FUNDS BULLETIN — DECEMBER 2015

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1. Global and EU Developments

1.1 IOSCO: third hedge fund survey

The International Organization of Securities Commissions (IOSCO) has published a report on the findings from its third hedge fund survey, which include:

- the Cayman Islands remains the most popular domicile and managers are mainly US based;
- hedge funds remain mostly US dollar denominated, and mainly invested in North American assets;
- the use of equity-based strategies remains the most popular;
- financial leverage is used by hedge funds globally, except in Japan;
- hedge funds appear aware of the market liquidity of their portfolio positions, and can generally manage investor redemptions through suspensions and gating.

1.2 European Long Term Investment Funds (ELTIFs) are available

European Long Term Investment Funds (ELTIFs) are available across the EU from 9 December 2015, see further our updated ELTIF briefing and note and item 2.1 below.

1.3 AIFMD: ESMA updates Q&As

The European Securities and Markets Authority (ESMA) has published an updated version of its questions and answers (Q&As) document on the application of the Alternative Investment Fund Managers Directive (the AIFMD). There are new Q&As (67-79) on reporting to national authorities under AIFMD arts 3, 24 and 42.

1.4 Listed Funds: European Commission proposal for a new Prospectus Regulation which would repeal the Prospectus Directive

The European Commission has adopted a legislative proposal for a new Prospectus Regulation which is intended to repeal and replace the Prospectus Directive along with its corresponding implementing measures (including the current Prospectus Regulation).

The main proposals are set out below.

- **A quicker and simplified frequent issuer regime:** an annual "universal registration document" (URD) can be maintained by issuers with their registered office in an EU member state and whose securities are admitted to trading on a regulated market or a multilateral trading facility. The URD should be drawn up annually and contain information on the company's organisation, business, financial position, earnings and prospects, governance and shareholding structure. An issuer whose URD has been approved by its competent authority for three consecutive years can file URDs annually without prior approval. This is likely to lead to cost reductions. It is also helpful that frequent issuers will benefit from a five day fast-track approval when they wish to issue shares, bonds or derivatives (this would apply during the period when approval is necessary).
- **A higher threshold to determine when companies must issue a prospectus:** under the Regulation, no EU prospectus would be required for capital raisings below EUR 500,000 (the current threshold is EUR 100,000). Member states will be able to set higher thresholds for their domestic markets; they will have the choice to exempt offers of securities to the public from the prospectus requirement under the Regulation, provided that the offer is only made in that member state and the total consideration of the offer is between EUR 500 000 and an amount which cannot exceed EUR 10 million.
- **Shorter prospectuses and improved investor information**, including a requirement that risk factors should be tailored to specific deals and it should be specified how material and likely they are.
- **Creating a "lighter prospectus" for public offers by SME's** with a market capitalisation below EUR 200 million (the current limit is EUR 100 million). This would only apply where SMEs have no securities admitted to trading on a regulated market.
- **A new prospectus summary** based on the key information document required under the PRIIPS Regulation – note this would apply to all securities, not just "retail" securities.
- **Simplifying secondary issuance** for listed firms.
- **A single online access point** for all EU prospectuses (on ESMA's website).

The following documents have also been published: a factsheet; annexes; a speech by Commissioner Hill; and executive summary.

The European Parliament and the Council of the European Union will now discuss the draft Regulation and in due course adopt it (under the co-decision procedure). A number of delegated acts will also need to be adopted by the Commission. The European Securities and Markets Authority (ESMA) will also have to prepare draft regulatory and technical standards and guidance in relation to some of the provisions of the Regulation.

1.5 Invest Europe Professional Standards Handbook updated

Invest Europe (formerly The European Private Equity and Venture Capital Association) has announced the publication of a new version of its Professional Standards Handbook.

"Before joining Invest Europe, members must agree to adhere to the Handbook, an annually updated publication, which brings together the principles of accountability, transparency and governance expected of our members. The Handbook also contains a code of conduct setting out the principles of ethical behaviour which members of Invest Europe should abide by."

"The Handbook reflects the heightened standards of transparency and accountability being pursued by investors in Europe's growing private equity industry, which represents €545 billion of assets under management. It also takes into account the new regulations in Europe, including the Alternative Investment Fund Managers Directive (AIFMD)."

