMs shall disclose any facts considered specifically relevant to the situation or development of the institution and must be reported immediately to the CNMV. Once analysed, the CNMV must disseminate and include any relevant development in the quarterly and annual or semi-annual report immediately.

The legislation applicable to open-ended AIFs states that a series of documents must be provided on a mandatory basis, the most important of which are: (i) a prospectus, containing the investment fund rules; (ii) the document containing the main information for the investor; (iii) an annual report containing, among others, the annual accounts, the management report and the audit report; and (iv) two quarterly reports. These are provided in order to ensure that all relevant circumstances that may influence the determination of the value of the assets and prospectus of the institution are publicly known, on a continually updated basis, as well as the inherent risks involved, and compliance with the applicable laws.

In the case of closed-ended funds, AIFMs must notify the CNMV, within 10 days, of any acquisition or loss of a significant interest held by the AIF, provided that the voting rights of the AIF in such company increase or decrease from a certain triggering percentage (10%, 20%, 30%, 50% or 75%). However, in the case of open-ended funds, the obligation to inform the CNMV arises when the investor position reaches, goes above, or falls below the triggering percentage (20%, 30% or 50%, as well as any stake that allows control over the managing company) of the company capital or fund assets). In terms of disclosure of information to investors, an annual report must be provided.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

There are no specific AIFMD-Spanish legislation requirements to provide details of participants in AIF. However, AIF managers must keep details of participants' data (with no reporting obligations).

On a side note, there is a register obligation which applies as per Act 10/2010, of 28 April, on the prevention of money laundering and terrorism financing "*Ley 10/2010, de 28 de abril, de prevención del blanqueo de capitales y de la financiación del terrorismo*" following provisions of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing ("IV AML Directive") and "*Orden Ministerial 319/2018*" regarding the register of beneficial owners, which follows that of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

An AIFM must provide the CNMV with any information it requires at any time, and shall provide, on a regular basis, information about: (i) the principal markets and instruments in which it trades on behalf of the fund, company or entity it manages; (ii) the main instruments in which the fund trades; and (iii) the principal exposures and concentration of each of the funds it manages. In particular, and as noted in question 5.1 above, AIFMs shall provide the CNMV with an annual report.

Open-ended AIFs must submit to the CNMV a monthly memorandum containing the operational statistics, and another investment portfolio. Also, they must provide every investor with a semi-annual and a quarterly report.

Closed-ended AIFs should inform the CNMV about, *inter alia*: (i) the percentage of the fund's assets that are subject to special arrangements arising from their illiquid nature; (ii) any new arrangements for managing the liquidity of the fund; (iii) the actual risk profile of the fund and risk management systems used by the management company for, among others, market risk, liquidity risk, counterparty risk and operational risk; (iv) the main categories of assets in which the Collective Investment Undertaking ("CIU") has invested; and (v) the results of the stress tests.

SGIICs, SGEICs or any other management companies providing services on a cross-border basis need to report statistical information on a regular basis to the CNMV. Circular 2/2017 of the CNMV defines the information requirements.

5.4 Is the use of side letters restricted?

Any preferential treatment granted to an investor(s) shall be disclosed in the prospectus. Moreover, AIFs shall comply with the relevant provisions in relation to conflicts of interest and the overall obligation to keep investors duly informed.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

The tax treatment of the main forms of Alternative Investment Funds depends on whether the fund is an open-ended or a closed-ended fund.

Open-ended funds are subject to a special tax regime foreseen in the Spanish Corporate Income Tax Law, which includes the application of a 1% tax rate if certain requirements are met.

Closed-ended funds (i.e. private equity entities) are subject to the general Spanish Corporate Income Tax rate of 25% on their worldwide income. However, these sorts of funds will benefit from: (i) a 99% tax exemption for capital gains derived from the sale of subsidiaries; and (ii) a 95% exemption for dividends obtained from their subsidiaries, both subject to certain requirements.

These tax measures are compatible with the existing participation exemption regime, which may also be applicable.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

The Spanish tax system does not foresee any special tax treatment for investment managers or advisers. Consequently, the provisions set out in the Spanish Corporate Income Tax Law will apply and the tax rate will be 25% on their worldwide income.

The management of the fund may be exempt from VAT if several requirements are met.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

No. However, further analysis would be required on the tax implications derived from the transfer of participations in a fund with more than 50% of its assets in real estate located in the Spanish territory. In particular, Spain has introduced an anti-abuse clause in order to avoid the transfer of real estate through the sale of real estate companies. However, this clause will not apply if the real estate owned by these companies is used for business activities.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

Both resident and non-resident investors, as well as pension fund investors, will be taxed on dividends and capital gains, if any, derived from the sale of shares. Capital gains will be assessed for the difference between the transfer value and the acquisition cost.

Residents

Individuals will be subject to a 19% to 26% tax rate, and companies will be subject to a fixed 25% tax rate.

It is important to point out that Spanish tax-resident individuals will not be taxed on the capital gains derived from the sale of participations in an investment fund, provided a subsequent investment in a qualifying investment fund is made.

Non-residents

Depending on the tax treaty enforced with Spain, capital gains may be taxed at the source or only in the country of residence of the seller. In addition, EU residents may apply for an exemption on the capital gains obtained in Spain. As a general rule, the applicable tax rate will be 19%. However, if the non-resident constitutes a permanent establishment ("PE") in Spain, the tax rate will be 25% and the Corporate Income Tax provisions will apply.

Capital gains arising from the transfer or reimbursement of participations in a closed-ended Alternative Fund obtained by a non-resident investor would not be considered to be obtained in Spain for tax purposes. However, this rule will not apply if the non-resident investor resides in a country qualified as a tax haven for tax purposes or if capital gains are obtained through a tax haven.

Pension fund investors

Tax treatment of pension fund investors will depend on their tax residence as indicated in previous paragraphs.

Income obtained by a Spanish-resident pension fund will be subject to Corporate Income Tax at 0% over its income if it is covered under the scope of Act 1/2002 of 29 November.

Dividends obtained by a pension fund resident in the EU or EEA will not be subject to withholding tax in Spain.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

It is not strictly necessary to obtain a tax ruling from the Administration as a step prior to establishing an AIF. However, it would be advisable to file a tax ruling in order to foresee the tax treatment given by the Administration to a particular AIF.

The ruling must be issued by the General Tax Directorate within six months following the request. Tax rulings duly requested are binding on the tax authorities, and their criteria must be compulsorily applied to taxpayers in similar cases, provided the regulations existing at the time of issuance and the applicable case law remains unchanged. However, in practice, the tax authorities may change their criteria on newly issued tax rulings from time to time, but such changes will not have retroactive effects for taxpayers (the new criteria will supersede the previous ones for future cases).

The filing of a tax ruling prevents penalties in case of a tax audit, provided the facts are the same.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

FATCA has been developed in Spain by "*Orden HAP/1136/2014*", which regulated Form 290, and which is used to provide information to the Spanish tax authorities in order to comply with the FATCA provisions. Spanish Royal Decree 1065/2007 Regarding the Obligation to Report Information on Financial Accounts, has also been adapted to incorporate the FATCA provisions.

Like many other jurisdictions, Spain will begin to report information after a maximum of nine months after 31 December 2017 with regard to complying with the CRS provisions.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Spain has passed measures to adopt the actions of the OECD's Action Plan with regard to Action 6 ("Prevent treaty abuse"). Spain has signed tax treaties with several countries (Belgium, Bolivia, Croatia, Cuba, Ireland, Israel, Nigeria, Portugal, Russia, Slovenia, etc.), with a specific Limitation on Benefits ("LoB") clause. The tax treaty between Spain and the United

States contains a global LoB clause. Spain has also introduced excluding clauses for several entities or regimes (for example, in the tax treaties with Barbados, Jamaica, Luxembourg and Uruguay).

In addition, in 2017 Spain signed the multilateral Convention to Implement Tax Treaty Related Measures to prevent BEPS.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

There are no tax-advantaged structures other than as described in question 6.1.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

No, there are not.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

No, there are not.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

As a result of the COVID-19 pandemic, many managers had to outline business continuity plans. In this sense, valuation procedures have played an important role, especially in the case of open-funded funds, given that such valuations are the basis for fees, subscriptions and redemptions. On the other hand, liquidity issues have struck hard, although in truth most open-ended funds have a variety of measures in place to limit the impact of the liquidity crisis (redemption gates, distributions in kind, side pockets, suspension of redemptions). However, liquidity issues are less significant in closed-end funds as investors do not have redemption rights.

Furthermore, in recent years, there has been a trend of creating customised products for large investors. Environmental, social and governance (ESG) reflections continue to rise in the financial sector in general. Also, co-investment remains attractive.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

With regard to the Spanish regulator, the CNMV has made a series of recommendations.

