

# Fund Management

In 15 jurisdictions worldwide

*Contributing editors*

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GETTING THE  
DEAL THROUGH

# United Kingdom

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## Fund management

### 1 How is fund management regulated in your jurisdiction? Which authorities have primary responsibility for regulating funds, fund managers and those marketing funds?

Fund management is regulated in the UK by the Financial and Services Markets Act 2000 (FSMA), various statutory instruments made under FSMA and the Financial Conduct Authority's (FCA) rules. The FCA is responsible for regulating funds, fund managers and those marketing funds.

### 2 Is fund administration regulated in your jurisdiction?

Fund administration will usually amount to the regulated activity of 'establishing, operating or winding up a collective investment scheme', which requires authorisation from the FCA. In addition, any administrator that performs custody must be authorised by the FCA to perform this service.

### 3 What is the authorisation or licensing process for funds? What are the key requirements that apply to managers and operators of investment funds in your jurisdiction?

The authorisation or licensing process for funds is outlined in questions 19 (in the case of retail funds) and 30 (in the case of non-retail funds).

Depending on the type of activity undertaken, a manager or operator of an investment fund must be authorised by the FCA to perform any of the following regulated activities in the UK:

- managing an alternative investment fund (AIF);
- managing an undertaking for collective investment in transferable securities (UCITS) fund;
- managing investments (in the case of a manager that does not directly manage a fund, but manages a fund as a delegated investment manager appointed by the fund manager, or a manager which manages assets of a single investor (a segregated account));
- advising on investments (in the case of a manager that only gives advice without having the power to invest the assets);
- establishing, operating or winding up a collective investment scheme (in the case of an entity that operates a collective investment scheme but does not manage the scheme). Operating generally means administering the scheme (for instance, determining investor entitlements and overseeing the calculation of net asset value and fund accounts); and
- arranging deals in investments (this is required for many intermediation activities, including distribution activities such as handling investor orders and subscription amounts).

### 4 What is the territorial scope of fund regulation? Can an overseas manager perform management activities or provide services to clients in your jurisdiction without authorisation?

FSMA prohibits a legal or natural person from carrying on a regulated activity (examples of which are listed in question 3) in the UK without authorisation. A person will carry on a regulated activity if it does so by way of business (which is itself determined by the scale of the activity and whether the activity is carried on on a commercial basis). There is an exemption for 'overseas persons', which are persons who carry on a regulated activity in the UK, other than from a permanent place of business maintained by them in the UK. Various conditions must be satisfied to rely on this exemption, in particular that the person relying on the exemption has either not

solicited contact with the client, or that the person relying on the exemption has solicited contact in compliance with the UK rules on financial promotion (see question 8).

### 5 Is the acquisition of a controlling or non-controlling stake in a fund manager in your jurisdiction subject to prior authorisation by the regulator?

Any person which wants to acquire 'control' over an FCA-authorized firm must obtain the FCA's consent before making the acquisition. 'Control' for this purpose is holding 10 per cent or more of the shares or voting power in the firm (or its parent undertaking) or holding shares or voting power as a result of which the holder is able to exercise significant influence over the management of the firm. Any person that wants subsequently to hold 20 per cent, 33 per cent and 50 per cent of the shares or voting power must obtain the FCA's prior consent. These rules implement the EU Acquisitions Directive.

### 6 Are there any regulatory restrictions on the structuring of the fund manager's compensation and profit-sharing arrangements?

There are two sets of remuneration rules that apply to fund managers. These will govern the structuring of the manager's compensation and profit-sharing arrangements and implement the remuneration rules in the Banking Consolidation Directive (as amended by Capital Requirements Directive III and Capital Requirements Directive IV) and in the Alternative Investment Fund Managers Directive (AIFMD).

An investment manager that is a 'BIPRU investment firm' (broadly, a firm other than an alternative investment fund manager (AIFM) that is regulated to carry out, among other services, discretionary portfolio management) is governed by the FCA's BIPRU Remuneration Code (which implements the remuneration requirements of the EU Banking Consolidation Directive). An AIFM is governed by the FCA's AIFMD Remuneration Code (which implements the remuneration requirements of AIFMD). Any manager that is subject to the remuneration rules will apply the rules in a way appropriate to its size, internal organisation and scope and complexity of its activities (the proportionality principle). The requirements of each code are similar but not identical. In particular, rules in the BIPRU Remuneration Code that require payment of part of the remuneration in equity of the fund or the manager and rules relating to deferral (ie, delayed payment) and clawback (ie, return of remuneration following a 'bad act' by the individual) of remuneration are automatically disappplied in the case of most investment managers that are BIPRU investment firms, while the equivalent rules in the AIFMD Remuneration Code may only be disappplied on the basis of the size and risk profile of the AIFM.

