1990 | 2015 25 YEARS

The global forum for the global hedge fund industry

aima Alternative Investment Management Association

AIMA Journal

AIMA's Silver Jubilee

CEOs past and present join the celebrations as AIMA marks its 25th anniversary: p26

CLIFFORD CHANCE

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AIMA updates

Cover photo:
Former AIMA CEOs Andrew Baker (pictured left) and Florence Lombard joined the current chief executive Jack Inglis at AIMA's 25th Anniversary Charity Dinner at the Guildhall, London on 23 September 2015. More than £125,000 was raised for the NSPCC, the children's charity. Photo: Clive Totman

From our members

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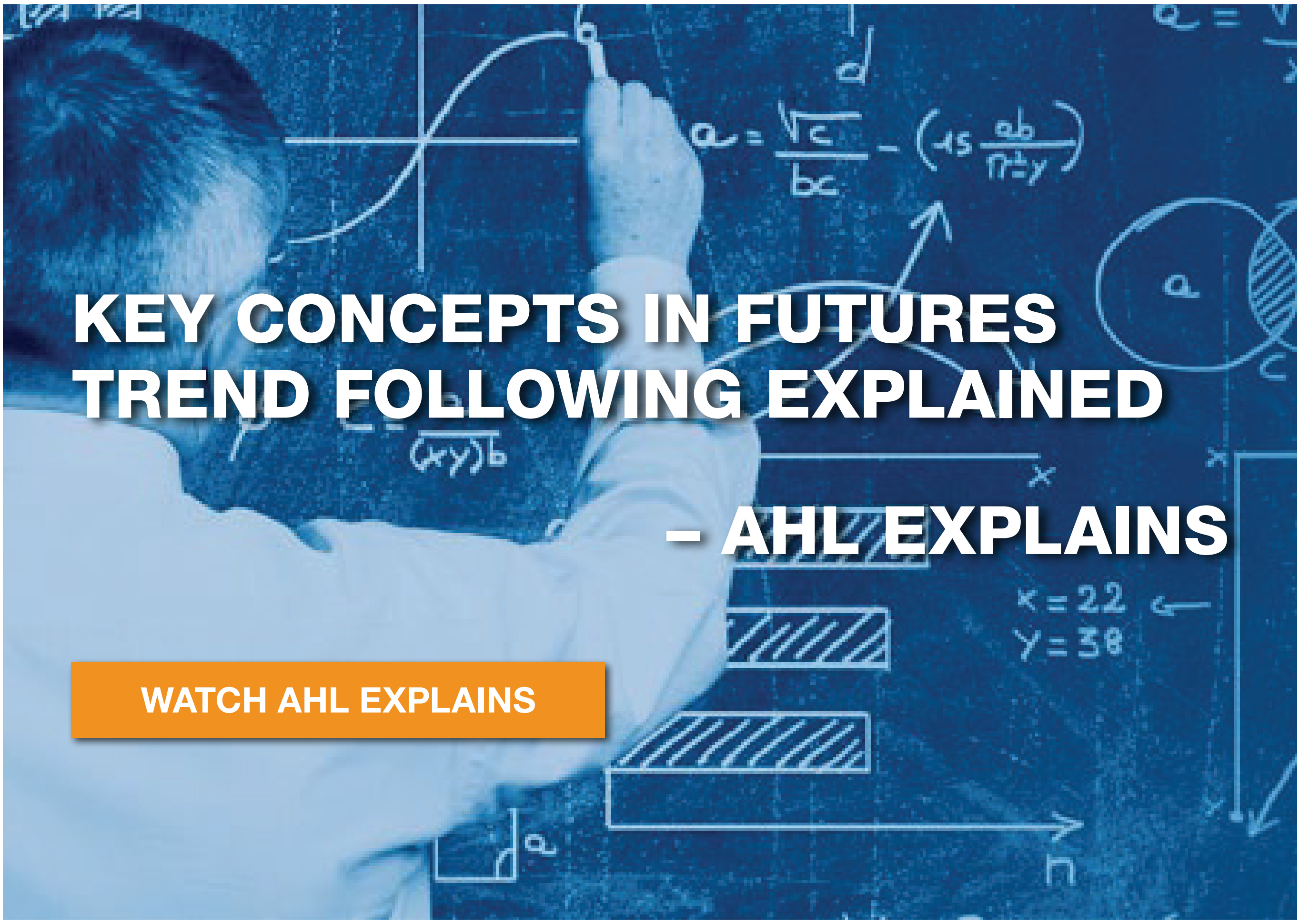
From our members

Would you like to write for the AIMA Journal in Q4?

The fourth quarter edition of the *AIMA Journal*, the global forum for the hedge fund industry, will be released in mid-December 2015.

If you are an AIMA member and would like to contribute to this edition, please contact Dominic Tonner by the end of October at dtonner@aima.org.

Only AIMA members may write for the AIMA Journal. If your firm is not currently a member and you would like to learn more about the benefits of joining, please contact Fiona Treble at ftreble@aima.org.



AHL Explains is a video series that has been created to explain key concepts in futures trend following. Narrated by Dr. Anthony Ledford, Chief Scientist at Man AHL, our intention is to bring each concept to life by focusing on principles rather than detail. Each video is just a few minutes long and we hope you will find them useful.

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A momentous week in AIMA's long and distinguished history

By Jack Inglis, CEO, AIMA

The last few days of September were momentous ones for AIMA. The Association celebrated its 25th anniversary on 23 September with a charity dinner at the Guildhall in London which I am delighted to say raised over £100,000 for the NSPCC, the children's charity. Close to 300 guests attended the evening reception at the Guildhall in London, with speakers including Emmanuel "Manny" Roman, CEO of Man Group, and NSPCC CEO Peter Wanless.

Raising over £100,000 for the NSPCC was a fitting way to mark our 25th anniversary and underlined once again the strong charitable and philanthropic tradition in the hedge fund industry.

The following day, 24 September, the Guildhall hosted our 25th anniversary Annual Conference, also which drew 400 attendees to the Guildhall and featured an address by the Rt. Hon. Greg Hands, the UK Chief Secretary to the Treasury.

The conference, sponsored by Simmons & Simmons, EY and State Street, also heard from David Wright, the Secretary General of IOSCO, as well as a number of senior representatives of fund management firms including AIMA Council members Simon Lorne, Vice Chairman and Chief Legal Officer of Millennium Management, and Stuart Fiertz, Co-Founder and President of Cheyne Capital Management.

To further mark the anniversary we published a special one-off magazine that looked back at the last 25 years for both AIMA and the global hedge fund industry. To read this publication, titled '25 Years in Hedge Funds', click here.

We are hugely proud of everything which AIMA and the industry have achieved over the last 25 years, a period for hedge funds marked of course by globalisation, institutionalisation and increased regulation. In that period, from humble beginnings, AIMA has grown into a truly global organisation, with offices in every region of the world and close to 1,600 member firms in 55 countries.

It is of course our members who are the backbone of the association. They comprise both the largest and smallest firms around the world, all contributing to important output such as responses to regulatory consultations, updates to DDQs and new industry guides. We have more than 70 committees and working groups globally, comprising more than 600 individuals from over 350 firms. It is that support that allows us to continue to deliver all the services our members ask us for; and to undertake, with the help of the members who volunteer their time, all our work on behalf of the industry around the world.

From small European beginnings, an impressive international network encompassing Asia-Pacific, EMEA and the Americas has been constructed. The US has the dominant market share in the industry and represents over 50% of the aggregate AUM of our global membership; our Americas presence is further augmented by the existence of our National Groups in Canada and Cayman as well as our activities in Brazil. In Asia-Pacific, we have National Groups operating in Hong Kong, Singapore, Japan and Australia, combined under a single regionally-focused operation.

As we explain in '25 Years in Hedge Funds', the international nature of investing, trading and regulation means it has never been more necessary for the hedge fund industry to have a global representative.

The next 25 years will doubtless see even more change - but ever present will be AIMA, representing and speaking up for hedge fund firms, large and small, wherever they are based around the world.

Q3 - AIMA regulatory and tax submissions and summaries

Please note that the hyperlinks in this table are restricted to AIMA members — please log in to www.aima.org.

Date	Authority	Description
22 September		AIMA Side Letter Guidance
15 September	EC	AIMA Position Paper - Shareholder Rights Directive II
14 September	ACER	Submission - Regulation on Energy Market Integrity and Transparency
9 September	EC	Submission - Further corporate tax transparency (part 1)
9 September	EC	Submission - Further corporate tax transparency (part 1)
4 September	BIS	Submission - Draft Limited Liability Partnerships (Application to Companies Act 2006) (Amendment) Regulations 2015
21 August	SEC	AIMA Guidance Note - US Private Placement
13 August	EC	Submission - EMIR Review
7 August	EBA	Submission - Consultation Paper on Draft Regulatory Technical Standards on the valuation of derivatives pursuant to Article 49(4) of the BRRD - Joint Response
6 August	SEC	Submission - Proposed Rule on Investment Company Reporting Modernisation
6 August	SEC	Submission - Proposed Rule Amendments to Form ADV and Investment Advisers Act Rules
6 August	US Deptment of Labor	Submission - Conflicts of Interest Rule and the Proposed Best Interest Contract Exemption
4 August	HMRC	Submission - Carried interest - Finance Bill legislation and guidance
3 August	Australian Treasury	AIMA Briefing Note - Investment Manager Regime - Deloitte/AIMA

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Date	Authority	Description
3 August	ESMA	AIMA Summary - ESMA's opinion and advice to the European Parliament, the Council and the Commission on the AIFMD passport
31 July	EC	AIMA Briefing Note - MiFID II
31 July	BIS	AIMA Summary - Small Business, Enterprise and Employment Act - Part 7 - Companies: Transparency - The Register of Persons with Significant Control
31 July	MAS	Submission - Draft Regulations for Mandatory Clearing of Derivatives Contracts
22 July	MAS	Submission - Proposed Enhancements to Resolution Regime for Financial Institutions in Singapore
16 July	BIS	Submission - PSC register
13 July		AIMA Briefing Note - The interplay between European and US derivatives trading rules
10 July	EBA, EIOPA, ESMA	Submission - Draft Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP
10 July	MAS	Submission - Regulatory Framework for Intermediaries Dealing in OTC Derivative Contracts, Execution-Related Advice and Marketing of Collective Investment Schemes
10 July		AIMA Briefing Note - Joint ESAs' second consultation on Draft RTS for margin for non-cleared trades
1 July	EC	Submission - Tax transparency


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Q3 regulatory, tax and policy developments globally

Many of the hyperlinks in this section are restricted to AIMA members — please log in to www.aima.org.

Global

AIMA publishes Side Letter Guidance

AIMA has published guidance on side letters, which sets out some guidance which members of a fund's governing body should take into account when considering requests to enter into side letters. The guidance supersedes AIMA's 2006 guidance on side letters and seeks to give guidance which should be globally applicable. The guidance covers issues such as (i) the fund documents; (ii) understanding the terms of a side letter; (iii) director's duties; (iv) listed funds; (v) parties and signatories to a side letter; and (vi) disclosure requirements.

IOSCO Task Force reports on cross-border regulation

Mid September saw the publication of the Final Report of the IOSCO Task Force on Cross-border Regulation. The IOSCO Task Force was first established in June 2013 to assist policy-makers and regulators in addressing challenges of cross-border regulation of financial services and products. It undertook a series of hearings and a public consultation to help in the drafting of its Final Report. In addition to identifying current trends in cross-jurisdictional engagement, the Final Report presents a series of next steps including the future specific identification and consideration of the cross-border implications of policy-making by IOSCO Policy Committees and greater engagement between IOSCO, G20 jurisdictions and the FSB in order to raise greater awareness of key issues. The Final Report also contains a detailed resource for regulators seeking cross-border regulatory options.

CPMI-IOSCO publish consultation on guidance for non-UTI/UPI data elements

CPMI and IOSCO published a consultative report Harmonisation of a first batch of key OTC derivatives data elements (other than UTI and UPI) - first batch. The consultation relates to the G20 Leaders' agreement to report OTC derivative contracts to trade repositories and the need to aggregate data being reported. It is the first consultation of the CPMI-IOSCO Harmonisation Group that has been mandated to develop global guidance on the harmonisation of data elements reported to trade repositories other than UTIs and UPIs - with UTIs currently the subject of a separate CPMI-IOSCO Consultation. The consultative report sets out different options for various key data elements, including: the effective and end dates of a contract; whether the contract is cleared; the settlement method; counterparty IDs; and the notional amount and currency. The deadline for comments is 9 October 2015. AIMA will be discussing the consultation alongside a cross-industry committee of trade associations led by ISDA.

CPMI-IOSCO consult on UTI harmonisation

The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) last week published a consultative report - Harmonisation of the Unique Transaction Identifier (UTI). The consultation relates to G20 jurisdictions' ongoing work on OTC derivatives market transparency and the importance of being able to aggregate reported data to TRs globally. To this end, the consultation is intended to help develop clear guidance for a uniform global UTI definition, format and usage that meets the needs of UTI users, is global in scale, based on relevant ISO technical standards where available and is juridisction neutral. The consultation follows a CPSS-IOSCO report OTC derivatives data reporting and aggregation requirements published in 2012 and a CPSS-IOSCO report Authorities' access to trade repository data published in 2013. It also complements a 2014 FSB Feasibility study on approaches to aggregate OTC derivatives data, following which the FSB asked CPMI/IOSCO to develop global guidance on the harmonisation of data elements, including UTIs and Unique Product Identifiers (UPIs). The consultation had a deadline of 30 September 2015.

IBA seeks stakeholder views on proposed changes on LIBOR administration

ICE Benchmark Administration (IBA) has been in touch with AIMA in relation to its work on the evolution of ICE LIBOR to a transaction-based rate, in line with the recommendations of the FSB. IBA recently released a Second Position Paper for which it is seeking feedback from all stakeholders who may be impacted by changes in calculation methodology for LIBOR. A questionnaire is available on the IBA website, to which the latter will be accepting responses until 16 October 2016.

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OECD takes further steps for implementing automatic exchange of information

On 7 August 2015, the OECD released three reports to help jurisdictions and financial institutions implement the global standard for automatic exchange of financial account information. The first publication is a Common Reporting Standard Implementation Handbook (here), which will provide practical guidance to assist government officials and financial institutions in the implementation of CRS, and to help promote the consistent use of optional provisions or identify areas of alignment with FATCA. The Handbook is intended to be updated on a regular basis. The other OECD publications are an updated edition of the report on Offshore Voluntary Disclosure programmes (here) and a Model Protocol to Tax Information Exchange Agreements that provides the basis for jurisdictions wishing to extend the scope of their existing TIEAs to also cover the automatic and/or spontaneous exchange of tax information.

EMEA

AIFMD

AIFMD Q&A

On 21 July 2015, the European Securities and Markets Authority (ESMA) published an updated version of its Question and Answers (Q&As) on the Alternative Investment Fund Managers Directive (AIFMD). The document adds and updates a variety of Q&As, including a previously included question about which AIFs have to be included in the reports when a non-EU AIFM reports information to the national competent authorities of a Member State under Article 42 of the AIFMD. In the updated response, ESMA has added that "[w]hen Member States apply ESMA's opinion on collection of additional information under Article 24(5) of the AIFMD, AIFMs should also report information on non-EU master AIFs not marketed in the EU that have either EU feeder AIFs or non-EU feeder AIFs marketed in the Union under Article 42." It is unclear whether this will affect Member State interpretations about the need to report on non-EU master funds not marketed in the EU and, if it does, when any such changes would take place in individual Member States that are not currently requiring the reporting of such non-EU master fund information. This document is intended to be continually edited and updated as and when new questions are received.

ESMA advice on AIFMD passport

On 30 July 2015 the European Securities and Markets Authority (ESMA) published its advice (the 'Advice'), as well as an opinion (the 'Opinion'), to the European Parliament, the Council and the Commission on the application of the Alternative Investment Fund Managers Directive (AIFMD) passport to non-EU alternative investment fund managers (AIFMs) and alternative investment funds (AIFs). In the Opinion, ESMA concludes that there is insufficient evidence to indicate that the AIFMD EU passport and NPPRs have raised major issues in terms of the functioning and implementation of the AIFMD framework. In its advice ESMA has conducted a country-by-country assessment for six jurisdictions (Guernsey, Hong Kong, Jersey, Singapore, Switzerland and the United States), concluded positively that no obstacles exist to the extension of the passport to Guernsey and Jersey, while Switzerland will remove any remaining obstacles with the enactment of pending legislation and offered no definitive decision on Singapore, Hong Kong or the United States. AIMA has produced a summary of the Advice and the Opinion. On 31 July, we issued a press release on the ESMA advice, which is here.

ESMA consultation on UCITS V / AIFMD remuneration guidelines

On 23 July 2015, the European Securities and Markets Authority (ESMA) published a consultation paper on setting out guidelines on sound remuneration policies under the fifth Undertakings for Collective Investments in Transferable Securities Directive (UCITS V) and the Alternative Investment Fund Managers Directive (AIFMD). The proposed Guidelines aim to ensure an application of the UCITS V remuneration provisions that converges with the AIFMD guidelines. The Proposed Guidelines provide guidance on issues such as proportionality, governance of remuneration, requirements on risk alignment and disclosure. The consultation also proposes a revision of the AIFMD Remuneration Guidelines specific to AIFMs in a group context. The deadline for comments is 23 October 2015 and ESMA expects to publish the final guidelines by Q1 2016.

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MiFID

ESMA publishes its final draft technical standards under MiFIDII/R

On 28 September 2015, the European Securities and Markets Authority (ESMA) published its Final Report on the technical standards under the amended Directive and new Regulation on markets in financial instruments (MiFID II/MiFIR), as well as two annexes containing the final draft regulatory and implementing technical standards and a cost benefit analysis. Originally expected to be made public back in July of this year, ESMA has been working on its draft RTS in collaboration with the Commission as part of an early legal review to avoid delays from Commission rejection or amendment of the draft RTS. Key areas of the final draft RTS include: (i) pre- and post-trade transparency; (ii) market microstructural issues; (iii) commodity derivative position limits; (iv) transaction Reporting under Article 26 of EMIR (including data relating to orders); (v) Straight-through-processing; and (vi) best execution. Once adopted by the Commission, the European Council and Parliament will have either a one or three month period in which to object. Please note that the RTS do not cover the issue of dealing commissions. The latter issue falls within the scope of the Commission's delegated acts, the adoption of which is expected to be delayed until early November 2015. The final draft technical standards now pass to the European Commission for adoption within three months, after which both the European Council and Parliament have their own objection periods during which they may reject the technical standards.

ESMA consults on draft ITS under MiFID II

The European Securities and Markets Authority (ESMA) published a consultation paper on three draft Implementing Technical Standards (ITS) in relation to the Level 2 development process of the amended Directive on markets in financial instruments (MiFID II). The ITS cover the: (i) suspension and removal of financial instruments from trading on an EU trading venue, relating to the timing and format of publications and communications; (ii) notification and provision of information for data reporting service providers (DRSPs), in particular when applying for authorisation and notifications relating to membership of a DRSP's management body; and (iii) market operator procedures for sending weekly aggregated position reports for commodity derivatives and emission allowances to ESMA at a specified time. The consultation closes on **31 October 2015.**

EMIR

ESMA list of authorised CCP under EMIR

ESMA updated its list of CCPs authorised to offer clearing services and undertake clearing activities in the EU in accordance with Regulation (EU) No.648/2012 on OTC derivatives, CCPs and trade repositories (EMIR). The list now includes CME Clearing Europe, which has been authorised to extend its activities and services to clear short term interest rate futures and deliverable swap futures.

EMIR clearing obligation for IRS

The European Commission released its Final delegated regulation on RTS for the mandatory central clearing of certain Interest Rate Swaps, which will place into law the formal Opinion adopted by ESMA on clearing of IRS under Regulation 648/2012 on OTC derivatives, CCPs and trade repositories (EMIR) adopted back in March 2015. The Final RTS will require: (i) fixed-to-floating IRS; (ii) floating-to-floating IRS; (iii) FRAs; and (iv) overnight index swaps, to be cleared with a CCP that has been authorised or registered by ESMA. The obligation will enter into effect six months after the entry into force of the Final RTS for Category 1 counterparties (clearing members), 12 months after the entry into force of the Final RTS for Category 2 counterparties (other Financial Counterparties and Non-financial counterparties with an aggregate month-end gross notional value of OTC derivatives of at least €8bn for the three months following the month of publication of the Final RTS in the Official Journal), and 18 months after entry into force of the Final RTS for Category 3 entities (Financial Counterparties and Non-financial counterparties that are AIFs falling below the threshold). Frontloading will be applied to contracts with a minimum remaining maturity of six months upon the relevant go-live date of the clearing obligation for: (i) Category 1 counterparty contracts entered two months after entry into force of the RTS; and (ii) Category 2 entity contracts entered five months after the entry into force of the RTS.

EMIR Review

AIMA submitted a response to the European Commission consultation on the EMIR Review. The response set

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out AIMA's central positions on possible changes to the EMIR framework as part of the formal review of EMIR currently being undertaken by the European Commission. Among other things, the response called for: (i) the availability of third-country equivalence under Article 13 of EMIR for transactions involving at least one counterparty 'subject to the rules of' an equivalent third-country jurisdiction; (ii) the replacement of dual-sided reporting with a robust single sided mechanism; (iii) the abolition of the frontloading requirement currently contained within Article 4(1)(b)(ii) of EMIR; (iv) the development of a fast-track process for the suspension of the EMIR mandatory clearing obligation; (v) an alternative mechanism for direct access to CCPs rather than as a formal 'clearing member'; and (vi) the swift removal of issues currently experienced around the definition of an 'OTC Derivative' under Article 2(7) of EMIR. In addition to industry feedback relating to its consultation, the European Commission received four reports published by ESMA on the functioning of the EMIR framework. Three of the reports, required under Article 85(3) of EMIR, cover: non-financial counterparties; pro-cyclicality; and the segregation and portability for central counterparties (CCPs), respectively. The fourth report responds directly to the European Commission's EMIR Review and includes recommendations on amending EMIR in relation to: the clearing obligation; the recognition of third country CCPs; and the supervision and enforcement procedures for trade repositories. Of particular interest to AIMA are ESMA's calls for the Commission to provide for the suspension of the clearing obligation upon particular market conditions, as well as the abolition of frontloading and an entire rethink of the EMIR equivalence and recognition process for CCPs. The European Commission will now use the consultation responses and the ESMA reports to assist in the compilation of a final report that the Commission will submit to the European Parliament and European Council.