In this regard, the CNMV points to the possibility of introducing a regulatory amendment to harmonise the regime for marketing alternative investment funds to retail investors with Europe. To this end, they specify that a series of requirements must be met: (i) the suitability of the instrument for the client must be assessed; (ii) if the investor's financial assets are less than EUR 500,000, the investment must represent less than 10% of the same; and (iii) the investment must be at least EUR 10,000.

The CNMV presents the need to modify the regulatory framework to bring it in line with the rest of the EU countries in the following scenarios: (i) the limitation of the liability regime for fund managers marketing global accounts in EU countries; and (ii) the possibility for funds to use securities lending.

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The establishment and operation of Alternative Investment Funds ("**AIFs**") (and their managers) is governed by the Federal Act on Collective Investment Schemes of 23 June 2006 ("**CISA**", SR 951.31) and its implementing ordinances, the Ordinance on Collective Investment Schemes of 22 November 2006 ("**CISO**", SR 951.311), the Ordinance of the Swiss Financial Market Supervisory Authority on Collective Investment Schemes of 27 August 2014 ("**CISO-FINMA**", SR 951.312) and the Ordinance of the Swiss Financial Market Supervisory Authority on Collective Investment Schemes of 6 December 2012 ("**CISIO-FINMA**", SR 951.315.2). In addition, the Federal Act on Financial Institutions of 15 June 2018 ("**FinIA**", SR 954.1) and its implementing ordinance, the Ordinance on Financial Institutions of 6 November 2019 ("**FinIO**", SR 954.11) set out the legal framework for financial institutions acting as fund management companies and investment managers of AIFs and their assets. Finally, the Federal Act on Financial Services of 15 June 2018 ("**FinSA**", SR 950.1) governs, among other aspects, the sale of financial instruments to clients in Switzerland.

In addition, a number of guidelines of the Asset Management Association Switzerland ("**AMAS**") have been recognised as a minimum standard by FINMA. The AMAS self-regulation and certain template documents provided by the association are currently undergoing substantial revisions in connection with the lapse of transitional periods under the FinIA and FinSA as of the end of 2021.

Investment companies that are incorporated as a Swiss corporation and that are either listed on a Swiss stock exchange or restricted to qualified investors (within the meaning of the CISA) do not fall within the scope of the CISA. Accordingly, the establishment and the operation of such investment companies are governed by Swiss corporate law and, in the case of listed companies, the listing rules and any additional regulations of the relevant stock exchange.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Subject to limited *de minimis* exemptions set out in the FinIA for asset managers of collective investment schemes up to a certain level of assets under management, asset managers to AIFs have to obtain a licence as a manager of collective assets from FINMA prior to engaging in asset management activities for AIFs. The licensing requirement applies to asset managers of Swiss and foreign collective investment schemes. The licence is subject to specific licence requirements that include, *inter alia*, minimum capital requirements and rules regarding the organisation and the operation of the asset manager. Asset managers who fall within the *de minimis* exemptions, however, require a licence as portfolio manager and are subject to the ongoing supervision of a FINMA approved supervisory organisation.

Investment advisors of AIFs which provide only advisory activities, without any formal or *de facto* authority to execute orders, do not need a licence from FINMA.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

As a matter of principle, four types of vehicles are available to set up an alternative investment fund in Switzerland: (i) a contractual collective investment scheme; (ii) a corporate collective investment scheme with variable capital (SICAV – see question 1.4 below); (iii) a limited partnership for collective investments; and (iv) an investment company.

Further, all Swiss AIFs require a licence from FINMA irrespective of their organisational structure (whether established contractually or as a company) and the type of investors. CISA provides that investment companies organised as a company limited by shares are out of the scope of the act, provided that (a) all their shareholders are qualified investors, or (b) they are listed on a Swiss stock exchange. Furthermore, a revision of the CISA is currently pending that would introduce a new type of collective investment scheme (the limited qualified investor fund or "**L-QIF**"), which does not require any licence if offered exclusively to qualified investors (see also question 7.2 below).

AIFs organised under a foreign law are subject to a licensing requirement only if they are offered to non-qualified investors. By contrast, there are no licensing requirements for foreign AIFs that are exclusively offered to qualified investors. However, Swiss rules on offering and marketing of AIFs apply (see below section 3).

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

The CISA distinguishes four different vehicles for structuring Swiss collective investment schemes. These are divided into

open-ended and closed-ended variants. Open-ended collective investment schemes entitle investors to request the fund or a related party to redeem their units at their net asset value at regular intervals. Closed-ended investment schemes exclude this right. The CISA provides for two types of open-ended collective investment schemes: the contractual investment fund; and the investment company with variable capital (*Société d'investissement à capital variable*; "**SICAV**"). The contractual investment fund and the SICAV constitute two variations of open-ended funds and are largely interchangeable. They allow for a broad category of structures, ranging from securities funds which are based on the EU-UCITS standard, to real estate funds, so-called other funds for traditional investments and so-called other funds for alternative investments.

Closed-ended investment schemes include limited partnerships for collective investments ("**LPCIs**") and investment companies with fixed capital (*Société d'investissement à capital fixe*; "**SICAFs**"). The SICAF and the LPCI do not share many commonalties other than being closed-ended structures: the SICAF is an investment company organised as a company limited by shares which is open to retail investors, whereas the LPCI is a special form of limited partnership reserved to qualified investors.

The contractual investment fund, the SICAV and the SICAF can be used for any generally permissible investment strategy. Typically, open-ended AIFs will be set up as "other funds for alternative investments", which provide the broadest flexibility in terms of permitted investments. However, depending on the strategy, an investment fund or a SICAV can be set up as another fund for traditional investments or even a securities fund if it can meet the demanding restrictions applicable to UCITS.

By contrast, the LPCI is conceived primarily as a vehicle for investments in venture capital, private equity and construction, real estate and infrastructure as well as alternative investments.

1.5 What does the authorisation process involve and how long does the process typically take?

The authorisation process for Swiss AIFs, fund management companies or managers of collective assets usually starts with a preliminary discussion with FINMA. Based on the outcome of such discussion, a licence application will be prepared and filed. The applicant has to demonstrate that it complies with the regulatory requirements and explain its business model and investment strategy.

When seeking a licence as a fund management company or manager of collective assets, the applicant will need to appoint a regulatory auditor to review its application and provide an assessment to FINMA. Later, the applicant has to appoint another recognised audit firm as its regulatory auditor.

The duration of the authorisation process varies and depends in particular on the complexity and the scope of the application, the applicable investment strategies, and also on the organisation of the applicant. FINMA seeks to approve AIFs that are open to all investors within a deadline of eight weeks and AIFs that are only open to qualified investors within a deadline of four weeks. These deadlines start once FINMA receives a complete filing and are merely indicative. No deadlines exist to authorise fund management companies or managers of collective assets. However, FINMA will usually take four to six months to process an application based on a complete submission (including the report of the licence application auditor).

Foreign AIFs are not subject to a licensing process. However, if they are offered to non-qualified investors, FINMA must authorise them: FINMA will grant the authorisation if the following conditions are satisfied: (i) the collective investment scheme, the fund management company or the fund company, the asset manager as well as the custodian, are subject to public supervision intended to protect investors; (ii) the regulatory framework regarding the organisation of the fund management company, the fund company and the custodian, the rights granted to investors and investment policy are equivalent to the framework set forth by the CISA; (iii) the designation of the collective investment scheme does not give reason for deception and confusion; (iv) the fund has appointed a Swiss representative and Swiss paying agent; and (v) FINMA and the foreign supervisory authorities have entered into an agreement on the co-operation and exchange of information regarding the offering of the fund.

As a practical matter, over the last decade, FINMA has only authorised UCITS for the offering in Switzerland. Existing foreign AIFs maintained their authorisation and can continue to be offered to the public. However, no new foreign AIF was authorised for offering to all investors.

There are no licensing requirements for foreign AIFs that are exclusively offered to qualified investors. However, Swiss rules on offering and marketing apply (see section 3 below).

1.6 Are there local residence or other local qualification or substance requirements?

Swiss AIFs must be administered, i.e. have their place of effective management, in Switzerland. Consequently, the ultimate supervision of the AIF must be carried out in Switzerland. However, the investment decisions may be delegated to third parties, including those domiciled outside of Switzerland. Such persons need to be supervised by a recognised supervisory authority, which entered into a co-operation agreement with FINMA, whenever such jurisdictions condition the delegation to managers in third countries on the existence of co-operation agreements. This is typically the case for EU Member States under the Directive on Alternative Investment Fund Managers ("**AIFMD**").

The members of the executive board of Swiss fund management companies or Swiss managers of collective assets must reside in a place which allows them to ensure the proper management of the business operations. Practically speaking, this means that they must reside in Switzerland or in the neighbouring areas.

Furthermore, the members of the board of directors and senior management must meet fit-and-proper requirements and possess adequate professional qualifications. These requirements are construed broadly and will generally be examined on a case-by-case basis.

