INTERNATIONAL ASSET MANAGEMENT AND INVESTMENT FUNDS REVIEW 2023 / 24

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Content

Introduction

2022's choppy markets offer hedge funds a chance to excel

AIMA

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BIO

Tom Kehoe joined AIMA as research manager in October 2008 and heads up all research and communications globally for the association. In this role, Tom is responsible for creating and executing the association's strategies to develop and maintain strong external stakeholder relationships. In doing so, he constructs the association's narrative through original research and thought leadership as well as design, implement and promote the association's communications and brand. In this capacity, he has authored more than 50 research and thought leadership pieces, which have been mentioned widely across the trade and business press as well as commented on radio and television.

He has been involved with hedge funds for 15 years. Prior to joining AIMA, Tom spent four years working in hedge fund research and due diligence with BNP Paribas in New York and Dublin.

Tom holds a Masters in Finance from the National College of Ireland, a graduate certificate in Investment Management from Dublin City University and is a Chartered Alternative Investment Analyst member (CAIA).

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2022 was unique, until 2023 began

In my foreword for this journal at the beginning of 2022, I argued that the choppy market conditions predicted for the year ahead presented hedge funds with an opportunity to excel. I noted rumblings of political unrest in Europe and speculated on the potential number of rate hikes; four said the Fed at the time with interest rates at 0.25%. At the start of 2023, nearly a year into the war in Ukraine and seven Fed rate hikes later the macroeconomic outlook is as fraught as ever.

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> A closer examination of published performance data indicates that the top decile of funds was up by around 40%

Despite this environment, 2022 was a good year for hedge funds when average performance is set against the backdrop of double-digit downturns being experienced across public markets in bonds and equities.

HFR's Asset Weighted Composite Index[1] advanced +0.44% in December, bringing its YTD performance to +1%. Meanwhile, major indexes recorded their worst year since 2008, with the S&P 500 down 20% and the Nasdaq dropping 33% as of year-end. Fixed-income markets had an equally torrid time, meaning 2022 was also a dire year for the 60/40 portfolio.

This data serves to underscore the utility of alternative investments as a protector of wealth and provider of uncorrelated returns for allocators, a point not lost on institutional investors that are re-evaluating their portfolios as the spectre of a global recession looms large.

A closer examination of published performance data indicates that the top decile of funds was up by around 40%, including many of the most well-known CTA/managed futures and global macro funds that performed admirably for much of the year. It is therefore unsurprising that AIMA's Q4 2022 Hedge Fund Confidence Index found that this same group of large multi-strategy and global macro funds managers are among the most confident in their economic prospects for the coming 12 months.[2] These managers are nimbly navigating the volatile, fast-changing market conditions and delivering for their investors in a way passive funds simply cannot match during such times.

The major drivers of volatility last year will no doubt be familiar to readers. For the alternative investment industry specifically, 2022 presented a host of additional challenges. From a regulatory perspective, 2022 was a year like no other, and I anticipate 2023 could match it. Many of the proposed changes – from the US SEC in particular – have the potential to fundamentally transform the alternatives industry, whether it be managers' relationships with their investors or their trading and investing strategies and activities.

The US regulator is proposing major changes to the Private Funds Advisor rule, Form PF, and short selling reporting frameworks, among many others, all which AIMA is addressing through proactive dialogue with regulators and senior policymakers to ensure our members' concerns are heard as many of the proposals in their current form would bring severe consequences for market stability.

1 https://www.hfr.com/hfri-500-indices-index-descriptions#:~:text=The%20HFRI%20500%20Fund%20Weighted,Macro%20or%20Relative%20Value%20strategies.
2 https://www.aima.org/educate/aima-research/aima-hedge-fund-confidence-index-2022.html

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Regulations in the UK and the EU also required intense scrutiny to ensure they were fit for purpose. AIMA is proud to have championed reform of the ELTIF rules by working with EU policymakers to provide technical solutions to the key areas in need of improvement. The adoption of the ELTIF reforms is very positive for European SMEs and investors and we estimate that the changes introduced will help unlock an additional €100 billion of financing for European businesses over the next five years and see ELTIFs become a key pillar of the Capital Markets Union.

Meanwhile, the EU continues to lead the way in the introduction of new ESG rules, although widespread uncertainty over how best to apply certain aspects of responsible investing, alongside a fear of being accused of greenwashing, is hampering more rapid adoption of these principles in other markets.

In APAC, Singapore continued to thrive in 2022 and capture an increased market share of the region's financial sector, including alternative investment funds, while Hong Kong grappled with balancing lingering COVID restrictions and the need to open for international business. Recent intervention by industry representatives – including the publication of AIMA's "Alternatives in Hong Kong" paper – led to fruitful discussions with regulators and policymakers and we are cautiously confident the city will recover in the coming year if it stays on its current trajectory.

Turning to the wider alternatives universe, AIMA's research indicates that private credit fund managers expanded their lending activity last year. Private credit funds responding to a survey by AIMA's Alternative Credit Council reported a 20% increase in their lending volumes in 2021, with further growth in 2022. The sector retains a positive outlook towards deployment opportunities over the coming year.

Despite my middling record at predicting the future of alternative investments last year, a generous reader may agree the picture I painted in January 2022 was at least in the right ballpark, notwithstanding some underestimation of the degree of severity with which some trends would inflict themselves on financial markets.

Regardless, my record to date gives me enough confidence to conclude by offering some predictions for the year(s) ahead.

I. **Alternatives will perform well again.** With most forecasts for the coming 12 months predicting market volatility will remain, the benefits of investing in hedge funds will continue to attract capital as investors diversify away from the traditional 60/40 model of investing.

II. **The resolve of ESG proponents will be tested.** The looming threat of a global recession will inspire investors to re-examine their portfolios and ask difficult questions about what they want from their alternative investment funds when it comes to the application of ESG principles, especially, if it's uncertain how this will affect returns.

III. **Regulatory initiatives will increase the compliance burden.** The next two years will see many of these proposals from 2022 finalised and put into action and there will be plenty of implementation work ahead.

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The adoption of the ELTIF reforms is very positive for European SMEs and investors and we estimate that the changes introduced will help unlock an additional €100 billion.

IV. **The next wave of capital into alternatives will come from retail investors.** While many institutional investors are already fully weighted in alternatives, private wealth assets by contrast are substantially underweight. This represents a huge opportunity for new capital for managers over the next decade if they can adapt their distribution channels and adopt the appropriate fund vehicles to access this.

Overall, 2023 will no doubt be demanding but there are many reasons for cautious optimism too and I am confident our industry has the skill set to prove its mettle once again in successfully navigating the more difficult times ahead.

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Rita Yu is practicing in Hengtai Law Offices for over 10 years of experience as investment fund lawyer. She has extensive experience on establishment and seeking governmental authorisation for foreign and local hedge fund, VC&PE and financial institutions. She also engages in advising the fund investment and on-going compliance, M&A and corporate restructuring. She has also been involved with advising in legislation of sustainable finance and asset management sectors.

Following Rita's law studies at China University of Political Science and Law, she worked in China Practice Group of a reputable international law firm on foreign investment and M&A before joining Hengtai.

Market Overview

For the asset management sector in China, public fund shall be authorised and regulated by Chinese Securities Regulatory Authority (CSRC), while, typically private fund shall be sold to eligible investors, recorded in fund industry self-discipline organisation (AMAC) and regulated by CSRC.

Despite the COVID-19 pandemic, according to official data of CSRC and AMAC, Chinese asset management sectors are still growing to RMB 68.34 trillion yuan in AUM, including public fund (accounting for 38.91%), private fund (29.25%), and collective investment schemes and pension products launched by public fund management, securities and futures companies (totaling 31.84%). The net fund inflow is RMB 2.47 trillion yuan over the past year.

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> Foreign investors shall be allowed to invest in China interbank bond market (CIBM) and exchange-traded bond market through QFI scheme

In recent years, China is always comitted to promote high-quality development of financial market opening-up, and has introduced new convenient vehicles and measures. In 2022 and early 2023, new reputable foreign financial institutions have entered into China, among them, three fund management WFOE and three wealth management JV have been approved through new establishment or investment, first foreign-invested pension management JV (Principal) has been approved. We also notice that there are some regulatory changes, like in ESG areas and investor protection’s aspect.

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Introduction of new bond direct investment scheme and connect of bond markets

Foreign investors shall be allowed to invest in China interbank bond market (CIBM) and exchange-traded bond market through QFI scheme (QFI scheme as specified below). In addition, foreign investors may invest in CIBM through Bond Connect (similar to Stock Connect as below).

In 2022, China has accelerated the connect of the above two bond markets and launched a new bond direct investment scheme, in addition to QFI and Bond Connect schemes. Under new direct investment scheme, eligible foreign investors shall be allowed to invest in both CIBM and exchange-traded bond market.

Remarkably, under such new scheme, (i) eligible foreign investors shall apply to the People’s Bank of China (Central Bank) to invest in bond market, while, the scope of eligible investors shall cover sovereign organisations and commercial institutions; (ii) the authorisation will be granted to the foreign investor applicant rather than single bond product, which shall improve the investment efficiency; (iii) QFI may freely transfer the bond between the QFI special account and direct investment account, and transfer the fund between the QFI special account and direct investment account, in order to facilitate the management of fund and multiple accounts; (iv) foreign investors may carry out relevant bond and interest derivative trading for hedging. The above measures shall further facilitate foreign investors in the bond market.

After the above connect of CIBM and exchange-traded bond market, foreign investors under Bond Connect scheme shall also have access to exchange-traded bond market.

Development of QFI scheme

China launched the QFII scheme in 2002 and then RQFII scheme in 2011, foreign investors may invest in Chinese securities market through R/QFII scheme. Since 2020, QFII and RQFII has been combined into one scheme (QFI). After such combination, original quota restriction of investment for QFI has been removed, and the scope of investment has been expanded to include, such as private fund, commodities futures, financial futures and options while, eligible products of futures/options are still subject to authority's approval.

In October 2022, the scope of eligible commodities and financial futures (including options) have been expanded to include thirty-nine products of commodities futures and options (from seven), and six products of financial futures and options. The new eligible products of commodities and financial futures (including options) include:

(i) commodities futures: Gold, Copper, Aluminum, Zinc, Silver, Steel Rebar, Hot-Rolled Coils,No.1 Soybean, No.2 Soybean, Soybean Meal,Soybean Oil, LLDPE,Methanol, White Sugar, Rapeseed Oil, and Polyester Staple Fiber;

(ii) commodities options: Gold, Copper, Aluminum, Zinc,Crude Oil,No.1 Soybean, No.2 Soybean, Soybean Meal,Soybean Oil, RBD Palm Olein, Iron Ore, LLDPE,PTA, Methanol, White Sugar,and Rapeseed Oil;

(iii) financial options: CSI 300 Index Options, CSI 1000 Index Options.

Since December 2022, SSE 50 index options is available in the financial futures market, and QFI has access to trade three financial options including CSI 300 Index Options, CSI 1000 Index Options and SSE 50 index options so far.

Development of connect scheme

China launched the Stock Connect scheme in 2014. Under the stock connect scheme, foreign investors in Hong Kong stock exchange are permitted to access to Shanghai and Shenzhen stock exchanges through northbound connect. For northbound connect, the scope of eligible stocks have been expanded in 2020, and further expanded in 2022 to include, (i) ETF products; and (ii) listed shares in Shanghai A-share Index and Shenzhen Component Index, and those A-shares for A+H share double-listed companies.

The authorities launched the Wealth Management Connect pilot scheme in 2021. Under Wealth Management Connect, the investors in Guangdong province, Hong Kong SAR and Macao SAR (Great Bay Area) are permitted to invest eligible wealth management products sold within Great Bay Area through designated banks. So far, eligible products in mainland China cover public fix-income and equity-based wealth management products.

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Under the stock connect scheme, foreign investors in Hong Kong stock exchange are permitted to access to Shanghai and Shenzhen stock exchanges through northbound connect.

Rapid development of foreign financial service industry

In 2019, China has announced further opening-up of foreign financial service industry, in relation to asset management sectors, (i) foreign investors are allowed to establish wholly-owned fund management companies; (ii) foreign financial institutions are allowed to establish foreign-controlled wealth management companies with subsidiaries of Chinese banks or insurance companies; (iii) foreign financial institutions are allowed to invest in pension fund management companies; (iv) the proportion of foreign shareholding in insurance asset management companies may be further increased from 25%.

So far, despite Covid-19 pandemic, more large foreign financial institutions has established new asset management companies and launched relevant products in China, specified as below.

(1) Six foreign wholly-owned fund management companies have been approved through new establishment or acquisition, including BlackRock, Fidelity, Neuberger Berman, Schroders, Manulife and J.P.Morgan. Inter alia, Schroders, Manulife and J.P.Morgan have obtained the approval in 2022 and early 2023.

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> In 2018, AMAC has published the guidance on disclosures for public and private investment fund, which incorporate the factors of environment, social and governance (ESG).

(2) Five foreign-controlled wealth management JVs have been approved, including Amundi (with Bank of China), Blackrock (with Temasek and China Construction Bank), Schroders (with Bank of Communications), Goldman Sachs (with Industrial and Commercial Bank of China), and BNP Paribas (with China Agricultural Bank), with the foreign shareholding ratio of exceeding 50%. Inter alia, Schroders, Goldman Sachs, and BNP Paribas have obtained the approval in 2022.

In September 2021, China has launched pension fund management products pilot scheme, BlackRock wealth management JV has launched first pension fund management product.

(3) Principal has completed the investment into the pension fund management joint venture with China Construction Bank and National Council for Social Security Fund at the end of 2022. After the above transaction, China Construction Bank, Principal and National Council for Social Security Fund hold the shares of 70%, 17.647% and 12.353% respectively.

Regulatory Changes

Dual carbon strategy and ESG investment

In 2018, AMAC has published the guidance on disclosures for public and private investment fund, which incorporate the factors of environment, social and governance (ESG). The disclosures for ESG shall be submitted to AMAC annually.

To promote Carbon Peak and Carbon Neutrality strategy, in 2021, China has announced the guiding opinions on green finance, then launched national carbon trading market and introduced carbon emission reduction support vehicles to support sustainable finance.

In 2022, Deutsche Bank and Societe Generale have been approved to access to carbon emission reduction support vehicles of Central Bank as pilot institutions.

After launching the above Dual Carbon strategy, Shanghai and other cities have promulgated local green finance policy to:

(i) encourage development of green finance, such as biodiversity financing and climate financing projects;

(ii) also enhance the disclosures of ESG factors on financial institutions.

The implementation rules are still in process.

Changes to custodian requirement and other changes

In June 2022, AMAC introduced a new policy regarding custodian. Private investment fund in contractual form (a collective investment vehicle) shall be under the custodian of designated financial institutions (commercial banks or securities companies) to better protect the investors' interest, while, private funds in corporate or limited partnership form have no such requirement yet. Considering that private securities funds typically adopt the contractual form in China, so the above changes mainly impact private securities funds.

In December 2022, CSRC has launched a public consultation on regulations of private fund registration and recordal, which plans to enhance the requirement of private fund registration and recordal covering local and foreign private managers. The CSRC will publish the conclusion in due course.

Conclusion

For initiatives of active and healthy financial market, China has promulgated series of new laws and regulations in relation to asset management, and continuously introduced convenient vehicles and opening-up measures for international investors. In the meantime, China is still under system of macro prudential supervision, and in the viewpoint of supporting the development in financial service industry with High Quality. We also notice that there is such tendency regarding sustainable finance and investor protection. We believe that Chinese financial market shall have great potential and asset management industry will be more and more prosperous.

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In December 2022, CSRC has launched a public consultation on regulations of private fund registration and recordal.

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HENGTAI LAW OFFICES

Hengtai Law Offices is a prestigious law firm in China with over twenty years, headquartered in Shanghai. We provide extensive legal service to local and international companies. We are always committed to provide efficient and practical solutions to our clients as a reliable legal expert. Our fund team has extensive experience to serve for local and international asset management companies.

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BIO

Daniel is an advocate, admitted to practice in both Cyprus and Greece, handling both common and civil law related matters.

He is experienced in the provision of legal advice relating to M&A and Corporate Law, Banking & Finance Law, Capital Markets and Collective Investment Schemes. He is regularly engaged by EU and third-country corporate and institutional clients such as banks, funds and investment firms as well as their legal advisers (predominantly major international law firms), on issues of project development and finance and commercial contract negotiations both from a transactional and regulatory perspective.

Daniel founded the firm after having worked for several years with the law firms of two Big4 firms and one of the largest law firms in Cyprus. Immediately prior to founding the firm Daniel successfully built the Financial Services, Funds and Capital Markets department of the law firm of a Big4 firm in Cyprus.

