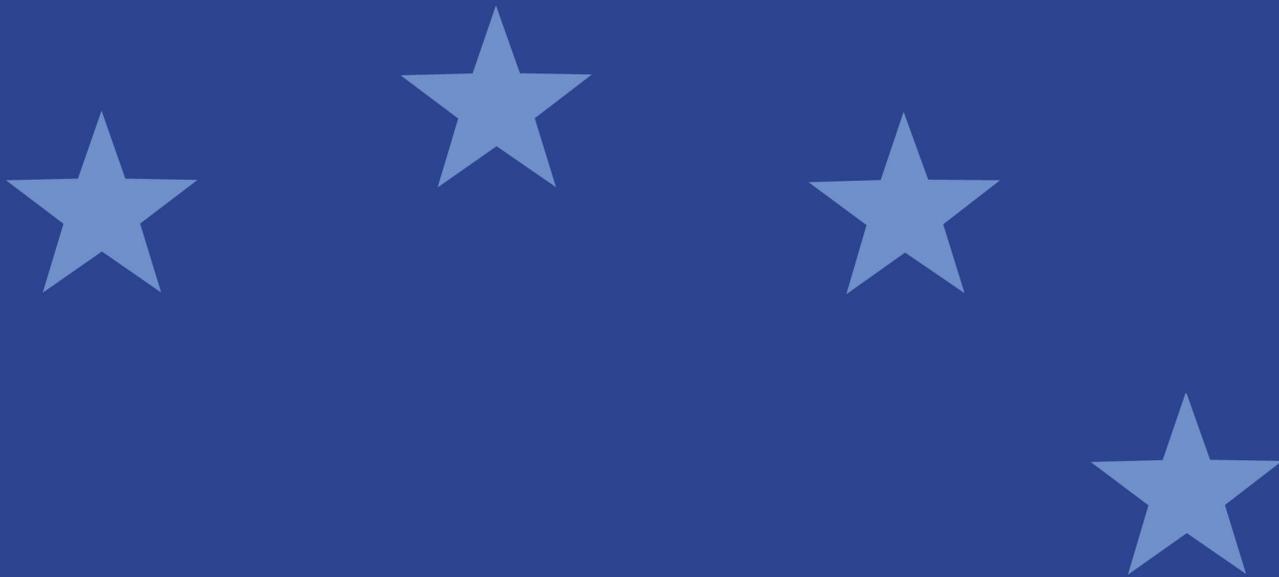




European Securities and
Markets Authority

Reply form for the Call for evidence AIFMD passport and third country AIFMs





European Securities and
Markets Authority

Date: 7 November 2014



Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Call for evidence - AIFMD passport and third country AIFMs, published on the ESMA website ([here](#)).

Instructions

Please note that, in order to facilitate the analysis of the responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, please follow the instructions described below:

- i. use this form and send your responses in Word format;
- ii. do not remove the tags of type <ESMA_QUESTION_CE_AIFM_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- iii. if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

- i. if they respond to the question stated;
- ii. contain a clear rationale, including on any related costs and benefits; and
- iii. describe any alternatives that ESMA should consider

Naming protocol:

In order to facilitate the handling of stakeholders responses please save your document using the following format:
ESMA_CE_AIFMD_NAMEOFCOMPANY_NAMEOFDOCUMENT.

E.g. if the respondent were ESMA, the name of the reply form would be
ESMA_CE_AIFMD_ESMA_REPLYFORM or ESMA_CE_AIFMD_ESMA_ANNEX1

Responses must reach us by **8 January 2015**.

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/Consultations’.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading ‘Disclaimer’.



Q1: Please describe your experience using the AIFMD passport:

Indicate your home Member State

<ESMA_QUESTION_CE_AIFMD_1a>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_1a>

Number of funds marketed in other Member States (please provide a breakdown by host Member State)

<ESMA_QUESTION_CE_AIFMD_1b>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_1b>

Number of funds managed in other Member States (please provide a breakdown by host Member State)

<ESMA_QUESTION_CE_AIFMD_1c>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_1c>

Q2: How have you found the passport application process?

Very satisfactory

Satisfactory

Problems encountered. Please explain

<ESMA_QUESTION_CE_AIFMD_2>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_2>

Q3: What is your overall experience of using the passport of the AIFMD? Please explain

<ESMA_QUESTION_CE_AIFMD_3>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_3>

Q4: What difficulties have you encountered when trying to use the passport?

<ESMA_QUESTION_CE_AIFMD_4>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_4>

Q5: Have you been deterred from using the passport and, if so, why?

<ESMA_QUESTION_CE_AIFMD_5>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_5>

Q6: Have you experienced issues of investor protection in relation to AIFs marketed or managed from another Member State, including AIFs marketed to retail investors under Article 43? If so, please provide details (e.g. number of complaints from investors, the reasons for those complaints etc).

<ESMA_QUESTION_CE_AIFMD_6>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_6>

Q7: Please describe the activity of your organisation in the EU:



Identify whether your organisation operates under Article 36 (marketing of non-EU AIFs by EU AIFMs in a Member State) or Article 42 (management and/or marketing of AIFs by non-EU AIFMs in a Member State) of the AIFMD

<ESMA_QUESTION_CE_AIFMD_7a>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_7a>

Identify the non-EU country of the AIFM and/or the AIF

<ESMA_QUESTION_CE_AIFMD_7b>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_7b>

Number of funds marketed in an EU Member State (please provide a breakdown by Member State)

<ESMA_QUESTION_CE_AIFMD_7c>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_7c>

Number of funds managed in an EU Member State (please provide a breakdown by Member State)

<ESMA_QUESTION_CE_AIFMD_7d>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_7d>

Q8: How many times has your organisation received a request for information from an EU NCA? Please indicate your average response time.

<ESMA_QUESTION_CE_AIFMD_8>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_8>

Q9: How many times has your organisation refused to provide the information requested by an EU NCA? Please explain the reasons.

<ESMA_QUESTION_CE_AIFMD_9>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_9>

Q10: How many times has an EU NCA performed an on-site visit at your organisation?

<ESMA_QUESTION_CE_AIFMD_10>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_10>

Q11: How many times has an EU NCA initiated enforcement action against your organisation?

<ESMA_QUESTION_CE_AIFMD_11>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_11>

Q12: How many times has an EU NCA imposed a sanction on your organisation?

<ESMA_QUESTION_CE_AIFMD_12>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_12>

Q13: Are there any specific limitations in the legal framework in your country that impede or limit your organisation from collaborating with an EU NCA? If yes, please specify.

<ESMA_QUESTION_CE_AIFMD_13>



TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_13>

Q14: Has your organisation experienced issues of investor protection in relation to AIFs marketed or managed in an EU Member State? If so, please describe (e.g. number of complaints from investors, the reasons for those complaints etc).

<ESMA_QUESTION_CE_AIFMD_14>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_14>

Q15: What have been the benefits of the National Private Placement Regimes (NPPR) to you?

<ESMA_QUESTION_CE_AIFMD_15>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_15>

Q16: What have been the obstacles or barriers to entry of the NPPR to you?

<ESMA_QUESTION_CE_AIFMD_16>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_16>

Q17: What obstacles did you encounter when trying to register through the NPPR?

<ESMA_QUESTION_CE_AIFMD_17>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_17>

Q18: What have been the costs?

<ESMA_QUESTION_CE_AIFMD_18>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_18>

Q19: Have you exited countries since the entry into force of the AIFMD NPPR and, if so, why?

<ESMA_QUESTION_CE_AIFMD_19>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_19>

Q20: Have you been deterred from undertaking private placement and, if so, why?

<ESMA_QUESTION_CE_AIFMD_20>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_20>

Q21: What is the possible impact on competition of an eventual extension of the passport to non-EU AIFMs?

<ESMA_QUESTION_CE_AIFMD_21>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_21>

Q22: What are the risks of an eventual extension of the passport to non-EU AIFMs in relation to market disruptions and investor protection?