1.7 What service providers are required?

Fund management companies, SICAVs, SICAFs and LPCIs must appoint a regulatory auditor, which acts as an extension of FINMA by carrying out most on-site audits and reporting on a recurring basis to FINMA.

Open-ended Swiss AIFs are required to appoint a custodian. The custodian must be a Swiss bank. AIFs may, subject to the approval of FINMA, also appoint a prime broker. If the prime broker is a licensed Swiss securities firm or a Swiss bank, a separate custodian is not required.

Foreign AIFs that are offered or, more broadly, marketed in Switzerland, are required to appoint a Swiss representative and a Swiss paying agent, unless the offering or marketing is strictly limited to qualified investors who are not high-net-worth individuals or private investment structures set up for them who opted to be treated as professional clients under the FinSA (i.e. only to "*per se*" qualified investors and not "elective" qualified investors).

Marketing foreign AIFs to *per se* professional investors (such as banks, securities firms, insurance companies or Swiss-licensed fund management companies or managers of collective assets, pension funds with a professional treasury, undertakings with a professional treasury) as well as to retail clients who entered into a long-term investment advisory or an asset management agreement with a regulated financial intermediary in Switzerland or a foreign financial intermediary subject to equivalent prudential supervision would not trigger the requirement to appoint a Swiss representative and a Swiss paying agent.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Foreign managers or advisers cannot act as fund managers of Swiss funds or Swiss AIFs. However, Swiss fund management companies, SICAVs, Swiss managers of collective assets or Swiss representatives of foreign collective investment schemes may delegate certain fund administration activities and the asset management function to foreign asset managers who are supervised by a recognised supervisory authority.

The tasks delegated to third parties must be set out in written agreements, which have to precisely describe the delegated tasks, powers and responsibilities, authority to further delegate any tasks, reporting duties and inspection rights. The delegation should not prevent the audit company from auditing or FINMA from supervising the activities of the AIF or the AIFM. In particular, where tasks are delegated to foreign managers, the Swiss regulated entity must be able to demonstrate that the regulatory auditors, FINMA and itself are able to exercise their inspection rights and enforce them if necessary. The regulatory auditors must review the documentation before outsourcing takes place.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

In December 2012, FINMA entered into a co-operation arrangement with the EU securities regulators (represented by the European regulator ESMA) for the supervision of AIFs, including hedge funds, private equity and real estate funds. The co-operation arrangements include the exchange of information, cross-border on-site visits and mutual assistance in the enforcement of the respective supervisory laws. This co-operation arrangement applies to Swiss AIFMs that manage or market AIFs in the EU and to EU AIFMs that manage or market AIFs in Switzerland. The agreement also covers co-operation in the cross-border supervision of depositaries and delegates of AIFMs.

In addition, with respect to the offering of foreign collective investment schemes to non-qualified investors, FINMA has entered into various agreements regarding co-operation and the exchange of information. As of 29 April 2020, FINMA had entered into such agreements with the supervisory authorities of Austria, Belgium, Denmark, Estonia, France, Germany, Guernsey, Hong Kong, Ireland, Jersey, Liechtenstein, Luxembourg, Malta, the Netherlands, Norway, Sweden and the United Kingdom.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

As mentioned above, Swiss AIFs can be set up as: open-ended funds, i.e. as a contractual fund managed by a fund management company or as a SICAV; or closed-ended funds, i.e. as a SICAF or an LPCI.

In terms of investment strategy, Swiss law does not distinguish between contractual funds and SICAVs. Typically, open-ended AIFs will be set up as "other funds for alternative investments" which provide the broadest flexibility in terms of permitted investments. However, depending on the strategy, an investment fund or a SICAV can be set up as an "other fund for traditional investments" or even a securities funds if it can meet the demanding restrictions applicable to UCITS.

By contrast, the LPCI is conceived primarily as a vehicle for investments in venture capital, private equity and construction, real estate and infrastructure as well as alternative investments. LPCIs have been mainly used for private equity investments or investments in real estate projects.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Investors are only liable for their investment in a Swiss AIF. Contractual funds and SICAVs can be set up as umbrella funds and have various sub-funds. In such a case, investors are only entitled to the income and assets of the sub-fund in which they invested and each sub-fund is only liable for its own liabilities.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Under the CISA, a fund management company must be organised as a company limited by shares. By contrast, a manager for collective assets can be organised as a company limited by shares, a partnership limited by shares, a limited liability company, a general partnership or a limited partnership. In practice, however, they tend to be organised either as companies limited by shares or limited liability companies.

Foreign asset managers of collective investment schemes may, subject to certain additional requirements, open a branch in Switzerland.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Investors in open-ended funds are, in principle, entitled to request the redemption of their units and payment of the redemption amount in cash at any time. This right to redeem at any time may only be restricted in the case of collective investment schemes whose value is difficult to ascertain, or which have limited marketability (e.g. investments which are not listed or traded on another regulated market open to the public; mortgages; or private equity investment). In any event, the right to redeem at any time may only be suspended for a maximum period of five years and such restrictions must be stated explicitly in the fund's regulations and in the prospectus.

Closed-ended funds cannot, by definition, be redeemed. However, an LPCI may have a limited duration, after which the LPCI will be wound up.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

The transferability of investors' interests in an AIF depends on the fund's legal structure. Generally speaking, there are no

statutory restrictions on transfers of investors' interests in open-ended AIFs. However, the fund's regulations may provide for such restrictions. This is typically the case if the AIF is restricted to qualified investors.

Further, the Swiss LPCI is, by design, a legal structure that is only available to qualified investors. Consequently, interests in an LPCI may only be transferred to other qualified investors. Furthermore, the partnership may also subject the transfer of a partnership interest to the consent of the general partner.

Typically, open-ended Swiss collective investment schemes and LPCIs, including AIFs, provide for a compulsory redemption in their fund documentation in case an investor no longer meets the eligibility requirements to invest in the fund or if their investment in the fund could jeopardise the interests of all the other investors.

Finally, investment companies that do not fall within the scope of a CISA (see question 1.1) are required to provide for transfer restrictions in their articles of association to ensure that their shareholders are exclusively qualified investors.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

There are no other limitations on a manager's ability to manage its own funds provided it satisfies the capital maintenance requirements.

Subject to the terms of the partnership agreement, general partners of LPCIs are allowed, without the consent of the limited partners, to conduct other business transactions for their own account and on behalf of third parties and participate in other companies, provided this is disclosed and the interests of the limited partnership for collective investment are not impaired as a consequence.

Finally, restrictions generally apply to related party transactions in connection with real estate, construction and infrastructure projects.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

The production and offering of marketing materials for Swiss and foreign AIFs offered in Switzerland are governed by the CISA and the FinSA and their implementing ordinances.

Investment companies that are not subject to the CISA are, consequently, not subject to these rules and must only comply with the general requirements of Swiss corporate law and, in the case of a listed investment company, the listing rules of the relevant stock exchange.

Finally, Swiss legislation against unfair competition provides for a number of prohibited marketing practices with respect to marketing activities in Switzerland.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The prospectus of a Swiss AIF must contain, *inter alia*, information on: (i) the AIF; (ii) the types of units it issued and the rights they carry, including the terms and conditions for the redemption of units; (iii) the investment policy and investment restrictions; (iv) the fees payable to the fund management company, the custodian and any other third party; (v) other fees and costs, such as performance fees, commissions, retrocessions and other financial benefits and rebates; (vi) the information on taxes (including any withholding taxes); (vii) the fund management company and the custodian; and (viii) third parties that carry out delegated tasks.

In addition, the fund's regulations, the prospectus, the key information document and any other marketing material made available to non-qualified investors in Switzerland must contain a notice regarding the special risks involved in alternative investments. The wording of such warning clause must be approved by FINMA and must be placed on the first page of the fund's regulations, the prospectus and the key information document. In addition, marketing materials for AIFs must be clearly labelled as such and must include a reference to the prospectus and the key information document and must include information on where they can be obtained.

Under the current transitional regime, AIFs are not required to prepare a simplified prospectus or a key investor information document. However, this is due to change when the FinSA is fully phased in at the end of 2021.

The prospectus for foreign collective investment schemes that are offered to non-qualified investors or high-net-worth individuals or private investment structures set up for them who opted to be treated as professional clients under the FinSA in Switzerland must include a "Swiss wrapper", containing specific Swiss information, including the name of the Swiss representative and of the paying agent, the place where the prospectuses, the last annual and semi-annual reports as well as the articles of association can be obtained without costs. This information must also be included on all marketing materials used in connection with the offering in Switzerland.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Swiss AIFs must file their prospectus and any amendment thereto with FINMA. Other marketing material does not need to be filed or approved by FINMA.