The Handbook also includes the core financial recognition and reporting requirements for private equity funds, in the form of the IPEV Valuation Guidelines (which are endorsed by Invest Europe) and the Invest Europe Investor Reporting Guidelines, as well as the Invest Europe Code of Conduct for Placement Agents.

1.6 New Luxembourg AIF

The Luxembourg government has announced the launch of a new type of alternative investment fund (AIF). This AIF is to be called "reserved alternative investment fund" (RAIF). The RAIF's salient features are designed on the ones of the widely popular Luxembourg specialised investment fund (SIF). However, unlike the SIF, the RAIF will not need to be approved and supervised by the Luxembourg supervisory authority (CSSF).

Since the RAIF qualifies as an AIF it will have to be managed by an alternative investment fund manager (AIFM). Although the RAIF is itself not regulated, its AIFM will be subject to the supervision of the CSSF. The RAIF has been created at the initiative of the Luxembourg investment fund community. Its aim is to reduce time-to-market for products designed only for sophisticated investors. Such investors do not necessarily require the protection and do not want to bear the additional costs of regulation at the level of both the product and its manager.

The RAIF will be of most use to established fund managers who already have a licensed AIFM, and should remove one of the current barriers that may deter such a manager from domiciling a new fund in Luxembourg. A little patience will however be required as the RAIF will have to undergo the Luxembourg legislative process.

2. UK DEVELOPMENTS

2.1 UK ELTIFs: new FCA application form and Handbook Notice 28

The FCA has published a form for use by alternative investment fund managers (AIFMs) when applying for authorisation of a UK European long-term investment fund (ELTIF) and/or approval to manage a UK ELTIF. This form also covers applications related to internally managed ELTIFs (which simultaneously must apply for authorisation as a full-scope UK AIFM). However, the form may not be used to apply to market the units or the shares of the ELTIF.

Another UK ELTIF development is FCA's Handbook Notice 28 which includes the ELTIF Regulation Instrument 2015, FCA 2015/66. This instrument came into force on 9 December 2015 and makes minor consequential changes to the FCA Handbook relating to the ELTIF Regulation (which has direct effect in Member states).

2.2 Listed Funds: Primary Market Bulletin No 12

The FCA published its Primary Market Bulletin No 12 which includes various changes to the Knowledge Base, including amendment of existing procedural and technical notes. It also covers the re-consultation of a new technical note on the application of related party rules to funds investing in highly illiquid asset classes. The revised draft technical note contains welcome changes to the original draft as its scope has been expanded to cover a potentially broad range of illiquid asset classes. The original draft was confined to listed infrastructure funds only.

The proposals are summarised in the Primary Market Bulletin and full details are given in guidance consultation GC15/7. Comments are requested by 11 January 2016.

2.3 Listed Funds: Prospectus Directive: upcoming changes to sending final terms to host competent authorities

The FCA has published a webpage containing information for issuers on upcoming changes to sending final terms to host competent authorities under the Prospectus Directive. From 1 January 2016, Article 5(4) of the Prospectus Directive will no longer require issuers to send final terms to the competent authority of host Member States. Instead, the home competent authority must send final terms that have been filed with it as home competent authority to the competent authorities of host Member States.

2.4 Listed Funds: Viability statements have become mandatory and FCA Quarterly consultation - impact on LR of PR changes based on Omnibus II

The FCA has introduced a new Listing Rule (LR) (LR 9.8.6 (3)(b)) which require companies to include in their annual report and accounts a statement by the directors on their assessment of the prospects of the company ("viability statement"). Previously this was included in the UK Corporate Governance Code (and in the AIC's Code of Corporate Governance) so the viability statement was required only on a "comply or explain basis". However, this statement is now mandatory as it is included in LR.

Another LR development is the FCA's quarterly consultation paper (CP15/42). Proposed changes include impact on the Listing Rules (LR) of changes to the Prospectus Rules (PR) based on the Omnibus II Directive. Certain LRs on listing particulars cross-refer to rules in PR. Current LR requirements would continue do so (and as such apply the relevant prospectus requirements to listing particulars). These are mainly consequential and administrative in nature.

Comments are requested by 4 January 2016.