UCITS V, the next iteration of the UCITS Directive, will introduce rules for UCITS managers that are very similar to the rules for AIFMs. These rules will apply from March 2016.

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## Fund marketing

### 7 Does the marketing of investment funds in your jurisdiction require authorisation?

UK investment funds will either be classified as a UCITS fund under the UCITS Directive or an AIF under the AIFMD. In broad terms, the marketing of a UCITS fund in the UK requires authorisation from the FCA, while the marketing of an AIF in the UK either requires notification to the FCA or

authorisation from the FCA, depending on whether the fund is marketed under the UK's private placement regime or under a marketing 'passport' provided by the relevant EU directive. Segregated accounts (where these are accounts structured as funds for a single investor) and joint ventures are outside the scope of AIFMD.

## 8 What marketing activities require authorisation?

Fund marketing activities in the UK are either governed by the UK financial promotion regime (see question 9) or the UK marketing regime. A financial promotion is an 'invitation or inducement to participate' in a fund and broadly covers marketing, distribution and promotional activity (whether or not the promotion was solicited by the investor). The concept of financial promotion is relevant to marketing, distribution and promotional activities for both UCITS funds and AIFs and any other investment product or service. The concept of marketing is only relevant to AIFs and was introduced on implementation of the AIFMD. Marketing is a 'direct or indirect offering or placement at the initiative of an AIFM or on behalf of an AIFM'. It is a narrower concept than financial promotion and is generally interpreted as the final offer stage of the marketing process.

## 9 What is the territorial scope of your regulation? May an overseas entity perform fund marketing activities in your jurisdiction without authorisation?

The territorial scope of the financial promotion regime covers communications made within the UK and promotions made from outside the UK to anywhere (inside or outside the UK) if they are 'capable of having an effect in the UK'. A promotion that is communicated to a person in the UK or a website accessible in the UK will be capable of having effect in the UK. There is an exemption for communications only 'directed at' persons outside the UK. It is possible to rely on this exemption by including appropriate disclaimers in marketing material and having controls in place on the making of such communications.

The territorial scope of the marketing regime covers marketing in the UK to investors domiciled or with a registered office in an EEA state. The FCA has commented that this only applies to 'marketing that takes place in the UK'. In practice, this includes communications to a person in the UK and websites accessible in the UK.

The promotion of UCITS funds is exempt from the financial promotion restriction. There are exemptions under the financial promotion regime and the marketing regime to allow financial promotion or marketing of alternative investment funds to categories of investors. The main categories of exemptions are 'professional investors' and other types of qualified investor, such as investment professionals and high-net-worth companies, trusts or associations. See question 25 for more details.

The authorisation or notifications required for financial promotion of UCITS funds and marketing of AIFs is outlined in response to questions 19 (in the case of UCITS funds) and 30 (in the case of AIFs). No authorisation or notification is required for the financial promotion of AIFs, although notification is required for the marketing of AIFs (ie, the latter stage of the offer process).

## 10 If a local entity must be involved in the fund marketing process, how is this rule satisfied in practice?

There is no requirement to involve a local entity in the fund marketing process. In practice, however, involving a locally authorised entity in the fund marketing process will facilitate marketing an AIF to various types of investors (in particular, individual investors). An FCA-authorised firm can market an AIF to, for instance, a certified high-net-worth investor, a certified sophisticated investor and a self-certified sophisticated investor. Such investors will usually be clients of the authorised firm to whom the authorised firm owes a responsibility to ensure that the investment recommended is suitable.

## Retail funds

### 11 What are the main legal vehicles used to set up a retail fund? How are they formed?

A retail fund will generally be established as an open-ended vehicle qualifying as a UCITS fund. An exchange-traded fund will typically be structured as a UCITS fund, which is listed on a stock exchange. Alternatively, a manager may wish to establish a closed-ended vehicle, typically to invest in assets (such as real estate) in which a UCITS fund is not permitted to invest. A closed-ended vehicle will typically be listed on a stock exchange,

to allow investors to realise their interests and (in some cases) to allow a retail offering of the vehicle.