The prospectus of foreign AIFs that are offered to non-qualified investors in Switzerland must be approved by FINMA. By contrast, no such requirement applies if the offering is limited to qualified investors.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Marketing of AIFs to investors in Switzerland does not require a licence from FINMA but may qualify as a financial service under the FinSA and, consequently, trigger the Swiss rules for the provision of financial services that include, *inter alia*, rules of conduct at the point of sale, organisational measures, a duty to register client advisors in a newly established register of advisers and a requirement for financial services provider to affiliate to an ombudsman's office. However, reference to the special risks involved in alternative investments must be made in the fund's name, prospectus and other marketing materials (see also question 3.3). Depending on the type of AIF, there may be restrictions on marketing an AIF to non-qualified investors (see also question 3.6).

AIFs organised under a foreign law are subject to an approval requirement only if they are offered to non-qualified investors. By contrast, there are no approval requirements for foreign AIFs that are exclusively offered to qualified investors. However, Swiss rules on offering and marketing of AIFs apply. Foreign AIFs that are offered to qualified investors in Switzerland who

are high-net-worth individuals or private investment structures set up for them who opted to be treated as professional clients under the FinSA ("elective" qualified investors) are required to appoint a Swiss representative and a Swiss paying agent.

Marketing foreign AIFs to *per se* qualified investors (such as banks, securities firms, insurance companies or Swiss-licensed fund management companies managers of collective assets, pension funds with a professional treasury, or undertakings with a professional treasury) as well as to retail clients who entered into an investment advisory or an asset management agreement with a regulated financial intermediary in Switzerland or a foreign financial intermediary subject to equivalent prudential supervision would not trigger the requirement to appoint a Swiss representative and a Swiss paying agent.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

Switzerland does not have a legally defined concept of "pre-marketing", meaning general information that falls short of marketing a specific collective investment scheme, as in the European Union. However, any activity addressed directly at certain clients that is specifically aimed at the acquisition or disposal of units in a collective investment scheme qualifies as a financial service triggering the respective requirements under the FinSA (see question 3.4). If advertising does not have sufficient information on the terms of an offering and the financial instrument or does not intend to draw the attention to a certain financial instrument and to sell it, the advertisement will fall short of an offer.

Similarly, for sales activity to be considered as providing a financial service pursuant to the FinSA, the collective investment scheme in question must exist or its key terms should be defined. This is the case if it is either already established or, at the latest, if the key characteristics (e.g. name of collective investment scheme, main parties, investment policy, fees, issuing and redemption terms) that will enable investors to make a decision to buy have already been definitely determined.

On this basis, exploratory discussions with investors on their general interest to invest in a new fund that is still in the early stage of its inception or abstract discussions with potential investors not relating to a specific product are not deemed to constitute a financial service or an offer. This is the case, for example, if information is provided on certain strategies or composites without reference being made to an actual specific product.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Open-ended Swiss AIFs can be marketed to all investors. However, they may, in particular if they seek exemptions from certain provisions of CISA, limit themselves to qualified investors. Similarly, limited partnerships for collective investments can only be subscribed by qualified investors.

Foreign collective investment schemes can be offered to retail investors, only if they were approved for offering in Switzerland by FINMA. Foreign collective investment schemes that were not approved for offering to non-qualified investors can only be offered to qualified investors, including clients who entered into an investment advisory or an asset management agreement with regulated financial intermediary in Switzerland or a foreign financial intermediary subject to equivalent prudential supervision.

3.7 What qualification requirements must be met in relation to prospective investors?

If a foreign AIF has not been approved for offering to retail clients in Switzerland, the fund's manager and any third party involved in the offering must ensure that the fund is only offered to qualified investors. According to the CISA, the following investors are considered as qualified investors: (i) supervised Swiss and foreign financial intermediaries (including banks, securities firms, insurance companies, fund management companies and managers of collective assets); (ii) central banks; (iii) public bodies and pension funds or institutions that have the purpose to provide occupational pension plans with professional treasury management; (iv) large corporations; (v) corporations and private investment structures set up for high-net-worth individuals with professional treasury management; (vi) national and supranational institutions with professional treasury management; (vii) investors who entered into an investment advisory or an asset management agreement with regulated financial intermediary in Switzerland or a foreign financial intermediary subject to equivalent prudential supervision; and (viii) high-net-worth individuals or private investment structures set up for them, provided they have opted to be treated as professional clients under the FinSA.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no restrictions on marketing to public bodies and government pension funds specifically. Public bodies such as government pension funds are considered qualified investors provided that they have professional treasury management. No special licence is required to market AIFs to Swiss government pension funds. However, the marketing activity may qualify as a financial service triggering the respective requirements under the FinSA (see question 3.4).

In addition, pension funds are subject to certain investment restrictions (see question 3.9).

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

There are no restrictions *per se*. However, certain financial institutions and other qualified investors, such as pension funds and insurance companies, are only allowed to invest a certain amount of their net assets in AIFs. In particular, pension funds are allowed to invest directly in AIFs only if this possibility is specifically covered by its investment regulations and it complies with the general principles for safe and diversified asset management.

Moreover, persons entrusted with the management of a general partner of an LPCI may only invest themselves in the LPCI if: (i) the partnership agreement provides for it; (ii) the participation is funded from private assets; and (iii) the subscription is made at the inception of the LPCI.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

The fundraising process may fall within the scope of the FinSA. Consequently, any Swiss and foreign persons assisting in the fundraising process, such as placement agents or other intermediaries, as a matter of principle, have to comply with the requirements of the FinSA if they target investors in Switzerland.

Foreign intermediaries qualifying as client advisors, however, are exempted from the duty to register themselves in the register of advisors if they work for an entity that is subject to prudential supervision in its home country and who provides financial services to professional or institutional clients only.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

As mentioned above, the investments depend on the specific type of collective investment scheme. Among open-ended collective investment schemes, funds for alternative investments offer the broadest range of possible investments and strategies. They are specifically designed to carry out investments that (i) have only limited marketability, (ii) are subject to strong price fluctuations, (iii) exhibit limited risk diversification, or (iv) are difficult to value. Such funds may engage in short-selling and borrow funds.

In particular, funds for alternative investments may invest in: (i) securities; (ii) units in collective investment schemes; (iii) money market instruments; (iv) sight and time deposits with a maturity of up to 12 months; (v) precious metals; (vi) derivative financial instruments whose underlyings are securities, collective investment schemes, money market instruments, derivative financial instruments, indices, interest rates, exchange rates, loans, currencies, precious metals, commodities or similar instruments; and (vii) structured products. In addition, FINMA may authorise other investments such as commodities and commodity certificates. In the latter case, the investment regulations must explicitly mention this fact.

Open-ended collective investment schemes for alternative investments may (i) raise loans for an amount of up to 50 per cent of the fund's assets, (ii) may pledge or cede as collateral no more than 100 per cent of the fund's net assets, (iii) commit to an overall exposure of up to 600 per cent of the fund's net assets, and (iv) engage in short-selling. The fund's regulations must explicitly set out those investment restrictions.

Furthermore, FINMA may grant exemptions from these principles on a case-by-case basis, in particular when the AIF is limited to qualified investors.

LPCIs can invest in risk capital, including private equity, debt, and hybrid forms. They can also engage in construction, real estate and infrastructure projects, as well as alternative investments generally speaking. They can take control of companies and sit on the board of target companies in order to safeguard the interests of limited partners.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

See question 4.1. Generally speaking, there are prohibitions on self-dealing and dealing with related parties in connection with construction, real estate and infrastructure projects.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Swiss AIFs have to comply with the general investment restrictions set out for the respective type of collective investment scheme. Entering into derivative transactions is generally permissible provided that the economic effects of using derivatives does not lead to a breach of the investment objectives stated in the fund regulations and the prospectus. Exotic derivatives such as, e.g., path-dependent options may, however, only be used if the minimum and maximum delta can be calculated over the entire price spectrum of the underlying assets and its effect and the factors determining its value are known. OTC derivatives must be entered into based on a standardised master agreement complying with international standards.

Further, restrictions apply to investments in certain assets and undertakings, e.g. residential real estate in Switzerland, banks, financial institutions and other industries. Such restrictions are driven by regulatory concerns related to the assets rather than to fund laws or regulations.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Open-ended collective investment schemes for alternative investments may raise loans for an amount of up to 50 per cent of the fund's assets and may pledge or cede as collateral no more than 100 per cent of the fund's net assets.

LPCIs are not subject to particular restrictions on borrowing.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

Open-ended Swiss AIFs are required to appoint a custodian. The custodian must be a Swiss bank. AIFs may, subject to the approval of FINMA, also appoint a prime broker. If the prime broker is a licensed Swiss securities firm or a Swiss bank, a separate custodian is not required.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

Open-ended AIFs or their manager must disclose information on the investment policy, the investment techniques (whether the fund uses leverage or engages in short-selling) and information on the maximum level of management fees in its prospectus. The prospectus will include the fund regulations. Furthermore, the AIF or its manager must publish annual and semi-annual financial reports.