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Mikaela is an advocate of the Supreme Court of Cyprus and member of the Cyprus Bar Association and of the Technology Committee of the Cyprus Bar Association.

Mikaela commenced her career at a London City law firm in the Financial Markets team and assisted on securitisation and portfolio sale transactions for reputable banks and financial institutions. Prior to joining the firm she worked for several years in the law firms of two Big4 firms serving in senior and managerial positions in Corporate & Commercial, Financial Services, Funds & Capital Markets teams.

She is experienced in the provision of legal and regulatory advice to alternative investment funds and fund managers, investment firms, financial institutions and other regulated entities. Mikaela has significant experience in the set-up and licensing of electronic money institutions and payment service providers and other FinTech companies. In the tech space she has assisted Cyprus start-ups with their business setup and seed proposals.

She regularly advises corporates in their digital transformation and innovation technology journeys, including the adoption of emerging technologies such as DLT, blockchain and AI solutions.

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I. OVERVIEW

While 2022 was pre-emptively defined as the year of anticipation of what the "new normal" would look like following the COVID-19 crisis, the expectations quickly dropped as the outbreak of war in Ukraine ushered in a fresh series of risks, concerns and considerations.

At the closing of 2021, Europe was warned that a divergent economic recovery from the COVID-19 pandemic risked deepening divisions at a time when collaboration was urgently required to address looming global challenges. Few would have anticipated though the extent of instability that would unfold in the year – this time driven by a war in Europe. In fact, the Collins Word of the Year for 2022 was 'Permacrisis', describing a period of extended instability and insecurity.

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> The growth and development of the investment funds sector in Cyprus has proven to be one of the most important contributors to the Cypriot economy.

As the conflict between Russia and Ukraine has been ongoing for over a year, societies and economies have switched focus from investing to "survival" - against today's crises, including, among others, the cost of living, social and political polarization, tepid growth, food, energy and material supply shortages. Consequently, many where those who chose to slow down, pause or postpone the establishment of new structure, launch of new ventures or undertaking of investments, in apprehension of the outcomes of the European and global instabilities.

Financial markets have also reacted negatively to the various ongoing crises and markets have witnessed one of their worst calendar year performances on record in 2022, with bonds and stocks declining materially simultaneously. This inherently meant that many investors were exposed or prone to losses in the overall value of their investments. Nonetheless, against the gloomy geopolitical and economic turmoil, and despite the huge challenges that Europe currently faces, substantial progresses have been achieved over the year in the regulatory and legislative front both on a European and local level.

In this overview, we provide a summary of the latest key developments in the investment funds/asset management sector in Cyprus.

II. CURRENT STATE OF AFFAIRS IN CYPRUS

The growth and development of the alternative investment funds sector in Cyprus has proven to be one of the most important contributors to the Cypriot economy, not only by increasing government revenues but also by creating new employment opportunities. Cyprus has experienced a significant increase in investments in the energy sector, while sustainable investments, shipping and FinTech also keep showing a progressive uptake.

In 2022, Cyprus witnessed a significant transformation with the establishment and expansion of operations of institutional global service providers in the funds sector on the island. This development has helped to position Cyprus as an alternative investment hub for managers and funds, contributing to the growth and development of the country's investment funds market. The Cyprus Investment Funds Association has highlighted that "it is not the sector's size but its rapid and notable growth that has captivated the global asset management and investor community and it will certainly continue to grow".

III. LATEST LEGAL/REGULATORY DEVELOPMENTS IN CYPRUS

A. Amendments to Companies Law Cap.113 for Variable Capital Investment Companies

Following the amendments to the Companies Law Cap.113 in late 2021, which introduced significant modifications to the legal framework governing Variable Capital Investment Companies (VCIC's), the adjustment period for adoption of the required amendments to the VCICs' constitutional documentation lapsed in November 2022. Specifically, all VCIC's were required to amend their Memorandum & Articles of Association to incorporate, among others, provisions reflecting (i) the procedure to be followed for the amendment of their M&AA in relation to their share capital and/or the rights attributed to different classes of shares; and (ii) the process for the redemption of shares.

B. Crypto-Asset Service Providers

CySEC in an effort to provide an initial legislative framework to regulate entities undertaking investments in crypto-currencies and/or other crypto-related assets, as well as adopt the provisions of the 5th AMLD, published Directive R.A.A 269/2021 on the registration of crypto-asset service providers (the "CASP Directive").

The CASP Directive regulates the registration and authorisation of crypto-asset service providers (CASPs) and the provision of investment services related with crypto-assets. To this extent, CASPs established in the EEA, are required to obtain the prior authorisation of CySEC to offer their services in Cyprus including the (i) provision of investment advice, (ii) reception and transmission of orders, (iii) execution of orders; and (iv) exchange of cryptoassets and/or fiat currencies and/or between cryptoassets.

As a result, various significant market players in the crypto-asset industry have obtained a CASP license and Cyprus now hosts branches of entities such as Binance, IQ Option and Lime Trading operating as crypto-asset service providers.

C. Cyprus UBO Register

With the introduction of the UBO Register by the Cyprus Registrar of Companies (the "Registrar") following the adoption of the 5th AMLD, much debate arose in the investment funds industry on the definition of the UBO, for the purposes of collective investment organisations including UCITS funds, AIFs, AIFLNPs and RAIFs.

The question mainly derives from the fact that the AML Law provides that any individual holding over 25% of the shares in an entity, acting in a management position of that entity should be recorded in the UBO Registry. However, for the purposes of externally managed AIFs and RAIFs, and in accordance with the AIF Law of Cyprus, the management of the entity is effectively assigned to the external manager.

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> Cyprus now hosts branches of entities such as Binance, IQ Option and Lime Trading operating as crypto-asset service providers.

With its announcement on 11 February 2022, the Registrar came to shed some light on the final requirements for notification to the UBO Register by investment funds. The Registrar clarified that the filing of the UBO details must be made for both natural persons holding management shares (of over 25%) and for any investment shareholders (natural persons) holding over 25% of the issued investment shares. In determining the beneficial owners holding more than 25% of the shares of an investment fund, the last official calculation of the Net Asset Value (NAV) should be taken into account.

Where all possible means are exhausted and no person is identified as the fund's beneficial owner, then the person(s) holding the senior management official positions should be declared as beneficial owners and included in the UBO Register. For externally managed investment funds, and should all possible means be exhausted with no person identified as the beneficial owner, then the General Manager of the External Manager should be reported as the fund's beneficial owner.

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MiCA is the first official attempt of the EU to put together a legislative piece addressing crypto-assets in Europe.

IV. LEGAL/ REGULATORY DEVELOPMENTS IN EUROPE

A. AIFMD II

Over the course of the year, significant progress has been made by legislators on the targeted review of the second version of the AIFMD/ UCITS Directive.

Ten years from the adoption of AIFMD I, the proposed changes that will form the basis of its successor - the AIFMD II, were published by the European Commission in November 2022. While the updated directive does not offer a radical departure from the existing provisions, there are potentially important changes with tighter checks and requirements to be implemented by fund managers. The final and published text of the directive is aimed to be released within 2023, with its adoption in national legislation expected to be completed by the end of 2024, at the earliest.

B. Market on Crypto-assets Regulation (MiCA)

One of the highlights of legal developments in the EU for 2022 is the agreement on the text for the Markets in Crypto-Assets Regulation (MiCA).

MiCA is the first official attempt of the EU to put together a legislative piece addressing crypto-assets in Europe. A much-anticipated regulation which has been under discussion and consultation for over two years is now in the final stages of adoption across the EU and its impact on the crypto-asset markets cannot go unnoticed. The agreement for the MiCA text was reached in late November 2022 and marked the first step towards regulation of crypto-assets in Europe. MiCA is the first comprehensive regulatory regime in the world tailored specifically to crypto-assets and it intends to close gaps in existing EU financial legislation by establishing a coherent set of rules for crypto-assets and related activities and services.

Once formally approved, MiCA will set harmonised EU-level definitions of all key terms relating to activities undertaken in crypto-asset markets. It will apply to persons involved in the issuance of crypto-assets as well as services related to crypto-assets in the EU which are not regulated by other pieces of European law, also capturing investment funds involved and/or undertaking activities with crypto-assets.

It will also set out rules on transparency and disclosure requirements for the issuance and admission to trading of crypto-assets, the authorisation and supervision of CASPs and issuers, the operation, organisation and governance of issuers of asset-referenced tokens, electronic money tokens and will introduce consumer protection rules and measures to prevent market abuse, further ensuring the integrity of crypto-asset markets.

MiCA is expected to enter into force in early 2023.

C. Environmental, Social and Governance Investments

Environmental, social, and governance (ESG) factors have risen in awareness and popularity over recent years and estimates suggest that ESG assets may reach USD53 trillion by 2025, nearly one third of global assets under management (AUM).

The last two years have seen a raft of regulations aimed at ESG requiring asset managers to navigate the different regulations and assess their implications. While the level 2 draft regulatory technical standards ("RTSs") referred to in Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (the "SFDR") were published in April 2022, their effective date remains unknown.

The RTSs mandate that External Managers must take into account ESG factors and sustainability risks, and evaluate their potential impact on the investment funds they manage. This obligation is part of the managers' overall risk management function for the funds. The SFDR pushes External Managers to be much more transparent in what their funds actually do from an ESG perspective, and on the outcomes of their decisions in terms on their wider impact on society. Relevant references must be included in the fund's constitutional documentation and Fund Managers are asked to closely monitor the development of ESG and more broadly, the European Commission's Sustainable Finance Action Plan, and inform investors for any material impact on the performance and returns to their investments in the fund.

V. CLOSING REMARKS

Cyprus has established itself as a modern and competitive investment fund and fund manager jurisdiction, gaining significant recognition both in Europe and globally over the last five years. The country's favorable tax regime, robust legal and regulatory framework, and strategic location have attracted international investment and contributed to its success. The selection of Cyprus as the hosting country for the 36th Annual International Conference of the International Investment Funds Association in 2023 is a testament to its position as an upcoming funds hub. As the country continues to build on its strengths and make further advances in the funds sector, it is well positioned to capitalise on future opportunities and maintain its strong position in the global investment landscape.

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> Cyprus has established itself as a modern and competitive investment funds and fund managers jurisdiction, gaining significant recognition both in Europe and globally.

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BIO

Huiqin is manager in Financial Services Group, providing a variety of advisory services to financial services companies in Japan including market research, commercial due diligence, business due diligence, operational due diligence, business projection review, and financial modelling. She has various project experiences to provide services to support M&A deals in the financial services sector.

Before joining KPMG, Huiqin had 7 years working experience at a major Japanese Bank. Huiqin has deep experience in risk management and regulatory reporting for both bank and bank holding companies.

INTRODUCTION

- The global asset management industry has experienced significant growth in recent years. In the U.S., the world's largest asset management market, both custodians, who provide service and infrastructure for fund managers, and distributors, who capture customers, are aggressively entering the asset management space, and the industry is undergoing significant restructuring. On the other hand, the Japanese asset management industry, which holds the world's second largest household financial assets, has not seen a large influx of funds from a global perspective, and there have been almost no new attempts. In this report, we will examine each component of the Japanese asset management industry's industrial structure, summarise their current status and challenges, and discuss necessary initiatives to resolve the industry's overall issues.

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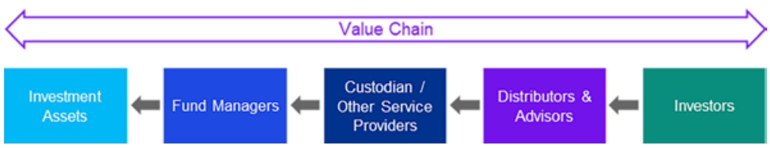
> Due to Japan's unique business requirements and licensing process, Japanese asset management firms are subject to high barriers to entry.

I. Current Status and Issues of Each Component of the Industry Structure of the Japanese Asset Management Industry

- The industry structure (Value Chain) of the asset management industry is shown in the figure below. The arrows represent the flow of money, with money flowing from right to left. In this chapter, we will discuss the current status and issues of each component of the asset management industry in Japan.



1.Investment Targets

- In recent years, alternative investments have been expanding rapidly in Europe and the U.S., and the market is expected to grow even more in the future. In Japan, on the other hand, investment in traditional assets remains the basic approach, with relatively few alternative investments, and neither the quantity nor quality of product development has expanded significantly.

- In addition, ESG investments have been attracting attention worldwide in recent years. In Europe and the U.S., industry standards for ESG investment have been established, and it is easier for fund manager that make ESG investments or ESG investment targets to gain trust by disclosing ESG-related information in accordance with industry standards. In Japan, on the other hand, ESG investment is still a relatively new investment approach, and the regulatory environment is not yet well developed. As a result, the sound development of ESG investment by Japanese asset management companies and the intake of ESG money from overseas have not progressed.

2.Fund Managers

(1) Weak Competitive Environment and High Barriers to Entry

- Due to Japan's unique business requirements and licensing process, Japanese asset management firms are subject to high barriers to entry, making it difficult for new players and foreign-affiliated firms to enter the industry. Insufficient competition among existing firms and the ability to earn profits without sufficient corporate effort have resulted in little shakeout or restructuring of firms. Because of this "protected" competitive environment, there has been no cost reduction through downward pressure on commissions, nor has there been Customer Experience-oriented functional development or organisational reform, as seen in the US and Europe.

(2) Power Relationship with Distributors

- In the value chain of the asset management industry in Japan, the influence of distributors is strong, and the market structure is such that market dominance is determined by whether or not a company has a strong distributor. This market structure can be seen in the fact that most of the investment trusts sold in Japan are structured and managed by asset management companies affiliated with distributors. As a result, asset management companies prioritise the development of products that will generate more commissions for the distributors rather than products that truly meet the needs of investors, creating a distorted market that is distributor-oriented rather than investor-oriented.

(3) Low Level of Information Disclosure

- Various disclosure regulations have been implemented in the UK and the EU to increase transparency in the asset management industry. As a result, information disclosure by asset management companies and managed funds has increased, leading to transparency of cost structures and a healthier industry, which has successfully attracted investment money. The industry as a whole has become a major success story. In Japan, on the other hand, the asset management industry has a low level of information disclosure, and cost structures, performance, and risk assessment are rarely explained. In such an obscure disclosure environment, investors are unable to determine whether the fees they are paying are reasonable and whether the management of the funds in which they are investing is appropriate, which makes it difficult for them to have confidence in the funds and discourages them from increasing their investment balance.

3. Custodians and Other Service Providers

(1) Business Practice Issues

- In the Japanese asset management industry, there are business requirements and practices that are unique in Japan and hinder the efficiency of custodians and the creation of a competitive environment. For example, in Japan, there is a long-standing practice of "double calculation of NAV," in which the NAV of a mutual fund is calculated by both the asset management company and the custodian, and the results are reconciled to determine the NAV. This practice, which is unique from a global perspective, has created a major obstacle to entry into the Japanese market by top-tier foreign players that provide excellent services at low prices globally. As a result, the competition between existing providers is insufficient, and there has been little progress in cost reduction efforts and little progress in functional development or industry restructuring as seen in Europe and the U.S. Consequently, the high costs are passed on to investors.

(2) High Administrative Costs

- The Japanese financial industry has not been making progress in bringing IT in-house through industry restructuring and the acquisition of human resources. Japanese custodians have long been in the practice of paying high costs to outsourced vendors for IT development, and have not made progress in creating added value or developing new functions through the utilisation of IT. As a result, the business model has remained and not evolved from a global perspective, and has yet to provide new added value to asset management companies and the asset management value chain as a whole. This, combined with the aforementioned high barriers to entry for foreign firms due to Japan's unique business requirements, means that Japanese asset managers are forced to use outdated services at a high cost, without access to global standard custodian services that offer advanced services at a low cost.

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> Various disclosure regulations have been implemented in the UK and the EU to increase transparency in the asset management industry.

4. Distributors

(1) Sales Practices That Are Not Customer-Oriented

- In 2017, Japan's Financial Services Agency (FSA) published its Principles for Customer-Oriented Business Operations, which consist of seven principals, in order to promote stable asset building for the Japanese public. In accordance with the Principles, Japanese financial institutions are required to implement customer-oriented business operations in substance, not in form, depending on their circumstances. In reality, however, some sales practices remain that cannot be deemed customer-oriented, such as prioritising short-term sales commissions and giving priority to investment trusts affiliated with the company. As a result of this structure, asset management companies are more interested in developing products that are easy to sell and earn commissions for the distributors, rather than products that are truly needed by investors. This business operation that prioritises the interests of the distributors and disregards the interests of investors has become the usual practice, and because the business is not contributing to investment asset building, it has fallen into a vicious spiral that is also damaging the medium- to long-term corporate value of the business itself.