ESAs consult on non-cleared margin

On 10 July 2015, AIMA submitted a joint response with the MFA to the European Supervisory Authorities (ESAs) on their Second Consultation Paper on Draft Regulatory Technical Standards covering margin requirements for non-cleared trades. The consultation paper contained amended draft RTS in light of the adjusted BCBS-IOSCO implementation timeline published in March 2015, as well as various comments received to the first joint ESA consultation dealing with daft RTS for non-cleared margin. Particular areas of comment within the joint response included: the treatment of third-country counterparties; the treatment of small counterparties in terms of potential VM delay and collateral concentration limits; the possibility of posting cash IM; the concept of independent legal review of netting and segregation arrangements; and, the application of collateral haircuts as a result of FX mismatches.

EC responds on Article 13 equivalence

The European Commission has responded to the Joint Trade Associations letter AIMA sent alongside a number of other trade associations on 22 June 2015 positing questions on a number of issues around equivalence under Article 13 of EMIR and Article 33 of MiFID. Jonathan Faull of the European Commission, responding on behalf of Commissioner Hill, has confirmed that the wording of Article 13 of EMIR does require at least one counterparty to a trade to be established in an equivalent third-county in order for the transaction to benefit from equivalence of third country clearing, reporting and risk mitigation rules. The response letter also confirms that the European Commission may move ahead with an equivalence determination under Article 13 on a rule-by-rule basis, rather than requiring a single holistic determination of the equivalence of numerous third-country requirements.

ESMA consults on CCP client accounts

ESMA published its Discussion Paper on the Review of Article 26 of its RTS No 153/2013 with respect to client accounts. The Discussion Paper relates to the liquidation period for the calculation of margin by CCPs for non-OTC derivatives under the relevant Regulatory Technical Standards under Regulation 648/2012 on OTC derivatives, CCPs and trade repositories (EMIR) and follows equivalence discussions held between the European Commission and the CFTC. The European Commission has requested ESMA's views on the matter of margining futures due to the current distinction between the CFTC's requirements for gross margin over a one day liquidation horizon and the EMIR requirement for net margin over a two day liquidation horizon. The deadline for comments was 30 September 2015, after which ESMA may choose to prepare a revised draft RTS to be included within a consultation paper.

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Other topics

HMRC released guidance note on OECD's Common Reporting Standard (CRS)

On 17 September 2015, HMRC published guidance notes on the Common Reporting Standard (CRS). The guidance does not replace or override the OECD's CRS Commentary, but brings together key concepts and provides additional guidance for UK - specific issues, including instances where there are differences between the CRS, FATCA, and CDOT rules. An informal consultation period has commenced for comments or suggestions for improvement (crs.consultation@hmrc.gsi.gov.uk).

ESMA publishes its final draft technical standards on MAR

On 28 September 2015, the European Securities and Markets Authority (ESMA) published its final draft technical standards under the Market Abuse Regulation (MAR). The draft technical standards follow consultation papers in November 2013 and July 2014, to which AIMA submitted responses, and provide technical details for nine areas of MAR: (i) notifications of financial instruments; (ii) conditions for buyback programmes and stabilisation measures; (iii) market soundings; (iv) the establishment, maintenance and termination of accepted market practices; (v) reporting suspicious orders and transactions; (vi) public disclosure of inside information; (vii) insider lists; (viii) notification of managers' transactions and arrangements for the objective presentation of investment recommendations; and (v) investment strategy and disclosure of particular interests or conflict of interest. The final draft technical standards will now fall to the European Commission for endorsement within three months, after which the European Council and Parliament will have their own respective objection periods during which they may reject the technical standards.

ESMA publishes its final draft technical standards on CSDR

On 28 September 2015, the European Securities and Markets Authority (ESMA) published its Final Report and draft technical standards under the Central Securities Depositories Regulation (CSDR). The final draft technical standards include both regulatory (RTS) and implementing technical standards (ITS) relating to the new requirements to be placed on central securities depositories (CSDs) and market participants under CSDR. It is noteworthy that controversial technical standards relating to the operation of the mandatory buy-in process have been delayed in order to analyse responses to an ESMA consultation undertaken earlier in 2015 and to continue discussions with the European Commission on the matter. The European Commission now has three months in which to endorse or reject the final draft technical standards. Once endorsed the European Council and Parliament will both have an objection period during which they may reject the technical standards.

ESMA consultation on ELTIF draft RTS

On 31 July 2015, the European Securities and Markets Authority (ESMA) issued a consultation on draft regulatory technical standards (RTS) under the Regulation on European Long-term Investment Funds (ELTIFs). The consultation sets out ESMA's draft proposals on (i) criteria for establishing the circumstances in which the use of financial derivative instruments solely serves hedging purposes; (ii) circumstances in which the life of an ELTIF is considered sufficient in length; (iii) criteria to be used for certain elements of the itemised schedule for the orderly disposal of the ELTIF assets; and (iv) costs disclosure and the facilities available to retail investors. Comments are due by 14 October 2015.

UK - FCA consultation on UCITS V, ELTIF and other Handbook changes

On 3 September 2015 the UK Financial Conduct Authority (FCA) published a consultation paper (CP15/27) containing three sets of proposals relating to the regulation of authorised investment funds. The paper is split three parts: (i) rules and guidance to transpose the most recent changes to the UCITS Directive (UCITS V); (ii) changes to the Handbook to seek to ensure the EU Regulation introducing European long-term investment funds (ELTIFs) will operate effectively and (iii) a number of other changes to the Handbook. The FCA is asking for comments on Part (i) by 9 November 2015, Part (ii) by 5 October 2015 and Part (iii) by 7 December 2015.

Ireland - FATCA reporting deadline extended

On 23 June 2015, the Irish Revenue announced the extension of the FATCA reporting deadline from 30 June 2015 to 31 July 2015 for Irish Reporting Financial

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Institutions to file a FATCA return with respect to 2014 (in future periods the reporting deadline will remain 30 June). This follows the briefing released on 17 June (here) confirming that relevant Holding or Treasuries Companies will no longer be treated as FI unless meeting the definition of the four original categories of FI. Please also note that (i) Financial Institutions must be registered on the Revenue On-Line Service (ROS) in order to file a FATCA return; and (ii) a set of FATCA FAQs have also been published in the automatic exchange of information section of the Irish Revenue website (here).

UK - BIS consultation on the PSC register

On 16 June 2015 AIMA responded to the UK Department for Business Innovation and Skills (BIS) consultation paper regarding the register of people with significant control ('PSC register') titled Scope, nature and extent of control, fees, the protection regime and warning and restrictions notices. In the response, AIMA argued, amongst other things, that for a UK body corporate, or the "person with significant control" over such UK body corporate, which is a firm regulated by the Financial Conduct Authority or Prudential Regulation Authority, the application of the PSC register obligation should not apply. AIMA also raised concerns that the disclosure obligation imposed on funds by the PSC register may be disproportionate and impossible for some of our members to comply with if investors in discretionary investment funds are considered to be PSCs. AIMA stated that persons with a purely economic interest in a discretionary investment fund (i.e. passive investors) should be exempted from the PSC register obligation on the basis that only persons who exercise "effective control" over the fund's activities should be disclosed on a company's register as a beneficial owner.

UK - Consultation on draft Register of People with Significant Control Regulations 2015

On 19 June 2015 the UK Department for Business Innovation and Skills (BIS) published a Consultation Paper on the draft Register of People with Significant Control (PSC) Regulations 2015. The consultation paper explains how the PSC register will work and seeks views on draft regulations covering the following aspects of the register: (i) the register's scope; (ii) how the nature of control is recorded on the register; (iii) what a company should record in its register if it has no PSC or cannot confirm information about PSCs; (iv) fees; (v) the protection regime; and (vi) how a company may seek to compel others to provide information.

UK - Application of the PSC register to LLPs

On 4 September 2015, AIMA responded to an informal consultation issued by the UK Department for Business, Innovation and Skills (BIS) regarding the draft Limited Liability Partnerships (Application to Companies Act 2006) (Amendment) Regulations 2015, which will apply the requirement to have a register of people with significant control ('PSC Register') to LLPs registered in the UK (the 'Draft Regulations'). Amongst other things, AIMA commented on several of the specified conditions set out in Part 1 of Schedule 1A of the Draft Regulations which would render an individual a PSC in relation to an LLP, including the specified conditions relating to a share in profits and voting rights.

UK - Taxation of performance fees

On 8 July 2015, alongside the Summer Budget measures on carried interest, HMRC released a public consultation (here) to "determine the criteria for determining when the rewards arising to investment fund managers are to be taxed as income" with the closing date for comments on 30 September. The Government states that it wishes to understand the trading and investing activities performed by collective investment schemes, and that it does not wish to change the "current tax treatment of some performance related rewards (for example, carried interest in private equity funds …)". The intent behind the consultation is to prevent the adoption of carried interest structures (giving rise to a CGT liability) to fund sectors where more typically a performance fee has been received, chargeable to income tax. The consultation will explore whether a basic statutory provision could be introduced to determine whether a manager's carried interest in the performance of fund assets should be treated as giving rise to capital gains or income, avoiding the uncertainty arising from the existing case law principles for determining whether a fund is trading or investing. The outcome of the consultation will only apply to performance-linked rewards and would not affect the taxation of investors in the fund, the application of the offshore funds legislation or the investment manager exemption, or the taxation of investments made in the fund by managers on normal commercial terms (i.e. co-investment). Two different approaches are suggested: (i) under Option 1 a list of activities would be drawn up that would be regarded as investment and therefore performance-linked interest in a fund performing such activities would be seen as investing and (where appropriately structured) could be charged to tax as chargeable gains. Such activities might require the purchase of significant equity or

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debt interests and holding these for a number of years; and (ii) under Option 2 the average length of time for which the fund holds investments would determine the proportions in which the performance linked amounts could be treated as capital gains and/or income in nature (with a two year holding period being required for full capital gains tax treatment). Draft legislation and guidance are expected for autumn 2015, and the legislation will take effect from 6 April 2016.

UK - Collective Investment Schemes Centre

On 9 July 2015, HMRC updated the contact details for its Collective Investment Schemes Centre – CISC (here). First published on 10 June 2014, CISC constitutes a centralised postal address and relevant contact details provider for UK fund entities (authorised investment funds, qualified investor schemes, tax elected funds, authorised contractual schemes, investment trust companies and unauthorised unit trusts) and for offshore funds (distributing and reporting fund status). CISC deals with all operational issues on behalf of HMRC and is the first point of contact for enquiries.

UK – HMRC guidance on Anson case

On 25 September 2015, HMRC published guidance in response to the Supreme Court decision in George Anson v HMRC case. The Supreme Court had ruled that a UK resident individual who was a member of a Delaware LLC is entitled to double tax relief in relation to US taxes he paid on his share of the profits of the LLC (contrary to HMRC's policy with regard to distributions from a Delaware LLC). It found that the position was determined by the terms of the agreement establishing the LLC and the provisions of the Delaware LLC law. However, HMRC has announced that *"after careful consideration [HMRC has] concluded that the decision is specific to the facts found in the case. This means that where US LLCs have been treated as companies within a group structure HMRC will continue to treat the US LLCs as companies, and where a US LLC has itself been treated as carrying on a trade or business, HMRC will continue to treat the US LLC as carrying on a trade or business"*. HMRC brief 2015/15 also notes that HMRC proposes to continue its existing approach to determining whether a US LLC should be regarded as issuing share capital. This guidance therefore seeks to put the Anson decision to one side and maintain the tax treatment of Delaware (and other) LLCs as HMRC has previously understood it. Nevertheless, it should be the precise terms of the LLC agreement that are relevant in any particular case.

EBA advice to the Commission on qualifying securitisation

On 7 July 2015 the European Banking Authority (EBA) published an Opinion and a Report on qualifying securitisation, setting out its advice to the European Commission on a framework for qualifying securitisation. The EBA suggests that the regulatory definition of 'qualifying' securitisation should follow a two-stage approach whereby in order to qualify for differential treatment, a securitisation transaction should first meet a list of criteria ensuring simplicity, standardisation and transparency and, as a second step, the underlying exposures should meet criteria of minimum credit quality of the underlying exposures. The requirements detailed in the report propose a more risk-sensitive approach to capital regulation for long-term securitisation instruments, as well as for asset-backed-commercial paper.

UK - Summer Finance Bill 2015

On 14 July 2015, the Summer Finance Bill 2015-2016, which will become the Finance (No 2) Act 2015, passed its first reading in the House of Commons (here). The second reading is to be on 21 July, immediately before the House of Commons rises for the summer, so the parliamentary process will continue in September and October. The Finance Bill includes a reform of the capital gains tax (CGT) treatment of carried interest. Other proposals in the Finance Bill include: (i) clause 46 creates a power to make regulations requiring FIs and tax advisers to provide to their clients specified details about information to be disclosed under the CRS; (ii) reform of non-UK domiciled status, so that individuals who have lived in the UK for 15 out of 20 tax years will be deemed domiciled for all tax purposes and that indirect interests in UK residential property will be within the charge to inheritance tax.

UK - CGT treatment of carried interest

The measure on the CGT treatment of investment managers' carried interest contained in the Finance Bill (tax impact note and draft legislation here) is intended to remove with immediate effect the so-called "base cost shift" and to prevent the use of enhanced base cost shift and "cherry-picking" to reduce the taxable amounts included in a receipt of carried interest, so that individuals pay the effective CGT rate on their economic gain from carried interest. It also will remove in many cases the ability of non-domiciled individuals to claim the remittance basis of taxation for amounts received as carried interest. On 20 July,

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HMRC published a guidance note on effects of the measure (here). Chapter 1 of this guidance sets out the background to the legislation, Chapter 2 runs through the main provisions and effects of the legislation, while Chapter 3 contains further examples (appendix deals with the 'base cost shift'). The Government has also begun a consultation (to close on 30 September 2015) concerning the criteria for determining when performance-linked rewards paid to investment managers should be taxed as income or capital gains, to which AIMA intends to submit a response.

UK - Carried Interest, Finance Bill legislation and guidance

The Summer Finance Bill contained changes on the capital gains tax (CGT) treatment of investment managers' carried interest. Further to the legislation, the UK Government also published (20 July) a guidance note on the key impacts of the proposed measure. AIMA has submitted a letter to HMRC (here) underlining the main issues identified by its members and tax secretariat (1 August 2015). The UK Government also initiated a consultation (to close on 30 September - here) concerning the criteria for determining when performance-linked rewards paid to investment managers should be taxed as income or capital gains, to which AIMA intends to submit a response.

EIOPA consults on a pan-European personal pensions product

The European Insurance and Occupational Pensions Authority (EIOPA) has issued a consultation paper inviting feedback on the proposals for the creation of a new harmonised and standardised Pan-European Personal Pension Product (PEPP). The PEPP has been proposed further to the Capital Markets Union initiative to provide a long-term retirement savings product into which EU citizens would be able to make contributions from wherever in the EU they may be working – allowing for switching between Member States whilst still contributing to the same pension pot. The consultation follows a European Commission Call for Advice on personal pensions last year and will close on **5 October 2015**.

UK - BOE consults on recognition of stays on early termination rights under resolution

The UK Prudential Regulatory Authority (PRA) consulted on CP 19/15 contractual stays on financial contracts governed by third country law. The consultation proposes a new measure for the PRA Rulebook, implementing the requirements under the EU Bank Resolution and Recovery Directive (BRRD) requiring the contractual adoption of UK resolution stays in certain financial contracts governed by the law of a non-EEA jurisdiction. It would prevent in-scope firms from either creating new, or materially amending existing, obligations under a financial contract without its counterparty's written agreement to become subject to restrictions on close-out, acceleration and other such rights as would apply as a result of the firm's entry into UK resolution if the financial contract were governed by the laws of the UK. The proposed rule would apply to those UK entities in scope of the BRRD i.e., banks, building societies and designated investment firms as well as their qualifying parent undertakings in respect of financial contracts governed by the law of a non-EEA jurisdiction.

UK - HMT consults on partnership legislation

On 23 July 2015, the Her Majesty's Treasury (HMT) published a consultation paper regarding amendments to UK partnership legislation as it applies to collective investment funds as announced in the 2015 UK Budget. This consultation comprises technical amendments to UK limited partnership legislation to "more effectively accommodate the use of limited partnerships for private equity and venture capital investments as well as other types of private fund." The amendments cover: (i) registration issues and on-going filing and notification requirements; (ii) the role, function and rights of limited partners; (iii) obligations of, and restrictions on, limited partners in respect of capital. The consultation closes on 5 October 2015.

EU – Restructuring and insolvency law

The European Commission Directorate General of Justice (DG Justice) has published a call for expressions of interest from individuals on the topic of EU restructuring and insolvency law. The call for expressions of interest follows the European Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency, as well as the Capital Markets Union (CMU) project that commenced earlier in 2015, and is intended to assist DG Justice in setting-up an expert group on EU restructuring and insolvency law to assist the Commission in the preparation of a possible legislative proposal for minimum harmonising rules on restructuring and insolvency law in the EU. The call for expressions of interest notes that the Group

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of Experts will be composed of up to 20 individuals appointed in their personal capacity and is envisaged to have a term of office commencing in October 2015 and lasting until 2018.

EU – Tax rulings and similar measures

On 4 September 2015, the European Parliament TAXE committee on tax rulings and other measures similar in nature or effect - published its draft report (here). In addition to framing the background of international tax agenda and emphasizing the convergence of the different global initiatives, the report sets out a series of conclusions and recommendations: (i) it endorses the Commission proposal amending Directive 2011/16/EU (DAC2) for a common framework of automatic exchange of information, in particular in the context of tax rulings; (ii) it seeks that MS should fully comply with the principle of sincere cooperation in order to eliminate mismatches in tax treatment between MS; (iii) it supports the Common Consolidated Corporate Tax Base and a reform of the Code of Conduct on business taxation; (iv) it calls on a common approach to tax havens – work on a clear definition, a set of criteria to identify those jurisdictions and appropriate sanctions on countries cooperating with them; (v) it recommends other measures on tax advisers and whistle blowers. Disturbingly, in the context of tax measures that may constitute State Aid and in order to circumvent the unanimity rule (veto right) within the Council, the TAXE committee calls on the Commission to use Article 116 TFUE. This article gives powers to the Commission when a particular framework is distorting competition in the internal market. The TAXE committee therefore wishes to extend its application to direct taxation, which in AIMA's view, is a matter within the sovereignty of the MSs and extends the application of the Article 116 powers beyond the intent of the Treaty.

UK – PAYE 'Special arrangement'

On 19 August 2015, HM Revenue & Customs (HMRC) released the final wording of the new Pay As You Earn (PAYE) special arrangement for short-term business visitors (STBVs) who are unable to claim exemption from UK tax under the provisions of a relevant double tax treaty (DTT).The arrangements provide a number of useful relaxations from normal reporting rules. The new arrangements cover individuals who are in the UK for no more than 30 days and either are resident in a country which does not have a DTT with the UK – such as Brazil or the UAE – or who are ultimately employed by a UK entity through a branch structure. Key features of the new arrangement, which is available for the 2015/16 and later tax years, include: (i) an employer may only operate one special arrangement scheme limited to its own employees (not employees of other group companies) (ii) days on which the only duties performed in the UK are merely incidental to the employee's main duties performed outside of the UK do not count toward the 30 day limit; (iii) the special arrangement does not apply to non-resident directors of UK companies; and (iv) the STBVs covered by the new agreement will not usually be required to file annual UK tax returns. The special regime does not apply to national insurance contributions, to which statutory rules apply.

EU - Further AIMA position paper on SRD II

AIMA has published a further position paper regarding the European Commission, the European Parliament (EP) and the European Council (Council)'s proposals to amend the EU Shareholders' Rights Directive (SRD II). In the paper, AIMA: (i) argues that references in the SRD II to instances when institutional investors and asset managers are required to make information available on "the company's website" or to "the company's clients" should be references to the institutional investor or asset manager's website and to the institutional investor's clients; and (ii) makes a number of comments on the proposed country-by-country reporting.

EU - REMIT implementation

AIMA and MFA have submitted a letter to the Agency for the Cooperation of Energy Regulators (ACER) regarding the Regulation on Energy Market Integrity and Transparency (REMIT). In the submission we highlight our concerns regarding unanswered questions that are fundamental to the correct implementation of REMIT by hedge fund managers and the broader asset management community ahead of the go-live of the regime on 7 October 2015. Specifically, we seek clarity on the following points: (1) Is an investment manager/its client required to register as a market participant? The answer to this ultimately determines whether our members have a reporting obligation. Our view is that investment managers and their clients should not be required to register as market participants; (2) If ACER does not agree with our interpretation of question 1 and instead takes the view that an investment manager or fund should report, when is the reporting start date? In the letter, we express our view that the reporting start date should be April 2016 in such scenarios.

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EU - Corporate tax transparency

AIMA has responded to the EU Commission public consultation on further corporate tax transparency. AIMA's submission is in two parts: (i) the AIMA response to the EU questionnaire regarding the EU approach on the tax transparency initiatives and the more concrete country-by-country reporting; and (ii) an AIMA position paper that details AIMA's policy on corporate tax transparency and offers insights on the main concerns the proposed framework will raise (confidentiality, consistency and appropriate use).

European Parliament recommendations on corporate tax policy

On 10 September 2015, the European Parliament published a draft report with recommendations addressed to the Commission on bringing transparency, coordination and convergence to corporate tax policies in the EU. This report is largely based on a paper from the TAXE Special Committee on tax rulings, initially setting out the background of the proposed framework (i.e. Lux Leaks, BEPS project). In addition, the draft report details a series of recommendations calling for the Commission to suggest as legislative acts: (i) country-by-country reporting by MNEs for all sectors; (ii) a new "Fair Tax Payer" label for companies which engage in good tax practices; (iii) automatic exchange of information on tax rulings to be extended to all tax rulings and to a certain extent made public; (iv) introduction of a Common Corporate Tax Base (CCTB); (v) strengthen the mandate and improve transparency of the Council's Code of Conduct on Business Taxation Group; (vi) a new approach to international tax arrangements under which the Commission should negotiate tax agreements with third countries on behalf of the EU as a whole instead of the current practice under which bilateral negotiations are conducted by Member States; (vii) create a common definition of 'tax havens' and establish countermeasures against companies which make use of tax havens; (viii) other measures which include most of the initiatives incorporated in the BEPS project.