On request, open-ended AIFs or their manager must provide information on the basis of the calculation of the net asset value per unit. Furthermore, investors may require further information on a specific transaction, including the exercise of voting rights, creditors' rights or risk management.

These obligations do not extend to LPCIs. Limited partners are, however, entitled to inspect the business accounts of the partnership and to obtain information about the performance of the LPCI at least once every quarter.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

As part of the authorisation process, FINMA ascertains that significant equity holders of AIFs, fund management companies,

asset managers, and LPCIs have a good reputation and do not exert their influence to the detriment of a prudent and sound business practice. A person is deemed to hold a significant stake in equity if they control directly or indirectly at least 10 per cent of the capital or votes or can materially influence the business activities in another way. Consequently, any change of participants needs to be approved by FINMA.

Furthermore, SICAVs are required to maintain a register of shares, and a register of the beneficial owners of the shares held by company shareholders who hold, directly or in concert with third parties, more than 25 per cent of the capital or shares of the SICAV. These registers are not public but may be made available to law enforcement agencies in accordance with applicable rules of procedure.

Investment companies that are not subject to the CISA are also required to maintain a register of shares and, if they are not listed on a stock exchange, a register of beneficial owners. Unlike the SICAV, these obligations apply to all shareholders and not only the company shareholders.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

Open-ended collective investment schemes and LPCIs are required to maintain accounts and publish an annual report and semi-annual reports.

The annual report must be audited and published within four months of the end of the financial year. The annual report includes financial statements, information on the number of shares/units issued and redeemed during the financial year as well the total number of shares/units outstanding, the inventory of the fund's assets at market value, valuation principles, a breakdown of buy and sell transactions, the performance of the open-ended collective investment scheme, possibly benchmarking it with comparable investments, and information on matters of particular economic or legal importance (amendments to the regulations, changes of manager, custodian bank, change of directors or officers, and legal disputes).

In addition, the semi-annual report has to be published within two months of the end of the first half of the financial year. It must include, among other elements, unaudited financial statements, information on shares issued and redeemed during that period and the number of shares outstanding, the inventory of the fund's asset at market value and a break-down of buy and sell transactions.

Further, fund management companies and SICAVs must publish the net asset value of their funds at regular intervals.

Investment companies that are not subject to the CISA are subject to the general rules on financial reporting, which vary depending on whether or not the company is listed.

5.4 Is the use of side letters restricted?

The use of side letters is not specifically restricted by Swiss law. However, they must comply with the general rules of conduct. Against this backdrop, AIFs and their managers should ensure that they comply with their duty of loyalty and their duty to treat investors equally when they enter into side letters.

As a practical matter, side letters can therefore only be used if they serve an objective purpose, such as facilitating the commitment of anchor investors, and do not breach these principles. In this context, commitments to provide detailed information do not raise any particular issue as long as all investors benefit from the additional transparency. By contrast, it would typically not be permissible to reduce fees for the exclusive benefit of one investor or to promise preferred liquidity under a side letter.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Swiss collective investment schemes (i.e. contractual funds, SICAVs and LPCIs) are viewed in a transparent manner from a Swiss corporate income tax perspective. They are thus not subject to Swiss corporate income taxes on their income or gains (except if they directly hold real estate situated in Switzerland. A collective investment scheme directly holding real estate situated in Switzerland may nevertheless be tax exempt for the purposes of corporate income tax if its investors consist exclusively of tax-exempt occupational pension institutions).

Distributions made by Swiss collective investment schemes are subject to withholding tax at a 35 per cent rate, unless they correspond to distributions of capital gains or income realised from real estate held directly by the fund. Swiss investors may claim the refund of withholding tax if they declare the income in their tax return or account for it in their financial statements. Foreign investors may qualify for an exemption from Swiss withholding tax under the so-called affidavit procedure (exemption provided for by Swiss internal law irrespective of the applicability of a tax treaty). This requires that more than 80 per cent of the Swiss collective investment scheme's assets are from a non-Swiss source and that the investors demonstrate (typically via their bank) that they are not Swiss residents. Foreign-resident investors may further qualify for a partial or total exemption from Swiss withholding tax under a double taxation treaty existing between their country of residence and Switzerland. The relief is typically granted by way of reimbursement rather than by way of exemption.

SICAFs, as well as investment companies that are incorporated as a Swiss corporation and are not regulated under the CISA (see question 1.1) are taxed as corporate entities and hence subject to corporate income tax and tax on net equity. In addition, their distributions are subject to withholding tax at a 35 per cent rate.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

Swiss investment managers/advisers organised in corporate form, as well as Swiss branches of foreign managers (whether organised in corporate form or as a partnership) are subject to corporate income tax at federal, cantonal and communal levels on their net profit as accounted for in the statutory financial statements and, as the case may be, adjusted for tax purposes. They are also subject to tax on their net equity at cantonal and communal levels. There is no special tax status available for investment managers/advisers. Managers/advisers organised in the form of a Swiss partnership are not subject to corporate tax; instead, the partners are subject to individual income and wealth tax in respect of their share in the partnership's income and net assets.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

In general, the issuance and redemption of Swiss collective investment scheme shares/units does not trigger any Swiss issuance

stamp duty or securities transfer tax. An exception applies in respect of the issuance of shares in a SICAF or an investment company in the form of a Swiss corporation (see question 1.1), which are subject to Swiss issuance stamp duty. The Swiss parliament adopted the abolishment of issuance stamp duty in June 2021, but the law bill may be subject to a vote of the Swiss population, so it is still uncertain if and when it will become effective.

Further, the transfer of shares/units in a Swiss collective investment scheme (irrespective of its legal form) is subject to transfer stamp duty if a Swiss securities dealer (e.g. Swiss bank, Swiss broker-dealer, Swiss investment manager, or Swiss holding company) is involved in the transaction as a party or an intermediary and no specific exemption applies.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

Broadly speaking, resident investors are taxable on the income (whether accrued or distributed) from AIFs; individual investors holding the AIF as part of their private wealth are not taxed on income generated by the AIF from capital gains or direct real estate holdings. Non-resident investors are not subject to income tax in Switzerland for the sole reason of investing in a Swiss AIF; however, they financially suffer the withholding tax paid by the fund, whereby such withholding tax may be recovered in full or partially, based on domestic law or depending on the terms of the applicable double taxation treaty, if any (see question 6.1). Tax-exempt domestic pension fund investors are exempt from tax on their income from AIFs and are fully entitled to a refund of withholding tax deducted by the AIF. Furthermore, an AIF whose investors consist exclusively of tax-exempt domestic pension fund institutions may apply for the declaration procedure for the purposes of the withholding tax. In respect of foreign pension funds, a number of Swiss double taxation treaties do allow for a full withholding tax refund on distributions from AIFs. In addition, certain foreign occupational pension institutions are considered tax-exempt investors for securities transfer tax purposes.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

The laws and regulations applicable to Swiss collective investment schemes are clear. Thus, it is generally not necessary to obtain a tax ruling as regards the AIF itself. This being said, when an entire structure is set up, including an asset manager in Switzerland with an AIF located offshore, then it is market practice to require rulings from the competent local tax authorities in respect of, e.g., the allocation of profits between the different entities of the structure (i.e. an asset advisor in Switzerland, a manager offshore, and investment funds). Furthermore, when dealing with private equity or hedge funds, tax rulings may be necessary to confirm the tax treatment of the carried interest or performance fees. In this respect, the practice of the tax authorities may vary widely from one Swiss canton to another. Finally, the contribution/transfer of assets into the AIF and the application of tax-exempt reorganisation provisions may require the filing of an upfront tax ruling request.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Switzerland has entered into a FATCA inter-governmental agreement ("**IGA**"). This Swiss IGA follows the Model 2 IGA. Accordingly, a Swiss Financial Institution (as such term is defined in the Swiss IGA) is required to register with the US Internal Revenue Service ("**IRS**") and enter into a Foreign Financial Institution ("**FFI**") agreement. Under the Swiss IGA, the Reporting Swiss Financial Institution will report its US-related accounts directly to the IRS. Further, it should be noted that the Swiss IGA provides for certain exemptions with respect to Swiss collective investment schemes. The Swiss IGA, as well as the Swiss Federal Act on the Implementation of the FATCA Agreement with the United States of America, entered into force on 30 June 2014 and non-compliance with the provision of the Act or the Swiss IGA may be sanctioned by a fine of up to CHF 250,000. Unlike most jurisdictions, which have entered into a Model 1 type IGA, Switzerland has not issued any official guidance notes regarding the implementation of the Swiss IGA. However, a committee known as the FATCA Qualification Committee, headed by the State Secretariat for International Financial Matters ("**SIF**") and consisting of representatives of the major financial industry associations including SFAMA, publishes a Q&A section in order to provide some assistance regarding questions arising from the implementation of the Swiss IGA.

