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United States

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RETAIL FUNDS: OVERVIEW

1. Please give a brief overview of the retail funds market in your jurisdiction. (How developed is the market? Has it been active in the past year?) Please highlight the changes in market practice in the past year.

Open-ended retail funds

Open-ended retail funds, commonly referred to as mutual funds, are pooled investment vehicles that generally continuously offer shares to the public. Open-ended retail funds issue redeemable securities, which means that except in extraordinary circumstances, on shareholder demand a mutual fund must:

- Redeem its shares at net asset value (NAV).
- Pay redemption proceeds within seven days.

Although exchange-traded funds (ETFs) are typically organised as open-ended funds, their shares trade on an exchange.

The mutual fund market is well-developed and active. According to Investment Company Institute statistics:

- As of 30 September 2010, there were over 7,500 United States (US) mutual funds with combined assets of over US$11 trillion (as at 1 November 2010, US$1 was about EUR0.7). Of this, about US$2.8 trillion was invested in money market funds.
- Investor interest in ETFs was also strong in 2010. As of 30 September 2010, the combined assets of US ETFs were over US$880 billion, a 27.3% increase from 2009. In 2009 alone, net issuance of ETF shares was US$116 billion.

Closed-ended retail funds

Closed-ended retail funds, which are often sold in underwritten public offerings, do not offer redeemable securities. Investors generally buy and sell shares of closed-ended funds in the secondary market on exchanges.

The closed-ended fund market is also well-developed and active. As of 30 September 2010, there were 620 US closed-ended funds with about US$244 billion in assets under management (*Investment Company Institute statistics*).

Legislation and regulation

2. What are the key statutes, regulations and rules that govern retail funds in your jurisdiction? What regulatory bodies are involved in regulating retail funds?

Open-ended retail funds

The Investment Company Act of 1940 (ICA) is the primary source of applicable law. The ICA:

- Imposes substantive requirements on funds' organisation and operation.
- Empowers the Securities and Exchange Commission (SEC) to regulate their activities.

Mutual funds are also subject to other federal and state laws, including the:

- Securities Act of 1933 (Securities Act), which governs the sale of shares and regulates the form and content of registration statements for sales to the public.
- Securities Exchange Act of 1934 (Exchange Act), which governs the form and content of proxy statements.
- Internal Revenue Code of 1986 (IRC), which imposes requirements on funds wishing to take advantage of the favourable tax treatment afforded to regulated investment companies.

The Financial Industry Regulatory Authority (FINRA) is a self-regulatory organisation overseeing securities firms doing business in the US. Regulations promulgated by FINRA govern FINRA members' sales and marketing of fund shares.

Closed-ended retail funds

Closed-ended funds are generally subject to the same regulatory regime as mutual funds. Closed-ended funds with shares listed on an exchange are also subject to the exchange's rules (as are ETFs).

3. Do the retail funds themselves have to be authorised or licensed? If so, what are the main steps involved? Are there differences between local funds and foreign funds?

Open-ended retail funds

A mutual fund must register as an investment company under the ICA and its offering of securities to the public must be registered under the Securities Act.

Form N-1A and Form N-8A. A fund must file a notification of registration on Form N-8A and a registration statement on Form N-1A. Form N-1A includes disclosure regarding, among other things:

- The fund's investment objective(s), strategies and related risks.
- Fees and annual fund operating expenses.
- Performance information.
- The fund's adviser(s).
- How to purchase shares.

SEC review. As part of the registration process, the SEC staff typically reviews and provides comments on a fund's registration statement. These comments can be incorporated into one or more pre-effective amendments (that is, amendments made before the fund can offer shares to the public). Once the SEC staff is satisfied with the form and content of the registration statement, the SEC will either:

- Declare the registration statement to be effective.
- Allow the fund to file an amendment that becomes effective in due course.

Generally, mutual funds can only offer their securities under an effective registration statement.

Continual offerings. To continually offer its securities, a fund must annually update its registration statement by filing a post-effective amendment on Form N-1A. This updates performance, fee and expense information, as well as any other old information. Additionally, most states require mutual funds to make annual notice filings and to pay fees if the fund's shares are sold in that state.

Fees. A mutual fund does not pay any upfront fees to the SEC for filing or amending its registration statement, but typically pays fees annually after the fund's financial year-end. Fees are based on the value of shares sold.