<ESMA_QUESTION_CE_AIFMD_22>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_22>



Q23: Is there any particular non-EU country where, as a consequence of the regulatory environment (financial regulation, supervision, tax and anti-money laundering provisions), an eventual extension of the passport would put EU AIFMs and UCITS management companies at a disadvantage vis-a-vis the AIFMs from that country? Please specify and explain.

<ESMA_QUESTION_CE_AIFMD_23>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_23>

Q24: Is there any particular non-EU country that imposes heavier requirements for EU AIFMs or UCITS management companies in comparison to those that non-EU AIFMs have to comply with in order to do business in the EU? Please specify and explain.

<ESMA_QUESTION_CE_AIFMD_24>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_24>

Q25: Have you experienced difficulties or limitations in establishing or marketing AIFs or UCITS in any non-EU country? Please specify the non-EU country and the specific difficulties or limitations that you have encountered.

<ESMA_QUESTION_CE_AIFMD_25>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_25>

Q26: Do you have evidence showing that existing difficulties or limitations in non-EU countries have deterred fund managers in your jurisdiction from deciding to establish or market AIFs or UCITS they manage in the non-EU country? Please specify the non-EU country and explain the difficulties or limitations.

<ESMA_QUESTION_CE_AIFMD_26>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_AIFMD_26>

Q27: Could you please identify the non-EU countries that, in your opinion, grant market access to EU AIFMs and UCITS management companies under broadly equivalent conditions?

<ESMA_QUESTION_CE_AIFMD_27>

ICI Global¹ believes that the United States grants EU AIFMs and UCITS management companies access to the US market under conditions that are broadly equivalent to those granted by the EU.

Accessing EU Investors: U.S. domiciled asset managers can obtain access to fund investors in the EU under the UCITS Directive (the regulatory framework for funds that are authorized and appropriate for sale to retail investors) and the AIFMD (the regulatory framework for managers of all funds other than UCITS that are marketed in the EU). To access investors under the UCITS Directive, a non-EU management company must establish (or domicile) a UCITS fund in the EU and

¹ The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US\$19.2 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.



also locate the management company of the fund in the EU. Non-EU funds cannot be qualified as UCITS. To market an EU or non-EU fund other than a UCITS to EU investors a non-EU asset manager must rely on the framework of the AIFMD, which is focused on professional investors. Currently, the marketing of non-EU funds must comply with certain provisions of the AIFMD and such funds may be marketed only as permitted under the individual Member State private placement rules. Member States can permit distribution of AIF to retail investors and can impose additional rules on such funds.

Accessing U.S. Investors: Similar to a U.S. manager wishing to access the EU retail market, an EU management company that wishes to access the retail market in the U.S. is practically required to register a fund under the Investment Company Act of 1940. Such a fund must be domiciled in the U.S., and the investment manager must be registered under the Investment Advisers Act of 1940. There is no requirement that the investment manager be domiciled or have a geographic presence in the U.S. To sell shares of a fund domiciled outside the U.S., a manager may sell such shares privately by relying on exemptions from certain U.S. laws, such as exemptions for limited offerings to institutional investors. Exemptions from registration as an investment adviser under the Investment Advisers Act of 1940 may also be available.

The Investment Company Institute² in 2013 released a white paper on *Market Access for Regulated Fund Managers in the United States and the European Union* which discusses these issues in much more detail. ESMA may find the Paper useful as it considers its advice to the European Commission. The text of the Paper is provided below, and is also available at <http://www.ici.org/pdf/27643.pdf>.

MARKET ACCESS FOR REGULATED FUND MANAGERS IN THE UNITED STATES AND THE EUROPEAN UNION

**Investment Company Institute
October 2013**

Trends towards globalization have prompted money management firms that traditionally served investors in a single country to explore asset management opportunities in other world markets. U.S.

² The Investment Company Institute (ICI) is the world's leading association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's US fund members manage total assets of US\$17.7 trillion and serve more than 90 million US shareholders. Non-US fund members manage total assets of US\$1.5 trillion.

firms are interested in selling regulated funds in Europe and elsewhere, and European firms are interested in entering the U.S. market as well as other markets to sell regulated funds, too.³ Both the U.S. and European markets have been attractive because they potentially offer large, continent-wide markets of retail investors, the type of investors for whom regulated funds are particularly appropriate. In this paper, the term “regulated fund” refers to (1) an investment company registered under the Investment Company Act of 1940 (RIC), in the case of a U.S. domiciled fund, and (2) UCITS or “undertakings for collective investment in transferrable securities,” that are established and authorized in a Member State of the European Union (EU), in the case of an EU fund.⁴

Regulated funds are essential to helping people save and invest to meet their most important goals and the substantial advantages that these funds provide to investors are consistent across international borders. They include professional management, diversification, and reasonable cost, as well as the benefit of substantive government regulation and oversight. This paper compares market access for foreign firms offering regulated funds in the United States with market access for U.S. firms offering regulated funds in the European Union.

Foreign domiciled management companies are readily able to enter the U.S. retail market through the establishment of a RIC. The U.S. regulatory approach to foreign managers marketing a RIC⁵ is consistent with World Trade Organization (WTO) principles of non-discrimination and national treatment: a foreign domiciled management company may organize and register a RIC on the same basis as a U.S. domiciled management company. In advising a RIC, a foreign manager also receives unconditional national treatment: it is on equal footing with a U.S. management company in registering as an investment adviser with the Securities and Exchange Commission (SEC).

A fundamental goal of U.S. regulation of RICs and asset management is the protection of investors.⁶ Requirements for foreign domiciled managers that wish to market shares of a RIC are not any more stringent than the requirements for domestic managers. Moreover, sensitive to the concerns of foreign management companies seeking access to the U.S. market and recognizing the desire of U.S. investors for investment advice regarding foreign markets, Congress and the SEC have made efforts to

³ Generally, we refer to regulated funds (or mutual funds) as those types of funds that are regulated to make them eligible for sale to the retail public, even if a particular fund may elect to limit its offering to institutional investors. Such funds have substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, investment restrictions (*e.g.*, leverage, types of investments or “eligible assets,” concentration limits and/or diversification standards).

⁴ The use of the term “Europe,” “European,” or “EU” in this paper refers to the European Union (EU) or as relevant the European Economic Area (EEA).

⁵ For ease of reference in this paper, we refer to all types of U.S. registered investment companies – including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts – as “RICs,” unless the context requires otherwise. See the 2013 Investment Company Fact Book, Appendix A, for a description of U.S. registered investment companies and their operation, available at <http://www.icifactbook.org/>.

⁶ Section 1(b) of the Investment Company Act of 1940 provides that “It is hereby declared that the policy and purposes of this title...are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in [section 1] which adversely affect the national public interest and the interest of investors.”



accommodate foreign management companies entering the United States. In some instances, as described below, the SEC has placed foreign managers in a more favorable position than domestic managers.

Part I of this paper describes the establishment and marketing of RICs and foreign domiciled funds, including UCITS, in the United States by foreign money managers. Part II of the paper describes the requirements for U.S. money managers to establish and market UCITS and RICs in Europe. The paper focuses on the distribution of regulated funds, like RICs and UCITS, in the United States and Europe and shows that it is no more difficult for European or other foreign domiciled money managers to access the U.S. market to sell RICs than it is for U.S. or other non-EU managers to offer UCITS funds in Europe.

I. MARKETING REGULATED FUNDS IN THE UNITED STATES

To obtain access to the entire U.S. retail market, a foreign domiciled investment management firm usually will organize RICs. Alternatively, a foreign manager lawfully may sell foreign domiciled funds in the United States in a more limited manner, generally through private offerings to certain investors.

A. Offering of U.S. Funds

1. Registration under the Investment Company Act

The most practical method for a foreign investment management firm to publicly market and sell investment company shares in the United States is to organize a fund in the United States and register the fund under the Investment Company Act of 1940 (1940 Act).⁷ The 1940 Act imposes the same regulatory standards on all funds, regardless of whether they are managed by a domestic or foreign manager.