2.5 Listed Funds: Transparency Amending Directive: FCA and Treasury policy statement on UK implementation and forms

HM Treasury and the FCA have published a joint policy statement setting out their response to feedback received in relation to their joint consultation on proposed amendments to the Financial Services and Markets Act 2000 (FSMA) and the Disclosure and Transparency Rules (DTR) to implement the directive amending the Transparency Directive, and certain other miscellaneous amendments to the DTR.

The FCA has also published the Disclosure and Transparency Rules Sourcebook (Transparency Directive Amending Directive) Instrument 2015 (FCA 2015/54), which implements the changes to the DTR as outlined in the joint policy statement. These changes came into force on 26 November 2015. See also FCA's standard form for issuers to use when notifying the FCA of their home member state in accordance with the revised requirements of DTR 6.4 which apply from 26 November 2015 (implementing the Transparency Directive Amending Directive).

2.6 UK - FCA publishes terms of reference for asset management market study

The FCA has launched an asset management market study, see Terms of Reference, which will focus on: (i) competition; (ii) control of costs; and (iii) the effect of investment consultants on competition for institutional asset management. The FCA will be approaching market participants for information and aims to publish an interim report in summer 2016 and a final report in early 2017. Depending on the outcome, the FCA may intervene to promote effective competition.

3. EU Tax Developments

3.1 Fiscale Eenheid X: CJEU rules that a real estate fund can be a "special investment fund"

The CJEU has confirmed in the case Fiscale Eenheid X (C-595/13) that a real estate fund can qualify as a "special investment fund". The "management" of such funds is exempt from VAT. The Court further ruled that property management services provided to a fund do not qualify for an exemption from VAT. Our newsflash can be found here.

3.2 Financial transaction tax update

The following statement has been issued by the 10 member states participating in the 'enhanced co-operation' procedure to introduce a European Financial Transaction Tax (NB – Estonia has dropped out). This follows the ECOFIN meeting in Brussels:

Statement by: Austria, Belgium, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia, Spain

Financial Transaction Tax

"We reached today [8 December 2015] an agreement on the tax that should have the following features:

1. Regarding shares:

    (a) All transactions including intra-day should be taxed.

    (b) All transactions in the chain should be taxed except agents and clearing members (when acting as facilitators).

    (c) In order to sustain liquidity in illiquid market configurations, a narrow market making exemption might be required.

    (d) The territorial scope of the tax should follow the commission's proposal. It is now being determined whether it is more sensible to start taxation with only shares issued in the member states participating in the enhanced cooperation. Important elements in this determination include relocation risks and administrative costs.

2. Regarding derivatives:

    (a) The territorial scope of the tax should follow the commission's proposal (cumulation of residence and issuance principles with application of counterparty principle).

    (b) The taxation should be based on the principle of the widest possible base and low rates and it should not impact the cost of sovereign borrowing.

    (c) The determination of the tax base for derivatives should abide by the following principles:

        (i) For option-type derivatives the tax base should preferably be based on the option premium.

        (ii) For products others than option-type derivatives and coming with a maturity, a kind of term-adjusted notional amount/market value (where available) might be considered as the appropriate taxable base.

        (iii) For products other than option-type derivatives and not coming with a maturity, the notional amount/market value (where available) might be considered as the appropriate taxable base.

        (iv) In some cases, adjustments to the tax rates or to the definition of the tax base might be necessary in order to avoid distortions.

    (d) No exemption for market making activities should be granted.

3. Other elements: Member States agreed that further analysis with regard to real economy and pension schemes is required. Negative impact on real economy and pension schemes should be minimised. Further, the financial viability of the tax for each country is required.

4. On the basis of these features, in order to prepare the next step, experts in close coordination with the commission should elaborate adequate tax rates for the different variants. A decision on these open issues should be made by the end of June 2016."

4. UK TAX DEVELOPMENTS

4.1 Autumn Statement announcements

(a) Stamp Duty Land Tax (SDLT): application to certain authorised property funds

The government will introduce a seeding relief for Property Authorised Investment Funds and Co-ownership Authorised Contractual Schemes (CoACSs) and make changes to the SDLT treatment of CoACSs investing in property so that SDLT does not arise on the transactions in units. This will include: a defined seeding period of 18 months; a three year clawback mechanism; and a portfolio test of either 100 residential properties and £100 million value, or 10 non-residential properties and £100 million value. These changes will take effect from the date Finance Bill 2016 receives Royal Assent.