### Open-ended funds

Open-ended retail funds are established in the UK either as UCITS funds or as non-UCITS retail funds (NURS). NURS are a type of non-UCITS fund that the FCA will authorise for distribution to retail investors. In either case, such a fund will be established as an open-ended investment company (OEIC), an authorised unit trust (AUT) or an authorised contractual scheme (ACS).

An OEIC is a type of company (the term 'investment company with variable capital' is synonymous with OEIC). It is formed with an instrument of incorporation, a single director (which may be a corporate director) (or directors) and shareholders. An AUT is a trust without separate corporate identity. It is established on the basis of a trust deed between the trustee and the manager. The trustee holds the assets on trust for the beneficiaries, which are known as the unitholders (as their beneficial interest is represented by 'units'). An ACS is a tax-transparent vehicle that can be established either as a co-ownership scheme or as a limited partnership. A co-ownership scheme is established on the basis of an agreement between the fund manager and depositary under which the investors hold beneficial title to the scheme's property as tenants in common.

Any of these vehicles (excluding an ACS established as a limited partnership) can be established with underlying sub-funds (an umbrella fund). The property of a sub-fund of an umbrella fund may only be used to discharge the liabilities of that sub-fund, allowing ring-fenced liability between sub-funds.

### Closed-ended funds

Closed-ended retail funds will generally take the form of companies listed on the London Stock Exchange (LSE)'s Main Market (traditionally called 'investment trusts' although they are now in corporate form). The LSE's Main Market is the most liquid market and offers the widest investor base. As the LSE's Main Market is a 'regulated market' that is governed by EU directives on listing and securities offerings, funds that are listed on the LSE's Main Market can be marketed to retail investors and will qualify for inclusion in institutional investors' mandates where such mandates limit investment to funds listed on a 'regulated market'.

Some investment companies are listed on the LSE's Alternative Investment Market (AIM) or the LSE's Specialist Fund Market. The AIM is an exchange-regulated market and is not an EU-regulated market. As such, it is generally easier and quicker to list a fund on the AIM as opposed to the LSE's Main Market (and to conduct follow-on offerings) if the offering is limited to institutional investors only, because compliance with the EU Prospectus Directive is not required. The Specialist Fund Market is designed for specialist investment funds which only target professional or institutional investors. These closed-ended retail funds can be formed under special regimes for venture capital trusts and real estate investment trusts.

Following the UK's implementation of the AIFMD, most investment trusts and other listed investment companies are now classified as AIFs (note that some real estate investment trusts are not classified as AIFs because they have a commercial, as opposed to an investment, purpose).

### 12 What are the key laws and other sets of rules that govern retail funds?

The establishment and operation of open-ended retail funds is governed by FSMA, various statutory instruments made under FSMA and the FCA's rules (in particular, the FCA's COLL rules). Closed-ended retail funds are generally not collective investment schemes in UK terms, and therefore substantially fall outside FSMA and FCA regulation. However, any closed-ended retail fund that is listed on the LSE's Main Market is governed by the FCA's Listing Rules, and any fund listed on the AIM and the Specialist Fund Market will be governed by the rules of those markets.

### 13 Must retail funds be authorised or licensed to be established or marketed in your jurisdiction?

#### Open-ended funds

Open-ended retail funds must be either authorised by the FCA (if a UK-domiciled fund) or recognised by the FCA (if established in another jurisdiction) to be marketed in the UK. In addition, establishment of an open-ended retail fund in the UK must be authorised by the FCA. Funds that are recognised by the FCA mostly comprise UCITS funds established

in other EEA jurisdictions. The authorisation process is outlined in question 19.

#### **Closed-ended funds**

Closed-ended retail funds that are listed on the LSE's Main Market or Specialist Fund Market are not authorised as funds by the FCA, although the listing itself requires approval by the FCA in its capacity as the UK listing authority. Funds listed on the AIM do not require the approval of the FCA. Any fund that lists on the AIM must appoint an independent adviser to act as a nominated adviser that will confirm compliance with the AIM rules to the LSE on the fund's behalf.

#### **14 Who can market retail funds? To whom can they be marketed?**

Open-ended retail funds that are authorised or recognised by the FCA, and closed-ended retail funds listed on the LSE's Main Market or Specialist Fund Market can be marketed to any type of person (although in practice a fund listed on the Specialist Fund Market will not make a retail offering because the LSE's guidance indicates that it will only admit funds to the Specialist Fund Market that are targeted at professional or institutional investors). A fund that is listed on the AIM is likewise in practice not usually offered to retail investors (any such retail offering would require compliance with the EU Prospectus Directive, which funds listing on the AIM generally seek to avoid). However, retail investors can and do acquire shares in funds listed on AIM.