The 1940 Act imposes substantive requirements and prohibits certain activities for the protection of investors. In particular, the 1940 Act requires safeguarding of fund assets, imposes substantial restrictions on transactions with affiliates, and limits leveraging. In addition, the 1940 Act imposes a number of corporate governance provisions and disclosure requirements on registered funds.⁸

Although the investor protection requirements of the 1940 Act are strict, there are several areas that are not subject to detailed regulation in the United States in contrast to many other countries. The

⁷ Form N-1A, the registration form for open-end investment companies, is an integrated form that allows registration of the fund under the 1940 Act and the shares under the Securities Act of 1933, allowing the fund to be registered and eligible for public sale. In addition, certain aspects of RIC operations and distribution are regulated under the Securities Exchange Act of 1934.

⁸ See the 2013 Investment Company Fact Book, Appendix A, for a description of the core principles underlying the regulation of RICs, available at <http://www.icifactbook.org/>.

1940 Act does not impose high capital, residency, or U.S. place of business requirements, and the absence of requirements in these areas contributes to the ease of access foreign firms have to the United States. The initial seed capital for a new fund that is required under the 1940 Act is only \$100,000, and the 1940 Act does not require RICs to have directors or managers who are residents or citizens of the United States. A RIC also can be administered outside of the United States.

As a result, it is easy for a foreign firm to establish RICs in the United States.⁹ For example, a foreign manager can organize a RIC in the United States and structure it to replicate an existing foreign fund, referred to as a “mirror fund.” The portfolio of the mirror fund can be identical to the portfolio of a foreign investment company (provided it is consistent with the requirements of the 1940 Act), and the fund can be managed and administered outside the United States. Moreover, the SEC’s flexibility in permitting performance information in prospectuses also helps foreign managers compete effectively in the United States against U.S. fund managers. In marketing a mirror fund, which does not have a U.S. track record, a foreign manager may be able to include in the prospectus of its RIC the performance of its foreign fund that is managed with substantially similar investment objectives, policies, and strategies.¹⁰

2. Registration under the Investment Advisers Act

A foreign or domestic management company that acts as an investment adviser to a RIC is required to register under the Investment Advisers Act of 1940 (Advisers Act).¹¹ A management company must file a Form ADV with the SEC and comply with certain recordkeeping and regulatory requirements.¹² Under court interpretations of the Advisers Act, an adviser owes a fiduciary duty

⁹ The United States achieved a true continent-wide market for RICs as a result of changes in the law enacted in 1996, which made it considerably easier for foreign firms to access the U.S. market. Prior to 1996, RICs were not only subject to regulation at the federal level but also by individual states, which imposed their own substantive requirements and marketing rules. With the passage of the National Securities Markets Improvement Act of 1996 (NSMIA), however, once registered with the SEC, RICs do not have to comply with state regulations except that states can require the filing of any documents filed with the SEC for notice purposes, along with a consent to service of process, and to charge fees in connection with the filings.

¹⁰ The SEC staff has taken the position that a RIC may include in its prospectus, and in its advertisements or supplemental sales literature, performance information of other registered funds or private accounts that are managed by the RIC’s adviser with investment objectives, policies, and strategies substantially similar to those used in managing the RIC, provided that such information is not presented in a misleading manner and does not obscure or impede understanding of required information in the prospectus or is presented as a substitute for the RIC’s own performance information in advertisements. GE Funds (pub. avail. Feb. 7, 1997); ITT Hartford Mutual Funds (pub. avail. Feb. 7, 1997); Nicholas-Applegate Mutual Funds (pub. avail. Feb. 7, 1997); Nicholas-Applegate Mutual Funds (pub. avail. Aug. 6, 1996). *See also* Salomon Brothers Asset Management Inc. and Salomon Brothers Asset Management Asia Pacific Limited (pub. avail. July 23, 1999) n. 2 (certain records could support use of non-U.S. fund’s performance unless differences between the unregistered fund and the registered fund, such as different valuation methods, make use of the information misleading). Under positions taken by the Financial Industry Regulatory Authority (FINRA), which are effectively applicable to most RICs, related fund performance cannot be used in advertising or sales literature.

¹¹ NSMIA also divided regulatory responsibilities for investment advisers between the SEC and the states. For investment advisers that are registered with the SEC, state law is pre-empted except for the anti-fraud provisions.

¹² Form ADV consists of two main parts. Part 1 is primarily designed to be used by regulators for administrative purposes. Part 2, which consists of two parts and is provided to clients, includes key information about the adviser, including the types of advisory services provided, the advisory fees charged, the adviser’s affiliations with other securities professionals and financial institutions, types of clients, disciplinary information, as well as a supplementary brochure for those supervised persons that provide advisory services to a particular client.



toward its clients.¹³ The Advisers Act does not impose any capital or U.S. place of business requirements, nor does it require the management company be a U.S. company. Foreign management companies may establish wholly-owned affiliates in the United States or provide services from overseas.

Prior to the early 1990's, foreign investment advisers that registered under the Advisers Act were subject to all of the provisions of the Advisers Act with respect to both their U.S. and non-U.S. clients. In some instances, registration with the SEC acted to prohibit foreign advisers from engaging in business practices that were legal and customary in their home countries. For example, historically, one of the most difficult provisions of the Advisers Act for foreign advisers was the prohibition against performance-based advisory fees.

Since the early-1990's, however, amendments to the Advisers Act and evolving SEC positions have permitted foreign advisers significantly greater flexibility in complying with the provisions of the Advisers Act without disrupting their non-U.S. activities. First, the performance fee prohibition of the Advisers Act does not apply to the foreign adviser's non-U.S. clients.¹⁴ Therefore, a foreign manager registered with the SEC may charge its non-U.S. clients performance-based fees.¹⁵

Second, the SEC revised its approach to regulating the relationship of registered foreign advisers with their clients residing outside the United States. Prior to this time, a foreign adviser only could avoid subjecting all of its operations to the Advisers Act by forming a separate subsidiary to provide advice to U.S. clients. The SEC required that the subsidiary be capitalized adequately and have personnel who were dedicated to rendering investment advice to the subsidiary's clients (and not engaged in the advisory business of the parent). If the subsidiary did not meet these conditions, the SEC required registration of the parent as well as the subsidiary. Foreign advisers found operating under these conditions difficult.

Beginning in 1992, the SEC staff adopted a "conduct and effects" approach whereby the substantive provisions of the Advisers Act generally do not govern the relationship between a foreign adviser and its foreign clients even if the adviser is registered with the SEC.¹⁶ Under the conduct and effects approach, a foreign adviser may create and register a subsidiary in the United States without registering the foreign adviser parent if the affiliated companies are separately organized and the

¹³ See *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.* 375 U.S. 180, 84 S. Ct. 275, 11 L. Ed. 2d 237 (1963).

¹⁴ Section 205(b)(5) of the Advisers Act.

¹⁵ Investment advisers also are permitted to charge performance fees to sophisticated U.S. clients under certain conditions. See Rule 205-3 of the Investment Advisers Act.