(2) Absence of Independent Investor-Oriented FAs

- In Europe and the U.S., qualifications and systems for providing independent investment advice that is not affiliated with any financial institution have been established and are widely used by investors in general. Independent FAs help to develop asset plans from the client's perspective and provide advice and financial products that contribute to asset building. In Japan, however, there is lack of qualifications and systems in place to provide such independent advisories, making it difficult for investors to seek out high-quality investment advisors. Although the FP qualification exists in Japan, FPs can only provide advice on overall asset building, and are not allowed to explain or offer the contents of financial products. There are also IFAs who can handle the contents of financial products, but IFAs are contractually in a position to sell financial products on behalf of financial instrument dealers, and since their income comes from sales commissions, they are structurally subject to the risk of conflicts of interest with their clients. Thus, the lack of infrastructure to provide independent investment advisors is one of the reasons for the lack of progress in asset building in Japan.

5. Investors

- Now that we have covered investment targets, fund managers, custodians and other service providers, and distributors, what are the features of investors at the top of the asset management value chain, and how do they view their own investment environment? In this section, we will focus on Japanese individual investors, whose asset building has not progressed well from a global perspective.

(1) Overview

- Japanese households have not been successfully able to achieve a "savings to investment" shift. Although Japan ranks second in the world in terms of the size of household financial assets, the percentage of risk assets under total assets is extremely low compared to Europe and the U.S., and asset building through investment is barely achieved. This has led to a lack of supply of money to the financial market and stagnation in the asset management industry.

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Independent FAs help to develop asset plans from the client's perspective and provide advice and financial products that contribute to asset building.

(2) Features and Preferences

- One of the features of Japanese individual investors is their relatively low level of financial literacy. In recent years, the financial literacy of individual investors has been improving due to the spread of education on investment and the ease of gathering information via the Internet, but they still have a lower understanding of finance and investment than in the West, and do not possess sufficient knowledge for proper asset building.

- Another feature of Japanese individual investors is their preference for conservative investments such as bank savings accounts. The ratio of savings accounts to household financial assets is very high, which can be seen as an asset allocation with a certain rationality in light of the fact that the Japanese stock market has not grown much in the 30 some years since the burst of the bubble economy and that inflation has not progressed. However, the fact that Japanese households have not had as many successful experiences related to earning investment income as Western households has also contributed to their lack of interest in investing.

(3) Pain Points

- From the perspective of Japanese individual investors, asset management in Japan is viewed as having high fees and an unclear cost structure. This is the result of a complex combination of issues in each of the component parts described above.

- Another pain point is the limited range of products available to Japanese individual investors. While institutional investors and a few wealthy individuals have access to alternative investment opportunities in Japan, few doors have been opened for mass retail investors. In addition, the small number of listed ETFs has also been pointed out. In order to list an ETF in Japan, the investment fund must meet strict screening criteria, such as having to be highly liquid, etc. From an investor's perspective, the small number of ETF is a pain point because it limits the opportunity to purchase investment fund in the same way as purchasing stocks.

II. Initiatives Needed to Resolve Current Issues

- The issues in Japan's asset management industry exist in each component of the industry structure, and they affect each other in complex ways. In order to resolve them, the following industry-wide efforts, in cooperation with the regulatory authorities, will be needed.

1. Regulation

- The enhancement of information disclosure is an effective means of eliminating the information opacity that exists within the industry and creating a healthy competitive environment. It is important to improve transparency of cost structure and performance by mandating information disclosure through regulations and other means, and to create the conditions for gaining the confidence and trust of investors.

- In addition, easing regulations on exchange-traded funds (ETFs) and providing investors with a wide range of options to purchase them in the same way as stocks and to diversify their investments is considered important for expanding the investor base.

- Also, following the example of Europe and the U.S., the establishment of an independent FA system would be an effective means of developing an infrastructure to provide investment advisors on a neutral basis without being affiliated to a financial institution.

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> Another feature of Japanese individual investors is their preference for conservative investments such as bank savings accounts.

2. Market Players

- It is important for Japanese asset management companies and custodians to change their unique business practices in preparation for accepting services provided by global top-tier custodians and service providers. The reduced costs and more highly advanced services resulting from this will contribute to the development of the entire industry.

- To date, Japan's asset management companies have failed to provide truly client-oriented products. In all times and places, an industry that cannot build win-win relationships with its clients will eventually decline. Japan's asset management industry is no exception to this rule, and the current distorted state of equilibrium is unlikely to continue indefinitely. Japan's asset management market players should seriously consider how to build win-win relationships with investors with a sense of crisis, and find a way to come up with an effective plan.

3. Investor Education

- In addition to the development of infrastructure as an external environment for investors to make appropriate decisions on investment, it is also essential to improve the financial literacy of investors themselves as a prerequisite for making appropriate decisions on investment. It would be effective for the public and private sectors to work together, such as incorporating financial education into the existing education system and for financial institutions to participating in the preparation of educational materials.

CONCLUSION

This article summaries the current status and issues in each component of the industry structure of the asset management industry in Japan, and discusses necessary initiatives to resolve these issues. The current status of each component and its comparisons with Europe and the U.S. are summarised in the figure below.

	Growth and Expansion of Investment Assets		Fund Managers (Mutual-fund, VC, PE)				Fund Admin	Custodian	Distributor	Investor (The opportunity to purchase investment fund)			
	Traditional Products	Alternative products	M&A	New entry	Disclosure obligations	Entry of foreign capital	Outsourcing, New entry	Up-to-date global service	New entry, application development	Total fee to be paid	Pension, Corporate	HNWI	Mass Retail
1.Japan	Weak	Weak	Few	Few	Weak	Weak	Weak	Weak	Medium	High	Strong	Weak	Weak
2.US	Strong	Medium	Many	Medium	Medium	Medium	Weak	Strong	Strong	Low-Medium	Medium	Strong	Strong
3.UK	Strong	Strong	Many	Many	Strong	Medium	Strong	Strong	Strong	Low	Strong	Strong	Strong

The issues described in this article are obstacles to the revitalisation and growth of the asset management industry in Japan, and are expected to be resolved as soon as possible. In recent years, the Japanese government has been implementing a variety of policies to improve the soundness of the industry, and the situation is gradually improving. However, as shown in the figure above, in countries where the asset management industry has made progress, such as the UK and the U.S, regulators have taken the lead in developing policies and regulations to enhance the industry, leading to the growth of the industry. We hope that the Japanese regulators will take the current industry challenges seriously and show strong leadership by introducing highly effective regulations and policies to break through the current state of the asset management industry in Japan.

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> To date, Japan's asset management companies have failed to provide truly client-oriented products.

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BIO

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Keita has been involved in a number of public offerings and private placements of units/shares of investment trusts/corporations established in a variety of jurisdictions, such as the Cayman Islands, Luxembourg, and Ireland, in relation to regulatory and disclosure compliance in Japan.

Also, Keita has advised on the formation and fund-raising of domestic and overseas partnership-type funds, such as private equity and venture capital funds and real estate funds.
He has substantial experience in advising general partners and similar entities on contract drafting and regulatory compliance, including filing notifications and discussing with the Japanese authorities in connection with the admission of Japanese investors.

Mori Hamada & Matsumoto

Overview

Although, from a legal perspective, the door to non-Japanese alternative investment funds has been open to Japanese institutional investors, many Japanese institutional investors had invested only in traditional investment funds and had been reluctant to invest in non-Japanese alternative investment funds. In recent years, however, Japanese institutional investors have become more active in investing in non-Japanese alternative investment funds. In addition, it has been difficult from a Japanese law perspective for Japanese retail investors to invest in non-Japanese alternative investment funds; however, in recent years, there have been developments in the methods used to market non-Japanese alternative investment funds to Japanese retail investors.

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> From a Japanese law perspective, non-Japanese traditional investment funds and non-Japanese alternative investment funds often have different structures.

The following sections analyse the differences in regulations imposed on non-Japanese traditional investment funds and non-Japanese alternative investment funds as a background, and then examine how the developments and trends in investments in non-Japanese alternative investment funds followed.

Differences under Japanese law between traditional investment funds and alternative investment funds

From a Japanese law perspective, non-Japanese traditional investment funds and non-Japanese alternative investment funds often have different structures. Non-Japanese traditional investment funds with Japanese investors are often structured as investment trusts, such as unit trusts in the Cayman Islands, while non-Japanese alternative investment funds are often structured as partnerships. Because of the difference in the legal entity employed, the required licenses for non-Japanese fund managers are substantially different, and there are also differences in the kinds of Japanese investors that non-Japanese fund managers can accept investments from. Regarding the licenses required in Japan, we need to focus on two aspects: solicitation and investment management.

(1) Non-Japanese traditional investment funds – unit trusts

As to solicitation, a Type II Financial Instruments Business License under the Financial Instruments and Exchange Act in Japan (the "FIEA") is required for any self-offering by an issuer of units of a non-Japanese unit trust; however, the registration as a Type II Financial Instruments Business Operator is a document-intensive and time-consuming process. Thus, in ordinary circumstances, it is common practice for the management company that is an issuer of a non-Japanese unit trust to appoint a distributor or placement agent in Japan and delegate the whole of the offering and solicitation activities in their entirety to such distributor or placement agent. Any person who offers or solicits units of a unit trust other than the issuer thereof is required to have a Type I Financial Instruments Business License; thus, the distributor or placement agent of a non-Japanese unit trust must have a Type I Financial Instruments Business License.

On the other hand, as to investment management activities, a management company of a non-Japanese unit trust is not subject to financial instruments business regulations unless such management company was incorporated under the laws of Japan or manages a non-Japanese unit trust in Japan. Also, an investment manager, sub-manager or investment adviser to a management company of a non-Japanese unit trust is considered as not being subject to financial instruments business regulations if it is established under the laws of any jurisdiction other than Japan and provides the relevant services outside Japan. Therefore, if a distributor or placement agent with a Type I Financial Instruments Business License is appointed and delegated with respect to the entire offering and solicitation of units of a non-Japanese unit trust, it is possible for the distributor or placement agent to solicit Japanese investors to acquire such units and for the management company, investment manager, sub-manager or investment adviser to manage funds invested by Japanese investors. In this case, there are no limitations on the category of Japanese investors, except in cases where such offering and solicitation is conducted under certain private placement requirements, and thus it is possible for Japanese retail investors to invest in non-Japanese unit trusts.

(2) Non-Japanese alternative investment funds - partnerships

The most common approach available for a general partner of a non-Japanese partnership for both solicitation and investment management is the Exemption for Special Business Activities for Qualified Institutional Investors (the "QII-Targeted Fund Exemption") under the FIEA. As to solicitation, a Type II Financial Instruments Business License is required for a general partner to make offers and solicitations of interests of a partnership-type fund to Japanese investors. Also, as to investment management activities, the general partner is required to have an Investment Management License in Japan to conduct investment management activities of a partnership with Japanese investors. However, if the general partner relies on the QII-Targeted Fund Exemption, it can conduct both solicitation and investment management activities without a Type II Financial Instruments Business License and Investment Management License, by filing a Form 20 with the Japanese regulator (together with supporting documents, such as the Articles of Incorporation, the LLC Agreement or an equivalent constitutional document, a pledge, notarised affidavits, and other required documents, which depend on the structure of the general partner). In order to rely on this exemption, at least one of the fund investors must be a "Qualified Institutional Investor" ("QII"), which is a professional investor, such as a bank or an insurance company. Also, the number of Japanese non-QIIs should not be more than 49 and each Japanese non-QII must be an "Eligible Non-QII", which is an investor who meets certain requirements, such as a company with paid-in capital of JPY 50 million or more or an individual whose financial assets are reasonably expected to be no less than 100 million yen and who opened his/her securities account more than 1 years ago.

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On the other hand, as to investment management activities, a management company of a non-Japanese unit trust is not subject to financial instruments business regulations unless such management company was incorporated under the laws of Japan or manages a non-Japanese unit trust in Japan.

Another approach is to appoint a placement agent with a Type II Financial Instruments Business license and delegate the whole of the offering and solicitation activities in their entirety to such placement agent, for purposes of satisfying solicitation requirements, and rely on the De Minimis Japanese QII Exemption, for purposes of satisfying investment management requirements. The De Minimis Japanese QII Exemption is an exemption that would allow a general partner of a partnership to conduct investment management activities without obtaining an Investment Management License in Japan if, in general terms, the partnership satisfies the following requirements: (a) the partnership must have fewer than 10 Japanese investors, directly and indirectly; (b) all direct and indirect Japanese investors must be QIIs; and (c) the aggregate capital contributions to the partnership of such Japanese investors must represent less than one-third of the aggregate capital contributions of all investors. If the requirements of this exemption are met, the general partner is exempted from registering and filing a notice with respect to its investment management activities.

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> If a general partner relies on the QII-Targeted Fund Exemption, it is not required to appoint a placement agent.

If a general partner relies on the QII-Targeted Fund Exemption, it is not required to appoint a placement agent. On the other hand, if a general partner relies on the De Minimis Japanese QII Exemption, it is not required to file any notification with a Japanese authority, as long as the general partner appoints a placement agent which has a Type II Financial Instruments Business License and delegates the whole of the offering and solicitation activities in their entirety to the placement agent. Therefore, these two approaches are reasonable options for non-Japanese partnership-type funds and have in fact been adopted by many non-Japanese partnership-type funds. However, either approach would make it difficult to admit Japanese retail investors because there are the limitations on the categories of eligible Japanese investors, as explained above.

Increased investment in alternative investment funds by Japanese institutional investors

From a Japanese law perspective, Japanese institutional investors have been able to invest in non-Japanese alternative investment funds, as such investors often fall under the category of QIIs under Japanese law. To be specific, general partners of non-Japanese partnership-type funds have been able to rely on the QII-Targeted Fund Exemption or De Minimis Japanese QII Exemption in many cases, in order to admit QIIs. However, some Japanese institutional investors were not familiar with these funds because they were in the form of a different legal entity from traditional investment funds formed as unit trusts, and such investors were not allowed to invest in non-Japanese alternative investment funds due to their internal rules.

Recently, as the understanding of non-Japanese alternative investment funds has deepened and precedents have increased, the number of Japanese institutional investors investing in non-Japanese alternative investment funds has been increasing. In addition, as the background of this trend, market volatility has increased due to the prolonged COVID-19 pandemic and the Ukraine war in 2022, and some Japanese institutional investors have been seeking to diversify their portfolios by investing in non-Japanese alternative investment funds that have risk-return characteristics different from those of

traditional investment funds.
We expect that Japanese institutional investors will continue to increase their investments in non-Japanese alternative investment funds for reasons such as better understanding of non-Japanese alternative investment funds, accumulation of precedents, and adoption as a method of risk diversification.

Development of access to non-Japanese alternative investment funds by Japanese retail investors

It has been difficult for Japanese retail investors to invest directly in non-Japanese alternative investment funds because Japanese retail investors often do not fall with in the categories of QII or Eligible Non-QII. General partners of non-Japanese alternative investment funds have not been able to meet the requirements for the QII-Targeted Fund Exemption or the De Minimis Japanese QII Exemption and to admit Japanese retail investors in many cases. However, in recent years, access to non-Japanese alternative investment funds by Japanese retail investors has developed by combining a partnership-type fund with a unit trust.

To be specific, as described above, if a distributor or placement agent which has a Type I Financial Instruments Business License is appointed and delegated the entire offering and solicitation of units of non-Japanese unit trusts, it is possible to solicit Japanese retail investors to acquire such units and manage funds with Japanese retail investors. Taking advantage of this, there are several cases where non-Japanese fund managers and Japanese securities firms which have a Type I Financial Instruments Business License have collaborated to form non-Japanese unit trusts as feeder funds of non-Japanese alternative investment funds, with Japanese retail investors acquiring units in the unit trusts. By investing in these feeder funds, Japanese retail investors can gain exposure to non-Japanese alternative investment funds, allowing non-Japanese fund managers to indirectly solicit funds from Japanese retail investors even if the Japanese retail investors do not fall with in the categories of QII or Eligible Non-QII.

Since the underlying asset is an alternative investment fund, there are unique risks, such as illiquidity, and caution is required when soliciting retail investors to invest in feeder funds of non-Japanese alternative investment funds; however, acceptance by Japanese retail investors is relatively easy because they are familiar with unit trusts as an investment product, as these are the same as traditional investment funds. In addition, it seems that the use of non-Japanese unit trusts as feeder funds for non-Japanese alternative investment funds is becoming a trend in recent years, as there is demand from a risk diversification perspective for Japanese retail investors with sufficient assets to have the opportunity to invest in non-Japanese alternative investment funds with low correlation to traditional investment funds in an increasingly uncertain market.

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It has been difficult for Japanese retail investors to invest directly in non-Japanese alternative investment funds because Japanese retail investors often do not fall with in the categories of QII or Eligible Non-QII.