A person that markets a retail fund must be an FCA-authorised person to the extent that: (i) that person performs a regulated activity (such as investment advice or 'arranging deals in investments') in the course of marketing the fund; and (ii) that person carries on the activity in the UK (subject to the overseas person exemption described in the response to question 4 above). A professional UK fund distributor is normally an FCA-authorised person either because it gives investment advice in the course of its distribution or because its distribution activities (such as handling investor orders and subscription amounts) comprise the regulated activity of 'arranging deals in investments'.

#### **15 Are there any special requirements that apply to managers or operators of retail funds?**

The manager of a UK UCITS fund that is established as an AUT must be independent from the trustee of the AUT and must be a body corporate established in the UK or another EEA state. The manager of a UK UCITS fund that is established as an OEIC will usually be the authorised corporate director of the OEIC and must be established in the UK or another EEA state.

The manager of a UK UCITS fund must be authorised by the FCA to perform the regulated activity of 'managing a UCITS', or may be a firm established in another EEA state operating under the UCITS management 'passport'. The manager of a NURS (see response to question 11 above) must be authorised to perform the regulated activity of 'managing an AIF'. The manager of a closed-ended retail fund must be authorised by the FCA, typically to perform the regulated activity of 'managing an AIF'. Alternatively, the fund itself can be authorised as a self-managed AIF.

#### **16 What are the investment and borrowing restrictions on retail funds?**

##### **Open-ended retail funds**

The investment and borrowing powers for UCITS funds are in the FCA's COLL Rules (which implement the UCITS Directive). A UCITS fund can invest its portfolio in the following asset classes:

- transferable securities or money market instruments traded on an EU regulated market. Transferable securities comprise shares, debt securities and other traded securities, such as depositary receipts. An EU-regulated market is an EU stock exchange that is classified as a regulated market under EU directives;
- cash and near cash (for example, bank deposits and treasury bills);
- units of other UCITS and other non-EEA collective investment schemes, subject to conditions; and
- derivatives and forward transactions.

A UCITS fund is subject to spread and concentration requirements, including:

- up to 5 per cent of the fund's assets can be invested in transferable securities or money market instruments issued by a single body.

The 5 per cent limit can be raised to 10 per cent for 40 per cent of the portfolio;

- up to 20 per cent of the fund's assets can be invested in deposits with a single body;
- exposure to a derivatives or broker counterparty cannot exceed 5 per cent except where the counterparty is an approved bank where the exposure can be up to 10 per cent;
- no more than 20 per cent of the fund's assets can be invested in transferable securities and money market instruments issued by the same group;
- no more than 20 per cent of the fund's assets can be invested in units of any one collective investment scheme; and
- no more than 35 per cent of the fund's assets can be invested in government or public securities, subject to conditions, including:
  - only 30 per cent can be invested in a single issue;
  - the securities must come from six different issuers; and
  - the names of the issuers must be set out in the prospectus.

A UCITS fund can borrow up to 10 per cent of the fund's assets on a temporary basis.

A NURS has broader investment powers. It can invest in those investments permitted for UCITS schemes. It can also hold:

- 100 per cent of its assets in real property;
- 10 per cent of its assets in transferable securities issued by a single issuer;
- 10 per cent in gold;
- 20 per cent in unlisted securities; or
- 35 per cent in other collective investment schemes (including other non-UK schemes whose investment and borrowing powers are equivalent to, or more restricted than, those of a NURS, and alternative investment funds, provided that the combined value of unapproved securities and unregulated schemes does not exceed 20 per cent of the NURS's value).

In addition, a NURS which is authorised as a 'fund of alternative investment funds' can invest in a range of AIFs. A NURS can borrow up to 10 per cent on a permanent basis. A NURS is subject to a number of concentration restrictions which are similar to but less stringent than a UCITS fund.

#### **Closed-ended retail funds**

Listed closed-ended retail funds are not subject to restrictions on investment or borrowing, although they will need to have a published investment policy covering asset allocation, risk diversification and gearing as a condition to listing. In practice, a fund will be required to draw up its own set of investment restrictions and will need shareholder approval to amend them.

A UK company which is listed on the LSE's Main Market will need to satisfy an investment condition in order to qualify for tax exemptions, namely that the business of the company consists of investing its funds in shares, land or other assets with the aim of spreading investment risk and giving members of the company the benefit of the results of the management of its funds.