¹⁶ *Murray Johnstone Holdings Limited* (pub. avail. Oct. 7, 1994); *Mercury Asset Management plc* (pub. avail. Apr. 16, 1993); *Uniao de Bancos de Brasileiros S.A.* (pub. avail. July 28, 1992). This position was reaffirmed in the 2011 release adopting rules implementing new exemptions from the registration requirements of the Advisers Act that were enacted as part of the Dodd-Frank Act. See Release No. IA-3222 (June 22, 2011) at 127.

registered entity is staffed with personnel (whether physically located in the United States or abroad) who are capable of providing investment advice.¹⁷ The SEC requires, however, that all persons who provide advice to U.S. clients or have access to information concerning which securities are recommended to U.S. clients prior to effective dissemination of the recommendation be deemed “associated persons” of the registered adviser.¹⁸ This requirement places responsibility on the registered adviser to assure these persons do not violate U.S. securities laws with respect to these activities. The SEC staff has also indicated that if a foreign entity’s national laws prohibit it from meeting the conditions of the SEC staff’s no-action letters, it may accept alternative representations or commitments.¹⁹

Although the SEC asserts no jurisdiction over the activities of a foreign adviser registered in the U.S. with respect to its foreign clients, the SEC would be concerned if the adviser’s activities abroad adversely affected its U.S. clients. Specifically, the SEC is concerned that it remain in a position to assure that a foreign adviser does not engage in practices that would operate as a fraud on its U.S. clients by, for example, systematically treating its U.S. clients less favorably than its foreign clients in allocating securities. Accordingly, a foreign adviser, on request, must provide the SEC with access to foreign personnel with respect to all its activities to enable the SEC to monitor and enforce a registered foreign adviser’s performance of its obligations to its U.S. clients and to ensure the integrity of U.S. markets. The foreign adviser also must provide on request access to trading and other records of each affiliate involved in or having access to U.S. advisory activities and to its personnel (including the trading records of such personnel) to enable the SEC to monitor and police conduct that may harm U.S. clients or markets.

3. Registration as a Commodity Pool Operator

As of 2012, operators of RICs that engage in more than a *de minimis* amount of commodity-related trading activities now are required to register with the Commodity Futures Trading Commission (CFTC) as commodity pool operators (CPOs). For RIC CPOs, the CFTC’s regulations largely permit substituted compliance based upon the RIC’s compliance with applicable SEC regulations. In order to take advantage of this substituted compliance regime, the RIC CPO must file a notice of its use of the substituted compliance regime with the National Futures Association, the self-regulatory organization for the futures industry, and satisfy several other conditions. The RIC CPO,

¹⁷ Royal Bank of Canada (pub. avail. June 3, 1998); Murray Johnstone Holdings Limited (pub. avail. Oct. 7, 1994); Mercury Asset Management plc (pub. avail. Apr. 16, 1993). The SEC has also reaffirmed that it would not recommend enforcement action, subject to certain conditions, against an unregistered non-U.S. adviser that is affiliated with a U.S. registered adviser despite sharing personnel and resources. See Release No. IA-3222 (June 22, 2011) at 125-128.

¹⁸ See Sections 202(a)(17) and 204A of the Advisers Act. A registered investment adviser may be subject to sanctions by the SEC for failing reasonably to supervise the activities of its associated persons who are subject to its supervision and for failing to implement procedures designed to prevent its associated persons from violating certain federal securities laws. See, e.g., Section 203(e)(6) of the Advisers Act.

¹⁹ ABN AMRO Bank, N.V., et al. (pub. avail. July 1, 1997).



however, remains fully subject to new systemic reporting obligations applicable to all CPOs under CFTC regulations.

4. Current Market Share of Foreign Managers in the U.S. Regulated Fund Market

Under this regulatory framework, foreign management companies²⁰ manage a significant proportion of total RIC assets, the dollar amount of which has more than doubled since 2000. As of June 2013, \$2,153.17 billion of the total value of U.S. open-end investment company assets, which represents 15.8% of open-end assets, were managed by foreign-owned investment advisers or their affiliates. These figures compare with approximately \$897.69 billion, or 12.6%, as of June 2000. For closed-end RIC assets, approximately \$63.5 billion, which represents 23.2% of closed-end RIC assets, are managed by foreign-owned investment advisers as of June 2013. These figures compare with approximately \$22.48 billion, or 16.19%, as of June 2000.

More specifically, European-owned managers represent the largest segment of foreign-owned managers of RICs. As of June 2013, \$1,616.17 billion of the total value of U.S. open-end RIC assets, which represents 11.9% of open-end RIC assets, were managed by European-owned investment advisers or their affiliates. In comparison, as of June 2000, European-owned management companies managed \$716.78 billion, or 10.06%, of open-end RIC assets. For closed-end RICs, European-owned investment advisers or their affiliates managed \$49.3 billion, or 18% of closed-end RIC assets, as of June 2013, compared to \$16.46 billion, or 11.85%, in June 2000. These statistics indicate that foreign-owned management companies, and especially European-owned companies, are readily accessing the U.S. regulated fund market.²¹

B. Offering of Non-U.S. Funds by Foreign Managers

A foreign management company that does not want to establish funds in the U.S. but, rather, wants to market its existing foreign funds in the U.S. has two options. First, under Section 7(d) of the 1940 Act, an investment company organized in a foreign jurisdiction may offer publicly its securities if the SEC finds by order that “it is both legally and practically feasible to effectively enforce” the provisions of the 1940 Act against the fund. Section 7(d) represents a prudential standard to ensure that U.S. investors receive the same essential investor protections whether they acquire shares in a

²⁰ The term “foreign management company” or “foreign investment adviser” refers to an investment adviser that has a non-U.S. parent company. These figures do not include RIC assets that are sub-advised by investment managers with a non-U.S. parent company because we do not track this information.

²¹ Similarly, U.S. domiciled asset managers are readily accessing the UCITS market. For example, U.S. headquartered members of ICI manage more than \$1.7 trillion in UCITS. Further, according to data published by Lipper, five of the top 12 top-selling fund groups in Europe are sponsored by firms with U.S. based parent companies, as of December 2012.

foreign fund or a U.S.-domiciled fund.²² Admittedly, because the requirements of Section 7(d) impose practical constraints on the ability of foreign investment funds to sell their shares publicly in the U.S. because of differences in business and regulatory environments in the U.S. and the country from which a fund originates, only a few foreign funds have chosen this approach.²³

Second, a foreign management company may sell its foreign fund shares privately without registering the fund or receiving approval to sell the fund from the SEC under Section 7(d) of the 1940 Act. To sell shares of a foreign fund into the United States on a private basis, a foreign manager is required to: (i) claim an exception for the fund itself under the 1940 Act, (ii) claim an exemption for the shares of the fund under the Securities Act of 1933 (Securities Act),²⁴ (iii) register or claim an exemption for itself and the fund under the Commodity Exchange Act (CEA), and (iv) otherwise qualify the fund under state blue sky laws.²⁵ A foreign manager of a fund sold privately in the United States also may need to register as an investment adviser if it does not qualify for an exemption from registration under the Advisers Act.

1. Exclusion from the Investment Company Act

Under U.S. law, a foreign manager may be able to take advantage of two exceptions in the 1940 Act. By offering its shares privately in the United States in reliance on these exceptions, a foreign fund does not have to register with the SEC. Section 3(c)(1) provides an exception for privately sold funds with no more than 100 beneficial owners,²⁶ and Section 3(c)(7) provides an exception for privately sold funds sold exclusively to “qualified purchasers.”²⁷ The SEC staff has taken the position that a foreign

²² For a detailed explanation of the history of, and rationale for, Section 7(d), and why, as a prudential standard, Section 7(d) should not be regarded as a trade issue, *see* ICI, “Section 7(d) of the Investment Company Act of 1940 and National Treatment,” January 16, 1996, available at http://www.ici.org/pdf/96_7d_national_paper.pdf.

²³ Fifteen foreign fund companies have received permission to register and publicly offer their shares for sale in the United States under Section 7(d) of the 1940 Act; of those 15, we understand that only two companies continue to operate and sell shares in the United States.

²⁴ In addition, certain activities related to the fund may be subject to regulation under the Securities Exchange Act of 1934 unless otherwise subject to an exemption.

²⁵ A foreign fund that is offered on a private basis in the U.S. generally must make a notice filing and pay a fee in each state in which an investor in the fund resides.

²⁶ Section 3(c)(1) of the 1940 Act provides an exception (for almost all purposes) from the definition of investment company for any fund that is not conducting, and does not propose to conduct presently, a public offering of its securities and that does not have more than 100 beneficial owners. The SEC staff takes the position that, for purposes of Section 3(c)(1), an offering is non-public if it complies with Section 4(2) of, or Rule 506 under, the Securities Act, which requires that sales only be made to “accredited investors” and up to 35 non-accredited investors. *See* Rule 501(a) of the Securities Act.