Spanish National Tax Court ruling on UK UCITS tax discrimination

On 14 September 2015, the Spanish National High Court released a judgement on the tax treatment of UK UCITS under the Spanish dividend withholding regime prior to its amendment in 2010. Dividends paid to UCITS in other Member States were taxed at rates of 15% - 18%, whereas the tax rate for Spanish UCITS was just 1%. Based on the long line of EU case law (i.e. decisions such as Denkavit), the Spanish Court held the dividend withholding tax rules prior to amendment to be discriminatory both on the basis of nationality (Article 18 TFEU) and as in breach of the free movement of capital (Article 63 TFEU). The court, in addition to allowing the claim for the refund of the difference between the withholding tax suffered by the UK UCITS and the tax chargeable on a Spanish resident fund, held the amount carried late payment interest, to run from the date the amount was wrongly withheld. It ruled that the claim arose for a breach of EU law and not under Spanish tax law.

Entitlement to double tax relief for a UK member of a Delaware LLC

The UK Supreme Court has ruled (1 July 2015) that a UK resident individual who was a member of a Delaware LLC is entitled to double tax relief in relation to US taxes he paid on the profits of the LLC (Anson v HMRC - here). The ruling depends on the interpretation of article 23(2)(a) of the UK/US Double Taxation Convention 1975 (now article 24(4)(a) of the UK/US Double Taxation Convention 2001) and the relevant question is whether the UK tax is "computed by reference to the same profits or income by reference to which the United States tax is computed." Mr Anson was a member of a Delaware LLC, classified as a partnership for US tax purposes but a legal entity under Delaware law. The Supreme Court unanimously reinstated the decision of the First Tier Tribunal, reversing the judgements of the Upper Tribunal and Court of Appeal that the Supreme Court held had incorrectly relied on the Memec decision, an apparently similar case but dependent upon a different provision. The analysis of the Supreme Court was that, under Delaware law and the terms of the members agreement establishing the LLC, Mr Anson was automatically entitled to a specific share of the profits of the LLC which was allocated to his capital account, and he did not merely become entitled to amounts by way of distributions as a transfer of profits previously vested in the LLC. It was not relevant that the LLC rather than its members beneficially owned the assets of the LLC. It followed that, for UK tax purposes, his "income arising" in the US was his share of the profits, not any distributions that might be made, and that is the income liable to tax under UK law. Mr Anson's liability to UK tax is therefore computed by reference to the same income as was taxed in the US and accordingly he is entitled to double taxation relief under article 23(2)(a). Although the decision is potentially beneficial to

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UK resident individual taxpayers in a similar position to Mr Anson, it raises questions of its own. It is hoped that HMRC will provide guidance on how the decision will be applied, and in particular its relationship with the Memec decision.

Dutch dividend withholding tax of non-resident portfolio investors

On 17 September, the Court of Justice of the EU (CJEU) published its judgment in the joined cases of Miljoen, X and Société Générale (C-10/14, C-14/14 and C-17/14 - here). The CJEU concludes that Dutch dividend withholding tax imposed on payments to non-resident shareholders may infringe the free movement of capital established in TFEU article 63 and 65.1(tax differentiation for non-residents). In the Société Générale case (joint cases also refer to foreign portfolio investors), the CJEU noted that the Netherlands imposes a withholding tax on dividends distributed by a resident company both to resident taxpayers and non-resident taxpayers, but provides a mechanism for deducting or reimbursing the tax withheld only for resident taxpayers. For non-resident taxpayers, both natural persons and companies, the tax withheld is a final tax. According to the CJEU, as Société Générale was unable to utilise the withholding tax against French tax liabilities, it constituted a restriction to the free movement of capital which on the facts and circumstances of the case could not be considered justified. The levying of dividend withholding tax on foreign shareholders is a matter of great importance throughout Europe. The decision in this case confirms once again that a foreign shareholder should effectively not be taxed more onerously than a comparable domestic shareholder.

Americas

Swaps

AIMA and Investment Association write to CFTC on margin proposals

On 11 September 2015, AIMA and the Investment Association wrote to the CFTC commenting on its Proposed Rules on Margin requirements for uncleared swaps for swap dealers and major swap participants - cross border application of the margin requirements. In the submission, we make the following points: (1) We are concerned that the framework presented in the Proposed Rule is extremely complex, which could make it more difficult for market participants – and foreign regulatory counterparts – to understand and apply. A consequence of this could be the cessation of existing business relationships and greater fragmentation of market liquidity. (2) We believe that it would be preferable to prioritise bilateral discussions with foreign counterparts, including the European Commission, over finalisation of the Proposed Rule, to ensure that a comprehensive cross-border agreement is first in place before rules are finalised. (3) We strongly support the Commission's proposed revision to the U.S. Person definition to exclude entities that are majority-owned by U.S. Persons; we believe that this will greatly improve the prospects of agreement between the Commission and foreign counterparts regarding the cross-border application of their respective rules. (4) We are not convinced that the concept of partial substituted compliance will work well in practice, and could lead to market participants being forced to margin their positions fully under the CFTC's rules. (5) We believe that there is a strong case to revisit the proposed implementation timetable associated with the margin rules and encourage the Commission to raise the possibility of a further extension of the application date.

FATCA

IRS announces competent authority agreements (CAA) with the UK and Australia

On 24 September 2015, the Internal Revenue Service (IRS) published a press release announcing that the United States has signed Competent Authority Agreements (CAA) with two jurisdictions with which it has entered into FATCA intergovernmental agreements (IGAs) – the United Kingdom and Australia. The CAAs with Australia and the United Kingdom are the first ones to be signed, but the IRS expects that numerous other CAAs with additional competent authorities in IGA jurisdictions will be signed in the near future. The CAAs set procedures for the automatic exchange obligations provided in Article 2 of the IGAs, the exchange of information on Nonparticipating Financial Institutions under Section 1(b) of Article 4 of the IGAs, and, among other things, detail on registration; information exchange timeline, schema format, and transmission; remediation and enforcement; and confidentiality and data safeguards.

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Extension of FATCA transactional rules

On 18 September 2015, the Internal Revenue Service (IRS) and the US Treasury issued notice 2015-66 (here) announcing their intention to extend FATCA transitional rules for gross proceeds, foreign passthru payments, limited branches and limited FFIs, and sponsored entities. The grandfathered obligation rule with respect to collateral will be modified to reduce compliance burdens. Where a partner jurisdiction has entered into a Model 1 IGA, or has committed to do so, but has not yet completed domestic legal or administrative processes to enable it to exchange information relating to 2014 by 30 September 2015, FFIs resident in the jurisdiction will be regarded as compliant if the jurisdiction commits to providing the information by 30 September 2016. Of particular interest is the extension of the date for when withholding on gross proceeds and foreign passthru payments will begin until after December 31, 2018.

US - FATCA news

On 27 August 2015, the Internal Revenue Service (IRS) released further information on GIIN registration. Sponsored entities will have to register under the Global Intermediary Identification Number (GIIN) for FATCA reporting and withholding purposes by 31 December 2015. To enable this condition the IRS FATCA Online Registration System has now been updated to allow sponsoring entities to register and receive a GIIN on behalf of sponsored entities and sponsored subsidiary branches, and facilitate submission of files with multiple records (i.e. bulk submissions).

Canada - Ruling on lawfulness of FATCA

On 16 September 2015, the Canadian Federal Court issued a ruling in litigation brought by two individuals who argue that the implementation of FATCA in Canada infringes the Canadian Charter of Rights (here). However, the judgement seems to be concerned only with separate arguments that the wholesale transmission to the IRS of information reported by Canadian FIs to the Canadian tax authorities was not authorised under the terms of the double tax treaty, the IGA and domestic legislation – which arguments the court rejected. The wider constitutional arguments are yet to be heard.

Other topics

FinCEN's proposed AML requirements for US registered investment advisers

The US Treasury's Financial Crimes Enforcement Network (FinCEN) has proposed rules that, if adopted as proposed, will require hedge fund managers that are registered with the US Securities and Exchange Commission as investment advisers to (i)(a) establish AML policies and procedures, (b) designate an AML compliance officer, (c) establish an ongoing employee training programme, and (d) have an independent audit function test the programme; (ii) comply with Currency Transaction Report filing requirements (which would supersede existing requirements to file Form 8300); (iii) comply with certain recordkeeping, transmittal of records and retention requirements for the transmittal of funds under the Recordkeeping and Travel Rules and certain other recordkeeping rules; and (iii) make suspicious activity reports. These requirements will apply to a registered investment adviser's entire business (not just its US business) regardless of (i) where the hedge fund manager was established; (ii) whether the hedge fund manager has custody of client assets; (iii) whether the manager is acting in a primary manager or sub-advisory capacity; and (iv) whether the hedge fund manager or any of its clients/funds are subject to an anti-money laundering regime in another country. Although these requirements are not currently proposed to apply to state-registered advisers, foreign private advisers or exempt reporting advisers, it is possible that these requirements could be extended to these categories in the future. The proposal also does not include customer identification requirements for investment advisers, which are expected to be introduced in a future proposal.

US - Disguised payments for services

The IRS issued proposed regulations on 22 July 2015 relating to disguised payments for services under section 707 of the Internal Revenue Code. The regulations relate to the characterisation of certain profit allocations, e.g. when made in place of a management fee charged to a fund, as payments for services and could affect the validity of management fee waiver arrangements. They would also modify the treatment of guaranteed payments. This measure follows similar legislation in the UK's Finance Act 2015 on disguised investment management fees.

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AIMA responds to Form ADV consultation

On 6 August 2015, AIMA submitted a response to the Securities and Exchange Commission (SEC) proposed rule on investment company reporting modernisation. In the response AIMA supported the modernising of fund reporting and the goal of reducing duplicative or otherwise unnecessary reporting burdens on the industry. AIMA also submitted a response to the proposed amendments to Form ADV, which argued, amongst other things, that the proposed umbrella adviser registration should also be available for registered investment advisers and exempt reporting advisers whose principal office and place of business is outside the United States and that there should be greater alignment between Form ADV and Form PF where questions are asking for similar data points.

SEC Division of Corporate Finance interprets 'general solicitation'

The Securities and Exchange Commission's Division of Corporation Finance has recently updated its interpretations related to the scope of the term "general solicitation" as used in SEC Rule 506 of Regulation D under the Securities Act of 1933. These interpretations confirm and reiterate many previously existing views and include some new flexibility around the communications and activities that could be undertaken without being deemed a general solicitation. The interpretations also provide further guidance on the concept of "pre-existing substantive relationships".

CFTC regulation requiring registered introducing brokers, CPOs and some CTAs to be members of the NFA

On 10 September 2015, the U.S. Commodity Futures Trading Commission (CFTC) approved a final rule, CFTC regulation 170.17, requiring that all registered introducing brokers and commodity pool operators (CPOs), and certain commodity trading advisors (CTAs) become and remain members of a registered futures association (RFA). All persons subject to the final rule must comply by December 31, 2015. Registered CTAs who qualify for an exemption from registration as a CTA based on Commission regulation 4.14(a)(9) are not subject to this rule. Currently, the National Futures Association (NFA) is the only RFA.

Cayman Islands issues CRS implementing regulations

On 14 September 2015, the Cayman Tax Information Authority (TIA) issued draft regulations to implement the OECD's framework to improve international tax compliance – the Common Reporting Standard (CRS). The proposed legislation includes three separate pieces (Parts 1-3) and Schedules 1 and 2. Parts 1 and 2 set the preliminary provisions and the application rules of the CRS, and Part 3 contains compliance and anti-avoidance rules. Schedule 1 is the official text of the OECD CRS and Schedule 2 contains a list of excluded accounts in respect of which CRS reporting will not apply. The financial services industry is invited to provide feedback in relation to Parts 1, 2 and 3 and Schedule 2 (no amendments can be made to Schedule 1). AIMA would welcome any comments from its members but please note that any submissions to the Cayman authorities are required to be made by 21 September.

Cayman – FATCA Guidance notes updated

On 1 July, the Tax information Authority (TIA) circulated an industry advisory note underlining that the FATCA guidance note has been updated (here). The new version, which is the result of a consultation with FATCA and CRSC working groups, includes the following amendments: (i) dual resident entities that are Cayman Islands FIs will need to apply Cayman regulations in respect to reportable accounts, unless there is actual knowledge that the reporting is being undertaken in other jurisdictions; (ii) a Private Trust Company (PTC) which is registered, or a similar trust company which is licensed, and conducting business in or from within the Cayman Islands, may be considered a Financial Institution;(iii) the filing of nil returns is non-mandatory under the Regulations, although there is the facility for financial institutions to submit nil returns via the AEOI Portal at their own option. Financial institutions with no reportable accounts will still need to complete the notification requirement via the AEOI Portal; and (iv) confirmation of extension of ARR election date in 2015 to 30 September 2015. If you require further details please refer to the DITC's website and in particular its AEOI Portal User Guide and FATCA Legislation and Resources.

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Asia-Pacific

Australia - IMR passes through Parliament

As we noted in a press release on 17 June 2015, Australia has taken a decisive step towards its advancement as a global investment market, with the smooth passage of the Investment Manager Regime (IMR) legislation through the Australian Parliament. It received Royal Assent on 25 June 2015. The IMR legislation is the product of consultations between the Australian Treasury and the financial services industry which began in 2012. The IMR has through that process developed into a measure that should be capable of delivering what it was proposed to achieve – the development of Australia as an attractive destination for foreign capital and fund trading operations. AIMA, working through the National Group and the Tax Committee, participated in the several rounds of public and informal consultations from the outset when it became clear that Australian tax rules produced potential liabilities for non-resident investors. Our representations were developed with other Australian and international industry representative bodies, principally the Managed Funds Association in the US and the Financial Services Council in Australia, and helped to encourage the Treasury to move away from their early unsatisfactory proposals and decide to model the IMR on the UK's investment management exemption.

Hong Kong - Extension of profits tax exemption to private equity funds

On 17 July 2015 the Hong Kong Government amended the profits tax exemption for offshore funds to ensure that private equity funds would be able to qualify. The amendments (here) include extending the definition of "securities" so that transactions in securities in eligible offshore portfolio companies will not be excluded from the definition of a "specified transaction" and making the profits tax exemption available to an offshore fund in respect of profits derived from the specified transactions when either the specified transactions have been carried out through a SFC-licensed or registered corporation or authorised financial institution or the offshore fund is a qualifying PE fund.

Singapore - Mandatory clearing

AIMA responded to the Monetary Authority of Singapore (MAS) Consultation on draft regulations for mandatory clearing of derivatives contracts. The consultation set out MAS's intended approach to implementing a clearing obligation in Singapore, with an initial focus on large banking entities and fixed-to-floating interest rate swaps denominated in Singapore dollars and US dollars. The AIMA response provides AIMA's general position on central clearing and expresses support for the MAS approach within the Consultation, which would introduce mandatory clearing of relevant contracts only: (i) by banks that have greater than S$20bn gross notional outstanding positions in OTC derivatives for each of the last four calendar quarters; and, (ii) when both counterparties to a transaction book the contract in in their Singapore-based operations. The AIMA response also sets out our position for cross-border transactions and highlights the importance of consistency of rules with other key jurisdictions globally.

Singapore - AML frequently asked questions

AIMA Singapore has been in discussions with Monetary Authority of Singapore (MAS) with regards to the option of creating AML FAQ's on the MAS website. The AIMA Singapore regulatory committee will lead this project and as such AIMA Singapore is reaching out to all members to understand which AML questions that members would like to have addressed.

Australia - Sector to pass A$100bn

Treasury reforms, financial innovation and growing demand is driving interest in Australia's hedge fund industry, according to AIMA. Currently managing A$96.9 billion (US$67 billion) in assets, according to the Australian Securities and Investments Commission (ASIC), this renewed interest is set to drive Australia's hedge fund industry through the A$100 billion mark, and continue strong growth that saw assets managed by hedge funds increase more than 45% from 2012-2014, AIMA said. For more information, read this AIMA press release.

India - Minimum Alternate Tax (MAT)

On 1 September 2015, the Central Board of Direct Taxes (CBDT) issued a press release confirming that the minimum alternate tax (MAT) will not be levied retroactively on foreign institutional investors and foreign portfolio investors (FIIs, FPIs), and that India's Income-Tax Act, 1961 will be amended to clarify that point. As reported previously (here), the Indian government has accepted the conclusion of the Justice A.P. Shah Committee (here). However, the report is

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silent on the position of foreign companies that are not FPIs or FIIs because its terms of reference as framed by the Finance Ministry did not mandate the Committee to review this aspect, even though many of the MAT dispute cases concern such foreign companies. Given its relevance, the Indian Supreme Court adjourned to 29 September 2015 the Castleton case appeal hearing so that the court may consider the Shah Committee report.

India - MAT - Shah Committee Report and Castleton appeal

On 24 July 2015, the Shah Committee submitted its report on the MAT, which has not been made public by the Indian Government. AIMA submitted a written representation to the Committee on 22 June, arguing that the MAT provisions should not apply to Foreign Portfolio Investors (FPIs) for years prior to 1 April 2015 (the position from that date has been clarified by legislation). We understand that the report concludes that foreign investors are not liable to MAT for that period. However, the report seems to be silent on the position of foreign companies that are not FPIs or Foreign Institutional Investors (FIIs) because its terms of reference as framed by the Finance Ministry did not mandate the Committee to review this aspect, even though many of the MAT dispute cases concern such foreign companies. Given its relevance, the Indian Supreme Court has decided to adjourn to 29 September 2015 the Castleton case appeal hearing so that the court may consider the Shah Committee report.

For more information on these and other regulatory and tax matters, AIMA members may contact:

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Man

AIMA marks 25 years with Charity Dinner and Annual Conference

AIMA marked its 25th anniversary with a series of events including a charity dinner for member firms (above) that raised over £100,000 for the NSPCC, the children's charity. Close to 300 guests attended the AIMA 25th Anniversary Charity Dinner at the Guildhall in London on 23 September 2015. The event featured keynote speeches by Emmanuel "Manny" Roman, the CEO of Man Group, and Peter Wanless, the CEO of the NSPCC. Photo: Clive Totman.

Around 400 delegates attend AIMA's sixth Annual Conference

On 24 September 2015, AIMA's 25th Anniversary Annual Conference drew 400 attendees to the Guildhall, London. The conference, sponsored by Simmons & Simmons, EY and State Street, featured an address by the Rt. Hon. Greg Hands, the UK Chief Secretary to the Treasury, and a discussion with David Wright, Secretary General of IOSCO. Other speakers included Simon Lorne, Vice Chairman and Chief Legal Officer of Millennium Management, and Stuart Fiertz, Co-Founder and President of Cheyne Capital Management.

Jack Inglis, CEO, AIMA

Rt. Hon. Greg Hands, MP, Chief Secretary to the Treasury

'Manager Issues' panel, left to right: Martin Donnelly, COO, PrimeStone Capital; Glen Mifsud, CEO, Bybrook Capital LLP; Simon Lorne, Vice Chairman & Chief Legal Officer, Millennium Management; Andrew Main, Consultant, Stratton Street Capital LLP & Chair of AIMA Next Generation Manager Group; and David Murphy, Managing Director, Hedge Fund Solutions EMEA, State Street (moderator). Photos: Clive Totman

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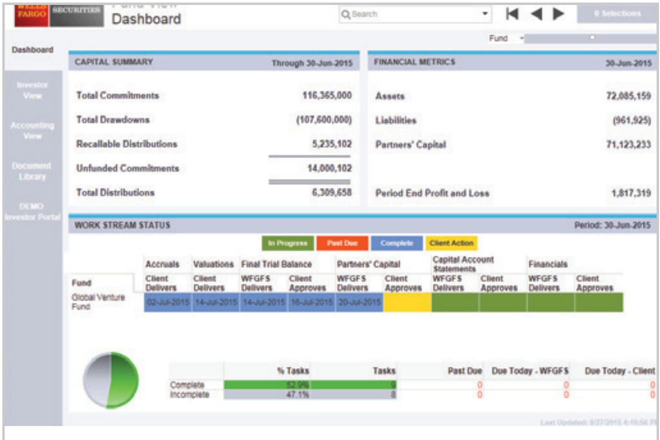

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Scenes from the AIMA Australia Hedge Fund Forum, Sydney

Steve Kuhn, CIO , Pine River Capital Management

Sandy Rattray, CEO, Man AHL

Around 300 industry practitioners descended on Sydney's Sofitel Hotel on 15 September 2015 for the AIMA Australian Hedge Fund Forum. Among the speakers were Steve Kuhn, CIO of Pine River Capital Management, Sandy Rattray, CEO of Man AHL, and Jack Inglis, CEO of AIMA. Topics included the future of CTAs, alpha and alternative beta, cyber security, research and the regulatory and tax environment. Many thanks to the Forum's sponsors - Capital Fund Management, Citco, CME Group, Deutsche Bank, EY, Man and Permal – and to the VIP Dinner sponsors, Advent and SS&C Technologies. Click here for a full review of the conference.

Inaugural AIMA Singapore Forum draws more than 150 attendees

AIMA Singapore held its inaugural Forum on 9 September 2015. The event drew 160 attendees across 75 member firms and was hosted by Bloomberg. The Forum had two panel discussions: one focused on global regulatory issues relevant to Singapore-based members; the second, an investor-led panel covering observations on asset raising activities and market opportunities. Newly appointed Singapore Exchange (SGX) CEO, Loh Boon Chye, graced the event with a welcome address. The Forum also hosted Lim Cheng Khai, Director and Head of Capital Markets Intermediaries II of Monetary Authority of Singapore (MAS), for a one-on-one discussion with AIMA Singapore Chair Ho Han Ming.