#### **17 What is the tax treatment of retail funds? Are exemptions available?**

##### **Open-ended retail funds**

The UK tax regime for AUTs and OEICs has been criticised for its complexity. Subject to special rules that apply for tax-elected funds, AUTs and OEICs are generally exempt from UK tax on gains on the disposal of investments but subject to corporation tax at 20 per cent on income (although dividend income is exempt, subject to conditions, and there are deductions for amounts distributed by bond funds).

UK-resident individual investors will receive dividend distributions with a tax credit that reduces the investor's tax liability (the treatment is broadly the same as applies on the receipt of dividends from a UK company). Such distributions are generally tax exempt for UK companies.

UK-resident individual investors in bond funds will receive their distributions after withholding at 20 per cent, which is creditable against income tax. UK companies will not be subject to withholding tax but will be subject to corporation tax broadly in accordance with their accounting treatment.

UK-resident investors are subject to capital gains tax on gains realised on disposal of an interest in an AUT or an OEIC.

UK non-resident investors are generally not directly subject to UK tax (including by withholding).

Funds which are structured as ACSs are not taxable entities for UK purposes. For tax purposes, investors will be treated broadly as if they had invested directly in the underlying assets in the case of an ACS structured as a partnership.

### Closed-ended retail funds

UK investment trusts are exempt from tax on chargeable gains but are otherwise generally subject to UK corporation tax. However, the rules have recently been modernised, including the introduction of an election for investment trusts to be treated in broadly the same way as AUTs and OEICs, which are bond funds as described above.

#### 18 Must the portfolio of assets of a retail fund be held by a separate local custodian? What regulations are in place to protect the fund's assets?

Open-ended retail funds must appoint an independent entity to hold their assets. This will be a trustee (for an authorised unit trust) or a depository (for an open-ended investment company). A trustee must be independent from the manager and established in the UK (or, if established in another EEA state, have a place of business in the UK). A depository must likewise be established in the UK (or, if established in another EEA state, have a place of business in the UK). Trustees and depositaries must be authorised by the FCA to perform this activity. They will be subject to the FCA's CASS rules on custody of assets, which ensure that custodians observe professional standards of care and diligence, including when they appoint sub-custodians.

As most closed-ended retail funds are classified as AIFs, they must under the AIFMD appoint a depository, to the extent the fund is established and managed in the EEA (see question 19). Closed-ended retail funds that are not required under AIFMD to appoint a depository will in practice appoint a custodian where they hold assets (such as listed securities), which require a custodian for settlement purposes.

#### 19 What are the main governance requirements for a retail fund formed in your jurisdiction?

The registration and governance requirements for UCITS funds established as AUTs, OEICs and ACSs are largely the same. Funds established in the UK must be authorised by the FCA. Application is made to the FCA with a draft prospectus, draft instrument of incorporation (in the case of an OEIC), trust deed (in the case of an AUT) or limited partnership agreement or co-ownership deed (in the case of an ACS), application form and solicitors' certificate to confirm that the constitutional documents comply with the regulations. The FCA has two months to consider a UCITS application.

UCITS funds that are established elsewhere in the EU can be recognised for sale by the FCA under the 'passporting' process. Under this process, the manager provides a notification letter and the fund documentation to its home state regulator, which then approves the application and provides the documents to the FCA with an attestation of compliance.

Certain schemes that are considered to be comparable to UK authorised schemes can also be recognised for sale by the FCA. In practice, it is rare for funds to be recognised for sale from any jurisdiction other than Jersey, Guernsey and the Isle of Man.

As noted above, most types of closed-ended retail funds are outside FCA regulation. A listed closed-ended retail fund is subject to the governance requirements of the rules of the exchange on which it is listed. In particular, the UK Listing Rules require that a majority of the fund's board are independent from the investment manager.

#### 20 What are the periodic reporting requirements for retail funds?

For open-ended retail funds, reports and accounts must be provided to investors biannually. The following must be prepared for each annual accounting period and half-yearly:

- short reports, which are sent to all holders and include various prescribed information about the fund's investment activity and performance; and
- long reports, which are available to investors on request. Long reports must include certain prescribed information including the accounts and a report from the auditor and both the manager and trustee or depository.