The Japanese Government strategy - shift to investment

Previously, Japanese have saved most of their assets and have not invested much. In recent years, however, the importance of finance and investment has begun to be recognised; for example, financial education has become a requirement in high schools starting in 2022. Also, the Financial Services Agency, the financial regulator of Japan (the "JFSA"), published "The JFSA Strategic Priorities July 2022-June 2023" on 26 September 2022 and mentioned that the JFSA would promote the shift of an individual's financial assets from savings to investment and realise a virtuous cycle in which the fruits of economic growth are widely shared with individuals.

Thus, with the Japanese government's focus on promoting financial education and investment, the above-mentioned increase in investment in non-Japanese alternative investment funds by Japanese institutional investors and the development of access to non-Japanese alternative investment funds by Japanese retail investors have occurred. We expect that this trend will not be transitory and that we will continue to see increased investments in non-Japanese alternative investment funds and the development of legal technology for access to non-Japanese alternative investment funds in the future.

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The importance of finance and investment has begun to be recognised; for example, financial education has become a requirement in high schools starting in 2022.

Liechtenstein

Key developments & the latest trends in Liechtenstein – from a legal perspective

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Key developments & the latest trends in Liechtenstein – from a legal perspective

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1. Introduction

Compared to the world's major wealth management nations, such as its important neighbour and close economic partner Switzerland, Liechtenstein is a small niche player. Nevertheless, it is a financial centre to be aware of, and increasingly so. Europe's fifth smallest economy, with a population of around 39,000, has by far the highest level of prosperity among the EU/EFTA states, as measured by gross national income per capita.[1] The country is rated AAA by Standard & Poor's and the capitalisation of Liechtenstein banks is strong, with an average Tier 1 ratio of 21.74%.[2] Based on this solid foundation, the Liechtenstein financial centre has undergone impressive development in recent years: The number of funds has increased by an astonishing + 83.3% between 2016 and 2022 and the fund volume grew by 19 % in 2021. The volume of client assets managed by Liechtenstein banks has risen steadily to over CHF 360 billion in 2021 and that of asset managers to around CHF 59 billion in bankable assets.[3] At the same time, Liechtenstein is not "only" a financial centre, as the share of industry in Liechtenstein's total economic value added (43%) is exceptionally high by international standards and the third highest in the world.[4]

> "The most important factor seems to be the political and economic stability of the country and its proximity to the EU and the Swiss financial market.

Before delving into key developments and recent trends from a legal perspective, it seems worthwhile to reflect on a few factors that are particularly important for asset managers, fund promoters and family offices when it comes to choosing the right domicile for their company or fund and that might contribute to the growing interest in establishing a Liechtenstein structure.

The most important factor seems to be the political and economic stability of the country and its proximity to the EU and the Swiss financial market. Liechtenstein is historically closely linked to Switzerland through a dense network of bilateral treaties. Under the Customs Treaty of 1923, Liechtenstein became part of the Swiss economic area and the two countries form a customs union and share a common currency. It is not only service providers who benefit from the political and geographical proximity of the two countries, but also Swiss fund investors, who, for example, do not have to pay stamp duty on the purchase of fund units in Liechtenstein funds. At the same time, the EU/EEA single market is important and easily accessible for funds and management companies. As Liechtenstein is an EEA member state, European fund and asset management regimes (AIFMD, UCITSD, MiFID II, ELTIFR, etc.) apply to local service providers, products and distribution activities. As a result, Liechtenstein service providers and products have full access to the European market through passporting. Liechtenstein funds are currently marketed in 24 European member states. EU/EEA asset managers can provide investment services in Liechtenstein on a cross-border basis on the basis of a MiFID II passport, and UK credit institutions and investment firms also benefit from a specific notification regime.

1 Government of the Principality of Liechtenstein, Economic and financial data on Liechtenstein Data as of: 24 June 2021, https://www.liechtenstein-institut.li/application/files/3316/3058/6915/Economic-and-financial-data-2021-1-.pdf, (29.01.2023).
2 FMA Liechtenstein, Liechtenstein Financial Centre 2022, https://issuu.com/fma-li/docs/liechtenstein_financial_centre_2022?fr=sYmY3ZDQ4NTg3NTk (29.01.2023), 6.
3 FMA Liechtenstein, Liechtenstein Financial Centre 2022, https://issuu.com/fma-li/docs/liechtenstein_financial_centre_2022?fr=sYmY3ZDQ4NTg3NTk (29.01.2023).
4 Government of the Principality of Liechtenstein, 9, 10.

Liechtenstein is a highly compliant jurisdiction in the area of anti-money laundering, which is an important factor for institutional investors as well as for large family structures. Particularly mentionable in this context is the recently published evaluation report by MONEYVAL (the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism), where the council examined Liechtenstein's compliance with the recommendations on combatting money laundering issued by the Financial Action Task Force (FATF).[5] The report finds that Liechtenstein's legal and institutional framework allows effective investigation and prosecution of all types of money laundering.[6] As a result, the country is subject to the regular MONEYVAL reporting process, along with only five other jurisdictions that have achieved this status to date.

Liechtenstein as a Fund Domicile

When it comes to investment funds specifically, Liechtenstein's image is that of a boutique location or a hub for private label fund solutions. One of the country's greatest assets is its flexible fund company law and complete lack of regulatory gold-plating. Liechtenstein funds can be established in any commonly used legal form. In addition to the contractual form, which is widely used and well known, and the SICAV or LP structure, funds can also be established as unit trusts, as Liechtenstein also is a trust jurisdiction. When it comes to fund company law and fund governance, the principle of private autonomy generally takes precedence. This further increases the flexibility and options for structuring a fund. For example, a SICAV may issue founder shares and investor shares, the latter of which may or may not carry voting rights or the right to attend general meetings.

Apart from the European product regulations in the area of UCITS, ELTIF and EUVECA, a similar flexibility exists with regard to the design of the investment strategy of Liechtenstein funds. Due to the lack of gold-plating in fund regulation, there is no product regulation applicable to AIF products. This means that alternative investment funds can pursue any investment strategy and do not have to comply with almost specific minimum diversification requirements.

Trends and Developments

The Liechtenstein fund centre is developing steadily also in terms of strategies, especially in the alternative sector. In our view, the most exciting trend from a legal perspective with an impact on products and processes is sustainability. The EU's Sustainable Finance Framework, which aims to increase the transparency and comparability of sustainable investments and to combat greenwashing on a large scale, has triggered exciting developments at the European level. As sustainability was politically anchored early on as an important value for the Liechtenstein financial centre and the country as a whole and has traditionally enjoyed a high priority, the initiative has been well received in Liechtenstein. The fund industry has been quick to recognise that green investments offer interesting opportunities for investors, while at the same time contributing to the transition to a sustainable future. Sustainable finance will certainly be one of the most important evolving themes in the coming years.

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Liechtenstein is a highly compliant jurisdiction in the area of anti-money laundering, which is an important factor for institutional investors as well as for large family structures.

5 MONEYVAL, Anti-money laundering and counterterrorist financing measures: Liechtenstein: Fifth Round Mutual Evaluation Report, May 2022 https://rm.coe.int/moneyval-2022-6-mer-liechtenstein/1680a71000 (29.01.2023).
6 MONEYVAL, 6.

Another important and no less exciting area of development is the digitalisation of the business and the financial market infrastructure, as well as of governmental and regulatory procedures. When it comes to innovative products and solutions, such as crypto funds or tokenised fund units, Liechtenstein has built a reputation not only as an early facilitator of blockchain-related business models, but also as a trailblazer in their regulation. Local companies have proactively embraced digitalisation and new technologies, seeing them as a tool to create new opportunities. Already at an early stage, even established market players have not shied away from developing high-quality and in-demand services and products in the field of blockchain and digitalisation, placing Liechtenstein among the pioneering jurisdictions.

> "The small size of the country offers great advantages for fund promoters, asset managers and management companies.

The small size of the country offers great advantages for fund promoters, asset managers and management companies: Liechtenstein is famous for its "short ways" and the accessibility and cooperative approach of the authorities. The responsiveness and competence of the well-resourced supervisory authority, the FMA, and the flexibility and innovativeness of the Liechtenstein lawmakers are often cited as pull factors when choosing a location. For more traditional projects, this means a shorter time to market; for innovative projects, such as the first crypto AIF launched in Liechtenstein in 2018, this is even more important, as it can make the difference between whether they can be implemented at all in a reasonable time and at what cost. With few areas of law developing as swiftly as digital finance and its regulation, we are excited to see what comes next in this space.

All in all, we are confident that Liechtenstein will continue to build its reputation as a fund centre and trust that this contribution has provided some interesting insights.

CM LAW

BIO

Practicing in Luxembourg since 1997, Raphael Collin has extensive experience on mergers and acquisitions and financing projects. He regularly works with private equity and real estate funds on structuring their investments and setting up joint ventures in Luxembourg and abroad.
Raphael also advises clients in the listing of securities on the Luxembourg stock exchange (regulated market and Euro MTF market).

Prior to founding CM Law in 2014, Raphael was one of the founders of Baker & McKenzie Luxembourg's office in 2010. He also gained substantial experience working several years in the Luxembourg's office of a UK magic circle firm and as a partner of another top-ten Luxembourg law firm.

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Max von Frantzius has more than 20 years' experience in investment fund, M&A and corporate finance law. He mainly advises private equity, real estate and venture capital as well as general partners in structuring, setting-up (incl. Supervisory Authority (CSSF) approval process) and managing their alternative investment funds in Luxembourg. Overall, Max specialises in legal and regulatory aspects of Luxembourg investment fund work and cross-border issues.

Before joining CM Law in 2019, Max worked 5 years in the Luxembourg branch of Big 4 Company and its network law firm. Prior to that, he spent 10 years as Head of Legal and Member of the Executive Board of a German private bank in Luxembourg and 7 years as a Lawyer in Luxembourg and French law firms. Max is a Lawyer admitted to the Bars of Luxembourg (list IV), Cologne and Paris.

Luxembourg, the place to be for investment funds in Europe

1. Introduction

The Grand-Duchy of Luxembourg, a small country big as Manhattan, but offering six golf courses, is located in the heart of Europe and well established as the most important hub for investment funds[1] on the continent – ranking just behind New York as number two worldwide.

The country's tremendous success as a fund domicile started in 1988, when the first European Directive 85/611/EEC of 20 December 1985 for harmonised investment funds[2] had rapidly been transposed into national Luxembourg law as a "first mover". Luxembourg quickly understood the opportunities that offer a Europe-wide harmonised fund-legislation for cross-border distribution inside the European Union (**EU**). In the following years, important distribution activities related to Luxembourg domiciled UCITS with the "EU Passport" throughout the EU has been developed, while nearly all UCI's actual portfolio management in terms of asset allocation was – and still is - located outside Luxembourg. Since 1988, the relevant fund industry, composed by all necessary service providers (Custodian banks, Management companies, Central administrators, Domiciliation companies, Statutory Auditors etc.), grew rapidly. During two decades, Luxembourg tremendously developed as a UCI domiciliation location. The next milestone for Luxembourg's success as a hub for UCIs was the entry of the AIFMD in 2013.[3] This Directive, once again after the UCITS success story, was rapidly transposed into national law in 2013 and since, a continuously growing number of regulated alternative investment funds (**AIFs**) can be observed. Since 2016, the newly introduced regime of the semi-regulated "Reserved Alternative Investment Fund" (**RAIF**) came on top and encounters a never seen success.

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> The assets under management (AuM) of UCIs domiciled in Luxembourg amount to EUR 5,166.373 billion compared to EUR 5,064.782 billion as at 31 October 2022.

All relevant players in the world of UCIs are present in Luxembourg. More than 50 fund promoters from over 12 countries have chosen Luxembourg as their international hub. Most of them come from Germany, Switzerland, USA, France and the UK. Luxembourg domiciled investment funds are distributed to over 76 countries in Europe, Asia, the Middle East and the Americas.

A key factor for this tremendous success story is certainly closely linked to an unmatched political stability and a stable and rewarding tax environment in the Grand-Duchy for decades. Luxembourg's Financial Supervisory Authority, the Commission de Surveillance du Secteur Financier (**CSSF**) applies the highest control standards and is worldwide recognised.

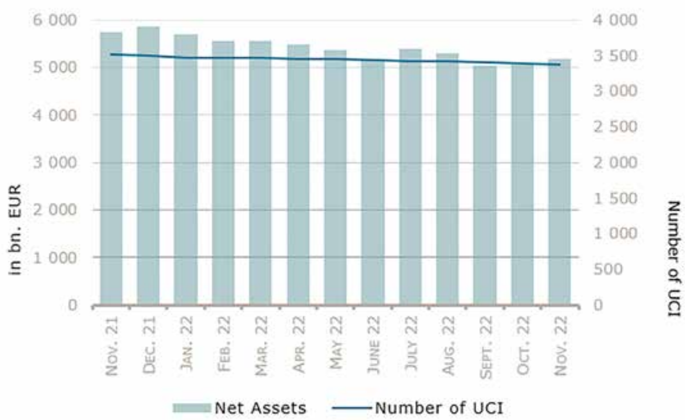
2. Global Situation of Investment Funds in Luxembourg (November 2022)

Today, the assets under management (**AuM**) of UCIs domiciled in Luxembourg amount to EUR 5,166.373 billion compared to EUR 5,064.782 billion as at 31 October 2022.[4] Over the year 2022, the volume of net assets decreased by 10.15%, which is certainly due to the global economic crisis.

But, the negative trend during 2022 should now be inversed: In November 2022, the Luxembourg investment fund industry registered a positive variation amounting to EUR 101.591 billion. This increase represents the sum of positive net capital investments of EUR 8.074 billion (+0.16%) and of the positive development of financial markets amounting to EUR 93.517 billion (+1.85%).[5]

1 Investment funds are generally known as "Undertakings for collective investment" – **UCIs**
2 Undertakings for collective investment in transferable securities - **UCITS**
3 European Directive 2011/61/EU of 8 June 2011 (**AIFMD**) for Alternative Investment Fund Managers (**AIFMs**).
4 Source: ALFI (Association of the Luxembourg Fund Industry), November 2022
5 Source: CSSF Communication 30 December 2022

The recent development of Luxembourg domiciled UCIs is as follows[6]:



3. Regulatory framework for Luxembourg domiciled investment funds

a. Fund vehicles

Luxembourg UCIs can be set-up in the contractual form (Fonds commun de placement – **FCP**) or in the corporate form (Société d'investissement à capital variable – **SICAV** or Société d'investissement en capital fixe – **SICAF**).

(1) Fonds commun de placement – FCP

The FCP is comparable to a simple "pool of assets", without legal personality, as a fund vehicle. Therefore, there is need for a Management Company (**ManCo**) that acts for the FCP on behalf of the investors who are joint owners ("**Unitholders**") of the FCPs' assets. The constitutional document of a FCP are the Management Regulations, which contain all rules relating to the investment policy, the procedures and all contractual relationships. This document is a "contract" entered into between the ManCo/AIFM and the Custodian Bank. Unitholders buy units in the FCP issued by the ManCo/AIFM, and which represent a portion of the "pool of assets" in the FCP. The unitholders become party to the "contract" and their relationship with the ManCo/AIFM is determined by the sales prospectus (also denominated "Issuing Document" or "Private Placement Memorandum – PPM" for AIFs). The unitholders rights are limited to the amount of their contribution and, since a FCP has no corporate structure, they have no voting rights.

(2) Société d'investissement à capital variable – SICAV or Société d'investissement en capital fixe – SICAF

UCIs in the corporate form are the investment companies with variable capital (SICAV) or with fixed capital (SICAF). Both can be used for any types of Luxembourg domiciled UCIs. SICAVs are much more used than SICAFs in practice. The advantage of a SICAV is that, despite the corporate form, each capital contribution or redemption does not need a notarial deed, nor another official formality. The amount of capital is at all times equal to the net asset value (**NAV**), calculated with the ManCo/AIFM on a regular basis. After each subscription or redemption, the SICAV's NAV increases or decreases automatically. SICAFs do not play an important role.

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The unitholders rights are limited to the amount of their contribution and, since a FCP has no corporate structure, they have no voting rights.

Each Luxembourg domiciled UCI can be structured as a stand-alone fund or as an umbrella structure with multiple "sub-funds" (or "compartments"). Between each sub-fund, there is a strict segregation of assets. This means that one sub-fund is not liable for the other sub-fund's assets and liabilities. The umbrella is the "virtual" corporate or contractual fund structure. Each sub-fund is, technically spoken, a bank account under the umbrella structure and can be provided with different share-classes with varying features (i.e. fees, dividends etc.).

b. Fund Products

The Luxembourg world of UCIs is divided into UCITS and AIFs.