Loh Boon Chye, CEO, Singapore Exchange (SGX)

Left to right: AIMA Singapore Chair Ho Han Ming; Lim Cheng Khai, Director and Head of Capital Markets Intermediaries II of Monetary Authority of Singapore

News in brief

AIMA vacancy - Associate Director, Markets Regulation

AIMA is seeking an Associate Director for the Markets Regulation team within its Government and Regulatory Affairs (GRA) Department. The position holder will report to the Global Head of Markets Regulation in London. The team is responsible for a significant volume of AIMA's regulatory output, covering issues such as MiFID2, EMIR, Basel III, and CFTC and SEC swaps rules, market abuse and short-selling rules. Click here for more on the role and our requirements. Please email any CVs or enquiries to Adam Jacobs (ajacobs@aima.org). No agencies, please.

AIMA's Annual Report 2014

Our audited Accounts for 2014 were published in September, before the AIMA annual general meeting in London. They are available online, viewable here.

Canada – Diversification versus 'Diworsification'
Date: 1 October 2015
Time: 1630 – 1930
Venue: Cambridge Club, 100 Richmond Street West, Toronto

UK - AIMA Guide to Sound Practices for Cyber Security Launch
Date: 6 October 2015
Time: 1600 – 1730
Venue: Macfarlanes, 20 Cursitor Street, London

US – AIMA Briefing and Regulatory Update
Date: 6 October 2015
Time: 0830 - 1000
Venue: The Cornell Club, 6 East 44th Street, NY 10017, New York (below)

Canada - AIMA Canada Hedge Fund Conference 2015
Dates: 7-8 October 2015
Time: 1500 - 2100
Venue: St. Andrew's Club and Hockey Hall of Fame, Toronto

Singapore – Networking Drinks
Date: 8 October 2015
Time: 1800-2100
Venue: Level 33, 8 Marina Boulevard, Singapore

UK - MiFID 2: How will it shape the hedge fund industry
Date: 13 October 2015
Time: 0845 – 1630
Venue: Bloomberg Auditorium, London

Canada - Emerging Managers Series Part 4 - Operations & Compliance Considerations
Date: 14 October 2015
Time: 1600 - 1730
Venue: PWC, 18 York Street, Suite 2600, Toronto

US - Liquid Alternative Funds: a path to growth for private fund managers
Date: 19 October 2015
Time: 1600 – 1900
Venue: KPMG LLP, 345 Park Avenue, 37th Floor (Between 51st and 52nd Streets), New York

US - AIMA Guide to Liquid Alternatives: Opportunities for private fund managers to grow
Date: 22 October 2015
Time: 1600 – 1830
Venue: Dechert LLP, One International Place, 40th Floor, 100 Oliver Street, MA 02110-2605, Boston

Canada – Investing in hedge funds: Adding hedge to your book
Date: 22 October 2015
Time: 1530 – 1730
Venue: Halifax Marriott Harbourfront Hotel, 1919 Upper Water Street, Halifax, Nova Scotia

UK – London launch of AIMA Guide to Liquid Alternatives
Date: 27 October 2015
Time: 1600 – 1830
Venue: JP Morgan Chase, 31st Floor, 25 Bank Street, Canary Wharf, London

Canada – Member Town Hall Meeting
Date: 4 November 2015
Time: 1600 – 1830
Venue: BLG Offices, 40 King Street West, Toronto

Dubai - AIMA Alternative Investment Summit
Date: 16 – 17 November 2015
Time: 0900 – 1700
Venue: DIFC Conference Center, DIFC Gate Precinct 4, Dubai

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Evolution - the emerging strategies in AIFMD marketing

AIMA SPONSORING PARTNER

CLIFFORD CHANCE

By Owen Lysak, Senior Associate, Clifford Chance LLP

We are witnessing an evolution in the marketing strategies used by alternative investment fund managers targeting EU investors, an evolution born largely in response to the issues faced by managers since the inception of the Alternative Investment Fund Managers Directive (AIFMD) marketing regime in July 2013.

As AIFMD begins to bed down, a number of common trends (and recurring questions) for fund managers are developing, including a continued focus on what can actually be characterised as a true "reverse-enquiry" under AIFMD, as well as ongoing debate around at what stage in a fund-raising a manager is actually "marketing" for the purposes of AIFMD. As managers continue to face diverging national approaches in a number of important areas, they are left with significant practical issues when trying to implement a cross-EU marketing strategy. The long-awaited advice from the European Securities and Markets Authority (ESMA) on the possible extension of the marketing passport, issued in July 2015, did little to dispel the uncertainty. Yet despite the challenges, those of the AIFMD alongside those posed by the wider regulatory agenda for institutional investors, there have been successes, as managers adapt their marketing strategies by adopting targeted, selective approaches, thereby developing market practice and driving a consensus on achieving AIFMD marketing compliance.

In this article, we discuss some of the practical issues that have triggered these trends and lead to the evolution of AIFMD marketing strategies in the EU.

Lack of guidance around "reverse-enquiry"

Because of the challenges of AIFMD registration in many jurisdictions, exactly when and how a manager can rely on reverse-enquiry from an EU investor has taken on real importance. And yet, other than an understanding that reverse-enquiry is interpreted narrowly under AIFMD, there has been a distinct lack of clear regulatory guidance (or examples) of what, in the regulators' eyes, would constitute a genuine reverse-enquiry.

Some EU regulators historically applied a relationship approach to reverse enquiry - if the original contact with an investor was established in line with local marketing requirements, then it was possible to reach out to that investor on similar, new investments in the future and that would not be considered marketing. However, other EU regulators applied a transaction-by-transaction approach, notwithstanding that you might have an ongoing relationship with an investor - a manager would need a fresh reverse enquiry for each and every transaction or investment. Post-AIFMD, it is not clear to what extent those differing approaches still exist. Certainly, taking into account other EU regulatory developments in the pipeline such as MiFID2 (the revised broker-dealer regulation) which has an even narrower definition of reverse-enquiry (linked to manager-investor interaction being at the exclusive initiative of an investor), it feels that the relationship approach could well be jettisoned by EU regulators.

A real stumbling block for regulators (and so adding to the uncertainty for managers) has been the variety of manager-investor interaction, ranging from the marketing of investment strategies (rather than specific fund vehicles) through to more novel approaches, such as investors collectively establishing websites and then issuing requests for proposals to managers. Such trends make the reverse-enquiry test regulators have typically applied in the past seem particularly inflexible. At the same time, there is a growing sense that regulators may start to pay particular attention to reverse-enquiry in the context of manager activity - looking at such factors as the number of investors involved, the audit trail of the manager in respect of the investor contact, and so forth. Interestingly, there are now often many more questions about whether the use of third party agents - such as the appointment of a placement agent in Europe or the use of a capital introduction provider/capital introduction services - jeopardises reliance on reverse-enquiry.

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The implications of this are certainly being felt in practice. To take the common example of a manager having an ongoing relationship with an investor from an existing fund, that relationship is likely to include discussions of the performance of the manager, possible new investments, interest in potential future fund raising and so on, without a specific fund or investment opportunity actually being proposed. However, once the manager comes to raise its next fund, it will want to gauge whether the existing investor is still interested in the new potential fund opportunity. While there has not, in that scenario, been any active marketing to the investor of the new fund, it is not clear that the manager can treat interaction with the investor as a reverse-enquiry (even though the relationship with the investor has already been established prior to the new fund raise). And so, more and more, we see managers analysing whether, in practice, they can discuss new funds with existing EU investors.

What is AIFMD marketing?

Two years in, what is still surprising under AIFMD is the lack of clarity that exists on what exactly is marketing. For example, is there a certain level of soft or pre-marketing that is acceptable? Is there certain promotional activity you can undertake before triggering "AIFMD marketing" requirements? Unfortunately, the answers can still vary from one EU jurisdiction to another.

What we have seen is jurisdictions taking different approaches to defining marketing, some adopting a narrow concept of what is acceptable as pre-marketing and others adopting a much broader interpretation. In some jurisdictions (such as Denmark and Sweden) "marketing" can potentially capture any form of advertising or sales promotion. In contrast, the position in other jurisdictions (such as The Netherlands and the UK) can be that there will not be AIFMD marketing until documentation is in sufficiently final form for an investor to be able to make a subscription in a fund.

This means that a real challenge has become establishing precisely where the tipping point lies between pre-marketing and marketing and how (if at all) this can be translated into a consistent, practical marketing strategy across the EU. That can be very difficult where, in some jurisdictions, even a draft offering document (such as a PPM) may not be far enough along the line to be AIFMD marketing, but in other jurisdictions a teaser on a specific fund vehicle can trigger AIFMD requirements.

Acknowledging this difficulty, ESMA (the European securities regulator) in its recent consultation on extending the AIFMD marketing passport noted that the feedback it had received included that marketing was hampered by a lack of consistency across EU countries on what is “marketing” (as well as a lack of guidance around reverse-enquiry). However, ESMA did not issue any additional guidance around the definition of marketing or reverse enquiry.

As a result of all of this, it is becoming more common now, particularly for non-EU managers, to focus energies primarily (or only) on those EU jurisdictions which allow soft marketing without triggering AIFMD requirements. Being able to talk to investors on the basis of draft documentation allows managers, in those targeted jurisdictions, to assess real investor interest and gauge whether the time and cost of AIFMD registration is worthwhile. Indeed, interestingly, those EU jurisdictions with a broader concept of pre-marketing have tended also to be the jurisdictions with more straightforward AIFMD registration requirements, making a manager's cost-benefit analysis much easier.

Extension of the AIFMD marketing passport

Against this backdrop, there has been an ongoing consultation in respect of extending the "marketing passport" currently available to some managers under AIFMD.

So far, under AIFMD, the marketing passport has only been available to EU managers marketing EU funds. EU managers marketing non-EU funds and non-EU managers marketing either their EU or non-EU funds have, instead, been required to use the ‘marketing without a passport’ route, using national private placement regimes (NPPRs).

However, the AIFMD did provide for the marketing passport to be potentially extended, to non-EU managers and to EU managers of non-EU funds, should this be advised by ESMA. ESMA has now issued this advice, concluding that the passport could be extended to Guernsey, Jersey and (conditionally) Switzerland, on the basis that there are no significant obstacles regarding investor protection, market disruption, competition and the monitoring of systemic risk in those countries that would impede funds and managers located in these countries applying for a passport.

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It is unclear at the moment how quickly assessment will be made of other non-EU countries for the passport, and it is not certain that ESMA will recommend the extension of the passport to all major asset management and fund jurisdictions. ESMA has not indicated a timetable for assessment and it is possible that the assessment process may become protracted. For example, ESMA has noted that assessing the extent to which the regulatory framework of the particular non-EU country varies from AIFMD is a necessary consideration. Experience from the implementation of EMIR in the OTC derivatives context shows that satisfying the test for reciprocity and equivalence is a hurdle not easily overcome (and since the equivalence process started in 2012 under EMIR, only a handful of equivalence determinations have been made). Furthermore, as the assessment methodology focuses on regulatory issues, ESMA suggests that the co-legislators may also wish to consider other factors, such as the fiscal and anti-money laundering and counter-terrorism regimes in the non-EU country, which will also add to the complexity of the assessment.

Additionally, it is also unclear under AIFMD whether the Commission has the discretion to extend the passport on a jurisdiction-by-jurisdiction basis, rather than to the non-EU as a single block. The Commission is required to take into account the criteria assessed by ESMA, but there is no indication that the Commission can extend the passport on a staggered basis, country-by-country (even where ESMA has given a positive recommendation in respect of some non-EU jurisdictions and not others). This will be relevant to the Commission's decision to switch on the passport or not, particularly the additional advice from ESMA that the Commission may want to wait before extending the passport until ESMA has completed its assessment of a larger number of non-EU jurisdictions.

Where a positive recommendation from ESMA is important (assuming the passport is extended to the non-EU as a single block), and so why many non-EU jurisdictions are interested in ESMA's assessment, is that being able to rely on the passport will require the non-EU manager to obtain prior authorisation in an EU "member state of reference". It is not clear whether such prior authorisation will be possible if the manager's home jurisdiction is not a non-EU jurisdiction for which ESMA has given positive advice.

Increasing pressure on EU institutional investors

Of course the AIFMD is not the only regulation affecting asset managers. A new challenge developing for managers is the sense that EU regulation is becoming more restrictive on investment by institutional investors in alternative investment funds. Solvency II (the prudential regulation of European insurers) imposes a higher regulatory capital requirement for insurers investing in certain types of alternative funds (including hedge funds) compared to more straightforward securities, and European insurers have started to factor this into their investment plans for the coming months. Similarly, there has recently been also an EU consultation on limiting the exposure (by applying higher capital charges) of European banks to "shadow banking" entities. The definition of shadow banking entities covers all funds (other than UCITS funds) that engage in "credit intermediation" (which includes simple lending), even if credit intermediation is not the fund's main business (bidcos, holding companies, etc.). These developments, potentially affecting demand, will need to be factored in by managers when planning EU fund-raising.

Conclusion

The key challenge for managers continues to be the lack of harmonisation of the AIFMD rules on marketing which, while recognised by regulators, seems unlikely to be helped by additional regulatory guidance any time soon. Against a backdrop of increasing regulation and focus on European institutional investment in funds, the challenges look likely to continue. However, the challenges are not necessarily insurmountable: managers can be successful by adopting targeted and selective approaches to EU investors. This is helping to develop a consistent practice amongst markets participants as to how to approach AIFMD marketing compliance.

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Another channel for China's domestic capital to invest overseas — The new Qingdao Pilot Operation for RMB Funds

AIMA SPONSORING PARTNER

By Kenny Lam, Tax Partner, PwC China

Due to foreign exchange restrictions, Chinese investors can only invest in overseas markets through certain channels, such as the Qualified Domestic Institutional Investor (QDII) and the Shanghai-Hong Kong Stock Connect programmes.

Introduction of Qingdao Pilot Measures

In order to accelerate the establishment of a wealth management and financial reform pilot area in Qingdao (a coastal city in eastern China), in February 2015 the Qingdao Municipal Finance Service Office and other government authorities jointly introduced 'Pilot Measures' for Qualified Domestic Limited Partnerships (QDLP). Under the Pilot Measures, foreign investors can establish an investment entity in Qingdao as a general partner, and set up a Qualified Domestic Investment Fund ("an RMB Fund Enterprise") to invest in overseas listed securities markets, and explore M&A of overseas unlisted entities and in overseas regulated commodities markets (collectively "overseas markets"). A series of significant breakthroughs have also been made in introducing the qualified foreign investors (QFI) system, including relaxing fund contribution restrictions and broadening the investment scope for RMB Fund Enterprises. In Appendix 1 we illustrate a typical investment operation framework under Qingdao's QDLP Pilot Measures.

Establishment of a Fund Management Corporation

The Pilot Measures provide that an FMC can be either established as a corporation or a partnership. The main business of an FMC involves setting up an RMB Fund Enterprise, managing it and advising on investments. The FMC would also need to be registered in Qingdao. At least one senior management officer should be appointed as a resident representative in the FMC. This senior management officer has to attend the annual investors' conference held by the FMC in accordance with a signed agreement. Although the Pilot Measures make the qualification requirements for the foreign investors, representatives or legal executive partners of the FMC more stringent, there are no specific limitations on the amount of registered capital or the capital injection timeline in the Qingdao Pilot Measures. This is one of the major differentiating factors between the Qingdao Pilot Measures and other pilot areas in China.

Establishment of a RMB Fund Enterprise

Under the Pilot Measures, a RMB Fund Enterprise can be established in the form of a limited partnership, with its main business being to invest self-owned capital into overseas markets. The RMB Fund Enterprise can invest in overseas listed securities as well as in M&A businesses in overseas unlisted entities and regulated commodities markets. The Pilot Measures also require the RMB Fund Enterprise to appoint a qualified commercial bank in Qingdao as custodian bank. This will operate the business of RMB and foreign exchange settlement within the quota approved by the Working Group.

Investment restrictions on a RMB Fund Enterprise

The Pilot Measures stipulate that a RMB Fund Enterprise can directly invest in overseas markets or make investments via overseas funds. However, it cannot make investments directly in China or invest through a qualified foreign institutional investor (QFII) or qualified foreign limited partnership (QFLP). The qualified RMB Fund Enterprise can only make investments in overseas markets by using RMB or foreign currencies within the quota permitted by the Working Group. The RMB Fund Enterprises can apply to the Working Group for extra credit if and when it reaches its investment quota. The Qingdao Pilot Measures do not specify the investment quota of a RMB Fund Enterprise.

Supervision of a RMB Fund Enterprise

Apart from the requirements on performance and internal control of foreign investors and their representatives, the Pilot Measures also impose requirements on the custodian bank and fund managers of a RMB Fund Enterprise. Fund managers and custodian

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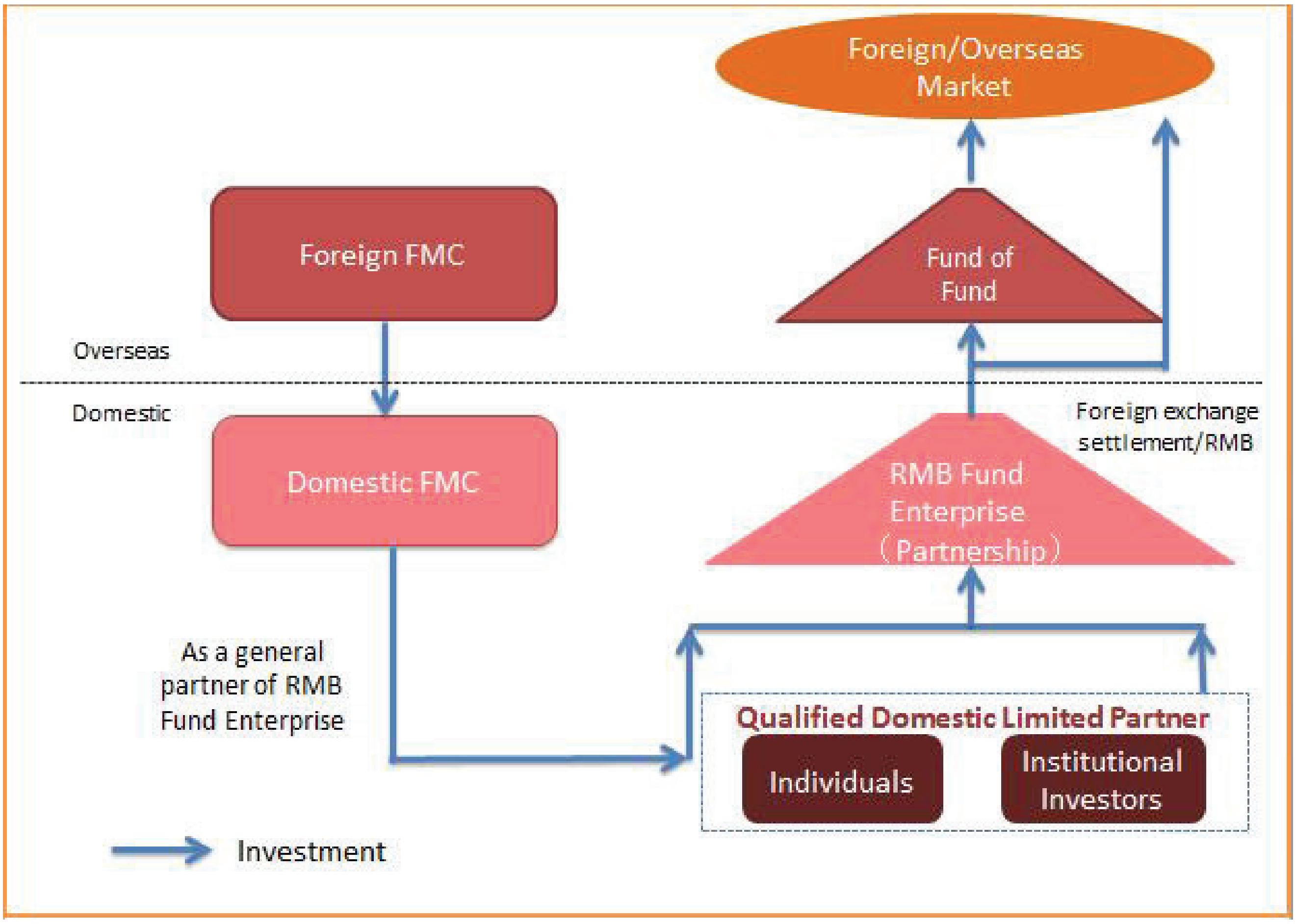
banks should report to the Working Group on any significant events or violations made by the RMB Fund Enterprise on a timely basis, and regularly report the net asset valuation. In addition, the Pilot Measures have specific information disclosure requirements.

Policy trends on RMB fund pilot programmes

Almost three years before the Pilot Measures were published in Qingdao, Shanghai issued its own implementation measures for the QDLP pilot programme in April 2012. Both pilot measures impose similar requirements on the credentials and performance of the FMC and the foreign investors in the RMB Fund Enterprise, as well as on the management's qualifications. Pilot enterprises in both Shanghai and Qingdao should appoint a qualified local commercial bank as custodian bank to deal with account management. It is interesting to note that Qingdao's restrictions on the registered capital of the FMC and the investors' contribution quota are more relaxed. Additionally, Qingdao has expanded the investment scope of the RMB Fund Enterprise to M&A businesses in overseas unlisted entities as well as regulated commodities markets, which is a breakthrough. It is fair to say that the Qingdao Pilot Measures are more lenient to foreign investors, the FMC and the RMB Fund Enterprise, making it quite attractive as a financial reform pilot area. Further details are set out in Appendix 2: "Comparison of the QDLP Pilot Measures between Qingdao and Shanghai". The Qingdao Pilot Measures have paved the way for onshore capital flows into overseas markets, and also allow RMB Fund Enterprises to make investments in overseas listed securities, unlisted companies and regulated commodity markets. We believe the Pilot Measures will be warmly welcomed by Chinese institutional investors and high net worth individuals.