Closed-ended retail funds that are listed on the LSE's Main Market, Specialist Fund Market or AIM must report twice a year to shareholders, with a long report every 12 months. A closed-ended retail fund that is listed on the LSE's Main Market also needs to obtain approval from the UK tax authority (HMRC) to obtain their exemption from capital gains tax (see question 17) and make ongoing notifications to HMRC in relation to this approval.

#### 21 Can the manager or operator place any restrictions on the issue, transfer and redemption of interests in retail funds?

Open-ended retail funds must offer issue and redemption of shares or units on each dealing day. There must be at least two dealing days in each month. Retail funds can limit the number of shares or units in issue or the number of shares or units issued for a particular month. It is also possible for retail funds that have a daily dealing day to defer redemptions of shares or units to the next valuation point, if redemption requests for a particular valuation point exceed 10 per cent, subject to certain conditions. Dealing in open-ended retail funds can be suspended in exceptional circumstances and where justified in the interests of unitholders, and must be notified to the FCA. NURS can impose limited redemption arrangements (to limit redemptions up to every six months) where the NURS is a property fund, offers some form of capital protection, or is a fund of alternative investment funds.

Listed closed-ended retail funds are traded on the exchange on which they are listed. It will usually be a condition to listing a fund and admitting the fund's interests to a settlement system that there are no restrictions on transfer, although limited restrictions (such as restrictions on transfer to US holders) can be accommodated. The fund can operate repurchases of its shares, which is a method used to reduce any discount of the trading price below underlying net asset value.

### Non-retail pooled funds

#### 22 What are the main legal vehicles used to set up a non-retail fund? How are they formed?

Non-retail funds (other than funds in the form of limited partnerships) are usually established outside the UK, because there are no UK non-retail tax exempt fund vehicles (other than unauthorised unit trusts which are only in practice offered to UK tax exempt investors).

In practice, closed-ended funds (such as private equity funds) are typically established as English or offshore limited partnerships and open-ended funds (such as hedge funds) are typically established as offshore companies or trusts. Scottish limited partnerships (which, unlike English limited partnerships, have separate legal personality) are occasionally used as fund vehicles and often used as vehicles for private equity 'carried interest' schemes. Popular offshore jurisdictions for limited partnerships are Jersey, Guernsey and the Cayman Islands. Popular offshore jurisdictions for companies are Ireland and the Cayman Islands.

Listed closed-ended vehicles that are only offered to institutional investors are typically formed in Jersey or Guernsey.

#### 23 What are the key laws and other sets of rules that govern non-retail funds?

Non-retail funds are subject to the governing law of their jurisdiction. Most offshore jurisdictions impose fairly light requirements on the establishment and operation of these vehicles.

Managers of non-retail funds are subject to UK law implementing the AIFMD. A number of requirements under the AIFMD apply indirectly to the fund (such as the requirement to appoint a depository). In addition, certain types of non-retail funds may qualify as European venture capital funds (EuVECA) and European social entrepreneurship funds (EuSEF) under the EU regulations governing those entities. The designation of a fund as a EuVECA and EuSEF fund is available to UK AIFMs. In particular, sub-threshold AIFMs (see question 24) may obtain such a designation to allow marketing of the fund to professional investors in the EU on the basis of an EU 'passport'.

It is possible to establish an AUT, OEIC or ACS as a qualified investor scheme (QIS), which is a type of scheme authorised by the FCA that can be promoted to certain types of qualified investor. In practice, few QISs have been established. As a QIS will constitute an AIF under AIFMD, it is uncertain whether a QIS will be an attractive vehicle in the future.

#### 24 **Must non-retail funds be authorised or licensed to be established or marketed in your jurisdiction?**

This depends on the status of the manager. The UK manager of a non-retail fund will be required to be authorised as an AIFM. 'Sub-threshold' AIFMs are managers whose aggregate AIF assets under management do not exceed €100 million or, where the funds are unleveraged and closed-ended, €500 million. Sub-threshold AIFMs are not subject to the AIFMD (other than a limited registration regime), but are subject to FCA rules similar to those rules that apply to discretionary investment managers that are not fund managers.

The AIFMD distinguishes between the management and marketing of:

- EU funds managed by an EU AIFM (which can only be established and marketed following FCA approval);
- non-EU funds managed by an EU AIFM (which can only be marketed following notification to the FCA); and
- EU and non-EU funds managed by a non-EU AIFM (which can only be marketed following notification to the FCA).