6 Source: CSSF Communication 30 December 2022

(1) UCITS [7]

UCITS go back to 1988 (see I. above) and target the widest range of investors possible, in particular retail investors. The sole object is the collective investment in transferable securities and/or in other liquid financial assets of capital raised from the public and which operates on the principle of risk-spreading. The units of UCITS products are, at the unitholders' request, re-purchased or redeemed, directly or indirectly, out of the UCITS' assets.

> "
> From a tax perspective, UCITS are levied with an annual subscription tax (Taxe d'abonnement) of 0.05% on the fund's assets (reduced to 0.01% in some specific cases).

UCITS provide the highest investor protection and therefore, the investment restrictions and eligible investments are more severe than in other fund products and provide higher transparency. UCITS regulations are unique and strong and enhanced risk controls are applied.

UCITS must appoint a Luxembourg based Custodian Bank, a Central Administrator, a "Chapter 15 Management Company"[8] (unless it is a "self-managed SICAV/SICAF") and an External Auditor.

UCITS must invest in "eligible assets". In this context, the CSSF clarified that a UCITS should clearly disclose in its investment policy the categories of eligible assets in which it is authorised to invest (i) in order to achieve its investment goals, (ii) for treasury purposes and (iii) in case of unfavourable market conditions. There are two types of eligible assets, so called "core" and "non-core" investments, which terms are market practice use and not defined in the applicable regulations.

"Core"-assets for UCITS are directly mentioned in Art. 41 (1) of the Law of 10 December 2010 on UCIs, as amended, and are:

- Transferable securities admitted to or dealt on a regulated market, including (i) structured financial instruments (SFIs), (ii) transferable securities or money market instruments embedding derivatives or (iii) recently issued transferable securities or money market instruments;
- Money market instruments (MMIs);
- Deposits;
- Closed-ended investment funds (special conditions apply);
- Open-ended investment funds (special conditions apply);
- Financial derivative instruments (FDIs), including FDIs on financial indices; and
- Ancillary assets.

"Non-core" assets are those that are eligible under Art. 41 (2) a) of the Law of 10 December 2010 on UCIs, as amended, which is commonly called the "trash ratio". This means that not more than 10% of a UCITS' net assets can be invested in non-eligible transferable securities (e.g. private equity investments) and MMIs, whereby precious metals and certificates representing them are specifically prohibited.

Luxembourg based UCITS can easily be distributed in the European Union on a cross-border basis with the so called "European (Marketing) Passport", which is linked to the product itself. Once established in Luxembourg, the EU-Passport can be obtained within 10 days via a regulator-to-regulator procedure, which is a pure formality.

From a tax perspective, UCITS are levied with an annual subscription tax (Taxe d'abonnement) of 0.05% on the fund's assets (reduced to 0.01% in some specific cases). There is no further taxation on fund-level in Luxembourg.

(2) Alternative Investment Funds (AIFs) [9]

AIFs are fund products that are not UCITS and that fall under the AIFMD. In principle, all asset classes are permitted (except for SICARs, see below). The most important assets in which AIFs invest are real estate, private equity, and infrastructure. The regulated and semi-regulated AIFs that fall directly or indirectly under the CSSF's supervision are:

7 Part I of the Law of 10 December 2010 on UCIs, as amended
8 Management companies according to chapter 15 of the Law of 10 December 2010 on UCIs, as amended
9 Law of 12 July 2013 on AIFMs, as amended

(a) Specialised Investment Funds (SIFs) [10]

SIFs are required to comply with general diversification and risk management requirements but are not subject to detailed investment or borrowing rules. CSSF Circular 07/309 on risk-spreading rules provides that a SIF must ensure an "adequate" risk diversification. A SIF cannot, in principle, invest more than 30% of its assets or its commitments to subscribe to securities of the same nature issued by the same issuer. There are exceptions for investments e.g. in securities issued or guaranteed by an OECD Member State or by its local authorities or by supranational bodies or organisations of an EU, regional or worldwide nature. Target funds with comparable risk diversification principles are also eligible. In this context, each compartment of a target umbrella investment-fund may be considered as single issuer. Short-selling cannot, in principle, result in the SIF holding uncovered securities of the same nature issued by the same issuer representing more than 30% of its assets. When using FDIs, the SIF must ensure comparable risk-diversification of the underlying assets. Furthermore, the counterparty risk of OTC transactions must be limited according to the quality and qualification of the counterparty. The risk diversification rules apply on each compartment-level separately, should the SIF be established with an umbrella-structure. However, the CSSF may grant exceptions on a case-by-case basis (i.e. granting "ramp-up periods" to comply with the diversification rules later than after the legally imposed first year).

SIFs are subject to the CSSF's direct supervision and must initiate a prior approval procedure on product level with the regulator.

(b) "UCI Part II-Funds" [11]

Part II of the Law of 10 December 2010 on UCIs, as amended, does not contain provisions regarding investment or borrowing rules for such UCIs Part II, but several CSSF Circulars and a "case-by-case" practice applied by the CSSF determine such rules. Eligible investments are therefore (i) transferable securities, (ii) alternative investments (i.e. hedge funds, real estate and private equity) and (iii) futures contracts and options. The risk diversification rules are quite flexible and can be discussed with the CSSF on a case-by-case basis. In practice, UCI Part II-Funds lost their importance over the years.

UCI Part II-Funds are subject to the CSSF's direct supervision and must initiate with the regulator a prior approval procedure on product level.

(c) Investment Companies for Risk Capital (SICARs) [12]

A SICAR is an investment product without investment restriction rules (i.e. only one investment is eligible), which was designed for investments in "risk capital". Eligible investments are quite restricted and the concept of "risk capital" is provided by CSSF Circular 06/241. In general, SICARs invest in private equity and venture capital, real estate investments are only permitted when there is a "development" factor (e.g. transforming warehouses into luxury lofts). A SICAR does not benefit from the numerous tax advantages of Luxembourg investment funds (i.e. only the subscription tax is levied), but various exceptions apply.

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> SIFs are subject to the CSSF's direct supervision and must initiate a prior approval procedure on product level with the regulator.

SICARs are subject to the CSSF's direct supervision, and an application file must be transmitted which must include both "risk" and "development" aspects of the SICAR project.

(d) Reserved alternative investment funds (RAIFs) [13]

The RAIF is the "rising star" in Luxembourg since its introduction in national law in 2016, since when it encounters a tremendous success.

The RAIF also qualifies as AIF, but is not directly supervised by the CSSF. Nevertheless, there is an indirect supervision since all RAIFs must appoint a fully licensed and supervised AIFM. The Luxembourg legislator considered that the strong supervision of AIFMs under the AIFMD must not necessarily be replicated on product level. Therefore, a RAIF is not subject to a prior approval procedure with the CSSF and can rapidly be launched. Another aspect of the RAIF's success is that the EU-Passport for cross-border marketing in the EU is also available. It is unique that an AIF without direct supervision on product-level can be distributed with the EU-Passport.

10 Law of 13 February 2007 on SIFs, as amended
11 Part II of the Law of 10 December 2010 on UCIs, as amended
12 Law of 15 June 2004 on SICARs, as amended
13 Law of 23 July 2016 on RAIFs, as amended

In a nutshell, the RAIF replicates the SIF- or the SICAR-regime, but without direct supervision by the CSSF. RAIFs have full flexibility with the assets it may invest in. There are no specific investment rules or restrictions, but a RAIF must adhere to the principle of risk-spreading (except when it opted for the SICAR-regime). It is in the responsibility of the RAIF's governing body to ensure that the minimum diversification rules are complied with.

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Common to all AIFs is that they raise capital from a number of investors with a view of investing it in accordance with a predefined investment policy.

It can also be noted that a RAIF can be transformed into a SIF at a later stage, should direct supervision on product-level be necessary. This allows to start operating the fund quickly ("speed to market") and to initiate a SIF approval-procedure with the CSSF on a parallel basis.

(e) European long-term investment fund ("ELTIF")[14]

The European long-term investment fund ("ELTIF") is an AIF for long-term investments, such as social and transport infrastructure projects, real estate and small and middle-sized enterprises (SMEs). The ELTIF regulatory framework is intended to facilitate long-term investments in these types of assets by institutional and retail investors and provide an alternative, non-bank source of financing for the real economy. In practice, ELTIFs have no significant success in Luxembourg so far.

Common to all AIFs is that they raise capital from a number of investors with a view of investing it in accordance with a predefined investment policy. In principle and compared to UCITS, AIFs have the broadest investment possibilities, depending on the actual product chosen. They must appoint a Depositary (Bank or licensed "Professional of the Financial Sector" – (PSF), depending on the nature of the assets under management), Central Administrator, fully licensed AIFM and an external Auditor. Eligible investors in all before mentioned AIFs are so-called "well-informed investors", which term includes professional and semi-professional investors, (ultra) high net worth individuals, family offices etc.

SIFs, UCI-Part II Funds, SICARs and RAIFs that have appointed a fully licensed and supervised AIFM can distribute their shares or units with the so-called "European (Marketing) Passport" in the European Union without further material approval procedure by local regulators. The appointed AIFM will obtain such EU-Pass within 20 days from the CSSF that applies the regulator-to-regulator procedure beforehand. For such AIFs too, obtaining the EU-Passport is a matter of formality.

From a tax perspective, AIFs (except SICARs, see above) are levied with an annual subscription tax (Taxe d'abonnement) of 0.01% on the fund's assets. There are no further taxes in Luxembourg applicable on fund level.

4. Corporate structures for investment funds

While an investment fund set-up in the contractual form (FCP, see above), which has no legal personality and is therefore no corporation, investment funds set-up in the corporate form of a SICAV or SICAF need a company form.

The constitutional document of an investment company is the articles of incorporation (also known as instruments of incorporation, articles of association or statutes) or the limited partnership agreement (LPA). SICAVs and SICAFs are also subject to the Luxembourg laws on commercial companies (in particular, the Law of 10 August 1915 on commercial companies, as amended) insofar as the laws governing the Fund Products (UCITS, UCI Part II, SIFs, SICARs or RAIFs) do not derogate from it. While a UCITS-SICAV must be set up as a public limited company (Société anonyme — S.A.) or a European company (S.E.), a SIF-SICAV and a RAIF-SICAV can be set up as a public limited company (S.A.), a private limited liability company (Société à responsabilité limitée — S.à r.l.), a partnership limited by shares (Société en commandite par actions — S.C.A.), a limited partnership (Société en commandite simple — S.C.S.), a special limited partnership (Société en commandite spéciale — S.C.Sp.), or a cooperative company organized as a public limited company (Société coopérative organisée sous forme de société anonyme — S.Co S.A.). A SICAV set up as a public limited company or a private limited liability company may be created for a single shareholder, enabling SICAVs to be incorporated

14 Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015

by a single entity/person and permitting their creation for a single investor. A UCI Part II-SICAF, a SIF-SICAF or a RAIF-SICAF may take any commercial company form, such as the before mentioned legal forms or, in addition, the form of an unlimited company (Société en nom collectif). SICAVs and SICAFs incorporated under the form of a capital company (S.A., S.à r.l., S.C.A., S.Co S.A. or S.E.) are not tax transparent, while those investment companies formed as a partnership (S.C.S or S.C.Sp.) are generally treated as tax transparent entities. The difference between S.C.S and S.C.Sp. is that the latter is similar to the Scottish limited partnership, without legal personality, that has been introduced in Luxembourg law in 2016 in order to provide anglo-saxon investors with a well-known corporate vehicle.

5. Recent developments in 2022

In the course of 2022, exciting new topics arose for the Luxembourg fund industry:

a. ESG

All Luxembourg fund promoters were heavily occupied by the interpretation and the application of the aspects of Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial sector (**SFDR**). The increased importance of ESG[15] impacted all facets of the establishment of new investment funds and required the adoption of existing investment funds to such new regulation. A delegated act[16] supplementing Article 8 of the Taxonomy Regulation established some technical screening criteria in order to determine when the investment activity of an investment fund qualifies as contributing substantially to climate change mitigation or climate change adaptation, within the meaning of Article 9 of the Taxonomy Regulation,[17] and that it does not cause significant harm to other environmental objectives. The aim is to increase market transparency and the fight against "greenwashing" by ensuring that investors are provided with transparent and necessary information about the environmental performance of an investment fund's assets. A second delegated act on technical screening criteria for economic activities, that make a significant contribution to the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control, or the protection and restoration of biodiversity and ecosystems[18] was published in the course of 2022. Finally, the European Commission adopted the regulatory technical standards (**RTS**) for the content and presentation of disclosures (in e.g. an investment fund's sales prospectus) under the Taxonomy Regulation. The RTS are applicable in Luxembourg since 1 January 2023. Since then, Article 8 and Article 9 SFDR RTS pre-contractual templates must form an integral part of all investment funds' sales prospectuses that are in scope.

b. AIFMD 2

On 25 November 2021, the European Commission announced an amendment to Directive 2011/61/EU on alternative investment fund managers ("**AIFMD 2**"). The main amendments relate to (i) delegation arrangements, (ii) liquidity risk management, (iii) supervisory reporting, (iv) the provision of depositary and custody services, and (v) loan origination by AIFs. The European Commission recognises the value of the delegation regime, which allows for an efficient management of investment portfolios. However, amendments are proposed to ensure that AIF managers retain core functions. A new Annex V of AIFMD 2 will be introduced that contains a list of liquidity management tools (**LMT**) available to AIFMs that manage open-ended AIFs. In order to better face redemption constraints under difficult market conditions, the portfolio managers of such AIFs should be required to choose at least one LMT from this list, in addition to the possibility of suspending redemptions. The European Commission also concluded that there is a need to harmonise requirements for AIFMs of AIFs that originate loans. The amended Directive is expected to be adopted in early 2023. EU Member States will then have 24 months to transpose AIFMD 2 in national law. It is expected that Luxembourg will – as always regarding European Fund Directives – be amongst the first countries that proceed to such transposition.

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All Luxembourg fund promoters were heavily occupied by the interpretation and the application of the aspects of Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial sector (SFDR).

15 Environmental, Social and Governance
16 The "Disclosure Delegated Act", adopted on 4 June 2021
17 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088
18 The "Environmental Delegated Act"

c. ELTIF 2

Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on ELTIFs is also under review. Given the degree of overlap, the European Commission is reviewing the AIFMD and the ELTIF Regulation at the same time. The proposed amendments to the latter aim to increase the use of ELTIFs across the EU for the benefit of the European economy and investors. This especially entails broadening the scope of eligible assets and investments, allowing more flexible fund rules that include the facilitation of fund-of-fund strategies, and lowering unjustified barriers that prevent retail investors from accessing ELTIFs. Probably ELTIF 2 will bring the so far outstanding success of this product in Luxembourg.

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> A Luxembourg based UCI was launched, which has the possibility to invest in cryptocurrencies, digital assets as well as in funds and equity of fintech or blockchain-linked companies.

d. Virtual “crypto” assets

A Luxembourg based UCI was launched, which has the possibility to invest in cryptocurrencies, digital assets as well as in funds and equity of fintech or blockchain-linked companies. UCIs in Luxembourg now have the possibility to invest in crypto assets. In this context, the CSSF is of the opinion that virtual assets can be suitable for AIFs marketed to professional investors and managed by an authorised AIFM, that has obtained a “specific extension” of its AIFM-license for investing in the wider field of crypto assets. In addition to the license extension requirement, AIFMs and service providers will need to reorganise their business model and the relevant governance, their organisational policies, their risk assessment as well as their procedures in order to comply with the CSSF’s “best practices”.
From a regulatory perspective, the European Markets in Cryptoassets Regulation (**MiCA**), which is expected to enter into force in early 2023, aims, inter alia, to limit the risks of fraud and illicit practices inherent to crypto asset-markets by imposing compliance requirements on the relevant service providers.

d. AIFs becoming “retail products”

The year 2022 was also marked by discussions (ALFI, LPEA[19] etc.) on the financial market around the potential opening of AIF-products to retail clients. The “retailisation” of AIFs is an incontrovertible trend based on expected higher returns through exposure to non-traditional asset classes and a desire on the part of AIFMs to widen their investor base in order to obtain additional financing for the AIFs they manage. It appears that the EU legislator is actively considering how an increase of net assets in investment funds can be obtained that also come from retail investors. To achieve that aim, a separate feeder fund only for retail investors could be established. Such “retail feeder” could then invest in a master fund, together with well-informed investors (i.e. institutional, semi-professional and professional investors). This type of master-feeder structure could help to address the liquidity concerns of retail investors since additional liquidity can be created in the “retail feeder” through the organisation of enhanced redemption options, or via the facilitation of secondary transfers amongst retail investors.

e. Register of Beneficial Owners

On 22 November 2022, the Court of Justice of the EU stated that the “public access” feature of the Luxembourg Register of Beneficial Owners (**RBO**)[20] is invalid in the light of the Charter of Fundamental Rights of the EU and that it constitutes a serious interference with the fundamental rights to private life and to the protection of data.
The Luxembourg Business Register (LBR) immediately suspended all access to the RBO. In the meantime, access to the RBO has been re-established for a number of professionals who already had identified access to the LBR and the RBO. Also press representatives that have a legitimate interest in being able to consult the RBO have been granted access.