²⁷ Section 3(c)(7) of the 1940 Act provides an exception (for almost all purposes) from the definition of investment company for any fund the securities of which are owned exclusively by persons who, at the time of acquisition, are qualified purchasers and that is not conducting, and does not at that time propose to conduct, a public offering of its securities. The term “qualified purchaser” is defined in Section 2(a)(51) of the 1940 Act and includes (1) individuals and certain family-owned companies that have not less than \$5 million in investments, (2) certain trusts if both the trustee or other person with investment discretion and all settlor or other contributors are qualified purchasers, (3) other persons that own and invest on



fund may make a private U.S. offering under these exceptions concurrently with an offshore public offering (*i.e.*, a UCITS could be sold publicly in European Union and privately in the United States).²⁸ Moreover, as interpreted by the SEC staff, a foreign fund remains eligible for an exception so long as it has 100 or fewer U.S. persons as beneficial owners or has U.S. investors who are qualified purchasers, regardless of the number or sophistication of its non-U.S. investors.²⁹

In addition, the SEC staff has issued interpretations that provide additional flexibility for foreign funds. For example, the SEC staff has permitted foreign funds to exceed the 100 U.S. beneficial owner limit or to have U.S. investors who are not qualified purchasers if this is a result of independent actions of the fund's securityholders (*e.g.*, as a result of the relocation of foreign securityholders of the fund to the U.S. or because of offshore secondary market transactions not involving the foreign fund or its agents, affiliates, or intermediaries).³⁰

2. Considerations under the Securities Act

Foreign managers of funds sold privately will want to avoid registration of the shares themselves, which can generally be accomplished by selling shares only to “accredited investors”³¹ and not engaging in a public sale of the shares. Under a recent change to Rule 506 under Regulation D, however, a fund is now able to engage in general solicitation or general advertising without registering the shares under the Securities Act, provided the other requirements of the Rule are satisfied.

3. CFTC Considerations

Foreign managers wishing to offer foreign funds to U.S. persons also must consider potential regulation under the CEA. In general, an entity that acts for U.S. customers, including investors in a

a discretionary basis not less than \$25 million in investments, and (4) most “qualified institutional buyers” as defined in Rule 144A under the Securities Act (generally institutions with at least \$100 million of investment securities.).

²⁸ Goodwin, Proctor & Hoar (pub. avail. Feb. 28, 1997); Touche Remnant & Co. (pub. avail. Aug. 27, 1984).

²⁹ Goodwin, Proctor & Hoar (pub. avail. Feb. 28, 1997). Similar to a U.S. fund relying on Section 3(c)(7), a foreign fund may become subject to registration and reporting requirements under the Securities Exchange Act of 1934. Private foreign funds may exclude from the numerical limit or qualification requirements certain “knowledgeable employees” under Rule 3c-5 of the 1940 Act.

³⁰ Investment Funds Institute of Canada (pub. avail. Mar. 4, 1996); Goodwin, Proctor & Hoar (pub. avail. Feb. 28, 1997).

³¹ The term accredited investor is defined in Rule 501 of Regulation D as: a bank, insurance company, registered investment company, business development company, or small business investment company; an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of \$5 million; a charitable organization, corporation, or partnership with assets exceeding \$5 million; a director, executive officer, or general partner of the company selling the securities; a business in which all the equity owners are accredited investors; a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds \$1 million at the time of the purchase, excluding the value of the primary residence of such person; a natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year; or a trust with assets in excess of \$5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes.



fund that the entity operates or advises, is required to register in an appropriate capacity with the CFTC if the entity engages in more than a *de minimis* amount of commodity-trading activities unless it is otherwise exempt. Commodity pool operators and commodity trading advisors are subject to certain registration and reporting obligations.

4. Exemption from the Investment Advisers Act

A foreign manager of a fund sold privately in the U.S. may avoid registration as an investment adviser if it qualifies for an exemption under the recently revised Advisers Act registration provisions. Although the long-established “private adviser exemption” was eliminated by the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2011,³² foreign managers now may be able to take advantage of one of two new exemptions under the Advisers Act, the “foreign private adviser exemption” or the “private fund adviser exemption.” To rely on the foreign private adviser exemption an investment adviser must: (i) have no place of business in the United States, (ii) have, in total, fewer than 15 U.S. clients and U.S. investors in private funds advised by the investment adviser, (iii) have aggregate assets under management attributable to U.S. persons of less than \$25 million and (iv) neither (a) hold itself out generally to the public in the United States as an investment adviser nor (b) advise RICs or business development companies.³³

Alternatively, a foreign manager that is unable to rely on the foreign private adviser exemption may be able to rely on the private fund adviser exemption, which is available to advisers that solely manage qualifying private funds with assets under management in the United States of less than \$150 million.³⁴ Non-U.S. advisers are required to count only private fund assets that are managed from a “place of business” within the United States toward the \$150 million threshold, and may qualify for this exemption regardless of the size or nature of the adviser’s activities outside of the United States, provided that all of its clients that are U.S. persons are qualifying private funds.³⁵ Although exempt

³² Until recently, a foreign management company (as well as a U.S. company) was permitted to advise clients without registering with the SEC if the adviser had fewer than 15 clients and neither held itself out to the public as an adviser nor advised a registered investment company. For purposes of determining its total number of clients, the adviser was able to count as one client a legal entity (such as a corporation) that received investment advice based on the investment objectives of the entity (rather than the individual investment objectives of its shareholders, partners, beneficiaries, or members).

³³ Section 202(a)(30) of the Advisers Act. For purposes of this exemption, a person that is “in the United States” may be treated as not being “in the United States” if such person was not “in the United States” at the time of becoming a client or, in the case of an investor in a private fund, at the time the investor acquires the securities issued by the fund. *See* Investment Advisers Act Rel. No. 3222 (July 6, 2011). The term “private fund” means an issuer that would be an investment company, as defined in Section 3 of the 1940 Act, but for Section 3(c)(1) and 3(c)(7) of the 1940 Act. Section 202(a)(29).

³⁴ A “*qualifying private fund*” means any private fund that is not registered under Section 8 of the 1940 Act and has not elected to be treated as a business development company. For purposes of this exemption, an investment adviser may treat as a private fund an issuer that qualifies for an exclusion from the definition of an investment company, as defined in Section 3 of the 1940 Act, in addition to those provided by Section 3(c)(1) or 3(c)(7) of the 1940 Act, provided that the investment adviser treats the issuer as a private fund under the Act and the rules thereunder for all purposes. *See* Rule 203(m)-1 under the Advisers Act.

³⁵ *See* Rule 203(m)-1 under the Advisers Act.



from registration under the Advisers Act, private fund advisers nevertheless must report certain information to the SEC.

C. Tax Considerations

For both U.S. and European managers, tax considerations will greatly affect the attractiveness of a fund domiciled in one country for investors in other countries. The tax ramifications of a cross-border investment in a fund can be quite complex. It requires an evaluation of the tax laws in an investor's country of tax residence, in the country or countries where the fund invests (*e.g.*, the impact of withholding taxes and tax treaties), and in the country where the fund is domiciled. Any special tax status or position of the investor also will impact the investor's evaluation of a fund.

1. RICs Domiciled in the United States

For U.S. federal income tax purposes RICs are considered corporations. As such, they are taxed just like operating companies organized in corporate form, unless they qualify for the tax treatment provided by Subchapter M of the U.S. Internal Revenue Code. Subchapter M is designed to provide RIC investors with tax treatment that is "comparable" to that received by direct investors in securities (*i.e.*, there is not "double" taxation at both the fund and shareholder levels). A RIC cannot qualify for Subchapter M treatment unless it meets several tests, including those regarding (i) registration with the SEC under the 1940 Act, (ii) the sources of its income, (iii) the diversification of its assets, and (iv) the distribution of its income. Virtually all RICs comply with Subchapter M.