#### 25 **Who can market non-retail funds? To whom can they be marketed?**

Following implementation of the AIFMD, non-retail funds can only be marketed in the UK to 'professional investors' (which is an investor that is a professional client within the meaning of the EU Markets in Financial Instruments Directive, including individuals which satisfy the conditions to be treated as professional investors). In addition, the UK allows non-retail funds to be marketed to a number of other types of institutional and private investor that may not qualify as professional investors. In particular, UK-authorised firms can market non-retail funds to various classes of individual investor (such as certified high-net-worth investors), subject to conditions (see question 10).

As noted above, a person that markets a non-retail fund must be an FCA-authorised person to the extent (i) that person performs a regulated activity (such as investment advice) in the course of marketing the fund and (ii) that person carries on the activity in the UK (subject to the overseas person exemption referred to in question 4 above). UK intermediaries such as placement agents (which advise managers on marketing strategy and locate prospective investors) are normally FCA-authorised persons.

#### 26 **Do investor-protection rules restrict ownership in non-retail funds to certain classes of investor?**

There are no investor protection rules in the UK that restrict ownership in non-retail funds (including listed funds) to certain classes of investor. There are rules that limit the marketing or promotion of non-retail funds to certain classes of investor (see above), and certain types of investor (such as pension funds or charities) are subject to rules governing the types of investment they can make from a prudential or risk perspective. In addition, FCA-authorised persons must ensure that any investment recommended to a client is suitable. There are also rules that apply to firms that sell complex financial products (including non-retail funds) on an execution-only basis to retail clients (ie, without giving advice) to ensure that any product sold is 'appropriate'.

#### 27 **Are there any special requirements that apply to managers or operators of non-retail funds?**

Following the implementation of AIFMD, managers of non-retail funds are subject to special requirements. The FCA's rules (in particular, the FCA's FUND rules) contain rules on (among other things) capital, risk and liquidity management, valuation, delegation, the appointment of a depositary for the fund, regulatory reporting, investor disclosure and anti-'asset stripping' for managers of private equity funds. These rules represent international best standards of practice for managers, in particular for hedge fund managers. The manager of a non-retail fund must also have regard to the rules of the domicile in which the fund is established. For example, Ireland imposes rules on governance and reporting required for funds established in Ireland.

#### 28 **What is the tax treatment of non-retail funds? Are any exemptions available?**

Funds that are structured as partnerships are typically exempt from UK direct taxes. Broadly, investors are taxed as if they had invested directly into the underlying assets.

Funds that are structured as offshore companies are typically not subject to UK direct taxes, provided that where their activities would otherwise constitute trading for UK tax purposes, the manager qualifies for the UK's investment management exemption.

Under the offshore funds rules, UK-resident investors are generally subject to income tax on gains realised on the disposal of holdings of offshore companies, unless, very broadly, the fund either distributes or reports (and is certified by HMRC as a reporting fund) its income annually to UK investors. In this case, UK-resident investors pay capital gains tax on gains but will be subject to income tax on any income on a current basis.

#### 29 **Must the portfolio of assets of a non-retail fund be held by a separate local custodian? What regulations are in place to protect the fund's assets?**

The AIFMD requires an EU manager of an EU fund to appoint a depositary to hold the fund's assets and perform other oversight duties, such as monitoring the fund's cash accounts and net asset value calculation. The AIFMD introduced new rules to govern the circumstances in which a depositary is liable for loss of the fund's assets (in particular, for loss by a sub-custodian of the fund's assets). The depositary will be subject to the FCA's CASS rules on custody of assets, which ensure that custodians observe professional standards of care and diligence, including where they appoint sub-custodians.

An EU manager of a non-EU fund that is not marketed in the EU need not appoint a depositary. An EU manager of a non-EU fund that is marketed in the EU must appoint one or more entities to perform the depositary functions (known as 'depositary-lite'), without application of the new depositary liability regime.

#### 30 **What are the main governance requirements for a non-retail fund formed in your jurisdiction?**

The UK manager of a non-retail fund must be authorised as an AIFM. An AIFM must notify the FCA of an intention to market an EU AIF in the UK and provide details of the AIF and a copy of the fund's prospectus to the FCA. The FCA has 20 working days to grant permission to the AIFM to market the AIF.

An AIFM must notify the FCA prior to marketing a non-EU AIF. It must provide details of the AIF. It may market the non-EU AIF following the notification (although in practice the manager will wait for acknowledgement of the notification from the FCA, which takes a day or so).

A non-retail fund is not subject to rules on record-keeping and officers, although its manager is subject to such rules (see question 27). The manager of an AIF must disclose information regarding the AIF to investors on a periodic basis (see question 31).