Switzerland has also created the necessary legal basis for the implementation of the CRS. The national legislation entered into force and data is being collected as of 1 January 2017.

Certain collective investment schemes may qualify as non-reporting financial institutions. Additionally, for an automatic exchange of information to actually take place, an international agreement between the respective countries is needed. Switzerland has entered into such agreements with various countries (i.e. the EU Member States, Japan, Canada and Australia).

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Switzerland, as a member of the OECD, has actively participated in the base erosion and profit-shifting ("**BEPS**") project. The Federal Council has instructed the Federal Department of Finance ("**FDF**") to offer analysis and proposals in order to implement the outcomes.

Switzerland has ratified the multilateral administrative assistance convention of the organisation for Economic Cooperation and Development/Council of Europe and put in place national legislation on this matter. Additionally, Switzerland has adopted a framework and procedures for the spontaneous exchange of information. Switzerland has also implemented country-by-country reports for multinational groups exceeding a certain size.

Treaty abuse is combatted through anti-abuse clauses in double taxation treaties, which Switzerland amends with the consent of its treaty counterparties based on the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**MLI**"), to which Switzerland is a signatory state.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Capital gains from the disposal of movable property are tax exempt for individual investors holding the investment as part of their private wealth. This allows investment funds generating return mostly from capital gains (including certain hedge funds and private equity funds) to achieve an interesting after-tax return for their Swiss resident private investors. Private investors therefore often seek to make investments in capital gain-oriented funds.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

This is not applicable.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

This is not applicable.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The Swiss fund market showed strong growth in 2020 despite the impact of the global pandemic. According to the AMAS annual report 2020, the total volume stood at some CHF 1,324.6 billion at the end of December 2020, an increase of CHF 83.6 billion or 6.7 per cent year-on-year. Generally speaking, topics that have garnered increasing attention are sustainable finance and ESG criteria.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

On 15 June 2018, the Swiss Federal Assembly passed a Federal Act on Financial Services ("**FinSA**") and a Federal Act on Financial Institutions ("**FinIA**"). The FinSA and the FinIA, which entered into force on 1 January 2020, entail far reaching changes to offering of financial products, including AIFs, to clients in Switzerland. The FinSA harmonises the rules of conduct that apply in connection with the offering of financial products. More importantly, the regime regarding the marketing of foreign collective investment schemes has changed fundamentally (see question 3.3 for further details). However, client advisors who provide financial services including investment advice will need to be registered in a register of client advisors, unless they work for a supervised financial institution. This requirement will also apply to foreign client advisors who provide financial services to clients in Switzerland. An exemption applies for foreign client advisors who work for entities that are subject to prudential supervision in their home country and who provide financial services to professional or institutional clients only.

In August 2020, the Federal Council adopted the dispatch on amending the CISA to introduce a new type of funds or, more specifically, a new regime for funds that are limited to qualified investors. The revision will exempt certain collective investment schemes, so-called L-QIFs (see question 1.3), from the requirement to obtain authorisation and approval from FINMA, on the conditions that they are offered exclusively to qualified investors and that their asset manager or fund management company is an institution supervised by FINMA. As they do not require any authorisation, the costs to set up such funds will be lower and the time to market will be substantially shorter. In addition, L-QIFs will in principle not be subject to restrictions regarding possible investments or the distribution of risk, making the concept more flexible and suited for alternative investments. The bill is currently being debated in parliament and is expected to enter into force in 2022 at the earliest.

Daniel Flühmann's practice focuses on banking, insurance and financial market laws as well as collective investment schemes.
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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The establishment and operation of investment funds is governed by state law. The two most popular forms of organisation are the Delaware limited partnership ("**LP**") and Delaware limited liability company ("**LLC**"), organised under the Delaware Revised Uniform Partnership Act and the Delaware Limited Liability Company Act, respectively. Other relevant U.S. legislation includes but is not limited to the U.S. Securities Act of 1933 ("**Securities Act**") (which regulates securities in the U.S.), the U.S. Securities Exchange Act of 1934 ("**Exchange Act**") (which regulates the offer and sale of securities in the U.S.), the U.S. Investment Company Act of 1940 (which regulates investment funds in the U.S.), the U.S. Investment Advisers Act of 1940 (which regulates investment managers and advisers in the U.S. or offering services to U.S. clients), and the U.S. Commodity Exchange Act of 1936 (which regulates commodity interests in the U.S.) ("**CEA**").

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Yes, managers and advisers must be regulated by the Securities and Exchange Commission ("**SEC**") or a state securities commission, or able to rely on an exemption from regulation. Please note that SEC regulations apply to both investment managers and investment advisers. For simplicity, this response only uses the word "adviser".

The requirements can differ depending on whether the adviser is domiciled inside or outside the United States.

Advisers located outside the United States

Advisers located outside the United States may be (1) able to rely on the Foreign Private Adviser Exemption, (2) able to rely on the Private Fund Adviser Exemption, or (3) required to register as an investment adviser with the SEC.

The *Foreign Private Adviser Exemption* provides an exemption for any firm which:

- has no place of business in the United States;
- has, in total, fewer than 15 U.S. clients (i.e., separate accounts) and investors in the United States in private funds advised by the adviser;
- has aggregate assets under management ("**AUM**") of less than $25 million attributable to (i) clients in the United States (including U.S. separate accounts and U.S.-domiciled private funds), and (ii) U.S. investors in private funds advised by the adviser; and
- neither (i) holds itself out generally to the public in the United States as an adviser, nor (ii) advises investment companies or business development companies registered under the Investment Company Act.

The *Private Fund Adviser Exemption* provides an exemption for advisers to private funds (such as hedge funds and private equity funds) with less than $150 million in AUM, but it requires such advisers to maintain certain records and provide certain reports to the SEC (such advisers: "**Exempt Reporting Advisers**"). The exemption treats U.S. advisers (i.e., those advisers with their principal office and place of business in the United States) and non-U.S. advisers differently. To rely on the exemption, a non-U.S. adviser only needs to include assets managed *at a place of business in the United States* in calculating whether it falls below the $150 million threshold. In addition, the firm's only U.S. clients must be private funds or U.S. persons investing in such funds. As a result, as long as a non-U.S. adviser does not manage any separate account mandates for U.S. investors and manages less than $150 million from a place of business in the U.S., the Private Fund Adviser Exemption allows the non-U.S. adviser to manage unlimited investments from U.S. investors. To claim this exemption, an adviser must file Part 1 of Form ADV within 60 days of beginning to rely on the Private Fund Adviser Exemption. Entities relying on this exemption must not have or take on any direct U.S. clients (i.e., separately managed accounts) until they have fully registered with the SEC as an investment adviser.

Non-U.S. advisers that cannot comply with either of the above exemptions must register with the SEC as an investment adviser.

Advisers located within the United States

Advisers located within the United States may be (1) able to rely on the Private Fund Adviser Exemption, or (2) required to register as an investment adviser. Depending on the level of AUM, the adviser may be regulated at the state level or the federal level (by the SEC).

As noted above, the Private Fund Adviser Exemption provides an exemption for advisers to private funds (such as hedge funds and private equity funds) who manage less than $150 million in AUM (Exempt Reporting Advisers, as defined above). The exemption treats U.S. advisers (i.e., those advisers with their principal office and place of business in the United States) and non-U.S. advisers differently. To rely on the exemption, a U.S. adviser needs to calculate AUM by including all assets managed for all clients. In addition, the firm's only clients must be private funds. As a result, as long as a U.S. adviser does not manage any separate account mandates and manages less than $150 million of assets, the adviser can rely on the Private Fund Adviser Exemption. Once the U.S. adviser manages more than $150 million in AUM, the U.S. adviser cannot rely on the Private Fund Adviser Exemption and must register fully as an investment adviser.

Depending on the level of AUM, a U.S. adviser may need to file at the state level, rather than with the SEC. Firms with less than $100 million in AUM must file with the states in which they have an office (either for full registration or to claim the Private Fund Adviser Exemption) with the exception of New York State (for which firms must file with the SEC when AUM exceeds $25 million). Firms with AUM exceeding $100 million file with the SEC rather than with any state (either for full SEC registration or to claim the Private Fund Adviser Exemption).

These requirements can be complicated and it is recommended that firms seek advice of counsel.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

No, Alternative Investment Funds do not need to be licensed, authorised or regulated by any securities regulator but must be able to rely on an exception from registration as an investment company under the Investment Company Act of 1940. Funds typically will seek to come under one of the "private" investment fund exceptions found in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act in order to avoid registration thereunder. Section 3(c)(1) limits the number of beneficial owners in a fund to no more than 100. Section 3(c)(7) does not impose any limits on the number of beneficial owners but limits investors to those meeting the definition of "qualified purchaser". Sections 3(c)(1) and 3(c)(7) also require that the fund must not conduct a public offering of its securities in the United States (essentially imposing the accredited investor requirements found in Regulation D under the Securities Act).