One notable requirement involves RIC distributions. Under Subchapter M, a RIC must distribute to shareholders each taxable year at least 90 percent of its income (other than net capital gains). Importantly, the remaining 10 percent of ordinary income, and all capital gain, may be retained. All retained income, however, is taxed at regular corporate tax rates.

Because a RIC that incurs corporate tax provides a lower return than one that does not incur such tax, RICs generally attempt to distribute all of their income. In addition, because RICs are taxable under an excise tax unless they distribute essentially all of their income in the calendar year in which it is earned,³⁶ RICs typically distribute their income currently.

As a result, subject to certain conditions, a RIC's distributed net income and long-term capital gains generally flow through to shareholders without the fund also incurring federal taxes on the amounts distributed. The effect is that income is directly taxable to shareholders. As such, RICs are

³⁶ Specifically, U.S. tax law imposes an excise tax on any RIC that does not distribute essentially all of its income during the calendar year in which it is earned. A tax of four percent is imposed on the amount, if any, by which the RIC's required distribution exceeds the amount actually distributed. The excise tax, in effect, acts as an interest charge on undistributed amounts.



generally referred to as “distributing funds.” This contrasts with the tax structure of many funds outside the United States, which are more typically structured as “accumulating” or “roll-up” funds as described below.

2. Regulated Funds Domiciled Outside the United States

Many foreign domiciled funds, including UCITS, have a roll-up tax feature whereby their income and capital gains are not distributed currently, and instead accumulate in the share value or price of the fund. Foreign regulated funds with this feature provide non-U.S. investors with two very significant tax advantages over investments in comparable U.S. domiciled RICs: (i) tax deferral, as income and gains are not recognized or taxed until an investor’s shares are sold; and (ii) the conversion of dividend and interest (“ordinary”) income into capital gains, which are often taxed preferentially at a lower rate.

The Internal Revenue Code, however, prevents U.S. investors from achieving the tax advantages offered by the roll-up feature when investing in foreign funds. The passive foreign investment company (PFIC) rules, which effectively tax PFIC gains currently at ordinary income rates, generally apply to holdings by U.S. investors of non-U.S. funds. The PFIC rules seek to ensure that U.S. investors in foreign domiciled funds do not have a tax advantage over RICs when sold to U.S. residents. Specifically, the value of a U.S. investor’s PFIC shares generally is: (i) marked to market (at the investor’s election) each year; or (ii) subject to an interest charge designed to eliminate any tax deferral benefit. Mark-to-market appreciation and all distributions are taxable at ordinary income rates. Gain from the sale of PFIC shares also is taxable at ordinary income rates. An alternative taxation regime for PFICs that elect treatment as “qualified electing funds” (QEFs) provides some opportunity for capital gain treatment; the QEF regime typically is not available to investors, however, as it requires the fund to calculate its income under U.S. tax principles. The PFIC rules impose such significant tax costs that U.S. taxpayers typically do not invest in non-U.S. funds.

II. MARKETING REGULATED FUNDS IN THE EUROPEAN UNION

This section reviews how a U.S. domiciled asset management firm can obtain access to fund investors in the European Union under the UCITS Directive and the Alternative Investment Fund Managers Directive (AIFMD). The UCITS Directive is generally viewed as a regulatory framework for funds that are authorized and appropriate for sale to retail investors and, as such, is viewed as having similar purposes to those of the 1940 Act, *i.e.*, providing a substantive regulatory regime for funds widely marketed and appropriate for retail investors.³⁷ Similar to a foreign manager wishing to access the U.S.

³⁷ UCITS, or “undertakings for collective investment in transferrable securities,” are collective investment schemes established and authorized under a harmonized EU legal framework, currently EU Directive 2009/65/EC, as amended (UCITS IV), under which a UCITS established and authorized in one Member State can be sold cross border into other Member States without a requirement for an additional full registration.

retail market, a U.S. management company that wishes to access the retail market in the EU practically would be required to establish an EU “mutual fund” in the form of a UCITS. Those U.S. managers wishing to offer RICs or privately place to institutional investors may do so under the recently-enacted AIFMD.

The AIFMD provides the regulatory framework for managers of essentially all funds other than UCITS (AIF) that are marketed in the European Union.³⁸ While aimed at the managers of AIFs, the AIFMD includes many requirements that impact AIFs themselves (*e.g.*, disclosure, reporting, depositary, valuation, risk management). Although focused on marketing to professional investors³⁹ in the European Union, the AIFMD permits Member States to allow marketing of AIF to retail investors subject to any additional requirements a Member State chooses to impose. There is no genuine U.S. “alternative fund” corollary to the AIFMD in relation to the detailed disclosure and operational requirements that are imposed on both AIF managers and AIFs themselves.

To access investors under the UCITS Directive, a U.S. management firm must establish (or domicile) a UCITS fund in the EU. Alternatively, for marketing funds other than UCITS to EU investors, whether the fund is domiciled in the EU or outside the EU (so-called third country funds), a firm must rely on the framework of the AIFMD.⁴⁰ Currently, managers of third country funds must comply with certain provisions of the AIFMD and can market such funds only as permitted under individual Member State rules. Further, under both the UCITS Directive and the AIFMD, only managers based in the European Union currently have the ability to establish an investment fund in one Member State that can be “passport” or distributed throughout the European Union rather than on a Member State by Member State basis. In the future under the AIFMD, managers of third country funds may have access to a “passport” that will permit them to market third country funds to professional investors on a cross-border basis in the European Union.

A. Offering of Funds Domiciled in the European Union

The two primary EU laws relating to funds are the UCITS Directive and the AIFMD.⁴¹ While the UCITS Directive only applies to funds domiciled in the European Union, the AIFMD has provisions for both EU-authorized funds and third country (or non-EU) funds.

³⁸ EU Directive 2011/61/EU.

³⁹ Under the AIFMD, a “professional investor” is any investor that is considered as, or may be treated as, a “professional client” under MiFID. The term generally includes regulated financial institutions such as banks, insurance companies, investment firms (broker-dealers), collective investment schemes and their management companies.

⁴⁰ The AIFMD was enacted in 2011 and is effective as of July 2013.

⁴¹ Other laws also may impact the operation and management of funds in the European Union, whether a UCITS or an AIF, such as rules for funds designated as a European Social Entrepreneurship Fund (EuSEF) or European Venture Capital Fund (EuVECA) (available from <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32013R0346:EN:NOT> and <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32013R0345:EN:NOT>). A Money Market Fund Regulation is also

1. UCITS Directive

The UCITS Directive was enacted in 1985 and has been amended several times since its passage. A central feature of importance for fund managers is that the UCITS Directive provides the framework for cross-border sales of retail funds in the European Union. The UCITS Directive allows a fund that qualifies under the Directive to be sold throughout the European Union subject to regulation by its home Member State regulator (*i.e.*, Member State in which it is domiciled). To distribute cross border, a UCITS must file a notification in each Member State in which it wishes to distribute the UCITS (a “host” Member State) and comply with any host Member State marketing rules. Importantly, the UCITS label has grown to establish itself as a global fund brand with the distribution and sale of UCITS to both retail and professional investors in many jurisdictions outside the European Union, including in both Asia and Latin America.⁴²

The UCITS Directive, as previously described, is limited by its terms to investment funds established in one of the Member States of the European Union. Therefore, to benefit from the UCITS Directive, a U.S. domiciled asset management firm must establish a fund in the European Union and also locate the management company of the fund in the European Union. The investment fund and the management company, however, do not have to be located in the same Member State⁴³ and certain functions or activities can be delegated, subject to requirements, to other entities, including entities outside the European Union.⁴⁴ The depositary functions of UCITS funds generally must be carried out in the Member State in which the fund is established.⁴⁵

Despite the geographic presence requirement for the UCITS and its management company, the delegation provisions of the Directive, to date, have enabled UCITS to access portfolio management

being actively pursued (available at http://ec.europa.eu/internal_market/investment/docs/money-market-funds/130904_mmfs-regulation_en.pdf).