Appendix 1: Typical Investment Operation Framework under the QDLP Pilot Measures



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Appendix 2: Comparison of the QDLP Pilot Measures between Qingdao and Shanghai

	Qingdao Pilot Measures	
Limitations on registered capital of FMC	No minimum requirement on the registered capital and the timeline of capital injection.	The registered capital for FMC should be no less than USD 2 million or equivalent currency, which is limited to the form of monetary contribution. At least 20% of the registered capital should be injected within 3 months of the issue date of business license and the remaining amount should be in place within 2 years.
Limitations on investment amount of qualified investors	No minimum requirement on investment amount.	Foreign investment funds should subscribe capital contribution of no less than RMB 100 million. The contribution of QDLP is limited to the form of monetary contribution. The number of partners of foreign investment funds in the form of partnership should be in the range of 2 to 50, and the capital injection of each limited partner of QDLP should be no less than RMB 5 million.
Criteria for foreign investors	More lenient restrictions on the qualification of foreign investors. Foreign investors of the qualified domestic FMC should satisfy one of the following conditions: 1. Foreign investors and their related entities are required to have at least 7 years of experience in operating private equity investment management businesses in an overseas market. The business operations have to be carried out with good performance; 2. Overseas related entities shall get approval from regulators where they are located to conduct investment and should get the certificate issued by relevant authority; 3. Foreign investors shall have a complete management structure and an effective internal control system. Foreign investors have not been severely punished by their local regulators in the last five years or have come under investigation by judicial departments or supervisory authorities.	The holding investor or the related entities of the foreign-invested FMC should satisfy all of the following conditions: 1. Operating private equity investment management business in overseas secondary market with good performance; 2. Overseas related entities shall get approval from their local regulators to conduct investment and shall get all necessary certificates; 3. Foreign investors shall have a complete management structure and an effective internal control system. Foreign investors have not been severely punished by their local regulators in the last five years or have come under investigation by judicial departments or supervisory authorities.
Investment scope	Broaden investment scope The investment scope is expanded to investing in overseas listed securities as well as prudently exploring M&A businesses in overseas unlisted companies and regulated commodity markets.	Invest in overseas listed securities

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Future taxation of performance awards: HMRC consultation

AIMA SPONSORING PARTNER

MACFARLANES

By Damien Crossley, Partner, Head of Tax Group, Macfarlanes

Traditionally, in the UK market, hedge fund managers have been rewarded for performance by performance fees taxed as earned income while private equity executives have been rewarded by carried interest taxed as investment income or capital gain taxed at low effective rates. This distinction arose as hedge funds were historically considered to be trading and so reliant on the investment manager exemption (IME) to avoid UK tax at the fund level. One of the (effective) requirements of the IME is that the performance reward is paid as a fee to the investment manager. On the other hand, private equity funds are considered to be investing, do not need to rely on the IME and so can structure their performance award as an equity interest (partnership or share) delivering investment income and gains.

The more recent blurring of the previously clearer dividing lines between the investment strategies of hedge funds and private equity funds has meant that the differences between them are often now just their structures and terms with investors and not the assets they invest in. In this context, the author has always thought it odd that two executives investing in the same asset can be subject to an entirely different tax regime as a result of how their respective fund is structured.

This view and the fact that many hedge funds are not trading for UK tax purposes has led to the recent growth of hedge fund carried interest – the delivery of annual performance awards to hedge fund managers as investment return through a class of share or partnership interest in the fund.

Properly structured, this can deliver the same tax benefits to hedge fund managers that private equity executives enjoy.

Despite the logical coherence and potential benefits of this structuring, it is fair to say that the take up of this structuring in the hedge fund industry has been sporadic. However, this might be about to change.

The tax benefits of carried interest were significantly reduced by the 8 July 2015 Budget following which, for UK residents, all carried interest is subject to an effective minimum UK tax of 28% (the current capital gains tax rate for higher rate taxpayers) (reducible only for non-domiciliaries on account of non-UK duties) with the potential for a higher effective tax rate depending on the nature of the profit satisfying the entitlement and the tax status of the recipient. However, even after those changes, it is still the case that carried interest produces a better tax result for a UK-based fund manager than a performance fee.

Also on Budget Day, but receiving less publicity, was the launch by HMRC of a consultation (open until 30 September 2015) on the types of funds whose carried interest can benefit from capital gains tax treatment (and which funds the carried interest in which should be taxed as income) with a view to changing the law again with effect from 6 April 2016. It seems that HMRC is intent on taxing carried interest at a flat (not minimum) capital gains tax rate for “good” funds and a flat income tax rate for “bad” funds.

From the consultation document, it is clear that HMRC is unhappy with the development of hedge fund carried interest. However, despite that, the outcome of the consultation might be that hedge funds with lower churn rates and/or investing in more illiquid assets are able to implement carry structures with more certainty.

The effect of the change, as currently proposed, will be to tax carried interest as income as a general rule with only specified funds being entitled to issue carried interest benefitting from capital gains treatment. Quite how and where HMRC will draw the line is not clear and HMRC is consulting on whether to define the line by

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reference to the assets held by the fund and/or the length of time they are held for.

If the first approach were adopted (i.e. looking at the investment assets), HMRC's initial proposal is for the funds investing in the following asset classes to be "good" funds:

- Controlling equity stakes in trading companies intended to be held for a period of at least three years.
- The holding of real property for rental income and capital growth where, at the point of acquisition, it is reasonable to suppose that the property will be held for at least five years.
- The purchase of debt instruments on a secondary market where, at the point of acquisition, it is reasonable to suppose that the debt will be held for at least three years.
- Equity and debt investments in venture capital companies, provided they are intended to be held for a specified period of time.

This would make direct lending funds, mezzanine funds, minority funds, many special opportunity funds and most hedge funds "bad" funds. Quite why HMRC draws some of the distinctions it does is not entirely clear.

HMRC also suggests that funds which do a combination of good and bad activity might have their carried interest pro-rated between capital gain and income tax treatment.

If the second approach were adopted (hold periods), HMRC says it would look to the average hold of investments of the fund, with only funds whose average hold is over two years being entitled to full capital gains tax treatment for carried interest. Under the initial proposal here, there would be some pro rating of income and capital treatments for funds with shorter average holds down to six months below which all carried interest would be income.

The author's view is that the second approach is the better one as it is clearer, simpler and will not produce the arbitrary distinctions of the first approach.

Whichever approach is taken, the outcome for hedge funds and other cross over funds might be positive. While certain funds will be classified as bad (and unable to effectively implement carried interest) (likely those funds who would not do so anyway due to concerns over trading), other funds will be treated as good in whole or in part and for those funds the statutory footing of carried interest might encourage them to structure their performance awards in that way. HMRC should not be concerned about hedge fund carried interest as the law should not be favouring one fund structure over another investing in the same assets. It is hoped that the consultation will bring about this result.

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The new collateral environment

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Bloomberg

By Jose Ribas, Global Head of Derivatives, Cash Structured Products, Risk and Treasury, Bloomberg LP

Until 2007, the process of collateral allocation was just that: a process. Before the crisis, derivatives traders – predominately banks and large asset managers – would post collateral to each other, protecting against the prospect of default. Back then, it was a relatively simple, operational concern – choose some collateral, post it to the deal, move on to the next one. But today it is much more than that. It is strategic, with significant consequences for return on equity – and therefore profitability.

The good old days

Before the crisis, a deal that needed collateral would generally see collateralised cash posted to it. Cash was cheap, it was simple to get your hands on, it could be borrowed easily. Many banks could fund a large percentage of their balance sheet overnight.

This meant those working the deal could focus on the investment itself, and didn't worry too much about where the collateral was coming from – or what form it was taking. However, the crisis' regulatory fallout changed all that.

Goodbye 2007, hello regulation

Following the crisis, a raft of new regulation – EMIR, Dodd-Frank's Title VII and AIFMD – arrived to prevent a repeat of the events of 2007. The seismic impact of these regulatory changes altered the collateral landscape, making more deals subject to collateralisation, while denaturing many of the traits that made cash effective collateral in the first place.

Banks must now fund over a longer term, while holding more capital against uncollateralised trades. This combines to raise the cost of cash while reducing the volume of cash available to lend. Furthermore, banks must trade through clearing houses, requiring variation margin on top of initial margin – which means yet more cash is needed as collateral. These factors inevitably create a cash shortfall – and that's before we consider the need for collateral to be posted more frequently, and the sharp growth in market participants who are subject to posting it. However, it is not just cash that has become more valuable. There is a general collateral deficit, thanks in part to buy-side requirements to post collateral that is not only better quality – but diverse too. What this adds up to is the 'collateral crunch'. This shortfall in suitable collateral must be met by a process that can ensure there is enough collateral to meet the demand of deal makers. That process is known as collateral transformation.

Collateral transformation

On one side we have the banks. They must post more collateral and hold more capital. This is hurting their return on equity, it's making them look unprofitable. So they need to be smarter and more efficient, because collateral, that checkbox eight years ago, is now a valuable resource.

On the other side there are funds and asset managers, and they need cash or high-quality bonds to post as collateral. Unfortunately, a buy-side worth its salt will likely have a higher proportion of high-yielding assets like equities or corporate bonds, because that's their business – driving yield. So now they need to temporarily swap these high-yield assets for the safe ones that will meet regulatory requirements – such as cash or government bonds. When they do this, they hurt their return – and pay a fee to the banks for the privilege, who will charge for swapping these assets. So now the buy-side has a headache, which can only be soothed by smarter, more strategic allocation of collateral.

Smarter collateral

Collateral optimisation, put simply, is the process of making sure your collateral is allocated efficiently. For example, a bank would avoid posting cash because cash is an asset they could lend and generate a return on. As collateral, cash generates nothing. So banks may instead seek to post government bonds, assets that would otherwise sit on their balance sheet.

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On the buy side, they need efficient systems to help them post collateral more frequently, and challenge the amount required in margin calls from banks. Meanwhile, the Alternative Investment Fund Managers Directive (AIFMD) means alternative investment fund managers need to find a depository to segregate house assets from client assets – while ensuring the assets belonging to the house are easily identifiable and distinguishable from those belonging to clients.

It's important to remember that collateral optimisation doesn't begin with STP and algorithms for managing your collateral distribution: it begins with clear oversight. The key to efficiently and effectively optimising collateral is knowing – and being able to visualise – your entire position, including collateral and exposure, your agreement terms, the collateral pledged and your inventory. Once you have captured this properly, with high-quality market data, you can begin to optimise collateral efficiently. And only then will technologies like STP, collateral automation and smart, readable algorithms be of benefit to your operation.

In conclusion

What was historically a back-office function, which had little to no interaction with traders and the middle office, is now moving to the front office. In order to manage collateral effectively, traders, risk analysts and collateral managers must work as one – which is where good systems can help. A good system will connect all three functions with live data and company information. It will enable them to communicate with the market, and will provide risk and simulation analytics, with access to trading systems.

Without a doubt, collateral management is more challenging today than it was eight years ago. But by breaking down operational silos and taking a holistic view of investments, firms can place themselves in the best position to cope with the changes and prosper in a derivatives market that is, ultimately, safer and more secure. Know your exposure across all traded products. Calculate margin calls across all collateral agreements. Get these basics right and you can allocate collateral based on a full view of available asset inventory.

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Data scraping: 'Everybody else was doing it, so I thought it was ok'

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Simmons & Simmons

By Angus McLean, Partner, Simmons & Simmons LLP

I learnt to my cost as a schoolboy that while there can be considerable merit in taking a risk-based approach to compliance decisions, the "everybody else was doing it" defence tends not to hold much water if you are the unlucky one who gets caught. In no area of my practice have I been reminded about this salutary lesson more frequently in recent years than on the issue of data scraping.

A fast growing trend

Call it what you will - data mining, web scraping or any of the other commonly used euphemisms - the practice of systematically extracting data from third party websites (without the permission of the website owner) is on the rise in the hedge fund industry. This can be done manually or, as is more often the case, by specially developed computer programmes. The same legal issues arise in both cases, although it is arguable that manual extraction is marginally less risky because it tends to be harder for a website owner to detect than software-enabled scraping.

The mere fact that data scraping is becoming so ubiquitous seems to be the main cause of the commonly held assumption that it carries no legal risk. However, as the 13 or so European flight price comparison websites that have been the target of Ryanair's wrath over the last 3-4 years can vouch, my childhood excuse does not provide much insurance against costly litigation.

Is data scraping illegal?

As things currently stand, many acts of data scraping are potentially illegal under UK law. The exact nature of the illegal activity depends on a variety factors. Unfortunately, therefore, every situation needs to be analysed on its own facts. However, the two most common claims that can be brought against data scrapers are (a) breach of contract and (b) IP infringement (specifically, database right infringement). Depending on the precise circumstances, it is possible that a data scraper could also infringe copyright or trade mark rights, breach data protection legislation and/or contravene the Computer Misuse Act 1990. To have a justified breach of contract claim, the owner of the website in question has to show that its terms and conditions of use (Ts&Cs) are enforceable and have been breached. The second requirement is obviously down to the wording of the Ts&Cs in question. However, it is becoming increasingly common for website Ts&Cs to expressly prohibit data scraping (or equivalent activities). The other issue is whether the data scraper is technically bound by the Ts&Cs in question.

At present there is no clear English case law on this issue. However, it is reasonably safe to assume that any Ts&Cs that a user has had to "click to accept" will be binding. If the Ts&Cs are binding and rule out data scraping, then in the vast majority of cases the website owner will have a valid breach of contract claim.

Determining whether there is also a database right infringement claim is also a highly fact specific exercise. The analysis will depend on:

- the type and volume of data that is being extracted;
- the frequency with which the data is being extracted; and
- the level of investment that was required to develop the database from which the data is being extracted.

If the database required a substantial investment to put together and data is being taken on a systematic basis, database right infringement may also be an issue.

What are the risks in practice?

To date, relatively few European website owners seem to have been sufficiently exercised about third parties extracting data from their sites to pursue full-blown litigation. That said, as the Ryanair cases show, past performance is no guarantee of future results. It is, therefore, important to understand what the consequences of a data scraping complaint might be to

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provide the proper context for any risk-based analysis of whether those risks are outweighed by the benefits the scraping activities are expected to generate.

Depending on the type of claim that is available to the website owner in question, the key risks faced by a data scraper under UK law are likely to be:

- injunction (including pre-trial injunctions);
- financial liability (in the form of damages or, in certain circumstances, an account of profits);
- disclosure obligations; and
- reputational damage.

Although the final two risks are not really formal legal remedies, in my experience they have just as much of a deterrent effect as the more traditional legal remedies (e.g. injunctions and damages or an account of profits). This is because the prospect of having to disclose the type of investment activities for which the data in question is being used, is often seen as the most commercially damaging consequence of a data scraping dispute. Of course, as with the other risks identified above, it may be possible to avoid having to disclose information about the ends to which the data is being applied by settling a potential claim before it escalates into full-blown litigation. However, assuming that will be possible in every case clearly involves a degree of risk in itself.

The calculation method that will be used to determine any financial liability a fund might incur also plays a big part in the risk analysis. The precise calculation method that applies will depend on the type of claims that are available to the website owner (in particular, whether it has a valid claim for database right infringement as well as breach of contract). If it is limited to a contractual claim, a website owner will generally only be able to recover the loss it has incurred. If it does not license out the data in question, its loss may well be negligible. In such circumstances the website owner might be able to claim damages based on a notional reasonable royalty set by the court by reference to the licence fees that are charged for similar datasets.

If a website owner also has a valid claim for database right infringement, it is entitled to opt for an account of the profits the fund has made from its infringing activities. Clearly, such an award could be substantial if the fund generates significant profits directly from the use of the data in question. However, it is often the case that the data in question forms just one data point in a model that includes a variety of other factors. In that case, the fund's liability should be limited to the proportion of any profits that are attributable to the use of the data in question only.

This means that it may ultimately be difficult for a website owner to identify any significant profits that are directly attributable to the use of the data in question. Unfortunately, that will not necessarily prevent a sufficiently motivated website owner from trying.

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ICAV — Ireland's new corporate fund structure

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Dechert LLP

By Mark Browne, Partner, Dechert

Legislation was enacted in Ireland earlier in 2015 providing for a new type of corporate fund – the Irish Collective Asset-management Vehicle or "ICAV". This much anticipated legislation has enabled the creation of an innovative corporate structure specifically designed for use as an investment fund. The ICAV features a number of specific advantages in comparison to previously available Irish corporate structures. This article gives an overview of the key features and differentiating characteristics of the ICAV, as well as exploring the instances where it is most likely to be of assistance to fund promoters establishing funds in Ireland, one of the primary jurisdictions for domiciling both traditional and alternative funds in Europe.

Background

With almost 6,000 authorised funds currently in operation, Ireland has established itself over the past 25 years as one of the key global fund domiciles. These Irish domiciled funds include entities authorised both as Undertakings for Collective Investment in Transferable Securities (UCITS) and also constituting Alternative Investment Funds (AIFs) under the Alternative Investment Fund Managers Directive (AIFMD).

A wide range of legal structures has existed for some time which may be used to constitute funds authorised in Ireland, including the variable capital investment company (VCC), unit trust, common contractual fund (CCF) and investment limited partnership. However, the Irish Collective Asset-management Vehicles Act 2015 (the "ICAV Act") was signed into law in March 2015 to reflect evolving industry requirements and to ensure a better fit for purpose.

Overview of the ICAV

The VCC, which is the structure used by over 70% of all Irish funds, has proven to be the most popular choice of legal structure for funds domiciled in Ireland to date. However, notwithstanding its popularity, issues with this vehicle have been identified.

As the ICAV offers a number of enhancements to the VCC as a form of corporate vehicle it is likely to replace the VCC as the structure of choice for newly established funds going forward. It is also likely that many existing funds may seek to convert into ICAVs to take advantage of the various advantages they pose, as discussed below.

Advantages of the ICAV

The VCC has its origins in general company law, rather than legislation specifically tailored to meet the needs of the funds industry. As such there are a number of provisions applicable to the structure which may seem inappropriate in the funds context. The new legislation providing for the ICAV has omitted all of the general company law provisions which were deemed inappropriate in this regard. The use of bespoke legislation aimed at funds has also eliminated the potential for any changes to general company legislation having unintended consequences for funds. It also has the benefit of ensuring that one piece of discrete and relatively straightforward legislation completely addresses the structure.

The new legislation also includes some specific changes. VCCs are subject to a requirement to ensure risk spreading or diversification under existing company law. There are therefore difficulties regarding the use of such structures in the context of single asset funds. These are relatively common in the context of property funds, for example. This concern also applies with regard to master-feeder structures (although the Central Bank has issued clarification that observance of this requirement could potentially be met by adopting a look through to the level of diversification carried on by the underlying master).

It will be possible to determine to dispense with the general requirement to hold an annual general meeting for an ICAV. This will entail providing 60 days' notice to shareholders and be subject to a right of 10% of shareholders or the auditor to require such a meeting to be held.

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No shareholder approval will be required for alterations of the Instrument of Incorporation of an ICAV provided the depositary certifies the changes are non-prejudicial to existing investors and have not been specified by the Central Bank as requiring approval.

It will be possible for an umbrella ICAV to determine to prepare separate accounts with respect to each sub-fund. Platform structures with multiple sub-investment managers will find this useful as it would permit the adoption of separate financial year ends for different sub-funds operated by different sub-investment managers, for example.

Provision has been made for the preparation of a revised Director's report to correct errors or with respect to aspects of non-compliance. Specific statutory provisions are included which will apply to fund mergers and amalgamations.

A primary attraction of this new product for some promoters is that the ICAV will be able to "check the box" and be treated as a partnership for US tax purposes. This is addressed in detail below.

Other distinguishing features of the ICAV

Although the Companies Registration Office is the relevant authority for registration purposes of a VCC, the Central Bank of Ireland, which is the regulatory body with responsibility for funds, will be responsible for both registration and authorisation of the ICAV. Upon registration a "registration order" is issued for an ICAV rather than a "certificate of incorporation", as would be the case for a company The constitutional document of the ICAV is the "instrument of incorporation", rather than the memorandum and articles of association. This is similar in many respects to that of a UK OEIC. Each ICAV will feature the word "ICAV" as a suffix in its name (instead of public limited company or plc, as appropriate, for the VCC).

A corporate fund structure

It is important to note that the ICAV does not represent a re-inventing of the wheel, but rather is a form of corporate structure and accordingly does also have many similarities with existing corporate funds, such as the VCC. As such the ICAV is merely an improvement on the existing structure which investors, service providers and counterparties will be familiar with.

The following provisions apply to both by way of example in respect of the following key headings:

- Structure: the entity has legal capacity and acts in its own name. Umbrella structures comprising multiple sub-funds may be established and in such cases segregated liability will apply between sub-funds;
- Enforcement: the (Irish) Director of Corporate Enforcement may exercise powers over both structures (as well as the Central Bank);
- Regulation: both may be established as UCITS or AIFs (including Qualifying Investor Alternative Investment Funds or "QIAIFs", the most popular type of Irish AIF);
- Listing: both may, but are not required to, be listed on a stock exchange (including but not listed to the Irish Stock Exchange which is the World's leading stock exchange for listings of investment funds); and
- Governance: Responsibility for governance is carried by a board of directors. An external management company may be appointed or the structure may exist as a self-managed entity. Corporate directors are not permitted in either case. Most of the current company law provisions relating to the appointment, removal and conduct of directors remain. Furthermore such provisions are overlaid by the Central Bank's fitness and probity and administrative sanctions regime.

Transparency and partnership treatment

A VCC established in Ireland is prohibited from electing to be treated as a partnership for US tax purposes. However, the ICAV will be eligible to "check the box" to be treated as a partnership for US tax purposes, at its discretion. US taxable investors will generally have a preference for investing through a partnership structure and accordingly the ICAV will be the vehicle of choice for managers seeking to target investors in this market.

The unit trust structure, which is eligible to check the box, could have been used prior to the introduction of the ICAV. However, there is a general preference for corporate master funds due to investor and counterparty familiarity with corporate entities.

Corporate structures used for funds in competing jurisdictions such as Luxembourg and the Cayman

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Islands (being the SICAV and exempt company, respectively) are not subject to this prohibition on electing for partnership treatment. This has allowed them to be used by US taxpayers as pass-through vehicles not subject to the more onerous "passive foreign investment company" and "controlled foreign corporation" anti-deferral regimes applicable to shareholdings in non-US corporate fund vehicles.

Master-feeder structures

ICAVs constitute an ideal vehicle to be used as corporate feeders because they are not subject to a requirement to diversify their investments (although, such a requirement may in fact apply depending on any regulatory authorisation of the ICAV post registration, such as under UCITS). It is appropriate to note that while they may elect to “check the box” to be treated as partnerships for US purposes they are not subject to a requirement in this regard and therefore a master-feeder combination involving two ICAVs could involve one checking the box and a second one refraining from doing so and hence acting as a corporate blocker.

Any decision to establish any such master-feeder would primarily be driven by the target investor base for the fund and would only be appropriate in specific circumstances.