Outlook

6. Many legal and regulatory changes have impacted the Luxembourg fund industry in 2022, and will continue to impact it in 2023. Some of them are likely to further developing the fund industry, such as the “retailisation” of AIFs, the widening of eligibility of permitted assets or the introduction of new products. A strong focus will certainly be on ESG and the sustainability of the UCIs’ assets. The negative impact of the economic crisis on the UCIs’ evolution in terms of AuM seems to be stopped and inversed. It is very likely that Luxembourg will further develop its financial place and defend its position as most important fund hub in Europe.

19 Luxembourg Private Equity Association
20 Article 30 of Directive (EU) 2018/843 (AMLD 5)

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Bernard joined the firm back in 1998 after successfully graduating in Bachelor of Accountancy Hons. from the University of Malta. In 2007, Bernard was seconded to the International Tax Structuring Group in Berlin.

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Lucienne Pace Ross is an Assurance Partner and the quality and risk Partner at PwC Malta. Lucienne is a Certified Public Accountant (CPA), a member of the Association of Chartered Certified Accountants (ACCA) and the Malta Institute of Accountants (MIA).

Lucienne has been with the firm since 1997 and acts as an assurance engagement leader on diverse client portfolios including groups of companies and other non-group companies that vary in size and structure.

Lucienne has significant audit experience in the financial services industry, particularly insurance and investment services, where she also complimented her experience with a number of short-term secondments to the PwC New York office. Lucienne is also PwC Malta's Asset Management leader.

Lucienne is also involved in a number of non-audit assurance engagements, including control assurance engagements under ISAE 3402

Fund Structuring in Malta

Malta's attractiveness as a financial centre has withstood the test of time. This is down to various factors including its geographical location, EU membership and multilingual workforce. In the asset management space, Malta has established itself as an alternative jurisdiction, home to start-ups and smaller asset managers looking to build track record or simply operate in a cost effective environment.

More recently, alternative strategies gained popularity. Locally, as at June 2022, in terms of aggregate Net Asset Value, 70.5% was accounted for by Alternative Investment Funds (AIFs), 15.6% by Professional Investor Funds (PIFs) and 13.9% by Undertakings for Collective Investment in Transferable Securities (UCITS).[1] This in the midst of various efforts to consolidate the robustness of the regulatory environment including initiatives which enabled the jurisdiction to be removed from the FATF grey list[2] in record time. This included a transformation in terms of both systems and approach within Malta's single financial services regulator, the Malta Financial Services Authority (MFSA), who completely updated its licence application and authorisation processes.

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> Malta has established itself as an alternative jurisdiction, home to start-ups and smaller asset managers.

The MFSA has also been active in proposing regulatory initiatives targeted at increasing the flexibility and attractiveness of Malta's asset and wealth management regulatory framework. Public consultation on a renewed asset management strategy[3] was conducted during 2022 and this included a number of proposals aimed at strengthening Malta's attractiveness to private equity (PE) managers, some of which we explore further below.

These initiatives are being proposed against a backdrop of an existing regulatory framework which allows for a high degree of flexibility in terms of fund structuring solutions. The legal forms available to Collective Investment Schemes (CISs) include:

- Investment Companies (typically SICAVs)
- Limited Partnerships
- Unit Trusts
- Contractual Funds

Furthermore, various other structural solutions are available to fund platforms and multi-fund umbrella structures, including:

- Multifund SICAVs - umbrella structures including a number of sub-funds with the option of each constituting a separate patrimony of assets and liabilities pursuing its own investment strategy with the possibility of cross-sub-fund investment.

- SICAV ICC - an Incorporated Cell Company (ICC) constituted of one or more Incorporated Cells (ICs) which can be open/closed ended and enjoy separate legal personality with the possibility of cross IC investment and one IC contracting with another.

- RICC structures - where the Recognised Incorporated Cell Company (RICC) provides administrative platform type services to Incorporated Cells (separate companies licensed as CISs).

1 Collective Investment Schemes licensed by the Malta Financial Services Authority: A Semi-Annual Analysis (2022) - October 2022.

2 Malta was added to the list of countries under increased monitoring for money laundering and counter terrorism by the FATF between June 2021 and June 2022.

3 Asset Management Strategy: Strengthening Malta's Position as an Asset Management Jurisdiction - MFSA Discussion Paper October 2021.

In terms of CIS licences available, besides UCITS and Alternative Investment Funds based on the related EU regulatory frameworks, two local regimes are typically used in the context of private equity strategies:

- Professional Investor Funds: a more lightly regulated structure fitting into the AIFMD de minimis thresholds (the total assets under management of the manager of the fund, or the fund itself if it is self-managed, cannot exceed €100m or €500m if unleveraged and have no redemption rights within 5 years of initial investment); and

- Notified AIFs (NAIFs): a structure which has better speed to market as NAIFs are essentially unlicensed on the basis of being managed by a licensed AIFM[4] which takes regulatory responsibility for the NAIF.

Private Equity Potential

Globally, alternative strategies including private equity keep showing huge potential for growth. In principle, investors continue to look to private equity to deliver the yields that lower-risk and more liquid asset classes are struggling to match. Assets under management (AuM) in private markets are expected to expand in line with the pace of economic recovery. Under the base-case scenario, these would make up more than 10% of global AuM by 2025, constituting a small but fast-growing part of the capital markets.[5]

Post pandemic, opportunities for acquisition and corporate turnaround increased. Furthermore, strong fundraising increased pressure to put dry powder to work. While leading to inflated valuations, these circumstances promised great conditions for private equity managers. However, more recently (particularly in the second half of 2022), the significant supply-chain, inflation and interest rate uncertainty is complicating matters. Predicted economic downturns and likely recessions in various economies typically spell slowdowns for private equity deal activity. Having said that, historically, companies that made deals during the downturn ultimately saw higher shareholder returns than others in their industries.[6]

This challenging outlook is leaving managers looking for new ways to create value. They are being pushed to make greater use of technology and data-driven insights to both speed up and better inform their deal processes, and to broaden their investment profile in new sectors and asset classes in their search for returns.[7]

Private equity remains an important engine for M&A (Mergers and Acquisitions) activity, being viewed as a perpetual source of deal-making capital that can be counted on to fuel deal volumes, irrespective of market challenges. As of June 2022, global PE dry powder stood at US$2.3tn - three times more than the amount in 2007. Furthermore, regulatory and market challenges faced by banks and financial institutions, as well as PE, have also fuelled the growth in the private credit market over the past few years and private capital for financing deals is now outstripping traditional lending sources.[8]

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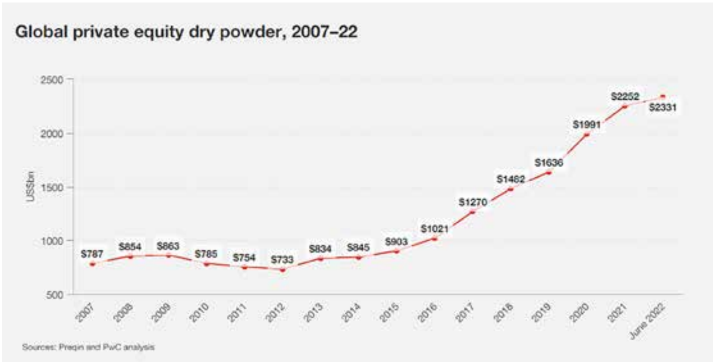
> Globally, alternative strategies including private equity keep showing huge potential for growth.

Exhibit 1: Global private equity dry powder, 2007-22



4 Full-scope Alternative Investment Fund Manager authorised and regulated under the Directive 2011/61/EC on Alternative Investment Fund Managers.
5 Prime time for private markets: The new value creation playbook - a 2021 PwC Report
6 Succeeding through M&A in uncertain economic times - https://www.pwc.com/us/en/services/consulting/deals/ma-in-uncertain-economic-times.html
7 Prime time for private markets: The new value creation playbook - a 2021 PwC Report
8 PwC Global M&A Industry Trends: 2022 Mid-Year Update - https://www.pwc.com/gx/en/services/deals/trends.html#spotlight-on-private -equity-and-value-creation

However, as the current market disruptions are likely to persist leading to a more challenging value-creation environment, capitalising on opportunities increasingly means a (renewed) concentration on critical value creation drivers - including digital, talent and ESG (Environmental, social, and governance)- which will be crucial to long-term success.[9]

Sustainable Finance and ESG

As we are all aware, one of the biggest challenges but also opportunities facing both society in general and the global Asset & Wealth Management (AWM) industry for the next 20 years is mobilising private capital to achieve sustainability related goals, starting with the shift to Net Zero and decarbonisation. Public-private partnerships are going to be essential in reaching the twin goals of providing a reasonable return on investment while also meeting the investment needs required to support a global transition to net zero. Indeed, we are witnessing an increased allocation to sustainable investments across all investment vehicles.[10] ESG is clearly transitioning from being a differentiator to being a core essential for private equity.[11]

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> European Private Markets (Private Equity, Real Estate, Infrastructure and Private Debt) ESG assets are expected to skyrocket to between EUR 775.7bn and EUR 1.2tn by 2025.

It is evident that in the asset & wealth management industry, ESG funds have moved from the margins into the mainstream and ESG-oriented AuM is set to grow at a much faster rate than the AWM market as a whole.[12]

In a recent PwC Global Survey of asset managers and institutional investors (‘PwC’s Asset and Wealth Management Survey’); a majority of investors (60%) reported that ESG has led to higher yields in their investment performance in comparison to non-ESG equivalents, therefore, it is to no surprise that investors are willing to pay higher fees for ESG funds. This is coupled with the fact that there hasn’t been an evident increase in fees being applied to retrofitted funds till now, notwithstanding the higher compliance costs for asset managers.[13]

European Private Markets (Private Equity, Real Estate, Infrastructure and Private Debt) ESG assets are expected to skyrocket to between EUR 775.7bn and EUR 1.2tn by 2025 - accounting for between 27.2% and 42.4% of the entire private markets industry’s asset base. European Private Equity ESG AuM are forecasted to increase to EUR 292.0 bn by 2025 under a base case scenario - making up 20.7% of total PE assets. Over 90% of this EUR 193.7bn increase is expected to stem from new funds.[14]

Exhibit 2: European PE ESG AuM: Forecasts to 2025 (EUR bn)

9 Private equity: US Deals 2023 outlook- https://www.pwc.com/us/en/industries/financial-services/library/private-equity-deals-outlook.html
10 PwC’s Keeping up with Tax - Alternative Investment Funds - December 2022
11 Prime time for private markets: The new value creation playbook - a 2021 PwC Report
12 PwC - ‘Asset and Wealth Management Revolution 2022 - Exponential expectations for ESG’
13 Ibid.
14 2022 EU Private Markets: ESG Reboot. Creating alpha and meeting investors’ needs: a matter of survival. Sustainable Finance Series - Private Markets - a PwC Luxembourg report.

Having said this, the speed and volume of EU regulatory developments stemming from the Sustainable Finance Agenda is a tough challenge for EU managers looking to pursue sustainable strategies. Managers who have been focusing on impact investing for some time are having to struggle to reconcile the data collection and reporting frameworks they built with the very far reaching and specific requirements imposed by EU regulation. Start-ups and new funds on the other hand may find the extent of regulation and cost of compliance a barrier to entry. In this sense, there is certainly a role for smaller alternative jurisdictions to look to clarify, streamline and facilitate compliance with a view to improving accessibility.

Malta's place as an alternative PE domicile

From an ESG perspective, the MFSA has stated its intention to facilitate the information flow to the asset management industry in respect of the ESG related regulatory developments and assess the impact of such legislative measures on the local market, seeking feedback from the industry as necessary to implement requirements in as proportionate a manner as possible.[15]

The MFSA also approved a particularly flexible regime allowing for the listing of green bonds on the local capital markets. In terms of the Malta Stock Exchange Green Bond List criteria (which are based on ICMA's Green Bonds Principles[16]), proceeds would need to be invested in projects that contribute towards one of the following six environmental objectives and adhere to the Do No Significant Harm principle:

- Climate Change Mitigation
- Climate Change Adaptation
- Sustainable and Protection of Water and Marine Resources
- Pollution Prevention and Control
- Transition to a Circular Economy
- Protection and Restoration of Biodiversity and Ecosystem[17]

Malta's traditional role as a cost effective domicile for alternative strategies including PE retains relevance in these uncertain times. The rise in inflation and interest rates in this geopolitical climate pushing up energy prices and the wider cost of living, will lead fund managers to search for ways to mitigate the impact of rising costs. The existing accessible and flexible infrastructure lends itself well to building the right substance without breaking the bank in these times of talent shortages.

Beyond costs, the MFSA, together with the local AWM industry have been working to further enhance the regulatory framework in place, looking to provide updated more flexible structures more suited to the current needs of PE managers. The MFSA's renewed asset management strategy referred to above, included a number of interesting proposals. Those more likely to be interesting to PE houses include:

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> Malta's traditional role as a cost effective domicile for alternative strategies including PE retains relevance in these uncertain times.

(1) A proposed Notified Professional Investor Fund (PIF) regime.

The MFSA has recently published for specific consultation, a proposed regulatory framework for Notified Professional Investor Funds.[18] Similar to the NAIF framework but applicable to PIFs, the regime is based on allowing for faster and cheaper set up with the CIS not being subject to regulation itself subject to the regulated status of its service

15 Asset Management Strategy: Strengthening Malta's Position as an Asset Management Jurisdiction - MFSA Discussion Paper October 2021.
16 The International Capital Markets Association's Green Bond Principles - which seek to support issuers in financing environmentally sound and sustainable projects that foster a net-zero emissions economy and protect the environment.
17 Bye-Law 5.02.13.01 Of The Malta Stock Exchange Plc Bye-Laws issued by the authority of the Board of Directors of Malta Stock Exchange Plc.
18 MFSA Consultation on the Proposed Establishment of a Framework for Notified Professional Investor Funds (22 December 2022).

providers and the qualified status of its target investors. Such a framework should be attractive in controlling costs and achieving good speed to market for smaller PE managers.

(2) A Restructured Limited Partnerships (LPs) Legal Framework for CISs.

Following the inclusion of a proposal to this effect in the above mentioned renewed asset management strategy,[19] discussions are ongoing to update the Maltese legal framework for LPs licensed as CISs to increase its flexibility and usability. Once launched, this should be particularly attractive to Anglo-Saxon PE managers looking to target European investors replicating the flexibility of familiar fund structures.

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> The fundamental objective remains to allow for as much flexibility as possible in terms of fund structuring solutions which is so key when it comes to Private Equity.

(3) Revisiting the Recognised Private CISs Framework.

This is another proposal included in the strategy document[20] issued for consultation aimed to improve the current regime targeting private wealth managers and family offices. Clarifying the concepts of external capital, pre-existing groups, family members and private nature/purpose and aligning these to the AIFMD and related guidance should help improve the already attractive environment for such private wealth vehicles.

These proposals are but a few of the various put forward in the MFSA's asset management strategy.[21] The fundamental objective remains to allow for as much flexibility as possible in terms of fund structuring solutions which is so key when it comes to Private Equity. In particular, in a time of both challenges and opportunities created by the current economic context.

19 Asset Management Strategy: Strengthening Malta's Position as an Asset Management Jurisdiction - MFSA Discussion Paper October 2021.
20 Ibid.
21 Ibid.

Asset & Wealth Management revolution: the power to shape the future

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BIO

Based in Singapore, Wee Hwee is currently the tax leader for the asset management and real estate industry at KPMG Singapore and he has about 25 years of experience in the tax advisory industry.

An expert in fund formation (both unlisted and listed including REITs), Wee Hwee is familiar with fund platforms in Singapore, Luxembourg, the Cayman Islands, Labuan, etc., as well as tax efficient divestment planning opportunities for funds with multiple exit strategies (be it trade sale, conversion to income producing funds or IPO exit).

He is also an expert in structuring carried interest from both a corporate and personal tax perspective. Specifically, Wee Hwee has extensive experience in structuring single country and multiple jurisdictional funds with an Asian focus, both close-ended and open-ended, listed and unlisted, and across various alternative asset classes including real estate, infrastructure, renewable energy, private equity, venture capitalist, hedge funds, crypto currency and debt.