⁴² The roll-up tax structure has also supported the global distribution of UCITS as most countries do not have a tax regime similar to the U.S. PFIC regime.

⁴³ The ability of the management company of a UCITS to be established in a different Member State than the fund, the “management company passport,” was introduced in 2009.

⁴⁴ For example, Article 13 sets forth the general requirements for the delegation of portfolio management which include conditions such as notification to authorities, delegating only to entities authorized to provide asset management services and subject to supervision, and for third-country firms, cooperation agreements among the concerned authorities. Article 13(2) of the UCITS Directive also requires that a management company not delegate to such an extent that it becomes a “letter-box entity.”

⁴⁵ The administration of a UCITS fund is one function of the fund’s “depository,” which also performs a custodian role. We note that there has been discussion of revising the requirement for this function to be carried out in the fund’s home Member State. *See e.g.*, European Commission, Consultation Document – UCITS, Product Rules, Liquidity Management, Money Market Funds, Long-Term Investments (July 26, 2012) (discussion of depository passport) (UCITS VI Consultation) available at http://ec.europa.eu/internal_market/consultations/docs/2012/ucits/ucits_consultation_en.pdf.

expertise outside the European Union. This has been important for managers seeking to offer UCITS with investment strategies that do not solely focus on European investments such as funds that primarily seek to invest globally or in specific regions like Asia or the United States.

While the European Union has made efforts to further develop and facilitate a single market for UCITS through the UCITS passport, the marketing of funds in the European Union under the UCITS Directive remains more challenging than the “national” marketing of RICs across the United States. The reason for this is two-fold.

First, given the presence of Member State regulators in cross-border distribution, there are still situations where different Member State regulators administer the provisions for registering a UCITS for sale differently. While the process has improved, for example, by new rules specifying the time period for registration through so called “notifications” among Member State regulators, this cross-border process still adds friction to the passporting of UCITS.⁴⁶ Second, the UCITS Directive does not have a single standard for marketing under the passport, so a UCITS must still comply with the marketing requirements of each host Member State in which it markets its shares. This can often also result in varied requirements, although there are efforts to address these challenges too.⁴⁷ In contrast, it is much easier to sell and market RICs across the entire United States.

2. Regulation of the Management Company of UCITS

All UCITS are required to designate a “management company” to perform, or ensure the performance of, certain functions related to the management and administration of the UCITS. The management company of a UCITS is required to seek authorization by the regulators of the Member State in which it is established.⁴⁸ The regulation of the management company is however dependent to a considerable extent on the “form of organization” of the UCITS (*e.g.*, contract law, trust law, or other law). The appointment of the depositary to the UCITS also must be authorized by the relevant

⁴⁶ For example, the European Commission proposed in the UCITS VI Consultation that electronic notifications be introduced more broadly and the process for notifying new share classes be improved. *See* UCITS VI Consultation. There are still, however, many costs associated with cross-border distribution, such as retaining a local paying agent in each jurisdiction in which the UCITS intends to market, costs for translation of written materials, and the submission of marketing material to Member State regulators.

⁴⁷ For example, changes introduced in 2009 require host Member States to review compliance with the marketing requirements in the host Member State after the start of marketing. This has helped alleviate delays in the initial marketing of a UCITS cross-border but increased the risk of later disciplinary action in the event that marketing material is deemed non-compliant with host Member State rules. *See* Recital 64 of UCITS IV.

⁴⁸ In cases where a UCITS is deemed to be “externally managed” (*i.e.* a separate management company has been designated), both the fund and the management company are required to seek separate authorisation of the regulator in the Member State(s) in which they are established unless the management company already has a valid authorisation (*e.g.* for another UCITS for which it has been designated a management company). Most funds constituted under trust law are deemed to be self-managed (also known as internally managed) and as such the management company and the fund are subject to a single authorisation in the Member State under whose trust law the fund is established.

Member State regulator as must the instruments of incorporation (in the case of investment companies) or the fund rules (in other cases).

The UCITS Directive imposes a number of organizational, conduct and governance requirements on the management company including ensuring it maintains sufficient financial resources to conduct its business. The financial resources that the management company must maintain are based on the size of the UCITS subject to a minimum which also takes account of the fixed overhead costs of the company.⁴⁹

3. Alternative Investment Fund Managers Directive

The AIFMD generally applies to managers of funds in the European Union or funds marketed in the European Union that are not subject to the UCITS Directive (with limited exceptions). The AIFMD was enacted in 2011 and Member States were required to implement the Directive in their respective jurisdictions by July 22, 2013.⁵⁰

The Directive was intended to regulate managers of “alternative” funds sold to professional investors (*e.g.*, hedge funds and private equity funds). Its broad scope, however, captures funds with a variety of investment objectives and strategies and includes funds that had previously been authorized by Member States for domestic sale to retail investors, as well as RICs.

The AIFMD by its terms regulates the managers of AIFs yet includes significant and substantial provisions impacting the operation of these funds. Following the style of the UCITS Directive, the AIFMD permits an EU management company of an EU AIF to qualify for an EU “passport” to market the EU AIF cross-border in the European Union solely to professional investors. The possibility of marketing AIF to retail investors is subject to the discretion of Member States which may impose additional requirements.⁵¹ Germany, for example, imposes additional requirements if an AIF is to be distributed to retail investors.⁵² There is, therefore, no EU-wide passporting right for marketing AIF to

⁴⁹ Additional revisions to the UCITS Directive are under consideration. Referred to as “UCITS V,” these revisions include three components: a strengthening of the role, appointment and liability for the loss of assets (*e.g.* through fraud) of fund depositaries; the introduction of rules governing the compensation/remuneration of the staff of management companies; and a regime for sanctions for non-compliance. See European Commission, Consultation Document – UCITS, Depositary Functions, Remuneration Policies and Sanctions (July 3, 2012) (UCITS V), available at http://ec.europa.eu/internal_market/investment/docs/ucits-directive/20120703-proposal_en.pdf.

⁵⁰ Despite this deadline, many Member States have provided for transitional arrangements until July 22, 2014. Not all Member States, however, have yet adopted their implementing laws.

⁵¹ Member States may not impose stricter or additional rules for the marketing of AIFs cross-border to retail investors in their territory than they impose for AIFs that are marketed domestically. See Recital 71 of the AIFMD.

⁵² These requirements including the following: (i) the AIFM and the AIF must meet all requirements of the AIFMD, (ii) all documents must be translated into German, (iii) the AIF and AIFM must have their respective registered office in the same country, (iv) the competent authorities of the AIF and AIFM must be cooperative in a way that is satisfactory to the German

retail investors. Like RICs in the United States with respect to retail investors, UCITS remain the only vehicle by which passporting funds to retail fund investors is available.

The AIFMD imposes on AIF managers a range of organizational, conduct, governance and disclosure based requirements related to the management and operation of AIFs. Like the UCITS Directive, the AIF must have a depositary to perform certain functions including custody, cash management and administration. In some circumstances other parties external to the management company, such as pricing services, or valuers, may perform functions. The AIFMD, similar to the UCITS Directive, permits management companies to delegate certain activities to other entities including entities based outside the EU. Such delegation arrangements are subject to conditions such as a “letter box entity” standard, under which sufficient substance must be performed by the AIFM.⁵³

B. Offering of Third Country (Non-EU) Funds

As discussed above, the UCITS Directive is limited to funds established in the European Union that meet the substantive requirements of that Directive. It does not provide any means by which third country funds, wherever managed, can be authorized under the UCITS Directive. As such, third country funds cannot benefit from any passporting rights granted by the UCITS Directive to market their shares to retail investors across the European Union.

The AIFMD, however, does include within its scope those third country funds that are either managed from within the European Union and/or marketed to EU investors. The Directive provides, for the first time, minimum EU-wide requirements on the marketing of third country funds to professional investors in EU Member States. Currently, third country AIF may be marketed only under individual Member State private placement regimes and must comply with some provisions of the AIFMD, *e.g.*, disclosure and reporting. Unfortunately, the private placement regimes differ significantly from one Member State to another, including some Member State regimes that effectively prohibit the marketing of third country funds to professional investors in their territory.