Umbrella ICAVs are also permitted to cross-invest between sub-funds so it is possible, from an Irish perspective, to have a single ICAV comprising the feeder and master in one legal entity by having one sub-fund elect to be treated as a partnership and a second not.

Establishing an ICAV

Establishing a new ICAV will entail a two-stage process, both of which are carried out with the Central Bank:

i. Registration - this is similar to the registrar role which is undertaken by the Irish Companies Registration Office with regard to all companies. The Central Bank will issue a Registration Order for a new ICAV within ten business days from the date of receipt by it of a complete application for registration. The prospectus and service provider agreements will not need to be submitted at this time. All related filings will be made to the ICAV registration section of the Central Bank.

ii. Authorisation - this is a separate process conducted through the funds authorisation section of the Central Bank. An ICAV may be authorised under UCITS or as an AIF (including a QIAIF) and the standard new fund authorisation process will apply. In the case of a QIAIF this includes the 24-hour approval process.

Converting to an ICAV

The ICAV Act also permits existing structures, both existing Irish VCCs and non-Irish (offshore) entities to convert into ICAVs. This is a somewhat similar process to that relating to the redomicilation of offshore companies and as such it has been tried and tested over recent years. Such a conversion will require shareholder approval and a declaration of solvency (necessitating an audit engagement, but not a full audit).

One of the most significant changes to Irish company law relating to fund vehicles in recent years was the introduction of redomiciliation provisions contained in the Companies (Miscellaneous Provisions) Act 2009 which enabled fund companies in specific offshore jurisdictions, such as the Cayman Islands, to change their domicile to Ireland from their existing domicile. Key advantages of effecting a redomicile rather than simply incorporating a new entity in Ireland are that this permits the company to preserve its track record and contractual arrangements.

The ICAV Act has removed an effective barrier preventing corporate structures targeting US taxable investors from redomiciling and we are already seeing evidence of redomciliations occurring to take advantage of this. It can be noted that a number of the first funds to be registered as ICAVs were essentially redomiciliations of existing funds from the offshore jurisdictions to Ireland.

Outlook

It is expected that the ICAV will become the standard choice for Irish fund structures in the future due to its suitability for funds and general flexibility. It is expected that, in time, many existing VCCs will elect to convert to an ICAV.

However, promoters may wish to wait before converting an existing entity to this structure until there is greater familiarity with the structure in the industry generally.

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It is expected that key factors for those considering converting an existing structure to an ICAV will be the extent to which it can ensure added benefits in light of their target investor base, the nature of the assets to be held, investor preference and cost.

ICAV structuring options

The flexible nature of ICAVs means that they are ideally suited to facilitate master-feeder structures. They can be used in different structuring options or combinations enabling them to be used in various scenarios targeting different investor mixes, including where:

1. Investors are a combination of US taxable investors, US tax exempt investors and investors from the rest of the world;
2. Investors are a combination of US taxable investors and investors from the rest of the world;
3. Investors are a combination of US tax exempt investors and investors from the rest of the world.

A US disclosure wrapper and US subscription documentation are highly recommended where US sales are contemplated, and Dechert, which has 13 offices across the US, is ideally placed to assist with this.

Summary

The ICAV is a new Irish corporate structure specifically designed to be used as an investment fund. It may be authorized as a UCITS or as an AIF and has a number of specific advantages when compared to the existing fund structures previously available. It is therefore expected to become the default choice for new investment funds domiciled in Ireland going forward and is already proving popular. This is especially the case as it facilitates addressing the needs of a key investor base – US taxable investors.

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Be prepared: What alternative investment funds need to know about the Common Reporting Standard

AIMA SPONSORING PARTNER

KPMG cutting through complexity

By Kevin Charlton, Director, and Jennifer Sponzilli, Global AEOI Lead Partner, KPMG

1. Purpose

Readers of the AIMA Journal will be aware of the regular commentary on the Foreign Account Tax Compliance Act (FATCA), Intergovernmental Agreements (IGAs) and the Common Reporting Standard (CRS), collectively referred to as the Automatic Exchange of Information (AEOI), over the last 18-24 months.

Implementation of the CRS is now less than five months away for early adopter countries. This article sets out the current status of the AEOI regimes, key aspects of the CRS, specific challenges for alternative investment fund managers (AIFMs) and significant requirements over the next six to 12 months. The AEOI regimes are replete with acronyms and jargon. In this article, unless otherwise specified, we refer to the current FATCA, IGA and Crown Dependencies and Overseas Territories (CDOT) regulations as the "current framework," and the approaching multilateral exchange framework as the CRS.

2. The current status of the AEOI regimes

The current framework came into effect on 1 July 2014, when the requirements for investor identification came into force. With regards to identifying US persons under the FATCA and IGA regulations, most of the jurisdictions in which AIFMs and service providers or administrators establish funds or management entities have entered into Model 1 IGAs with the US - for example, the British Virgin Islands (BVI), the Cayman Islands, the Channel Islands, Malta, Ireland, Luxembourg, Singapore and the UK. These countries will report information to their local tax or competent authority, which will then provide the information to the Internal Revenue Service (i.e. IRS, the US tax authorities). This is in contrast to other countries, including Bermuda, Hong Kong and Switzerland, which have entered into Model 2 IGAs and, consequently, will report any information with respect to US account holders (i.e. investors) directly to the IRS. Over the past few months, funds, AIFMs and fund administrators have addressed the first reporting deadlines under the IGAs, specifically with respect to investments by US persons between and including 30 June 2014 to 31 December 2014.

This has been a challenge to the industry as requirements differ between jurisdictions (e.g. filing deadlines, the process for filing reports, the requirement for "nil returns", the need for local registration in addition to a FATCA registration on the IRS portal). In a number of jurisdictions, the deadlines for reporting, the requirements, and possibly both have been amended as a result of tax authorities revising guidance, re-interpreting the regulations or addressing issues arising from new portals and web based filing databases.

Within the alternative fund business, these developments have an impact on the number of vehicles that need to comply with the regulations, in addition to the volume of reports that must be filed. They also highlight the need for managers and fund boards to ensure they are aware of any changes to the regulatory framework so that they can confirm compliance across their business model; this can mean relying on advisors or service providers for current information.

The CDOT framework differs from FATCA and the IGAs in a number of aspects, including:

- it only applies to 11 specific territories, including the UK, Cayman Islands, and Channel Islands;
- it requires reporting on UK tax residents and, for UK funds/managers only, Channel Islands tax residents;
- there is an alternative reporting regime, which provides for limited reporting on UK resident non-domiciliary (UK RND) persons subject to various conditions being satisfied; and
- the first reports under this regime are not due to

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be filed until 2016, albeit for the 2014 and 2015 tax years.

Although the CDOT regime came into effect in 2014, the relatively limited scope of the regime and its lower profile in terms of consultation and debate compared to FATCA has led to a lower level of awareness of its requirements within the alternative funds community. The deferral of the reporting deadlines until 2016 means that managers yet to address the requirements have an additional six months to establish procedures and arrangements to comply. For a number of years, the OECD and other groups (i.e. G5, G20) have been working towards the development of a Global Standard multilateral AEOI framework. In October 2014, the EU Commission established an Expert Group on Automatic Exchange of Financial Account Information to "assist the [EU] Council and Member States to ensure that EU legislation on automatic exchange of information in direct taxation is effectively aligned and fully compatible with the OECD Global Standard on automatic exchange of financial account information."[1]

AIMA is one of more than 20 European industry bodies represented in this Expert Group. In December 2014, the EU amended the Directive on the Automatic Exchange of Information (DACII) to, in effect, require EU members to implement a multilateral tax reporting framework within the EU on 1 January 2016.[2] It is now apparent that there will not be a lengthy consultation period prior to the implementation of the CRS within Europe. It will be implemented within the EU and at least twenty other jurisdictions (e.g. Bermuda, the Channel Islands, and the Cayman Islands) on 1 January 2016.

1 http://ec.europa.eu/taxation_customs/taxation/tax_cooperation/mutual_assistance/financial_account_information/index_en.htm

2 http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0107&from=EN

	Current FATCA/IGA	CDOT	CRS
Which entities need to report?	Investment funds and some management entities	Investment funds and some management entities	Investment funds and most management entities
Who needs to be reported?	Specified US investors	Specified UK and Crown Dependencies (plus Gibraltar) tax residents	Specified investors tax resident in any country which has implemented CRS vis-à-vis the fund jurisdiction
To whom will the reports be submitted?	Local tax /competent authority or The IRS if the entity is subject to the FATCA or a Model 2 IGA	Local tax/competent authority	Local tax/competent authority
When is it effective?	From 1 July 2014 First reporting due in 2015 with many deadlines now passed	From 1 July 2014 First reporting due by 31 May 2016 for 2014 and 2015	From 1 January 2016 for early adopters First reporting currently scheduled before September, 2017; exact date varies by jurisdiction
How many countries have implemented the rules?	Approximately 100 territories have either implemented or have agreed "in substance" IGAs.	11 (UK , 3 Crown Dependencies and 7 Overseas Territories including Cayman)	Currently, 56 countries are early adopters Another 38 have committed to implement by January 2017, (excluding the US) with first reporting in 2018.

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3. CRS compared to the current framework: Highlights

The CRS framework is largely based on the current IGA framework which means that AIFMs will be familiar with many of the concepts. A summary of some key points in the table below.

Early adopters include: All EU Member States except Austria, the Cayman Islands, Bermuda, and the Channel Islands. Switzerland, Hong Kong and Singapore will adopt the CRS in 2017.

4. What is the operational impact for alternative investment fund managers?

The relative impact of CRS on an AIF compared to the current frameworks will vary from business to business, depending on the number of countries in which the business has either funds or management entities, and their investor base. However, it is important that AIFs do not regard CRS as "FATCA but just a bit bigger".

Implementing and complying with the AEOI framework may impact an AIF's business model in a number of areas, including:

- Governance and reporting: it is highly likely that all management entities and investment funds will have both domestic registration and annual reporting obligations to domestic tax authorities related to customer information. This is in contrast to the current framework where "nil returns" and "no requirement to register" options are common. AIFs will need to establish a clear and appropriate governance structure with responsibilities and timelines allocated to and agreed-upon by the management entities, funds and their responsible officers, and third parties (i.e. administrators, advisors). This structure should include appropriate oversight.

- Client onboarding procedures and documentation: CRS requires that the identification of investors' tax residence(s) and CRS status of entity investors be collected and validated prior to accepting a new investment/subscription. AIFs may need to amend existing documentation, particularly if current self-certification procedures are based on the US Forms W-8 or W-9. They may also need to increase resourcing to address account opening issues. Clarification of the roles and responsibilities of administrators, intermediaries and AIFMs is required prior to 1 January 2016 for those in early adopter countries.

- Customer experience: under the current framework investors only need to prove that they are not US citizens or UK, CD or Gibraltar tax residents. As a result, the touch points between investors and funds/AIFs are likely to be few and far between. Under AEOI, investors will potentially be faced with additional documentation and correspondence: increased requests for tax residency, notification from investment entities that they will be submitting reports to local tax authorities and, in due course, correspondence from tax authorities around the world with queries relating to AEOI reports and investor tax returns.

  A major consideration for AIFs and others in the high net wealth individual, family office and trust space will be to what extent they will provide support and assistance to clients/investors with respect to queries, communications from tax/competent authorities and explanations related to the reporting framework.

- Compliance and audit: AIFs will need to ensure that records and systems are maintained to demonstrate compliance with all aspects of the regime (e.g. investor identification and due diligence, entity registration, ongoing reporting) in accordance with timelines. Bearing in mind that compliance remains the responsibility of a Fund, AIFs should consider whether fund administrators should retain records, and the extent to which records could be retrieved for audit reviews on a timely basis.

- Systems and IT: compliance with all aspects of CRS will, for many large financial institutions, including administrators, banks and asset managers, require significant updating of IT systems. While AIFMs do not typically rely on in-house technology for FATCA/IGA compliance, those who are dependent on third parties should ensure that these organisations are on track with necessary upgrades.

5. What are the technical differences with CRS?

This article does not provide the space for a full analysis of the differences between the CRS regulations as drafted and the current frameworks.

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What is apparent is that AIFMs, in addition to other financial businesses, will need to keep up to date on the latest regulatory developments, guidance and industry discussions as these will determine how CRS is implemented within the jurisdictions in which their funds and management entities are based.

It has become apparent during the relatively short lifespan of the IGAs to date that in addition to the UK, the Cayman Islands and the Channel Islands, tax authorities and industry groups have a key role in matters of interpretation and practical implementation of the rules. AIFs and their advisors will need to keep close to both during the transition to CRS in order to ensure efficient preparation for and compliance with the new regime.

Below, we highlight in brief three specific differences which will be relevant to AIFMs.

<u>Deemed compliant entity status for investment managers as non-reporting financial institutions under the IGAs is likely not permitted under the CRS</u>: many entities within the AIF and asset management industry have been classified as deemed compliant, non-reporting financial institutions on the basis that their activity is only or primarily investment management and they have no reportable persons, resulting in no obligations under FATCA, the IGAs or CDOT.

CRS limits the types of deemed compliant entities that will qualify as non-reporting financial institutions and the qualification criteria for a non-reporting financial institution appears unlikely to be met by investment managers. As a result, entities which have been classified as deemed compliant under the current framework will very likely need to register, perhaps for the first time, and comply with the CRS.

<u>"Look through" to controlling persons of certain investment entities which are invested in funds</u>: the CRS regulations regard any investment entity in a jurisdiction which has not signed up to the CRS as a passive non-financial entity (PNFE). Consequently, it will be necessary to identify the tax residency of any controlling persons of that PNFE to determine whether they are reportable persons. In the AIF model with high net worth individuals, family office and trust investors, this could have a significant impact on investor due diligence. It is important to note that, at present, the US appears unlikely to be considered as a participant in the CRS, which means that US feeders are likely to be PNFEs.

<u>Sponsoring</u>: CRS does not contain the concept of sponsoring – the practice whereby a sponsoring entity (i.e. an administrator or a management company) acts on behalf of one or more sponsored entities which could be based in different jurisdictions – for registration and reporting under the current framework. It does, however, provide for the use of third party service providers that could essentially serve the same function albeit with slightly different qualification criteria. Businesses that have made use of sponsoring will need to address the separate registration and reporting requirements of each sponsored entity prior to implementation of the CRS.

6. Awareness of CRS

As could be expected, the level of awareness of CRS differs from region to region. The following examples highlight possible areas of inconsistency on operational and technical issues which may challenge AIFMs with operations in different territories.

In the Cayman Islands, one of the leading hedge funds jurisdictions, most providers are aware of CRS. This is evidenced based on the large majority of funds that are asking for tax residence in their self-certification documents in addition to US status.

The Cayman Islands Fund Administrators Association is participating in the working group consulting with the tax authority on CRS. There is some suggestion that the CRS regulations will be passed into law at the end of September 2015, when no doubt the industry will be fully focused on ensuring Cayman Islands hedge funds are CRS compliant.

Within Jersey, which has agreed to implement the CRS by 1 January 2016, the regulations are currently being drafted and will be lodged for discussion in the States of Jersey in September 2015.

The interaction of the CRS and the CDOT agreement with the UK presents two issues:

- Given that both Jersey and the UK are early adopters

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of the CRS, unless the existing CDOT is terminated or transitional provisions are introduced, it is not inconceivable that Jersey financial institutions with UK investors will be obliged to report 2016 information under both the CRS and the UK IGA.

- The CRS does not contain a similar provision to the alternative reporting regime for UK RNDs (i.e. see section 2). As such, it is expected that the alternative reporting regime, which has been adopted by some financial institutions, will be effective only up until 31 December 2015.

In ASPAC, there are still jurisdictions which have not finalised IGAs to address US reporting requirements. As a result, while there is a general awareness of AEOI, a number of financial institutions in ASPAC are delaying analysis of CRS. This reluctance is causing some concern given that the region is responsible for the launch and management of a large number of hedge funds domiciled outside of the region (e.g. Cayman Islands) and with administrators/service providers in a number of jurisdictions. Hong Kong, Singapore and the majority of ASPAC countries will not adopt CRS before 1 January 2017 which gives rise to the potential for inconsistency in data gathering, scheme disclosures and addressing compliance with AEOI during the transition to CRS.

Governments and industry groups will be instrumental in pushing through regulations and guidance although it is not yet clear to what extent there will be a consistent approach in the region.

Although not relevant to many AIFs, it is worth noting that with the implementation of the CRS, the EU Savings Directive is set to be repealed within the EU in order to minimise duplicate reporting. Timelines for the repeal are likely to differ within the EU, associated territories (e.g. the Cayman Islands, the Channel Islands) and third countries (e.g. Switzerland), providing another reason for managers to keep a close eye on both the introduction of new regulations and the repeal of existing ones over the next 18 months.

7. Next steps

With very little time before January 2016, AIFMs should resist the urge to turn their attention from AEOI compliance now that the first round of reporting is drawing to a close. Even those AIFMs operating in the later adopting countries (e.g. Hong Kong, Singapore, Switzerland), should recognise that many of their entities might be in early adopter countries and, as a result, will need to comply sooner.

An immediate effect of the approaching deadline is that scheme documentation for new funds or revisions to existing offering memoranda should take into account the latest developments.

AIFMs would be well advised to address the impact of CRS themselves and to evaluate the readiness of their service providers as soon as possible, and to allocate the appropriate resources and time in order to do so.

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If you were put in charge of all of the pensions in the world tomorrow, what is the first step you would take?

By Michael Oliver Weinberg, CFA, Senior Managing Director, Chief Investment Strategist, Protégé Partners

It is not every day that one is asked a question that is so critical to the sustenance and well-being of such a material percentage of the developed world. Over the last century, it can be said that western society has evolved to incorporate the notion of a pension as an ideal. Just this past summer it was not inconceivable that Greece would leave the European Union. Why? At least partially because its politicians and society were extraordinarily averse to the prospect of Troika (the IMF, World Bank and European Central Bank) mandated pension cuts that were desired for it to receive funding to refinance its then imminently maturing debt.

Despite this western notion of a pension as an ideal, US corporations have en-masse frozen defined benefit plans (plans where beneficiaries are guaranteed payments in retirement), and are no longer allowing employees not already enrolled in them to participate. Instead corporations have replaced these defined benefit plans with defined contribution plans, i.e. 401ks, where it is incumbent upon beneficiaries to contribute voluntarily, and assume the rate-of-return on plan assets that is afforded by the markets.

Nonetheless, public pension plans, those administered by federal, state or local governments, are still prevalent. We believe this is one of many indicators that the western public still holds on to this notion of a pension, and fiscally secure retirement, as an ideal. That said, the flaw is that in the western world many pension plans are underfunded. The present value of their liabilities is in excess of the present value of their assets.

In addition, the assumptions needed to arrive at the funding status are often unrealistic and overly optimistic, i.e. assuming return rates that are in excess of the rates that are likely to be achieved.

This gets us to the crux of the matter. If we were put in charge of all of the pensions in the world tomorrow, what is the first step we would take? Just as Dustin Hoffman was given a one-word piece of advice in The Graduate, though our one-word answer to a similar question would not be 'Plastics' as it was in the film, our answer would also be one word: 'Alternatives'.

I teach a course at Columbia Business School with the verbose title, Institutional Investing: Alternative Assets in Pension Plans. Before we answer the question of why alternatives, we will mention the historic funding composition of pension plans. Historically, pensions were invested in some combination of fixed income, bonds and equities, stocks, often entirely the former. Importantly over the past few decades, we believe more astute plans have incorporated alternatives.

Alternatives generally include hedge funds, private equity, venture capital, real estate, infrastructure, commodities and other non-equity/non-fixed income instruments. If we look at modern portfolio theory, one of the primary concepts is the efficient frontier. The concept behind the efficient frontier is to choose a level of risk and maximise return or alternatively (pun intended), choose a level of return and minimise risk.

Different asset classes have different attributes, i.e. return and risk parameters. The more asset classes a pension adds to its opportunity set, the greater the possibility or probability of pushing out the efficient frontier, i.e. achieving more return for the same risk, or the same return with less risk. The next question to ask is why alternatives are attractive. The answer to that is alternatives returns aim to be reliant on alphas (returns in excess of beta or the market return) and returns that are not reliant on traditional equities or fixed income.

In traditional equity or fixed income investing, whether one is active, i.e. trying to beat the benchmark, or passive, i.e. trying to match the return of the benchmark and minimise fees, one is reliant on markets achieving

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positive returns over time. Though the markets may achieve positive returns over the very long term, i.e. a century, there may be decades where markets do not achieve positive returns. For example, the Japanese stock market, the Nikkei, peaked at 38,916 in 1989. On 8 September 2015, the index closed at 17,427. It is down more than 50% over the most recent quarter-of-a-century period. The S&P 500, the predominant US and global benchmark, was flat on a price basis point-to-point for over 13 years from the turn of the twentieth century in 2000 to 2013.[1]

If a pension was reliant on these markets going up over these periods, the pension would have flat or negative returns. The advantage of alternative assets is that they may derive their returns from factors other than rising markets. For example, equity market-neutral hedge funds may simultaneously long and short stocks with no net market exposure, deriving returns from the spread, i.e. that the longs will go up and the shorts will go down. This strategy can achieve positive returns despite a market that is flat (or even down) over many years.

This same strategy may be employed with corporate bonds, and is called credit long/short. Similarly one could apply this strategy to real estate securities, such as REITs. Commodities are another asset class a similar strategy might be applied to. We will save a discussion on infrastructure, private equity and venture capital for a different article, but suffice it to say, these asset classes are also reliant on different return drivers than traditional equity and fixed income markets, and similarly may expand a pension fund's efficient frontier.

In the US, public pension plans have often been at the global forefront in acknowledging this proverbial 'free lunch' by adding alternatives to what was formerly a more traditional allocation. Corporate plans have also adopted alternatives, though to a lesser extent. There has been at least one example of a large, high profile US public pension plan that very publicly abandoned its hedge fund allocation, though kept the vast majority of its alternative allocation, including its private equity and real estate. Though scalability and fees were cited as the rationale for the de-allocation, based on our experience and due diligence we do not believe that to have been the case.