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

There is no such distinction.

1.5 What does the authorisation process involve and how long does the process typically take?

There is no authorisation process for Alternative Investment Funds in the United States, but the vehicle must be organised under state law and make the appropriate organisational filings.

1.6 Are there local residence or other local qualification or substance requirements?

No, but Delaware LPs and LLCs must make the necessary filings under state law in order to form the LP or LLC, must appoint an agent for service of process in Delaware, and must make the necessary local tax filings.

1.7 What service providers are required?

A general partner for an LP or a managing member for an LLC, a custodian, an administrator, and an auditor. Certain funds may wish to appoint one or more prime brokers.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Foreign managers and advisers must either be registered as an investment adviser with the SEC or fit within an exemption from the requirement to register as an investment adviser with the SEC (see question 1.2 above). Foreign managers must also comply with regulations of the Commodity Futures Trading Commission ("**CFTC**") if the fund utilises commodity interests to any extent. Finally, if the funds allow investment by "benefit plan investors" pursuant to the U.S. Employee Retirement Income Security Act of 1974 ("**ERISA**"), the managers and advisers need to be aware of potential ERISA requirements.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The SEC has entered into a number of bilateral Memoranda of Understanding ("**MOUs**") as well as signed the International Organization of Securities Commissions' Multilateral Memorandum of Understanding. These MOUs are designed to make cross-border regulatory cooperation and information-sharing a convenient and attractive option. *See* the International Organization of Securities Commissions, *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information*, (May 2012), text available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD386.pdf [link accessed 10 May 2021]. *See also Memorandum of Understanding between the SEC and the FSA Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight and the Supervision of Financial Services Firms* (14 March 2006) under which the UK Financial Conduct Authority (FCA) (previously named the UK Financial Services Authority or FSA) will provide assistance to the SEC in conducting compliance inspections or examinations and obtaining specified information and documents from persons, as well as in questioning or taking testimony, in the UK. (Text available at https://www.sec.gov/about/offices/oia/oia_multilateral/ukfsa_mou.pdf [link accessed 10 May 2021].)

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

The two most popular forms of organisation are the Delaware LP and Delaware LLC, organised under the Delaware Revised Uniform Partnership Act and the Delaware Limited Liability Company Act, respectively; however, it is common for non-U.S. legal structures (such as Cayman corporate funds, Cayman LPs, and other structures of Alternative Investment Funds) to be marketed in the United States.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Under Delaware law, an investor in a Delaware LP is not liable to third parties for the obligations of the LP, as long as the investor does not participate in the management of the fund. Similarly, an investor in a Delaware LLC is not liable to third parties for the debts, obligations or liabilities of the LLC unless the investor agrees to become personally obligated.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

For managers and advisers domiciled in the United States, the firm must be organised under state law. The choice of state and structure within the state will vary depending on the personal preferences and tax requirements of the individuals forming the firm. However, common choices are the Delaware LLC and the Delaware corporation. An investment manager or adviser is not required to be formed in the United States, and it is common for firms formed by individuals who are not U.S. citizens to organise the manager or adviser under local law in Europe or Asia.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

There are no limits under Delaware laws governing Delaware LPs or Delaware LLCs. However, an investment manager or adviser fully registered as an investment adviser with the SEC is deemed to be a fiduciary and is subject to the requirement to act in the best interests of its clients and provide detailed disclosure to investors in funds it sponsors.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no limits under Delaware law governing Delaware LPs or Delaware LLCs. However, under the provisions of the Securities Act, an investor typically is required to qualify as an "accredited investor", and a U.S. accredited investor must transfer any interests to another person (U.S. or non-U.S.) who is an "accredited investor".

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

There are no limits under Delaware laws governing Delaware LPs or Delaware LLCs.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

Firms registered as an investment adviser are subject to the advertising rules under the Investment Advisers Act. Registered broker-dealers are subject to certain advertising requirements by the Financial Industry Regulatory Authority ("**FINRA**") and commodity pool operators ("**CPOs**")/commodity trading advisers ("**CTAs**") are subject to advertising requirements by the CFTC.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The Investment Advisers Act provides that it is unlawful for an adviser to engage in any act that is fraudulent, deceptive or manipulative. The Act grants the SEC authority to issue rules and regulations to prevent such acts, and the SEC has issued various rules and no-action letters regarding which activities are deemed to be fraudulent. Some examples of activities that are seen as fraudulent are the use of testimonials, publication of past specific recommendations, and showing performance gross of fees. It is not possible to go into detail in this chapter. Please also note that the SEC has recently updated the advertising rules, with the new requirements taking effect on 4 November 2022. Finally, please note that although the SEC's substantive advertising rules apply only to fully registered advisers, the prohibition in the Investment Advisers Act not to engage in fraudulent, deceptive or manipulative acts applies to all firms regardless of SEC registration status.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

No, marketing materials and legal documents are not required to be registered with or approved by the local regulator.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Alternative Investment Funds must be sold in the U.S. on a private placement basis.

The SEC has adopted Rule 506 of Regulation D as a "safe harbour" for private placements. Rule 506(b) requires that: (i) sales are made only to "accredited investors" (defined in question 3.7 below); (ii) there is no general solicitation or advertising involved with the offering; and (iii) the accredited investors buy the securities for investment and not for resale. Regulation D also contains a relatively new provision, Rule 506(c), which eliminates the ban on general solicitation and general advertising, provided the issuer takes reasonable steps to verify that all purchasers are accredited investors. However, the private fund industry has been hesitant to rely on Rule 506(c) in part due to uncertainty about future regulatory requirements.

The restriction on general solicitation and general advertising applies to any person acting on behalf of a fund, including any marketing or placement agent. The term "general solicitation and general advertising" includes:

- any advertisements, articles, or communications published in any newspaper or similar media or broadcast;
- seminars or meetings whose attendees have been invited by general solicitation or general advertising and cold postal mailings;
- cold calling or email messages sent to previously unknown persons; and
- the offer of securities on publicly available websites.

In order to ensure that a private placement is valid, the persons responsible for marketing should be able to identify each person to whom interests were offered and have information to support the conclusion that the investor is eligible to invest in the Alternative Investment Fund.

In addition, Regulation D also technically requires a fund to file a short notice (a Form D) with the SEC within 15 days of the first sale of interests to U.S. investors.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

No, there is no concept of permitted "pre-marketing" in the United States.

3.6 Can Alternative Investment Funds be marketed to retail investors?

No, Alternative Investment Funds cannot be marketed to retail investors.

3.7 What qualification requirements must be met in relation to prospective investors?

All investors must meet the definition of "accredited investor" as defined in Rule 501(a) under the Securities Act. Very generally, an "accredited investor" includes: (1) an individual whose net worth (or joint net worth with that person's spouse) exceeds $1 million (excluding the value of the individual's primary residence), or whose income was in excess of $200,000 in each of the preceding two years (or, together with that person's spouse, in excess of $300,000 in each of the preceding two years) and who reasonably expects to reach the same level of income in the current year; or (2) corporations, partnerships, trusts or foundations with total assets in excess of $5 million.

In addition, investors in funds relying on the Section 3(c)(7) exception from registration under the Investment Company Act must meet the definition of "qualified purchaser", which very generally consists of: (1) natural persons who own at least $5 million in "investments" (as such term is defined in the Investment Company Act); and (2) entities that, in the aggregate, own and invest on a discretionary basis at least $25 million in investments.

For U.S.-domiciled funds, all investors must meet the qualification requirements; for non-U.S.-domiciled funds, only U.S. investors must meet these qualification requirements.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

The SEC has adopted the "pay-to-play" rule (Rule 206(4)-5 under the Investment Advisers Act), which prohibits registered and unregistered investment advisers from providing advisory services for compensation to a government entity within two years following a contribution to an official of the government entity by the adviser or certain "covered associates". Providing advice for compensation to an Alternative Investment Fund in which a government entity has invested is considered to be providing advisory services for compensation to a government entity. Registered and unregistered investment advisers and their covered associates are also prohibited from compensating third-party solicitation agents unless they are investment advisers or registered broker-dealers who are themselves complying with the applicable pay-to-play rules.

In addition, many states have adopted state "procurement lobbying" laws or provisions, many of which are broad enough to apply to fund managers seeking investments from state or local government entities and pension plans. In some instances, the state has adopted specific laws. However, in most instances it is simply a matter of an advisory opinion by the state attorney general. Those that do apply specific laws include California, Ohio, Illinois, and New York City. The state laws, however, do not include local city or county laws that may apply to large local pension plans such as LACERS or LACERA.