While the AIFM Directive seeks to introduce minimum harmonized standards for EU domiciled AIF, the framework for third country AIF is both new and complex. There remain considerable differences among Member States on marketing and private placement of AIF for third country funds and managers to learn. The need to navigate the various Member State rules for the

regulator, (v) appropriate cooperation agreements must be in place between the German regulator and the third country supervisory authority, and (vi) an agreement must be in place between the third country and Germany in accordance with Article 21 of the OECD Model Convention to avoid double taxation of income and assets of the non-EU AIF.

⁵³ The so-called “letter box entity” test is specified in greater detail under the AIFMD than the UCITS Directive (see Recital 83 and Article 20 (3) of Directive 2011/61/EU and Recital 91 and 93 and Article 82 of Commission Delegated Regulation EU (No) 231/2013 available from <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF> and <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:083:0001:0095:EN:PDF>).

marketing of third country funds to professional investors stands in contrast to the U.S. private placement regime, which does not distinguish between U.S. domiciled funds and their managers and non-U.S. funds and their managers, and does not necessitate significant navigation through the laws of individual States.

We note that the AIFMD does contemplate that third country AIF access to the European Union may improve. Under the AIFMD, it is possible that in the future better and additional marketing rights may be granted to third country funds and managers. Specifically, the Directive provides that, subject to several substantive requirements, the management company of a third country fund could be granted a passport to market the fund to EU professional investors beginning in 2015. Such a passport would be similar to that available to EU AIF for marketing to professional investors. If such a passport were to become available, the AIFMD contemplates the abolition of national private placement regimes after 2018.

C. EU Investors – Taxation of European Funds and RICs

As described above, European domiciled funds such as UCITS are typically “roll-up” funds where investors do not incur taxes on fund income until their shares are sold. RICs, in sharp contrast to the roll-up structure, are distributing funds where investors incur current taxes on the fund’s distributions.

European investors, if confronted with the option of investing in either a RIC or a UCITS (assuming other features are the same) typically choose to invest in the UCITS to obtain the more favorable tax treatment. As described above, RICs elect to qualify under Subchapter M of the Internal Revenue Code to ensure that there is not taxation at both the fund and the investor level. The Internal Revenue Code does not permit a “roll-up” structure and there also are other tax disadvantages to RICs for EU investors.

As a consequence RICs are simply not attractive investments for European investors when compared with European domiciled funds such as UCITS. Generally, the disadvantages for EU investors are: (i) U.S. taxation of non-U.S. source income;⁵⁴ (ii) current distribution (and therefore current taxation) of income and gains;⁵⁵ and (iii) resident country taxation at “regular” rates of capital

⁵⁴ EU investors in a RIC would be taxed in the United States when the RIC invests outside the United States. Because a RIC’s distributions are treated as U.S.-source dividends, they are subject to U.S. withholding tax (at 30 percent or a lower treaty rate). Any EU investor investing in the same non-U.S. securities directly or through an EU fund would not incur any U.S. tax. Thus, the income may be taxed in three countries (the source country, the United States, and the residence country) when the investment is made through a RIC, whereas the income would be taxed only twice (or perhaps once) if the investment is made directly or through an EU fund. While an EU investor may be able to claim a foreign tax credit for the U.S. withholding tax, such a credit in all likelihood would not be available for the tax withheld by the source country on the payment to the RIC.

⁵⁵ EU investors in RICs in all likelihood will be taxed currently in their country of residence on the RIC’s annual distributions. Residence country taxation occurs irrespective of whether that country otherwise permits deferral of tax through funds that do not distribute their income.



gain distributions where capital gains would receive favorable treatment in the investor's residence country.⁵⁶

A temporary legislative change effective for 2005 through 2013 made certain RICs more attractive to non-U.S. investors than they were previously; funds focused on investments in debt issued in the U.S. in particular benefit from these provisions. Specifically, distributions from RICs that relate to U.S.-source interest and short-term gain can be treated as such items of income by non-U.S. investors. Non-U.S. investors are thus now able to take advantage of the exclusions from U.S. withholding tax for "portfolio interest" and capital gains paid to non-U.S. persons. This allows non-U.S. investors in RICs to receive tax treatment comparable to that received by non-U.S. investors that invest in the U.S. directly or through a non-U.S. collective investment vehicle. Only long-term gains previously were exempt from U.S. withholding tax when paid by a RIC to a non-U.S. investor. Importantly, this legislation did not apply to non-U.S.-source interest income received by a RIC and distributed to its shareholders. All such income is treated as dividend income subject to U.S. withholding tax.

One last relevant feature of U.S. tax law involves information reporting of amounts paid to non-U.S. investors. U.S. payors (including brokers, banks, and funds) must report such payments to investors and to the IRS. This tax information is available to resident-country governments under exchange of information provisions in U.S. tax treaties.

II. CONCLUSION

For funds intended to be marketed and sold to retail investors, the 1940 Act permits non-U.S. fund management companies to establish funds in the United States on the same basis as U.S. management firms. The UCITS Directive framework takes a similar approach and requires funds to be established in the EU to reach the broad retail market in the European Union.

For managers of regulated funds, there is no requirement that an investment adviser to a U.S. fund registered under the 1940 Act be physically located in the United States; however, a UCITS management company must be established in the European Union. Nevertheless, the delegation provisions of the UCITS Directive (to date) have enabled U.S. management companies to provide portfolio management services to UCITS.

The United States has a well-established "national" private placement regime for accessing professional fund investors. In the European Union, the AIFMD now encompasses the marketing and sale of AIF to EU professional investors. Under the AIFMD, however, third country AIF and managers, unlike EU domiciled AIFs and their managers, must comply with certain provisions of the AIFMD and the requirements of individual Member States for the private placement of AIFs to

⁵⁶ We understand that under EU tax laws, a RIC's capital gain dividends would generally be treated as "regular" dividends; the preferential "capital gains" nature of the distribution is not retained for EU tax purposes. Thus, a RIC's distributions of capital gains typically would not qualify for any tax preference provided in a residence country for capital gains.



professional investors on their territory. EU domiciled managers and AIF must comply with the entire AIFMD and have access to an EU passport for cross-border marketing to EU professional investors.

In considering the current fund regulatory regime in the European Union, the most effective way for a U.S. manager of regulated funds to obtain access to the European market as a whole is to establish funds in the EU under the UCITS Directive. Establishing a fund in the European Union under the AIFMD is also an alternative if the manager wishes to only sell to professional investors. Under both Directives, the “passport” for EU domiciled funds is an important feature that allows a fund to be more efficiently and readily sold on a cross-border basis throughout the European Union.⁵⁷

Similarly, the most effective way for EU fund managers to distribute and sell to U.S. retail investors is to establish U.S.-domiciled funds under the 1940 Act. Registration under the 1940 Act allows a fund to be sold in all 50 states, subject to minimal state filings (*e.g.*, notice filings). For accessing U.S. professional fund investors, EU and other non-U.S. fund managers are most likely to simply use the U.S. private placement regime. Such managers may be subject to the Advisers Act and the CEA but there is no requirement for a geographic presence in the United States so the manager and the fund can both be domiciled outside the United States.

<ESMA_QUESTION_CE_AIFMD_27>

Q28: What are the conditions that EU AIFMs and UCITS management companies have to comply with in order to manage or market AIFs or UCITS in your jurisdiction? Please specify.

<ESMA_QUESTION_CE_AIFMD_28>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_28>

Q29: In what way is your current regime (regulatory, tax etc.) different from the EU framework? Please explain.

<ESMA_QUESTION_CE_AIFMD_29>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_CE_AIFMD_29>

⁵⁷ Other details in the UCITS Directive and the AIFMD may also impact why a manager would opt to utilize one Directive or the other (*e.g.*, certain investment strategies may not be permitted under the UCITS Directive).