In summary, we believe pensions should incorporate alternatives to best meet their liabilities to beneficiaries . Alternatives may allow pensions to expand their efficient frontier and achieve the proverbial free lunch, namely the same return with less risk, or more return with the same risk. This is why when we are asked if we were put in charge of all of the pensions in the world tomorrow, what is the first step we would take? 'Alternatives'.

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1 Nikkei and S&P 500 prices based on Bloomberg


A successful fund is about more than investing. Strong operating models, advanced reporting tools and systems are critical. Hedge, private equity and real estate funds globally rely on our skills. They depend on our tools. And our scalable systems help us evolve with your business.
Infrastructure? We've Got You Covered

Ireland's Central Bank publishes new governance and operational oversight criteria for UCITS and AIFMs

By Aymeric Lechartier, Managing Director, Carne Group

The Central Bank of Ireland recently took steps to provide further clarity on the governance framework it expects from Fund Management Companies (FMCs)[1] in Ireland. In a 42-page guidance note, it also provided feedback on delegate oversight, the expected organisational effectiveness of FMCs, and further insight into its expectations on director time commitments. This will have operational and governance implications for both internally managed alternative investment funds (AIFs) and UCITS, as well as third-party management companies.

The key areas the Central Bank is focusing its efforts on can be distilled as follows:

- The separation of the Designated Person (DP) role from that of Non-Executive Directors on Irish fund boards;
- The re-organisation of key managerial functions for Irish UCITS and AIFMs;
- More emphasis on the oversight of key management areas for FMCs, like risk management and distribution;
- The introduction of parameters for the time commitments of directors, measured in terms of "aggregate professional time commitments".

For hedge funds the main impact of these changes is likely to be felt by self-managed UCITS funds and internally managed AIFs. For those utilising their own management company or a third party management company, the changes will primarily impact those entities. The impact on Irish funds with external AIFMs will also be relatively limited and relate to the level of oversight the Board should have over the operations of the AIFM. This article will concentrate primarily on the impact on self-managed Irish funds and internally managed AIFs although the section on Fund Boards is relevant to all Irish funds.

Irish Fund Management Companies (FMCs)

For FMCs in Ireland, the number of managerial functions are being reduced to six. There are now two items surrounding risk, reflecting the increased importance being placed on risk by the Central Bank, with a risk appetite statement and a risk framework now required. Distribution has been introduced as a new function, with associated analysis and implementation requirements. Importantly, there has been a separation of the DP role between the risk DP and the investments DP. The Central Bank now requires that DPs have the skills and experience to take on these roles, and that this is thoroughly documented.

The DPs must also now have a contract in place with the FMC describing their role and the amount of time that they must allocate to their roles. This requirement now also applies to non-executive directors who fulfil these roles. The boards of FMCs also face further requirements, including the assignment of an independent director, who is not responsible for any of the six managerial functions, to ensure organisational effectiveness. The Central Bank would now like to see a documented rationale for the board's composition, as well as the capacity, willingness and expertise of directors for assuming DP roles with the managerial functions. Significantly, it would also like to see clear documentation of directors' full professional time commitments.

A designated person role should be considered separately to the role of director. A separate time commitment should be allocated for each such designated person and should be commensurate with any additional work that this role required. The time allocated should take into account the ongoing oversight role, daily availability, report review and onsite visits to delegates.

1 In the guidance note, the Central Bank defined 'fund management company' as a UCITS management company, an authorised Alternative Investment Fund Manager, a self-managed UCITS investment company and an internally managed Alternative Investment Fund which is an authorised AIFM.

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Risk management roles are a larger theme of Central Bank oversight, with the creation of two separate managerial functions, namely fund risk management and operational risk management. The same DP may not perform both risk and investment management functions, although outside this area, it remains acceptable for a DP to handle more than one managerial function. The guidance requires the board of an FMC to confirm its own risk appetite and that of its underlying funds, and to mitigate applicable risks (i.e. develop a risk framework specific to the FMC). Risks should be appropriate to the fund and the FMC. Risk policies should include clear procedures for reporting to the board and the consideration of any breaches of established limits. It will no longer be enough for the board to rely on the risk management functions of the FMC's delegates.

Boards will now also be required to approve a detailed distribution strategy and the Central Bank's guidance note includes further information on what this should cover. In particular, tasks will have to be assigned and an appropriate control framework put in place that meets legal and regulatory requirements. The board should receive, and be satisfied with regular reports regarding distribution, should police these reports for possible conflicts with the prospectus, and also be aware of similar conflicts within marketing material, including where there are significant elaborations to the investment approach. The Central Bank requires existing FMCs to update their business plans / programmes of operation to reflect revised managerial functions and organisational effectiveness by 30 June 2016.

Irish Management Companies

In cases where investment funds have appointed an Irish management company, all of the requirements already outlined will apply to the management company. This will make it easier for a fund to comply with the new requirements. The board of the fund will be expected to hold that management company to the same standards as an FMC, as well as ensuring there is a clear split of the responsibilities of the fund board and the management company, namely strategic versus operational considerations. The board of the investment fund should receive detailed reports from the management company outlining how the delegated tasks are being performed and how potential conflicts of interest are being considered and managed. The board of the management company should hold that management company to the same standards of oversight that an FMC sets for a delegate, but it does not need to replicate the detailed oversight of delegates that an FMC must ensure. Where the board of the fund has appointed an external AIFM the level of oversight expected of a fund board over the AIFM would be similar to that expected over the management company.

Fund Boards

All Irish funds will have to review the current composition of their boards and will be responsible for assessing the time commitments of board directors. There will now be increased scrutiny of annual director time commitments. Any director with more than 20 directorships and an aggregate annual time commitment of more than 2,000 hours will be considered as higher risk. Post 1 January 2016, any investment funds with directors in this category will be subject to additional regulatory scrutiny and prioritised for inclusion in thematic reviews by the Central Bank. The Central Bank has also commented that individuals with multiple directorships should consider the conflicts which may arise when sitting on a number of boards and the corporate interconnectivity that is created. In addition to their total number of directorships, individuals should consider the additional time required to deal with sub-funds, the type and complexity of the products they are responsible for, the number of their various separate client commitments, and any applicable legal and regulatory obligations. The Central Bank has also said that it will take other factors into account which might impact an individual's ability to fulfil their board roles at an appropriate standard.

Boards and promoters may need to perform a gap analysis of their current governance models, putting in place any required structural changes. Such a process could include analysis, change identification, new resources requirements, further documentation needs, new procedures and final implementation. The Central Bank has written to the chairmen of fund boards to ask them to review current board compositions, in particular taking the guidance note into account to ensure that each director has sufficient time allocated to this important role. Chairmen are being asked to note whether the directorship numbers of sitting directors are in line with the new guidelines and are at acceptable and manageable levels.

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Summary of roundtable discussion on 457A and deferred compensation

By Michael Shore, Tax Advisor, Arthur F. Bell Jr. & Associates, LLC

As the sunset for long-term deferral of fees from offshore feeder funds creeps closer, hedge fund managers are facing the realisation that the end of the deferral period means that the tax man cometh, along with a potentially large tax bill. A recent Alternative Investment Management Association (AIMA) roundtable event sponsored by Arthur F. Bell Jr. & Associates, LLC titled "Preparing for the end of deferred compensation - what it means for you and your fund" addressed this sunset for deferred compensation, as well as possibilities for future deferral of income from offshore funds. The panel was moderated by Alex Cummings of Arthur Bell, and included Jon Brose of Seward & Kissel, and Josh Morgenstern of Arthur Bell.

The good old days…

Mr Brose began the discussion by explaining that prior to 2008, fund managers who operated a standard master feeder hedge fund typically received a performance allocation from the onshore feeder, which was ordinarily formed as a US partnership. The use of a US flow through entity, generally permitted fund managers to retain the preferential tax character of income items, such as qualified dividends and long-term capital gains that were earned by the onshore feeder. Alternatively, some fund managers received their share of the fund's performance in the form of a fee, which was ordinary income to the fund manager, and deductible to the investors in the onshore feeder. Investors in the onshore feeder generally would not permit the fund manager to defer its fees since such a deferral would result in a deferral of the partnership's deduction, which would be contrary to the ordinarily prudent tax planning of accelerating deductions.

On the contrary, Mr Brose explained, the offshore feeder, which is typically formed as a foreign corporation in tax-friendly jurisdiction like the Cayman Islands or British Virgin Islands, would pay the fund manager a performance fee that the fund managers generally deferred and reinvested in the fund. This deferral led to Congress' 2007 addition of section 457A to the Internal Revenue Code (IRC), which, with certain exceptions, generally disallowed US persons to defer income earned from a tax indifferent foreign entity, for a period that exceeded 12 months. Such tax indifferent entities include foreign corporations, or partnerships whose partners are not subject to US or foreign taxation. However, a sunset provision permitted income that was previously earned before 2008 to remain deferred provided that the deferral did not extend past 31 December 2017. In other words, any previously deferred income would become subject to US taxation and reported on a US income tax return no later than on the 2017 tax return.

Mr Brose noted that as a reaction to this legislation many fund managers amended their deferred income plans to accommodate the 2017 deadline, and were also quick to restructure their compensation arrangement with the offshore feeder to receive an allocation from the master fund, as opposed to a fee from the offshore feeder. This restructuring was intended to replace the benefits of deferral with the benefits of passthrough income as described above. However, Brose noted that this restructuring was not a one size fits all. In fact an allocation from a master fund that doesn't generate long-term capital gains, or that previously made an election under IRC section 475(f), provides little benefit to the fund manager by way of preferential tax treatment. A fee from the offshore feeder, even without the deferral option may allow the fund manager to minimize its exposure to the net investment income tax (NII) and self-employment tax depending on the overall structure of the fund and fund manager as a limited partnership or a limited liability company.

As an aside, the panel noted that any restructuring from a fee to an allocation or vice versa should also consider the implications for New York City's Unincorporated Business Tax.

Proactive planning

While Morgenstern noted that industry experts have suggested that as much as $200 billion from the alternative investment industry is expected to come onshore by 2017, recent articles have highlighted

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examples of fund managers who individually have deferred income in excess of $10 billion that will become taxable income by 2017.

Morgenstern further noted that in addition to anticipating the recognition of income, fund managers should be planning to generate offsetting deductions such as charitable contributions to public charities, private foundations, and donor advised funds. Morgenstern also noted that in the current low interest rate environment, charitable lead annuity trusts (CLAT) may be useful tools to generate charitable deductions and transfer wealth to the next generation. If the CLAT's assets, which are invested in the fund manager's hedge fund generate a return that exceeds the required "hurdle rate" the additional growth inside the CLAT represents a tax-free transfer of wealth to the fund manager's children or other beneficiaries of the CLAT. Nonetheless Morgenstern warned that multi-generational planning requires other vehicles that could allow fund managers to allocate some or all of their generation skipping tax (GST) exemption, which CLATs cannot provide for.

The panel also considered whether a fund manager's relocation to a zero or low tax state may eliminate state income taxes when the deferral comes due. The panel warned that such a move is not without risk of a clawback from the state in which the fund manager lived when the income was earned. The panel advised seeking legal counsel before undertaking such a strategy.

Considerations for future deferral

While the recognition of taxable income between now and 2017 is inevitable, careful consideration may reveal new opportunities to defer future earnings from offshore funds, while complying with the IRS guidelines.

Cummings focused on the deferral opportunity that is available by making a qualified electing fund (QEF) election for the shareholders of the offshore feeder. Provided that the offshore feeder is eligible to be treated as a passive foreign investment company (PFIC), the QEF election should defer future income but at the cost of interest charges to the IRS. Provided that the fund outperforms the currently low interest charge, the QEF election may be an easy solution for future deferral.

Please note that this election will not benefit any income that was deferred prior to the QEF election. Cummings also noted that the benefit of receiving a fee from the offshore PFIC instead of an allocation from the master fund is that PFIC-level expenses, which would otherwise be portfolio deductions, are netted with PFIC gains, thereby ensuring that the investor receives the full benefit of these expenses. However, such expenses if reported on a Schedule K-1 from the master fund, are separately stated and not netted with trading gains. The result is that various limitations on deducting these expenses could effectively render these expenses as lost to the fund manager.

Brose who has written extensively about stock appreciation rights (SARs) noted that the IRS has recently approved SARs as an exception to the 457A anti-deferral rules. SARS, which generally avoid an annual crystallisation of the fund manager's share of trading gains, allow a measure of deferral while aligning the fund manager's interest with the interests of the fund's investors. Brose noted that his practice has yet to implement a SARs program and that the perceived implementation and administrative burdens that likely accompany SARs have kept many in the alternative investment industry from utilising this deferral option.

Other suggestions raised by the panel and the audience during a robust discussion included the use of an IRC section 83(b) election as well as converting the fund manager from a cash method taxpayer to an accrual method taxpayer.

This conversion is typically an automatic change of accounting method, which by its nature does not need approval from the IRS. The result of this change is that certain income and deductions are recognised over a period of years thereby resulting in a quasi-deferral of income. While this deferral will only postpone income recognition for a few years, it may also satisfy other accounting and operational needs that funds which are on the cash method face on an annual basis, such as capturing current year deductions for bonuses paid.

Other considerations

Cummings noted that for offshore funds whose investors consist mainly of the funds' principles and a few remaining legacy investors, now might be a good time to evaluate the role of the offshore fund. Cummings noted that often such funds remain in existence simply to hold the deferred income. However, as 2017 looms,

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thereby eliminating the deferral, the offshore feeder may lose its utility.

Converting to a family office model may be a worthy alternative, which could result in reduced fees due to the elimination of an annual audit, which without outside investors should no longer be needed. Depending on the nature of the family office, (trader v. investor) expenses may remain deductible and could offset trading gains. Such a conversion may also liberate fund managers, who were previously bound by the terms of subscription agreements and private placement memorandums to explore new strategies and other opportunities that were previously off limits when the fund had fiduciary responsibilities to its investors.

Communication is key

The panel concluded with a message that communication with investors about anticipated changes to the fund structure are imperative and should be clear and timely. Communications with tax and legal advisors should likely be undertaken at least nine months prior to an anticipated execution date for any significant planning. Working with advisors in advance should allow for the necessary time to tailor solutions to the fund manager's goals, while considering the derivative effects of such solutions. As has been described above there is no one-size-fits-all approach to tax planning.

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Emerging from the gloom: shadow banking brought into sharp relief

By Michael Beaton, Managing Partner, Derivatives Risk Solutions LLP

Introduction

"Shadow banking" refers to that part of the financial system which extends credit but is fully or partially outside the regular banking sector, i.e. non-bank credit intermediation. Despite the real benefits associated with shadow banking, the financial crisis of 2007-2008 highlighted a number of risks, particularly a heavy reliance on short-term wholesale funding, lack of transparency that hid growing amounts of leverage and maturity mismatches, and growing interconnectedness with the rest of the financial sector. Together with the Money Market Funds Regulation (which is currently being reviewed by the EU Parliament and should soon enter the trialogue process), the proposed SFT Regulation[1] (SFTR) was the EU Commission's first attempt to address these risks.

What does the SFT Regulation say?

The SFTR lays down rules regarding transparency of SFTs and the reuse of financial instruments received as collateral. Broadly, it requires:

- SFT data to be reported to trade repositories;
- Detailed disclosure on SFT usage by:
    - UCITS management and investment companies (UCITS); and
    - Alternative investment fund managers (AIFMs); and
- Prior disclosure and written consent before counterparties are permitted to rehypothecate assets.

Reporting

The general obligation to report

The reporting framework created under the SFTR is largely identical to that under EMIR. "Counterparties" must report the details of each "SFT" concluded on or after the date on which the obligation to report becomes effective, a date which seems unlikely to occur before 2018 in the case of UCITS and AIFs (the "Effective Date"), as well as any modification or termination thereof, to a trade repository no later than the following working day. Broadly, all SFTs which were concluded before the Effective Date and which remain outstanding on that date and:

- have a remaining maturity in excess of 180 days; or
- have an open maturity and remain outstanding for a further 180 days

("Open Transactions") must be reported within 190 days of the Effective Date. Delegation of reporting is permissible.

In-scope entities

Reporting must be undertaken by "counterparties" to SFTs – a very wide definition which includes both "financial counterparties" and "non-financial counterparties". "Financial counterparty" encompasses:

- Investment firms;
- Credit institutions;
- Insurance and reinsurance undertakings;
- UCITS and their management companies;
- AIFs;
- Pension funds;
- CCPs and Central Securities Depositories; and
- Any third country entity which would require authorisation or registration as one of the above if it were established in the EU.

A "non-financial counterparty" is any undertaking established in the EU or a third country which is not a "Financial counterparty".

1 EU Regulation on "reporting and transparency of securities financing transactions", http://www.consilium.europa.eu/en/press/press-releases/2015/06/pdf/st10197_en15_pdf

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In-scope transactions

An "SFT" means:

- A repurchase transaction;
- Securities or commodities lending and securities or commodities borrowing;
- A buy-sell back transaction or sell-buy back transaction; or
- A margin lending transaction.

“Derivative contracts” as defined in EMIR are not considered to be SFTs. However, the definition does include transactions that are commonly referred to as liquidity swaps and collateral swaps, which do not fall under the definition of “derivative contracts” in EMIR.

Who reports (one-sided or two-sided)?

Like EMIR, reporting is two-sided. However, where a financial counterparty concludes a SFT with a non-financial counterparty which is a “medium sized undertaking” for the purposes of the Accounting Directive[2], the financial counterparty is responsible for reporting on behalf of both counterparties. A non-financial counterparty will qualify as a “medium sized undertaking” where it complies with at least two of the following criteria:

- balance sheet does not exceed EUR 20 million;
- net turnover does not exceed EUR 40 million; or
- average number of employees during the financial year does not exceed 250.

Recordkeeping

Counterparties must keep a record of any SFT concluded, modified or terminated for at least five years following the termination of the transaction.

2 Directive 2013/34/EU, Article 3(3)

Transparency

Transparency in periodical reports

UCITS[3] and AIFMs[4] must inform investors about the use they make of SFTs and total return swaps (“TRS”). The information to be provided is very detailed, but broadly focuses on five key areas:

- The amount of fund assets being employed in SFTs and TRS;
- Concentration data;
- Aggregate transaction data (currency, maturity, domicile of counterparty etc.);
- Collateral arrangements; and
- Returns and costs associated with SFT and total return swap activity.

Transparency in pre-contractual documents

Every prospectus of a UCITS and the disclosure AIFMs are required to make to investors under the AIFMD[5] must include detailed information regarding:

- The general permitted use of SFTs and TRS (together with a “clear statement that these techniques are used”);
- Parameters around the use of SFTs and TRS (such as types of assets that can be used and maximum allowable usage as a proportion of assets under management);
- Criteria for selecting counterparties;
- Acceptable collateral;
- Collateral valuation practices;
- Risks associated with SFTs and TRS;
- Safe-keeping arrangements;
- Restrictions on re-use of collateral; and

3 UCITS must include this information as part of the half-yearly and annual reports they are obliged to make under the UCITS IV Directive (Directive 2009/65/EC, Article 68)

4 AIFMs must include this information in the annual report they are required to make under the AIFMD (Directive 2011/61/EU, Article 22)

5 Directive 2011/61/EU, Article 23(1) and 23(3)

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- Revenue sharing arrangements.

Transparency of Reuse

Any right of counterparties to reuse financial instruments received as collateral are subject to at least all the following conditions:

- The provider must have been "duly informed in writing" by the receiver of the risks and consequences that may:
  - be involved in granting consent to a right of use of collateral; or
  - be involved in concluding a title transfer collateral arrangement; and
  - arise in the event of the default of the receiver;
- The provider must have:
  - granted its "prior express consent, as evidenced by its signature in writing or in a legally equivalent manner" to a security collateral arrangement; or
  - expressly agreed to provide collateral by way of a title transfer collateral arrangement.

In addition, the reuse of collateral must be in accordance with the terms of the relevant collateral arrangement and involve the transfer of the financial instruments received under the relevant collateral arrangement from the account of the provider (unless the provider is established in a third country and its account is maintained in and subject to the law of a third country whereby the reuse can also be evidenced "by other appropriate means").

Enforcement

As an EU regulation, the SFTR will be directly enforceable in all Member States. Sanctions exist for breach of the obligation to report or provide transparency in relation to reuse of collateral. However, any failure to report will not affect the validity or enforceability of an SFT or give rise to any claim of compensation from a party to a SFT. Sanctions range from 'cease and desist' orders to censure to fines of up to 10% of turnover and extend to the members of the management body of a legal person. Firms must have in place appropriate internal procedures for their employees to report any breaches.

Current status

The European Parliament's Committee on Economic and Monetary Affairs (ECON) issued a press release on 17 June 2015 announcing that an "informal deal" had been reached with the EU Council on the proposed SFTR. The EU Council subsequently approved the final compromise text of the SFTR and the EU Parliament is scheduled to consider the matter further at its plenary session on 6 October 2015. If it is passed at first reading, the text will then be passed to the EU Council for adoption. The SFTR enters into force on the 20th day following its publication in the Official Journal of the EU (OJ). It seems likely that this will occur in Q4 2015/Q1 2016. Once enacted, the SFTR requires the EU Commission and ESMA to produce a number of technical standards and guidelines, including those regarding:

- The information to be reported for different types of SFTs as well as the format and frequency of reports;
- The types of transactions that have an equivalent economic effect and pose similar risk to SFTs;
- The data to be published by trade repositories; and
- The procedures to verify the details of SFTs reported to trade repositories.

In most cases, these are to be submitted by ESMA to the EU Commission within 12 months of the entry into force of the SFTR. The implementation of reporting and transparency obligations are phased over the 21 months following publication in the OJ, meaning that we are unlikely to see meaningful implementation commence until late in 2017 at the earliest.

Final thoughts

Unfortunately, the EU has not embraced the practical benefits of one-sided reporting. As such, if EMIR is anything to go by, transaction data of sufficiently high quality to assist in the monitoring of systemic risk is likely to remain a distant prospect which imposes huge burdens on in-scope firms. In terms of transparency, the SFTR represents a challenge in managing and monitoring the interaction between structured and unstructured data.

Fortunately, parallels exist with previous initiatives, such as collateral optimisation. In effect, pre-contractual disclosure will commit UCITS and AIFMs to a definite path with respect to their usage of SFTs and TRs. They will then be expected to deploy the tools necessary to monitor and report back on subsequent compliance with these commitments as part of their periodic disclosures. This fact will require a number of firms to generate and analyse wholly new views of their data, views which extend beyond pure transactional information to include permitted counterparties, eligible collateral, concentration and overall usage limits, collateral re-use and custodial arrangements.