Funds seeking these types of investors should take care that the requirements of any relevant state and local laws are being met before soliciting investments from these types of investors.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

No, there are no restrictions other than restrictions on retail investors investing in Alternative Investment Funds (discussed above). Funds should be aware, however, that investment in a fund by certain investors, such as state or local government pension plans, private pension plans or certain banking entities, may trigger additional compliance obligations.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Yes, intermediaries involved in fundraising should be registered as a broker-dealer with FINRA. Introductions made by certain fiduciaries (such as a regulated investment adviser) also may be permissible in certain circumstances. Use of unregistered "finders" is strongly discouraged.

Finally, "associated persons" ("**APs**") of a fund (including partners, directors and employees of the fund or its investment manager, managing member or general partner) who market the fund in the United States also may be subject to broker-dealer registration, but usually rely on a safe harbour from registration. Pursuant to the Rule 3a4-1 safe harbour under the Exchange Act, no registration is required of an AP if the person is not: (1) subject to a statutory disqualification; (2) being compensated by sales-based compensation in connection with the offering; and (3) an AP of a broker-dealer. Several potential other conditions apply, but the further condition most frequently utilised requires compliance with the following additional criteria: the AP (1) performs substantial duties for the issuer that are not connected to the offering, (2) was not a broker-dealer or an AP of a broker-dealer within the preceding 12 months, and (3) does not participate in the selling of securities for any issuer more than once every 12 months.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

There are no limits under Delaware laws governing Delaware LPs or Delaware LLCs. Please note, however, that an Alternative Investment Fund may be subject to other restrictions under other U.S. legislation. For example, an Alternative Investment Fund with a CPO relying on an exemption from CFTC regulation will be subject to restrictions on the level of commodity interests in which the fund can invest. Funds that are deemed to be "plan assets" under ERISA are subject to certain restrictions on investments. Funds also may be subject to restrictions on certain activities under provisions of the U.S. Internal Revenue Code of 1986, as amended.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Please see the answer to question 4.1 above.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Under the CEA and implementing CFTC regulations, an investment fund is considered to be a "commodity pool" subject to CFTC regulation if the fund transacts in commodity interests (i.e., futures contracts or options on futures contracts or commodities and most types of over-the-counter derivatives) to any extent. Thus, even a fund that is predominantly a vehicle for investment in securities and makes use of commodity interests only for hedging purposes is deemed to be a "commodity pool" under CFTC requirements.

Without registration in an appropriate capacity with the CFTC, a firm and its employees may not solicit U.S. investors for a commodity pool (i.e., under CFTC interpretations, a fund which engages in transactions in commodity interests to any extent). Unless an exemption is available (as discussed below), the operator or marketer of a commodity pool must register as a CPO, and one who manages a fund that trades in futures or who gives advice about futures trading must register as a CTA. Marketing personnel and their supervisors would be required to register as APs of the registered firm.

Loans

There are no local regulatory requirements with respect to investing in loans (although there may be tax issues arising from investment in loans).

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

There are no limits under Delaware laws governing Delaware LPs or Delaware LLCs. However, as noted above, Alternative Investment Funds may be subject to other restrictions under other U.S. legislation, including tax issues.

4.5 Are there are any restrictions on who holds the Alternative Investment Fund's assets?

There are no restrictions under Delaware laws on who may hold the assets of a Delaware LP or LLC. However, the Advisers Act requires all registered advisers to maintain custody of client assets with an eligible custodian in compliance with certain requirements under Advisers Act Rule 206(4)-2 (referred to as the Custody Rule).

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties, including on environmental, social and/or governance factors?

Alternative Investment Funds domiciled or sold in the United States are expected to make detailed disclosure of all material terms of the offering, as well as potential risks and conflicts of interest, to prospective investors. There is no requirement to file the fund's offering materials with the SEC. Investment advisers that are fully registered with the SEC are required to make detailed information about the firm, its investment techniques, its fees, its risks and other information available publicly by filing Form ADV (Part 1 and Part 2) with the SEC and providing a copy of Part 2 to all clients and fund investors. As part of a firm's requirement to disclose information about its investment techniques, a firm using environmental, social or governance ("**ESG**") factors is required to accurately disclose its ESG investing approach and have adopted and implemented policies, procedures, and practices that accord with their ESG-related disclosures. The SEC's Division of Examinations has recently published a Risk Alert on ESG Investing (https://www.sec.gov/files/esg-risk-alert.pdf [accessed on 10 May 2021]). Firms that have filed with the SEC as an Exempt Reporting Adviser must make certain information publicly available as well.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

There is no requirement in the United States to provide details of fund investors to any local regulator or the public for purposes of a register of beneficial owners. However, investment advisers that are fully registered or registered as an Exempt Reporting Adviser with the SEC are required to disclose to the public certain direct and indirect owners of the adviser.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers, including on environmental, social and/or governance factors?

Investment advisers that are fully registered or registered as an Exempt Reporting Adviser with the SEC are required to report updated information on their Form ADV annually (or certain materials changes must be reported "promptly") to the SEC. Information on Form ADV is available to the public on the SEC's website. Investment managers or advisers to certain categories of funds (hedge funds, private equity funds, liquidity funds, etc.) that exceed certain asset level thresholds are required to report information on holdings periodically to U.S. regulators on "Form PF". This is similar to the "Annex IV" reporting required for European Alternative Investment Funds. There are no reporting obligations with respect to ESG investments (other than the disclosure requirements discussed in question 5.1 above).

5.4 Is the use of side letters restricted?

No, the use of side letters is not restricted under Delaware law.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Delaware funds are typically tax transparent and generally not subject to income taxation. Non-U.S. funds may be tax transparent or opaque, but in either event generally operate in a manner that qualifies for safe harbour relief from net income taxation. Withholding taxes may apply to non-U.S. opaque funds.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

These entities can be either tax transparent, in which case they are generally not subject to income taxation, or opaque, in which case corporate income taxes apply.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

Cash contributions generally can be made on a tax-free basis. Transfers generally are taxable events.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

U.S. citizens and residents are subject to taxation on worldwide income. Non-residents are taxable directly on net income derived in connection with U.S. trade or business activity (including U.S. real estate-related disposition gains) and through withholding on the gross amount of dividends and other categories of U.S. source income not connected with a U.S. trade or business. U.S. tax-exempt investors are generally taxable only on income derived from (i) a business that is unrelated to their exempt purpose (with certain exclusions), or (ii) debt-financed property.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

Generally, no. Entity classification elections may be desirable.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

U.S. funds are withholding agents for FATCA purposes. Diligence is achieved through collection of IRS W-8/9 forms from investors. The U.S. is not a participant to the OECD's Common Reporting Standard.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

The U.S. is generally supportive of BEPS. Tax reform enacted in 2017 made significant changes designed to address profit-shifting, base erosion and taxation of U.S. multinationals in a manner that provides incentives to maintain operations in the U.S. The U.S. has not agreed with the OECD measures that would allow for taxation of digital services. In June 2020, the then-U.S. Treasury Secretary recommended a pause in OECD talks to allow governments to focus on their COVID-19 pandemic responses. More recently, however, a newly appointed U.S. Treasury Secretary has signalled a change in position, favouring engagement with the OECD to address digital taxation and a global minimum tax.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Non-corporate taxpayers pay reduced rates on long-term capital gains (generally, from dispositions of investment assets held for more than one year) and certain corporate dividends. Certain asset-specific structures that can avoid entity-level taxation if various conditions are satisfied include REITs, REMICs and RICs.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Generally, no.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

Given the recent change in administration following the November 2020 elections, significant tax reform is possible. In particular, the new administration is considering proposals that would increase the corporate tax rate and increase taxes on wealthy individuals, including through elimination of reduced rates for long-term capital gains and inheritance tax reforms.

7 Trends and Reforms

7.1 What have been the main trends in the Alternative Investment Funds space in the last 12 months?

The SEC has updated certain provisions of the advertising rules, which will impact the marketing of Alternative Investment Funds. The new provisions will be effective on 4 November 2022.

7.2 What reforms (if any) in the Alternative Investment Funds space are proposed?

No major reforms have been proposed.

Karen L. Anderberg advises UK, U.S. and European asset managers and investment funds on all aspects of U.S. financial services regulatory issues, including Securities and Exchange Commission (SEC) investment adviser and investment fund registration and exemptions and Commodity Futures Trading Commission (CFTC) requirements. Ms Anderberg's practice also consists of advising investment funds (including UCITS and AIFs) on global distribution issues, both via registration or passporting and on a private placement basis. Ms Anderberg also counsels large financial services firms on global compliance and distribution matters.

Ms Anderberg co-edited *US Regulation for Asset Managers Outside the United States* published by Sweet and Maxwell in 2017. She has spoken extensively on financial services regulatory matters, and has co-hosted a regular seminar series on "US Regulation for UK Legal and Compliance Professionals" since 2008.

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