#### 31 **What are the periodic reporting requirements for non-retail funds?**

Following implementation of the AIFMD, the manager of an AIF must:

- prepare an annual report in respect of each EU AIF it manages and each AIF it markets in the EU. The annual report contains the fund's financial statements and a disclosure of various aggregate amounts of remuneration paid to various groups of individuals at the manager;
- disclose information regarding the AIF (such as changes in liquidity or leverage) to investors on a periodic basis; and
- regularly report to the FCA on, among other things, its principal exposures, risk profile and categories of assets (Annex IV reporting).

#### **Separately managed accounts**

#### 32 **How are separately managed accounts typically structured in your jurisdiction?**

A managed account is usually structured by arranging for the client to: (i) appoint a custodian to hold the client's assets in an account; and (ii) give an investment manager discretionary investment management authority to acquire and dispose of assets in the account. Managed accounts are increasingly structured as 'funds-of-one', which are fund vehicles established for a single investor and exempt from the AIFMD.

#### 33 **What are the key legal issues to be determined when structuring a separately managed account?**

The terms for a separately managed account may be negotiated in an investment management agreement between the investor and manager.

**Update and trends**

A number of EU regulatory developments are expected that may have a significant effect on UK fund management, namely:

- the proposed EU Regulation on Money Market Funds may be finalised in 2015;
- UCITS V, the next iteration of the UCITS Directive, will introduce remuneration rules for UCITS managers, enhanced rules for UCITS depositaries and a harmonised penalty and enforcement regime. These rules will apply from March 2016;
- the AIFMD marketing 'passport' could be granted to non-EU AIFMs in 2016, allowing non-EU AIFMs to market their funds in the EU, subject to full compliance with the AIFMD;
- the proposed EU Regulation on European Long-Term Investment Funds will create a new brand of closed-ended fund available for retail and professional investors;
- the EU Regulation on Packaged Retail and Insurance-based Investment Products will introduce new disclosure requirements for all funds which are distributed to retail investors; and
- other EU initiatives such as the proposed Regulation on Securities Financing Transactions and the next iteration of the Market Abuse Directive (MAD II).

Depending on the type of investor, this is typically a considerably negotiated agreement. An investor will particularly seek to negotiate terms relating to the standard of care that it requires of the manager; any waiver or limitation of liability of the manager; any indemnification required to be granted by the client in favour of the manager; and the term and termination.

**34 Is the management or marketing of separately managed accounts regulated in your jurisdiction?**

Management of a managed account will fall under the regulated activity of 'managing investments' and will require authorisation from the FCA.

A managed account will not generally comprise either a collective investment scheme or an AIF. A fund of one will not be treated as an AIF either, subject to a condition that its constitution restricts the admission of more than one investor. Marketing of a managed account is restricted under the UK financial promotion regime. Marketing of a managed account

by a non-FCA authorised person is restricted to certain classes of investors (with some exemptions for individual investors). An FCA-authorised person can market a managed account to any investor, subject to complying with rules relating to the form and content of the communications.

**General****35 Are there proposals for further regulation of funds, fund managers or marketers of funds in your jurisdiction?**

The EU's next iteration of MiFID (MiFID II) will take effect in January 2017. MiFID II contains significant new rules on the distribution of funds which will apply to any EU entity which either manufactures or distributes funds.

The UK Treasury published a paper in March 2013 (The UK investment management strategy) which outlined various proposals to increase the competitiveness of the UK as a fund domicile. This included plans to improve the tax regime for UK-domiciled funds (which were implemented in the Finance Act 2013) and reform of the Limited Partnership Act 1907, including the possibility of allowing limited partnerships to elect for legal personality (which has not yet been implemented).

**36 Outline any specific requirements for stock-exchange listing of retail and non-retail funds.**

See questions 11–21 regarding the stock-exchange listing of funds. Most funds that are listed will be classified as AIFs following the implementation of the AIFMD, although their listed status may allow the funds to be distributed to retail investors.

**37 Is it possible to redomicile an overseas vehicle in your jurisdiction?**

It is not possible to redomicile an overseas fund into the UK. It is possible to put in place a scheme of arrangement whereby an overseas fund is liquidated and investors receive interests in a UK fund.

**38 Are there any special rules relating to the ability of foreign investors to invest in funds established or managed in your jurisdiction or domestic investors to invest in funds established or managed abroad?**

Other than the marketing restrictions referred to above, there are no special rules in this regard.

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