KPMG

Introduction

As many would agree, the current economic situation makes it extremely challenging for fund managers to raise capital in an environment that is already fiercely competitive. At the same time, complexity surrounding tax and legal regulations for funds is evolving so quickly, it can be hard to keep track of what is going on. Further, investors and especially the ones with deep pockets, have also become more sophisticated and demanding over the years. For instance, some investors have started to scrutinize the tax structure of the fund and are making onerous requests on fund managers to make certain commitments in order to achieve the tax outcome that they desire. So if you think that fund structuring is as easy as just replicating an existing structure and only having to worry about dealing with tax and legal issues after you have raised the monies, then you may be in for a rude shock.

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> The overarching objective for any fund manager is naturally to maximise investors’ return on investment.

In essence, other than having the right investment strategy, it is pivotal that fund managers consider and are familiar with other aspects when structuring their funds in order to have a competitive edge against their peers. The above is especially true for aspiring and start-up fund managers as well as family offices who are looking to manage third-party monies for the first time.

This article discusses some of the key practical considerations from a tax and commercial perspective, with a light touch on the regulatory issues, when it comes to setting up a fund.

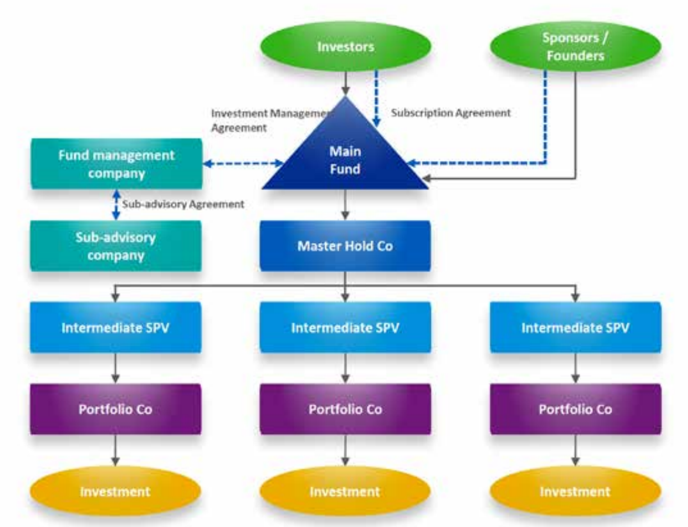
Key objectives of fund structuring

The overarching objective for any fund manager is naturally to maximise investors’ return on investment. However, without any proper tax planning, the return on investment could be substantially reduced and may even have an impact on the entitlement to carry. An efficient fund structure should therefore seek to minimize tax leakages at all levels -from the main fund vehicle to the portfolio entity holding the investment.

The viability of a tax-efficient fund structure should include the following commercial and legal features which would greatly enhance the fund’s marketability:

- Familiar to investors
- Complies with investors’ regulatory requirements
- Optimal capital structure for ease of cash repatriation
- Allows exit flexibilities and caters to exit parameters
- Cost efficient with minimal compliance
- Flexible enough to cater to future shocks

The failure of a fund manager to properly consider any of these factors could impair the fund’s ability to attract investors or cause the fund to generate sub-optimal returns on investment. We will now discuss how tax considerations and the above factors would impact the fund structure.



Location and legal form of the main fund vehicle

There are quite a number of jurisdictions where one can set up a fund. The more common ones include the Cayman Islands which by far is the most widely used and popular, followed by Luxembourg, Ireland and more recently Singapore. Less common jurisdictions include Bermuda, Jersey, Guernsey, the UK, Scotland, Mauritius, Australia, Delaware, Canada, Labuan and the list goes on.
There are far fewer choices when it comes to legal forms and this would typically include limited partnerships, companies and trusts.

The following are key factors to consider when deciding on the legal form of the main fund vehicle and its location:

Tax neutrality

As the main fund vehicle is often perceived by investors as functioning predominantly as a pooling vehicle, it should be tax neutral. In other words, taxes should only be levied at the investment level and where applicable, in the hands of the investors. Specifically, this means that the fund vehicle should not suffer taxes on investment income and gains. Further, taxes should not be levied on profit distributions and capital returns to investors.

For these reasons, funds are traditionally set up in tax haven jurisdictions such as the Cayman Islands and Guernsey. This is not to say that funds cannot be set up in high tax jurisdictions as tax neutrality can be achieved through other means such as tax transparency. Examples would include limited partnership vehicles that are set up in the UK and Delaware. Essentially, such vehicles are considered as "pass-through" vehicles for tax purposes and accordingly, taxes would not be levied on the fund vehicles.

Fund vehicles can also obtain tax neutrality by availing themselves of specific tax regimes tailored to develop the on shoring of funds. The concept of "on shoring" refers to having the fund manager and the fund in the same location. For instance, funds that are domiciled in Singapore can apply for tax exemption from the Monetary Authority of Singapore. Funds set up in Hong Kong can also enjoy tax exemptions.
Some countries provide tax neutrality in more than one form. Luxembourg is a good example. It offers transparency treatment to funds that are set up as partnerships. At the same time, funds that are set up as corporate vehicles enjoy tax exemption if they qualify as regulated alternative investment funds. Examples include the Specialised Investment Fund (SIF), Investment Company in Risk Capital (SICAR) and Reserved Alternative Investment Fund (RAIF).

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> Fund vehicles can also obtain tax neutrality by availing themselves of specific tax regimes tailored to develop the on shoring of funds.

Investor familiarity and comfortability

Investor familiarity and comfortability are critical in ensuring the fund's marketability. Marketing a fund structure that investors are not familiar with or are not comfortable with could significantly lengthen the time it takes for an investor to "tick the box" before subscribing to the fund. In the worst case scenario, the potential investors may even walk away.

Jurisdictions like the Cayman Islands have historically been popular fund locations due to the absence of taxes and a light-touch regulatory environment. Needless to say, investor familiarity with a Cayman Islands fund would tend to be high. In particular, investors from the US, Canada, the Middle East and Asia are used to investing into Cayman Islands funds. On the other hand, institutional investors from the European Union are more familiar with funds that are set up in Luxembourg and Ireland. German pension funds and insurance funds, for instance, are well known for their preference to invest into Luxembourg-domiciled funds (often due to regulatory reasons). Whilst the more seasoned investors in Europe have moved on to funds set up in alternative jurisdictions, those who are just starting to venture beyond Europe and especially the small and medium-sized investors, are still very fond of Luxembourg and Ireland.

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> Notably, investors are becoming increasingly sophisticated and are exposed to a myriad of investment platforms.

That said, fund managers should not rule out other jurisdictions for establishing their funds. Notably, investors are becoming increasingly sophisticated and are exposed to a myriad of investment platforms. For example, since the launch of the Singapore limited partnership framework in 2008, whilst Asian investors are generally familiar with Cayman Islands funds, many are also becoming more open to invest into funds set up as a Singapore Limited Partnership. Of late, investors from Canada, the Middle East, Korea, Malaysia, Germany and the Netherlands have also started to invest into Singapore domiciled funds.

Hong Kong, with the recent introduction of the Hong Kong open-ended company and with a limited partnership framework in the works, is the new kid on the block. Whilst it is a tad too late in the game, like they say, it is better late than never.

Further, a spate of scandals in tax havens such as the Paradise Papers and Panama Papers leaks and a renewed focus by governments on tax evasion and Base Erosion and Profit Shifting (BEPS) have caused some groups of investors to shy away from investing in funds established in ‘tax havens’ because of reputational concerns. In particular, institutional investors such as pension funds and sovereign wealth funds have even implemented internal policies prohibiting or discouraging the use of investment in vehicles established in ‘tax haven’ jurisdictions. Increasingly, we are also noticing that investors from Japan, Korea and Indonesia are becoming less comfortable about investing into Cayman Islands funds and are exploring Singapore funds as an alternative.

To make things worse, with its recent blacklisting by the European Union, which came as a surprise to most, European investors would find it difficult to invest into funds set up in the Cayman Islands, at least for now. To some extent, this could impact the Cayman Islands’ reputation as a fund domicile and consequently affect reputation-conscious investors, deterring them from putting money into a Cayman Islands fund as well. Admittedly, it is fair to say that fund managers may also think harder about setting up a Cayman Islands-domiciled fund going forward. Would this pave the way for more Cayman Islands funds to be redomiciled to jurisdictions like Singapore and the likes? Only time will tell.

Another growing trend that demonstrates the importance of investor familiarity involves US and Australian-based fund managers targeting Asian investor monies. In such cases, it is pertinent for the fund to be domiciled in an Asian jurisdiction such as Singapore which Asian investors are familiar with. Put simply, a US-based fund manager would find it most effective to market a US real estate focused fund to Asian investors through a Singapore fund platform rather than a Delaware platform. Equally important is of course for these managers to also set up an office in Singapore.

KPMG

Moving on, a related point of consideration is investors' familiarity with the legal form of the main fund vehicle. Most would agree that the limited partnership framework is by far the dominant legal form for alternative investment funds with the exception of hedge funds. Hedge funds, because of their open ended nature and multiple strategies which require the setting up of sub-funds, on the other hand, tend to be set up as corporate vehicles with cell structures having a separate legal personality. Examples include the tried and tested Luxembourg SICAV and Cayman Segregated Portfolio Company and more recently, the Hong Kong open-ended fund company and Singapore variable capital company (VCC).

Trusts are commonly associated with estate planning and are perhaps the least familiar legal form to most investors. Having said that, there are exceptions. In particular, unit trusts seem to be the most common legal framework used for funds in Australia and Korea. Not surprisingly, these funds focus on domestic investors though obviously, the lack of investor familiarity has unfortunately resulted in a lack of appeal of these vehicles to international investors. Another example -a unit trust -is the default fund vehicle where the preferred or eventual exit strategy is listing a real estate investment trust (REIT) on the Singapore Exchange. Further, a lesser known vehicle domiciled in the Luxembourg, the Fonds commundе placement (FCP), the equivalent of a unit trust under French civil law, was at one point widely distributed in the European Union but is now considered outdated and is rarely used except in the case of Pan-Asian real estate funds to allow easy access to the Managed Investment Trust (MIT) regime in Australia.

Feeder vehicles

A feeder fund acts as a pooling vehicle for certain groups of investors and then injects the capital into the main fund, or sometimes known as the Master Fund. This is often required because of specific domestic tax or regulatory requirements of these investors, which render it impossible to invest directly into the Master Fund. A good example would be US investors and specifically, taxable and tax exempt investors with conflicting tax objectives to achieve.

To illustrate, US taxable investors generally invest in entities that are fiscally transparent for US federal income tax purposes, allowing the income, losses, credits and deductions of those entities to pass through to the investors, and thereby allowing such investors to facilitate the use of those losses and deductions. Furthermore, such transparent entities would generally allow US taxable investors to facilitate the use of foreign tax credits and enjoy long term capital gains tax rates depending on the nature of the underlying assets and the type of investor (e.g. individual investor) and at the same time, avoid burdensome reporting and / or filing obligations related to certain anti-deferral tax regimes such as controlled foreign corporations (CFCs) and passive foreign investment corporations (PFICs).

On the other hand, US tax exempt investors such as qualified pensions, charitable organizations and foundations, generally invest through one or more entities that are not fiscally transparent (opaque) for US federal income tax purposes ("Blockers") to prevent receiving unrelated business taxable income (UBTI). Certain non-US government investors also generally invest through one or more Blockers to preserve their ability to claim certain exemption from US federal income tax with respect to US-sourced income.

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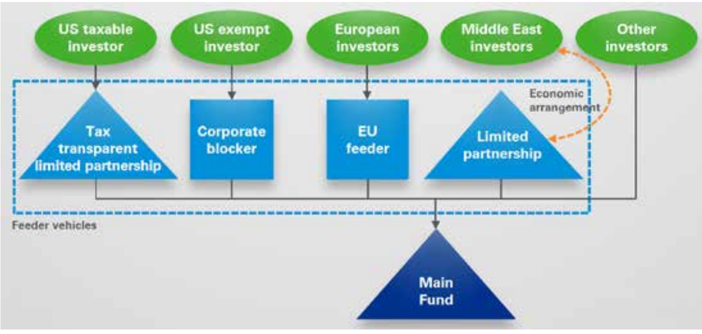
A feeder fund acts as a pooling vehicle for certain groups of investors and then injects the capital into the main fund, or sometimes known as the Master Fund.

It is also common for Middle East investors to invest via a feeder fund, particularly for investors who wish to be Shariah compliant. Generally, the feeder would be a Cayman Island LP or a Jersey LP. Interestingly, Middle East investors, instead of subscribing to equity interests in the feeder, would enter into some form of Islamic financing arrangement with the feeder, which grants them economic interests. The feeder would then subscribe to equity interests in the main fund.



Regulatory considerations

Regulatory regimes in the target investors' home jurisdictions could have a significant influence on the location of the main fund vehicle. Perhaps the most well-known regime is the Alternative Investment Fund Management Directive (AIFMD) regime which fund managers raising monies from European investors should be familiar with. The application of AIFMD is complex but put simply, both the fund manager and fund domicile would have to be set up in the EU to comply with the AIFMD. Not surprisingly, Luxembourg is the most common jurisdiction for the "AIMFD compliant fund". For Asian and US fund managers that do not yet have a presence in Europe, they could consider "renting" a third-party AIFM for a fee if it is proving to be too time consuming and costly to set up and maintain one. Having said that, it is also possible to raise money from EU investors through the private placement option under which, apart from investor familiarity, there is conceptually not a requirement for the fund to be set up in the EU. For instance, it is not uncommon for seasoned German and Dutch investors to invest into a Singapore domiciled fund. However, the private placement option may not be practical for funds that are open ended in nature or for those that are intended to be marketed to numerous countries in Europe.

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> Alternative investment funds are normally set up as limited partnerships.

Master Hold Co & Intermediate holding entities

Alternative investment funds are normally set up as limited partnerships. It is common for these funds to in turn set up a holding company, typically in a country with good access to an extensive network of tax treaties. The holding company would either hold the portfolio companies directly or indirectly through intermediary companies.

These entities are employed in a fund structure for a myriad of legal, commercial and tax reasons. Just like the main fund vehicle, we would also need to consider their locations. Next, we outline some of these reasons in the succeeding section as well as factors to consider when evaluating the appropriate location. For ease of our discussion, we shall refer to the holding company and intermediary companies as "holding platforms".

Legal considerations

Fund managers may seek to ring fence each of the fund's investments to safeguard against potential claims on other fund assets in the event of a failed investment. This may be achieved by segregating the fund's investments in Intermediate SPVs. Intermediate SPVs are often interposed where offshore debt financing is involved as creditors' claims are limited to the assets of the Intermediate SPV instead of the fund.

For such legal ring fencing to be effective, the holding structure should be set up in a jurisdiction with a well-established legal framework that is internationally recognized to provide the necessary protections. Investors should also be comfortable and familiar with the protection afforded under the relevant legal framework.

Treaty platforms

Tax treaties play an important role in mitigating withholding taxes on dividends, interest and capital gains and in enhancing returns to investors. Generally, only companies or entities treated as corporates for tax purposes are eligible for treaty benefits. Partnership and trusts, on the other hand, are not. This issue may be addressed by interposing a vehicle or vehicles established as companies below the main fund entity. In the tax world, we sometimes refer to these vehicles collectively as "treaty platforms".

It is not difficult to identify suitable tax neutral jurisdictions as candidates for the treaty platforms with an extensive treaty network. European holding structures were commonly adopted because of their participation exemption regimes that do not tax dividend and capital gains as long as certain minimum holding period and ownership requirements are met.

Traditionally, the Netherlands would have topped the list given that to-date, it has signed almost 100 Avoidance of Double Taxation Agreements (DTAs), with possibly more to come. It is admittedly widely used, not just for investments into Europe but also for investments into Asia and Latin America. Luxembourg is a very close second and some may say it even surpasses the Netherlands, particularly for alternative investment funds investing into Europe and to some extent for investments into Asia as well. For instance, prior to Singapore, Luxembourg was commonly used for investments into Japanese real estate.

Other examples in Europe include Cyprus (for investments into Russia), Malta, Ireland, Switzerland and even the UK and Belgium (interestingly for Korean investments). It is also worth mentioning that for funds investing into Europe, the holding structure is commonly set up in the EU to allow access of the EU parent-subsidiary directives, under which withholding tax is exempted on interest, dividend and royalty payment between EU states.

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> Tax treaties play an important role in mitigating withholding taxes on dividends, interest and capital gains and in enhancing returns to investors.

Moving away from Europe, Singapore and Hong Kong are both popular treaty platforms for investments into Asia. Hong Kong, in particular, is commonly used for investments into China whilst Singapore, although less popular as a holding location for Chinese investments, is widely used for investments generally in Asia. Other notable mentions include Mauritius and Labuan, Malaysia's attempt at creating an offshore financial hub. Mauritius was widely used for investments into Africa and the Middle East, although in this part of the world, it is probably most famous as an investment platform into India (although of late, it is fast being replaced by Singapore). Labuan, at one point, was widely used for investments into Korea. It has also been used for investments into Taiwan and ironically, for investments into Malaysia until the loopholes were closed by the Malaysian tax authorities.