There are five basic data inputs which need to be effectively analysed if compliance is to be achieved - documentation, assets, collateral, investment guidelines and regulations.

An analysis of legal agreements is a logical starting point. Once granular and validated legal data is obtained, it can be mapped to asset/collateral inventories. In turn this data must be tracked against investment guidelines. The circle is closed by amending legal agreements, where necessary, to ensure that they reflect investment guidelines and other pre-contractual disclosures as well as ongoing disclosure and consent requirements.

Given that each of the basic inputs can (and probably will) change, the circle then needs to be monitored. This necessitates the creation of a flexible data architecture capable of manipulating, relating and visualising data with a view to anticipating, and not just reacting to, breaches of the SFTR. Robust internal process will also be required in order to remedy breaches. The lesson is to start early and have a clear plan. All of the technology and processes necessary to achieve compliance already exist. The SFTR is large and casts a long shadow, but it's not one that you need fear.

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Top five UK tax issues for CFOs

By Michael Beart, Director, Kinetic Partners

Many outside of the industry could be forgiven for thinking that asset managers would be in for an easy ride under the first exclusively Conservative Government since 1997. However, with the latest raft of announcements in George Osborne's Summer Budget following a plethora of changes over the past two years, this couldn't be further from the truth. CFOs earn their keep by juggling multiple issues at any one time and this article seeks to flag the top five UK tax issues to concentrate on and what action needs to be taken.

Diverted Profits Tax (DPT) - effective from 1 April 2015

Popularly known as the "Google Tax", the DPT regime is intended to counteract the diversion of profits by multinational groups using arrangements lacking economic substance to exploit tax mismatches or seek to avoid creating a UK permanent establishment. Although initially designed to target large technology and web-based businesses, the scope of DPT goes much wider, imposing an additional 25% charge on diverted profits. Protection under double tax treaties is not available, nor is reliance on OECD compliant transfer pricing policies and documentation. As a result unless 100% of group profits are taxed in the UK, DPT could be applicable.

Operating outside of the standard self-assessment regime, taxpayers potentially subject to DPT are required to make disclosures direct to HMRC within three months of the end of the accounting period. This is likely to catch out many taxpayers who will naturally only contact HMRC when they have a form to complete. Autonomy around calculating DPT liabilities rests with HMRC and DPT must be paid within 30 days of a notice being issued. Payment cannot be postponed on any grounds irrespective of any ongoing review or appeal in respect of the notice.

The original draft legislation excluded partnerships and businesses with UK customer sales less than £10m, however following the consultation period both were removed, dragging more of the industry within scope of the legislation. An SME exemption remains but this is complex and it is important to understand how this applies in a group context.

CFO Action Points: Review the final DPT legislation and apply it to the business taking particular note of operations outside the UK. Determine whether a charge could arise, quantify it and assess whether any exemptions are available. Consider whether any pre-emptive steps are appropriate. Finally, document the decision whether to make a disclosure or not, making such a disclosure where required to do so. Schedule to review the position annually.

Disguised investment management fee (DIMF) - effective from 6 April 2015

The disguised investment management fee (DIMF) legislation applies where individuals provide investment management services to a collective investment scheme (CIS) through any arrangement involving a partnership. The existence of an LP in the fund structure is sufficient to meet this requirement, although operating via a UK LLP is a more obvious trigger point. The DIMF legislation operates by recharacterising untaxed income (essentially anything not taxed as trading or employment income) arising to an individual as UK trading income subjecting it to income tax and NIC. Exclusions exist for amounts defined as carried interest and co-investments, but any other fees paid from a CIS are potentially caught.

Income recognised outside the UK is one of the targets of this legislation but it extends as far as the receipt of dividends from a UK company, meaning that even the simplest of structures could potentially be within scope. HMRC suggests that dividends will be treated as being received in the capacity of a shareholder only where the company carries on a trade of providing investment management services on a commercial basis and the individual receives arm's length remuneration. As such, asset managers will be subject to a far stricter tax regime than other industries in the UK who retain flexibility between salaries and dividends in owner managed businesses. Furthermore, caution is urged

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in attempting to restructure out of the rules as strict anti-avoidance provisions apply.

CFO Action Points: Determine whether any untaxed amounts arise to individuals performing investment management services that would fall to be untaxed. Where dividends are received, determine if that individual receives an arm's length level of remuneration. Where untaxed amounts exist that are not excluded as carried interest or co-investment then prepare for a DIMF charge.

Taxation of carried interest - effective from 8 July 2015

Admittedly more of an issue for private equity managers, the changes to the taxation of carried interest announced in the Summer Budget demonstrate the Government's determination to ensure the industry pays its fair share of tax. Brought in with immediate effect, the changes to carried interest overturned long standing practices in the industry by removing base cost shifting and bringing offshore gains within the UK tax net where duties are performed in the UK, the latter point predominantly impacting non-domiciled individuals. In addition, there was the release of a consultation into the taxation of performance linked rewards paid to asset managers. The stated objective of the consultation is to introduce statutory tests to clarify the circumstances in which performance fees may be treated as capital, and provides two possible options to determine this.

Under option 1, certain activities are to be treated as long-term investment activities and would give rise to capital gains treatment. Examples include holding a controlling equity stake in a trading company for at least three years, or real estate for at least five years. However it is option 2 that is likely to be of more interest to the alternatives industry. This is based on the average length of time for which investments are held. This proposal utilises a graduated system that could see part of a portfolio with an average holding of more than six months categorised as capital, meaning part of the performance fee will be subject to lower rate of taxation. Whichever option is adopted there are likely to be fewer winners than losers, but assurances have been made that the changes will not impact the taxation of funds or investors, and the consultation explains that neither the IME nor RFS regime should be impacted.

The consultation closes on 30 September 2015. Draft legislation is expected in December 2015, coming into force from 6 April 2016.

CFO Action Points: Those with carried interest structures should assess the impact of the changes (although this is unlikely to have gone unnoticed by those impacted). All asset managers should follow the consultation closely as certain investment strategies could be affected. Those wishing to make responses on the consultation can do so direct or may wish to liaise with their advisors or AIMA to respond.

Dividend taxation - effective 6 April 2016

The much heralded pre-election promise of a tax lock did not extend to the taxation of dividends as the Chancellor announced an overhaul of the dividend tax regime in the Summer Budget, removing the current 10% tax credit and increasing the rate for additional rate taxpayers. Although a dividend tax allowance of £5,000 per year will be introduced, it will still represent an absolute increase of at least 7.5% for individuals.

For owner managed business the changes to both the dividend tax regime and corporate tax rates will again lead to a reassessment of the most suitable structure. Tax rates alone are only part of the puzzle but a direct comparison of profit extraction routes available to individuals is set out below. Note Class 4 NIC also fell out of the fine detail of the tax lock so the LLP comparative is likely to increase in the future. See table below.

	2015-2016	2016-2017	2017-2020	2020-2021
LLP profit allocation	47.00%	47.00%	47.00%	47.00%
Salary	53.43%	53.43%	53.43%	53.43%
Dividend	44.44%	50.48%	49.86%	49.24%

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CFO Action Points: Consider the consequences on shareholders, modelling the potential financial impact. Reassess the suitability of the structure for the business model and long term plans. Consider whether declaring dividends in advance of the rate change is beneficial.

Changes to the non-domicile regime - effective 6 April 2017

Perhaps the most fundamental announcement in the Summer Budget was the removal of permanent non domicile status. An individual who has been resident in the UK for more than 15 out of the last 20 years will be considered from 6 April 2017 to be domiciled in the UK and will no longer be able to access the remittance basis of taxation, i.e. not be taxed on foreign income not remitted to the UK.

A personal issue rather than a business issue some would say, but non-domiciled individuals make up a significant proportion of the UK's investment management sector, the majority of which are owner managed businesses. It is unlikely that asset managers will move away wholesale but those already with established offices outside the UK may see staff relocating as individual long term plans change, particularly where they have significant personal wealth outside the UK.

CFO Action Points: Assess the impact for the business should senior personnel look to relocate. Consider the impact for the owners of the business, both in term of their ownership but also any co-investments where RFS may now be more relevant. Establish a clear understanding of their long term intentions and plan accordingly.

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Screening advisors for high net worth investors: A checklist provides a framework in the selection process

By David Rowen CFA, FRM, Managing Director, Phocion Investments Inc

In today's investment arena, high net worth (HNW) individuals are challenged to choose the best advisor to meet with their unique, individual circumstance. Several issues need to be kept in mind during the selection process. No matter whether the advisor is employed by a large or small firm, investors need to be armed with the right checklist to minimise mistakes. Large investment advisory firms do allocate additional resources to protect against reputational risk. However, they also tend to be more complex entities and therefore it should not be assumed that they always represent a lower risk proposition as compared to their smaller peers. This article provides a framework of items to pay attention to when deciding on an advisor.

Credentials and experience matter

One's wealth needs to be managed with utmost integrity and professionalism. To increase the odds of this, investment advisors should possess superior credentials and a vast amount of experience. The gold standard, the Chartered Financial Analyst® (CFA) credential, has become the most respected and widely recognised investment designation in the world. CFA® represents a high level of commitment to the evolving field of investments, and a strong understanding of financial theory. If the advisor does not have the credential ask him whether he intends on completing it. If the answer is "no", ask why not.

HNW investors should also consider the amount of years that the advisor has worked within the investment industry. Experience breeds wisdom, which can be invaluable. Questioning the advisor on how he dealt with two or three specific turbulent periods in the market may provide valuable insight as to whether this person would be the right match. A minimum of 10 years of experience should be sought.

Advisors need to "know your client"

Advisors are in the business of earning a living by growing their assets under management. To do so successfully requires a certain degree of skill at selling. When confronted with a prospect, advisors are wired to perform a three-step selling process that takes the form of: Meet, Propose and Close. The "Propose" stage represents an opportunity for the advisor to provide a customised proposal. For the investor, this document is very important as it provides a clear indication whether the advisor listened to his investment objectives and tolerance for taking on risk during the initial meeting. It is also an opportunity to see whether the advisor understood the client's source of wealth and backstory. The proposal is unlikely to witness the misspelling of the prospect's name, although stranger things have happened. If a proposal consists of too much boiler-plate and not enough original content, the recommendation is straightforward: run for the hills!

Another consideration is the turnaround time. For instance, if it takes twelve days to receive the proposal despite the advisor having a ten-person team working for him, this would not be a good sign. Especially if the expectation was given such that the document would be prepared within a few days.

Understanding the advisor's distinctiveness

Every advisor is distinct and making an effort to understand this is important. For instance, knowing how many clients the advisor has may provide one with an idea as to whether capacity exists to properly service new client relationships. For instance, if the advisor claims to have 200 clients all of which are serviced by himself, it is more than likely that he is dropping the ball on client servicing or in monitoring client portfolios, or both. At the very least, one should sit down one-on-one with their investment advisor once per year. Establishing the frequency of interaction early on in the relationship is imperative.

Also, understanding whether the advisor will be present himself during the service call or will have a representative is also important. Being serviced by someone else is fine so long as the client has been

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properly introduced and feels comfortable with this person. Looking forward to a meeting only to learn on the spot that someone else is representing the advisor is a strong signal for questioning whether one's wealth is being properly cared for. This type of behaviour can happen and especially by advisors that are driven by their bonus rather than by building solid, long-term business relationships.

Conflicts of interest need disclosure

When it comes to conflicts of interest, the important thing is full disclosure. Failing to do so can give the impression of impropriety even if none is present. Performing background checks and asking questions may reveal that the advisor is performing additional paid professional duties such as being on boards of directors or having a consulting business on the side. These additional functions create a concern over whether the advisor is:

- Committed to meeting their fiduciary duty
- Misappropriating client information

Through questioning, one may come to learn that the advisor has a referral agreement with an accountant or lawyer with advantageous terms. Full and transparent disclosure is required, and a candid discussion around determining the conflicts' impact on the advisor's focus needs to take place.

Products and processes

HNW investors should bear in mind that past performance has no bearing on future performance. Having said this, they should make it a point to investigate what their advisor's investment performance has been over one, five and ten years. Investors should also study the various portfolios being proposed to ensure that there do not exist the same underlying investments across investment vehicles. Investors should understand the kind of investment vehicles being used such as:

- Traditional investments: stocks, bonds and mutual funds.
- Alternative investments: hedge funds, high-yield debt, real assets and emerging markets

Understanding where the investment securities are held is also an important piece of information. For instance, if they are held in "client name" it typically means that they are placed in safekeeping at a third-party custodian. However, if held in "street name" the securities would remain in the advisor firm's custody.

In a structure where an advisor's firm selects pooled funds from external managers, the investor should comprehend the manager selection process. For instance, do managers present their portfolio with some frequency to a Steering Committee justifying their performance? Is there operational due diligence (ODD) performed on the managers to ensure that they follow best practices? Is there preference given to a certain family of products influenced by the conflict of an ownership interest? Is there some other bias such as the concentration of managers in certain geographies? If there is a selection of more than one manager are the strategies different? Investors need to ask these questions and others like them simply to ensure that manager selection is performed with integrity.

Similarly, if the advisor and his team select securities, the investor should understand the process. Understanding the advisor's investment philosophy and process is important. Who makes the final decision? Is there a security screening process in place? Does the advisor use his own tools or does he use tools provided for by his firm? Is there a top-down, bottom-up bias? Are decisions driven by fundamentals, technical analysis or perhaps both methods?

Basic questions need answers

Ensuring that the advisor actually has a handle on the proposed investment strategy is critical. One way to investigate would be for the investor to inquire how the proposed mandate performed under a period of high volatility. Knowing the projected average portfolio turnover is important. A higher percentage of turnover may infer a higher level of capital gains taxes, whereas a lower percentage may signal a high level of tax deferral. The advisor should be able to quickly provide the investor with this information during the proposal stage. If he is not able to do so it may indicate that he does that not have a concrete investment philosophy.

Investors should put the question to the advisor how long it would take to gain access to their wealth – in other words, liquidity. In the case whereby public securities would be redeemed the answer would be three business days.

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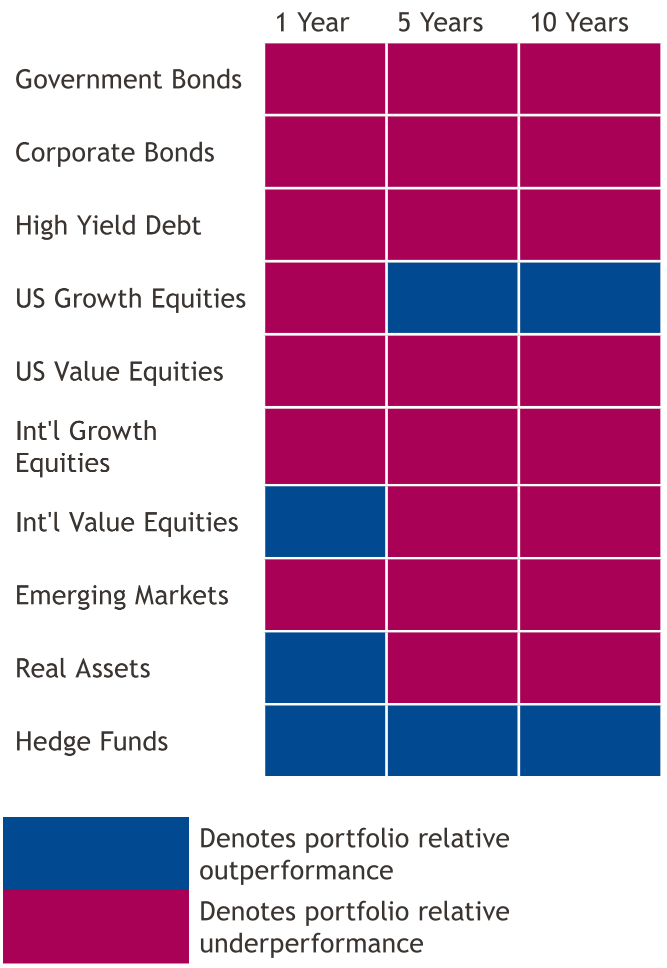
Performance

When it comes to investing, past performance does not dictate future performance. Nevertheless, looking at what the advisor has delivered in the past is indeed important because in essence it represents a live case study. Investors should study the proposed investment portfolios on a relative basis by comparing each to their appropriate benchmark on a one, five and 10-year basis. In Excel, one can create a nice visual of the relative performance of varying portfolios and their time periods. For instance, a green cell may indicate an outperforming time period and while red cell an underperforming time period. The table below provides a visual:



Stay clear of advisors that calculate and publish their own performance

When being presented with performance returns in marketing presentations, HNW investors should ask the investment advisor which person was responsible for actually calculating the returns. Should the advisor mention that he and his team calculate and publish the returns this would constitute a violation of industry best practices. The advisor and his team may reveal that the returns were vetted by their firm's compliance department. However, one should be cautioned to take too much stock in these performance numbers. For one, the lack of duty segregation creates a conflict of interest that unavoidably makes one question the integrity of the numbers. Secondly, compliance departments understand the nuances of compliance, however they lack the intricate knowledge about performance, which is a completely different discipline. More than likely, the compliance department never even looked at the formulas behind the performance computations and they certainly cannot keep on top of it daily, weekly or monthly. Advisors who calculate and publish their own performance should be eliminated from being considered in the management of wealth.

Marketing material can mislead - be ready

Just because tables, facts and figures are in print and provided by an advisor does not mean that they are absolutely without error. Mistakes can be made some of which are the result of the advisor firm's missed oversight. To increase certainty what one is presented is correct, the investor should take out a pencil and paper, or use an Excel spreadsheet. Mistakes could include:

- Asset mix summaries
- Security sector allocation

Be prepared to inspect each provided document.

Personal trading policies and procedures

HNW investors should inquire about the policies and procedures that are put place at advisor firms that ensure that personal trading activities are made transparent and do not occur ahead of client transactions. Trading ahead of clients is an activity that is known as "front-running" and is not permitted by law. At no time can an advisor or another firm place personal trade order ahead of clients'. Typically, a restricted securities list

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is created as a pre-emptive measure to front-running. As well, some firms take it many steps further and prohibit all active employee transactions all together. In these cases, employees are only allowed to invest their personal wealth by using managed accounts, mutual funds, ETFs, index products and the like.

Anti-money laundering and client information

With the influx of globalisation, investment advisor firms require increasingly stricter processes, procedures and policies in regards to anti-money laundering, suspicious transactions and relationships with politically exposed persons. HNW investors need to ask their advisors what controls are in place to protect against related malfeasance. This is important for smaller firms but equally if not more so for larger ones, particularly those with a global footprint.

Advisors also need to provide concrete ways in which client information is protected. HNW should hope to hear that the advisor firm's culture around client confidentiality has become increasingly rigorous and that all employees must pass an exam at least with annual frequency. As well, manuals and other reference sources such as intranet are also valuable aids.

Fee structure

When it comes to fees, the devil is in the detail. HNW investors need to clarify the following fee types:

- Management fees
- Mutual/pool fund management expense ratios (MERs)
- Transaction fees
- Custodian fees

In addition to understanding the above percentages, the HNW investor should comprehend the total fee dollar amount. A management fee of 1% does not sound like much. However, when applied to a $2 million pool of capital pool, this would amount to $20,000, which is significant even for an affluent investor. Again, it comes down to full transparency and to make certain that the advisor is providing it with respect to the fee structure. One can never be too careful when discussing fees.

Final words

American writer Maria Snyder once said: "Trusting is hard. Knowing who to trust, even harder". During the advisor selection process, investors need to be able freely ask all of the questions that they feel they need to. They need to meet with the advisor as many times as they see fit. They may even need to examine several anonymous client portfolios until the moment that they can begin to feel trust. Each investor is different, including with respect to the time it takes to commit to a trusting advisor relationship.

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The following corporate member firms joined AIMA during the second quarter of 2015.

Membership of AIMA is corporate. For further details, please contact Fiona Treble at ftreble@aima.org. To learn about the benefits of an AIMA membership, click here. All information supplied in the following member profiles has been provided by the member company and its accuracy is not guaranteed by AIMA.

AGCAPITA PARTNERS LP

Country: Canada
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Business activity: Hedge fund manager / adviser
Website: www.agcapita.com

AGILITY FUND MANAGEMENT SEZC LTD

Country: Cayman Islands
Contact: Tom Barbour
Telephone: +1 345 945 3722
Business activity: Hedge fund manager / adviser
Website: www.agility.fm

AKO CAPITAL LLP

Country: UK
Contact: Peter Towler
Telephone: +44 (0)20 7070 2400
Business activity: Hedge fund manager / adviser
Website: www.akocapital.com

ALBOURNE AMERICA LLC

Country: USA
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Business activity: Consultant (investment)
Website: www.albourne.com

ALBOURNE PARTNERS (CYPRUS) LTD

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Business activity: Consultant (investment)

ALBOURNE PARTNERS BERMUDA LTD

Country: Bermuda
Contact: Michael Hamer
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Business activity: Consultant (investment)

ALBOURNE PARTNERS DEUTSCHLAND AG

Country: Germany
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Business activity: Consultant (investment)
Website: http://village.albourne.com

ALBOURNE PARTNERS GENEVA LTD

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ALGONQUIN CAPITAL CORPORATION

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Business activity: Hedge fund manager / adviser
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ALLEN & OVERY LLP

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Website: www.allenovery.com

ALTQUEST PARTNERS LIMITED

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Website: www.altquest-partners.com

ATLANTIC DIRECTORS LIMITED

Country: Cayman Islands
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Telephone: +1 345 938 0517
Business activity: Consultant (other)
Website: www.atlanticdirectors.com

BLACK SWAN DEXTERITAS INC

Country: Canada
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Business activity: Hedge fund manager / adviser
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BLOOMBERG LP

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BLOOMBERG LP

Country: Canada
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Telephone: +1 416 203 5750
Business activity: It/systems/software services

BRAHMAN CAPITAL MANAGEMENT PTE LTD

Country: Singapore
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Telephone: +65 6535 8631
Business activity: Hedge fund manager / adviser
Website: www.brahman.sg

CAPRICORN CAPITAL PARTNERS UK LIMITED

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CDAM LTD

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