(b) SDLT: additional properties

Purchases of additional residential properties (above £40,000), such as buy to let properties and second homes, will be subject to higher SDLT rates from 1 April 2016. The higher rates will be 3 percentage points above the current SDLT rates. The higher rates will not apply to purchases of caravans, mobile homes or houseboats, or to corporates or funds making significant investments in residential property given the role of this investment in supporting the government's housing agenda. The policy detail will be open to consultation, including on whether an exemption for corporates and funds owning more than 15 residential properties is appropriate.

(c) Annual Tax on Enveloped Dwellings (ATED) and 15% rate of SDLT: scope of reliefs

The reliefs available from ATED and the 15% higher rate of SDLT to equity release schemes (home reversion plans), property development activities and properties occupied by employees from 1 April 2016, will be extended by the Government.

Source: Autumn Statement

4.2 Diverted Profits Tax – updated guidance

HMRC has published its final guidance on the diverted profits tax (DPT). This updates and replaces the draft guidance of March 2015. The overview at the beginning of the guidance states:

> *"The Diverted Profits Tax (DPT) is an important new tool to be used to counter profit shifting. It is, however, a closely targeted measure which addresses certain specific arrangements and it should therefore be seen in the context of HMRC's wider strategy to tackle international tax risk.*
>
> *DPT applies to profits arising from 1 April 2015 and is focused on contrived arrangements designed to erode the UK tax base. Its primary aim is to ensure that the profits taxed in the UK fully reflect the economic activity here: this is consistent with the aims of the OECD Base Erosion and Profit Shifting project. Specifically DPT aims to deter and counteract the diversion of profits from the UK by large groups that either:*
>
> *(i) seek to avoid creating a UK permanent establishment that would bring a foreign company into the charge to UK Corporation Tax, or*
>
> *(ii) use arrangements or entities which lack economic substance to exploit tax mismatches either through expenditure or the diversion of income within the group.*
>
> *DPT is set at a higher rate than corporation tax to encourage those businesses with arrangements within the scope of DPT to change those arrangements and pay corporation tax on profits in line with economic activity.*
>
> *The requirement to pay the tax "up front" provides a strong incentive for groups to provide timely information about high-risk transactions and how they fit into the group's global operations.*
>
> *It reduces the information bias inherent in complex cases and promotes full disclosure and constructive early engagement with HMRC."* (Page 4).

Important changes in the guidance include:

(a) Consideration of the PE threshold (DPT1140).

(b) Tax mismatch (DPT1180; DPT1190; DPT1191).

(c) Independent investment managers and the tax avoidance condition (DPT1141).

The guidance will be updated to reflect experience and stakeholders' comments, and the International Manual will be amended accordingly.

Source: PLC: HMRC publishes final DPT guidance.

4.3 **CGT treatment of carried interest preserved (mostly)**

Earlier this week the UK Government published draft legislation detailing new rules governing the taxation of carried interest. Hogan Lovells has produced an article about its impact, which can be found here.

In summary (where a whole fund carry is calculated), carried interest will be taxed as capital gains provided the average investment holding period (at the time the carry arises) is at least four years. The average investment holding period is to be calculated as a weighted average by reference to the cost of investments and the period over which they are held. Specific rules designed not to discourage follow-on investments or managed sell downs will apply to Funds taking controlling stakes in trading groups (or which will, at the time of exit, have had more than 50% of their value invested in such controlling stakes for over 4 years). These specific rules are narrow in their application and the BVCA has expressed concern that they are too narrow given that the norm for many Funds is to take only minority stakes. Provision is also made for circumstances where some carried interest is paid out early in a Fund's life but the average holding period is expected to exceed 4 years at specified later dates. CGT treatment will be provisionally available for the 'early' carry.

4.4 **Budget 2016 date announced**

The Chancellor of the Exchequer, George Osborne, has announced that the Government will publish its next Budget on Wednesday 16 March 2016.

Hogan Lovells
15 December 2015

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