Unfortunately, gone are the days when all that was required was to "stick a box" in the relevant jurisdictions with minimum substance, which was sufficient for a company to obtain a tax residency certificate to facilitate access to treaty benefits. Tax authorities around the world have become smarter and with international tax policies evolving and becoming more complex in the last few years, the following considerations must be taken into account when setting up a treaty platform:

- A country's tax treaty network cannot be the sole determinant for incorporating an entity in the country. Such practices (also known as "treaty shopping") have been identified as being abusive and contributing to BEPS. One of the measures to combat BEPS was the introduction of the Principal Purpose Test (PPT), which is now a key feature in many tax treaties. Under the PPT, the tax authority can deny treaty benefits where it is reasonable to conclude that one of the principal purposes of the arrangement or transaction is to obtain a treaty benefit.

- Tax authorities in the investee jurisdictions may also deny tax treaty benefits if the intermediate holding entity is not the beneficial owner of the income. Based on the OECD commentary, beneficial ownership means that the entity should have the right to use and enjoy the income unconstrained by a contractual or legal obligation to pass on the payment received to another person. The commentary goes on to clarify that agents, nominees and conduit companies are not the beneficial owners of the income due to their narrow powers over the income.

In order to satisfy the PPT and beneficial ownership requirements, fund managers should ensure that there are strong commercial and legal reasons for establishing the treaty platform, which should have sufficient "substance" in the country of establishment. For instance, the board of directors should comprise of majority, if not at least half, tax residents of the country of establishment, have the relevant experience and qualifications and be genuinely empowered to make strategic decisions. This is the bare minimum and often, would negate the use of nominee directors who are employees of third-party service providers. As the fund and its affiliated entities are mere investment holding entities, the substance provided by the fund manager would be of paramount importance. Obviously, the fund manager should also be based in the country of establishment of the treaty platform and as a gold standard, the senior management such as the CEO, COO and CIO should also be based in the same location. Accordingly, if the treaty platforms are set up in Singapore, one would expect the fund management company and their C-suites to be also based in Singapore.

Exit Reasons

The use of an intermediate holding entity in an offshore jurisdiction helps to facilitate an exit by selling the offshore entity. This is commonly known as an indirect disposal and is popular as it does not attract capital gain taxes in the country where the investments are made (though not in all instances). However, its usefulness extends way beyond tax efficiencies, the most obvious one being the creation of multiple exit options.

From a legal perspective, it is sometimes pertinent to use intermediate holding entities for ease of exit. For instance, in jurisdictions such as Vietnam and China, disposal of the onshore SPV may require regulatory approval, which can be cumbersome and time consuming. For this reason, foreign buyers would typically prefer to acquire the offshore vehicle which generally enables them to avoid the red tape associated with an onshore acquisition.

From a foreign ownership perspective, using an offshore SPV to hold the onshore portfolio company can be critical during both the investment and divestment phase. For instance, a Cayman Islands fund seeking to invest into the Indonesian healthcare sector, under which foreign ownership is normally restricted to 49%, would find that setting up a Singapore company as the intermediary could potentially allow the fund to acquire a higher percentage because of the ASEAN connection. On the other hand, having an offshore SPV allows a 100% divestment to a foreign buyer even if the investee locations were to amend the law to restrict or further restrict foreign ownership in the relevant sector in the future.

Without stating the obvious, having a master holding company to own the entire investments of a fund further facilitates a portfolio exit simply by selling this company. Not only does this help to avoid signing multiple SPAs, it could, in some cases, also achieve some tax savings. This is particularly true in the case of mitigating offshore disposals in respect of "land-rich" investments in countries like Australia, the UK, Japan, Malaysia, Vietnam, and China, just to name a few. Specifically, these countries would impose capital gains tax where the market value of the assets of the offshore SPV at the point of disposal were to comprise at least 50% (in some cases 75%) in "land-rich" assets in the respective countries. In the case of a portfolio exit involving investments in multiple countries, a sale of the master holding company is less likely to attract these taxes, particularly in the case of funds that invest in multiple countries and where normally this is a 30% to 40% cap on each country in order to manage concentration risk. A very simple idea indeed but easily overlooked.

Optimal capital structure

The internal rate of return (IRR) for a fund is also determined by how fast cash can be returned to investors. Obviously the sooner the cash is returned, the higher the IRR, making it one step closer to getting the carry. In the case of a core fund, the manager often has the obligations to meet certain cash yield requirements. Hence, having an optimal capital structure that allows cash to be freely repatriated is undeniably important.

The most common form of cash repatriation is dividend. However, the amount of dividend that one can declare is often subject to the availability of retained earnings. Where there is a mismatch of cash available for distribution and retained earnings, resulting from non-cash expenses such as depreciation, unrealized foreign exchange loss, impairment loss, etc, this results in what we call a "cash trap" issue. This issue is exacerbated in countries with laws that mandate companies to set aside a certain percentage of their profits to go into a legal reserve. To be honest, the cash trap issue originates in the country where the investments are made but having said that, we certainly do not want the capital structure of the holding platforms to worsen the issue.

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Where the holding platforms are located in tax haven jurisdictions like the Cayman Islands and BVI, the cash trap issue is probably not serious, if at all, as entities incorporated in these countries normally don't need to adopt or follow complex accounting regulations, are able to make distributions out of capital or can pay dividends so long as the relevant entity is not insolvent thereafter. Admittedly, the company law is generally less stringent in these countries. However, as these countries do not have an extensive tax treaty network, the holding platforms are often incorporated elsewhere.

The cash trap issue at the offshore level is generally mitigated by managing the debt-equity ratio of the holding company and its intermediaries.

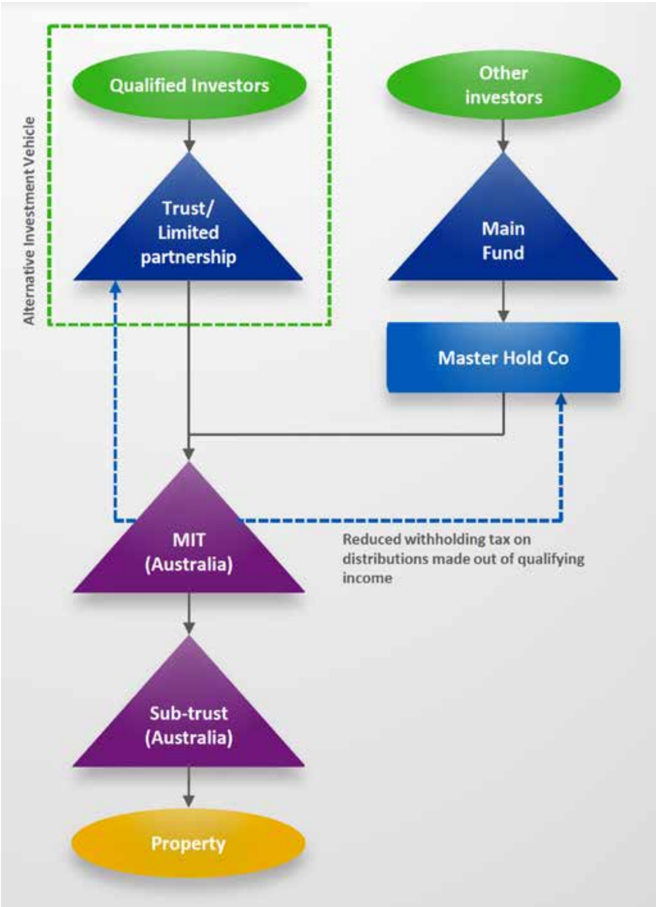
Where intermediate holding entities are capitalised mainly by ordinary shares, one way of returning trapped cash could be by way of capital reduction. However, this can be time consuming, cumbersome and costly, especially if court approval is required. On the other hand, where the majority of the share capital is instead issued as redeemable preference shares, a return of capital can shorten the process significantly. However, this is not fool-proof as the redemption process may typically entail all the directors of the company signing a solvency statement. In some countries, it can be extremely onerous to sign the solvency statement, which can potentially be accompanied with a fine and in the worst-case scenario, a jail term, if the relevant company turns out to be insolvent in the future.

> "Where intermediate holding entities are capitalised mainly by ordinary shares, one way of returning trapped cash could be by way of capital reduction.

A much simpler and more straightforward way would be to inject capital as shareholder's loan, which could be either interest-free or interest bearing. For one, the repayment of shareholder's loan is fast and easy and at most, requires the pens of the directors to approve through a resolution via circulation. Ideally, the loan should be interest-free and this should be fine so long as it does not create too much complication from a transfer pricing perspective.
It is probably obvious that by now, a company should be capitalized with more debt than equity –the question is what is the right ratio? Ideally, the minimum that is allowed under the law and that can be as low as just a dollar. However, where treaty access is critical, this could affect the beneficial ownership requirements and eligibility to the preferential tax treatment under the relevant treaty as mentioned above. In particular, a thinly capitalized company is often seen as a shell company and conduit. As a guidance, a 3:1 debt equity ratio is a good starting point but there is obviously flexibility for a proportionately lower quantum of debt where substantial capital injection is involved, especially where there are other positive factors to substantiate beneficial ownership.

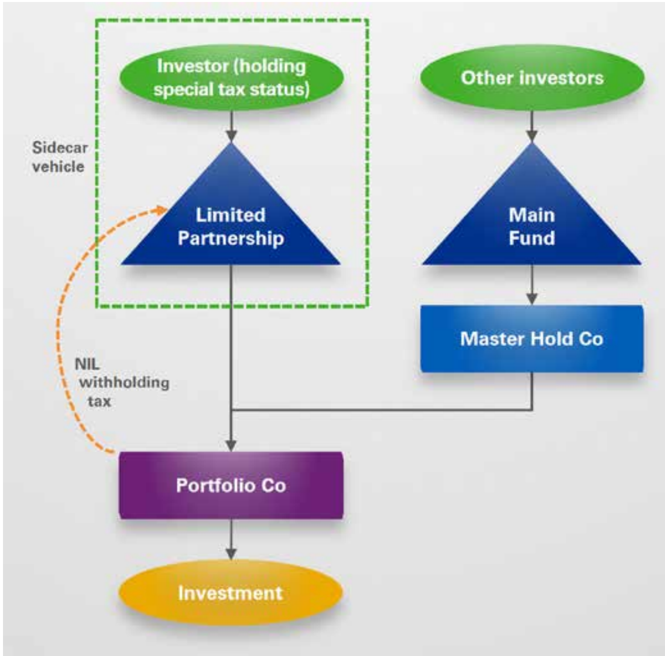
Side car / Alternative investment vehicles

Under certain circumstances, it may not be the most tax efficient for the main fund to make an investment directly. The fund, would instead, make such investments through a side-car or an Alternative investment vehicle (AIV) would have to be set up only for specific investors as there are occasions where they can be set up for specific investments or investee locations. One such example is Australia's Managed Investment Trust (MIT) regime which halves the exit taxes from 30% to 15% if structured properly but would only work if the fund has most of its investors being qualifying investors such as pension funds and life insurance funds. Unfortunately, funds that are structured as limited partnerships would find it difficult most of the time to take advantage of the MIT concessions unless an AIV such as a trust is being set up to pool all the investors as illustrated in the diagram. The AIV is used only for investments into Australia which means that in the case of a Pan Asian Fund, all investments into other countries would still go through the main fund.



A side car or AIV may also be required for investors that are exempt from tax under local law and where the fund invests locally. For instance, in Singapore, charitable organizations and co-ops are exempt from income tax and therefore where possible, their investments should not be co-mingled with other investors, particularly where the fund invests in Singapore real estate, which generates taxable rental income that is otherwise not taxable for charitable organizations and co-ops.

From a legal perspective, a side car is sometimes needed where a major investor may not necessarily want to invest in all the investments made by the main fund. In other words, it wants to be able to "pick and choose" and participate only in investments it considers "desirable".



Other considerations

Cost of formation and maintenance

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> When structuring the fund, fund managers should also seek to minimise the set-up and ongoing maintenance costs of their fund structure.

When structuring the fund, fund managers should also seek to minimise the set-up and ongoing maintenance costs of their fund structure. These include incorporation expenses, advisor fees, fund administrator fees, custodian fees and ongoing compliance costs etc. The formation and ongoing maintenance costs vary widely from country to country. A fund established in Luxembourg is considerably more expensive to set-up and maintain as compared to a fund established in the Cayman Islands or Singapore. Due to stricter regulatory oversight of the fund management industry in Luxembourg, ancillary costs such as advisor fees, administrator fees and depository fees are understandably higher. If the fund manager engages a third-party AIFM in Luxembourg, the AIFM's fees will add to the overheads. While the Cayman Islands used to be a cost-efficient platform to establish a fund, the recent introduction of the Mutual Funds (Amendment) Bill and the Private Fund Law, alongside the additional compliance requirements in relation to valuation and cash monitoring etc, would inevitably increase the costs of setting up and maintaining a Cayman Islands fund structure. Though not absolute, this may potentially make setting up onshore vehicles in Singapore and Hong Kong relatively more attractive.

> "It is important for fund managers to bear in mind that there is no 'one size fits all' approach and that the tax, legal and commercial considerations would vary from fund to fund.

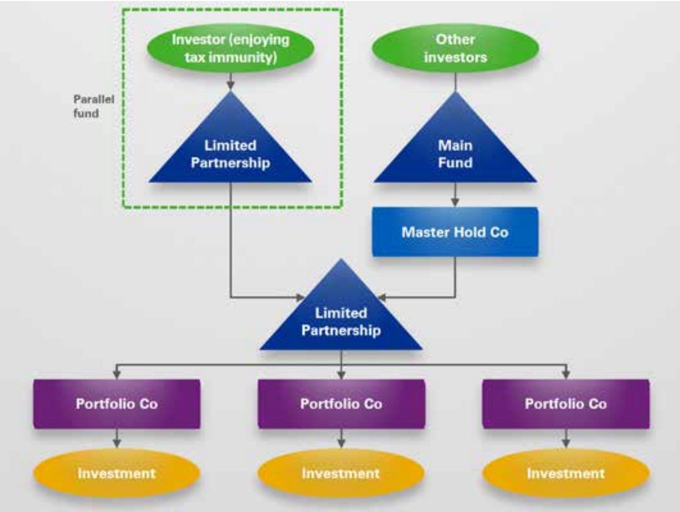
While there are benefits to using intermediate holding entities for reasons such as treaty access and legal ring fencing, fund managers should be aware that an increased number of entities in the overall fund structure adds to the fund's overhead costs. Further, if the entities are located in multiple jurisdictions, there would also be added monitoring costs to ensure that the fund structure is not adversely affected by new laws and regulations.

Parallel funds

Under certain circumstances, it may not be the most tax efficient for an investor to invest directly into the main fund. For example, government entities, sovereign wealth funds and some inter-governmental organizations may, either by way of domestic / international law or tax treaties, enjoy tax immunity on income and gains derived from investee locations. For tax immunity to apply, these investors would be required to invest via a parallel fund vehicle which needs to be tax transparent from the perspective of the investee locations. Often, for legal and administrative purposes, where possible, there should also be a pooling vehicle for both the main and parallel funds. Again, the pooling vehicle needs to be tax transparent as well.

There could also be investors from a certain country that has concluded a tax treaty with the investee location that offers a more preferential treatment compared to the one that the treaty platform has entered into with. One good example is the Japan-Korea treaty which offers tax free return for a certain structure for Korean investors investing into Japan. As a result, Korean investors would often invest via a parallel fund structure in order for them to take advantage of the said benefit.

Parallel funds are sometimes required when raising capital from investors with specific and strict regulatory requirements. Perhaps the most common example would be managers who want to comply with AIFMD when raising money from EU investors. A lesser known example involves raising money from Islamic investors such as those from the Middle East that have strict requirements to comply with Islamic laws. This group of investors can either come in via a feeder fund or a parallel fund where they would enter into some form of Islamic financing arrangement, which grants them economic interests.



Conclusion

Fund structuring is as much of an art as it is a science. There are numerous factors to be considered when choosing a fund structure and the domicile of its vehicles. It is important for fund managers to bear in mind that there is no 'one size fits all' approach and that the tax, legal and commercial considerations would vary from fund to fund.

In addition, the location of the fund manager, the investment decision making process and the activities carried on by the fund manager would also have an impact on the fund structure. The regulatory issues for the fund manager and how its income and carry would be taxed are also critical issues to be considered. Stay tuned for the next article where we will discuss these issues.

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