Non-US funds. It is difficult and uncommon for a fund organised outside the US to register as a mutual fund. The ICA prohibits a foreign fund from offering shares in the US except under an exemptive order. The SEC (in special circumstances or arrangements) can grant an exemptive order, provided that:

- It is both legally and practically feasible to effectively enforce the provisions of the ICA against the foreign fund.
- The issuance of the order is otherwise consistent with the public interest and the protection of investors.

However, the SEC has issued exemptive rules that make it easier for Canadian funds to register under the ICA, subject to conditions.

Closed-ended retail funds

The registration process for closed-ended funds is generally the same as for mutual funds, except that a closed-ended fund:

- Files its registration statement on Form N-2.
- Is exempt from the requirement to annually update its registration statement if it includes certain information in its annual shareholder reports.
- Must pay upfront filing fees based on the amount of the offering.

Closed-ended funds that list their shares on an exchange are also subject to the exchanges' registration requirements.

Marketing

4. Who can market retail funds? Are there differences between local funds and foreign funds?

Open-ended retail funds

Mutual funds typically offer their shares to the public through a distributor registered with the SEC as a broker-dealer under the Exchange Act. Distributors are also members of FINRA and subject to FINRA's rules and regulations. The distributor purchases shares from the fund and then sells the shares to the public directly or indirectly through financial intermediaries.

The ICA limits the use of fund assets to pay for the distribution of its shares. Generally, a fund cannot use fund assets to finance distribution unless the fund has adopted a written plan under Rule 12b-1 of the ICA. The SEC recently proposed significant changes to Rule 12b-1. The timing of the enactment of any changes is currently uncertain.

Closed-ended retail funds

Closed-ended funds typically offer shares through a broker-dealer in a single underwritten public offering. After the public offering, the shares of most closed-ended funds are traded on exchanges.

5. To whom can retail funds be marketed? Are there differences between local funds and foreign funds?

Open-ended retail funds

Generally, mutual funds can offer and sell their shares to any investor. However, mutual funds can restrict sales to certain investors, to comply with or avoid the application of certain anti-money laundering laws.

Mutual funds can also adopt policies, such as frequent trading policies, that can result in sales restrictions on certain investors. Additionally, broker-dealers selling the fund's shares may be subject to FINRA requirements regarding the suitability of the fund's shares for a particular investor.

Closed-ended retail funds

As with mutual funds, there are no general investor eligibility requirements for investors in closed-ended funds.

Managers and operators

6. What are the key requirements that apply to managers/operators of retail funds? Are there differences between local funds and foreign funds? Can a foreign manager manage a local fund?

Open-ended retail funds

Mutual fund advisers, including foreign advisers, are subject to the Investment Advisers Act of 1940 (Advisers Act) and the ICA. Among other things, these Acts require a mutual fund adviser to:

- Register as an investment adviser with the SEC.
- Adopt written compliance policies and procedures.

- Act in the best interests of its clients.
- File periodic reports with the SEC and maintain certain records.
- Seek the best execution for portfolio transactions.
- Obtain board and shareholder approval of advisory contacts with the fund.

Closed-ended retail funds

Advisers to closed-ended funds are subject to the same requirements as for open-ended funds.

Assets portfolio

7. Who holds the portfolio of assets? What regulations are in place for its protection?

Open-ended retail funds

A mutual fund must place and maintain its assets with a qualified custodian (*ICA*), typically either a:

- US bank meeting certain capital requirements.
- Broker-dealer.

If certain conditions are met, the fund can act as its own custodian. Rules under the ICA also permit the use of:

- Securities depositaries.
- Futures commission merchants.
- Commodity clearing organisations.
- For foreign assets:
  - government-regulated foreign banks;
  - subsidiaries of US banks or bank holding companies;
  - foreign securities depositaries.

Closed-ended retail funds

Closed-ended funds are subject to the same requirements as open-ended funds.

Legal vehicles

8. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures? What are the participants' interests in the fund called (for example, share or unit)?

Open-ended retail funds

A mutual fund or ETF can be organised as:

- A business or statutory trust.
- A corporation.
- A limited partnership.
- A limited liability company (LLC).
- Another entity under the laws of any US state.

In practice, most mutual funds are set up as Massachusetts business trusts, Delaware statutory trusts or Maryland corporations.

These forms of organisation are attractive to fund sponsors because they:

- Offer significant governance flexibility.
- Do not require annual shareholder meetings.
- Are not subject to state income tax or franchise tax at the entity level.

Liability and indemnification issues may also influence the fund sponsor's choice of vehicle.

Participants' interests in a fund are commonly referred to as shares. A mutual fund can offer multiple classes of shares, subject to different expenses and offering different services, such as different shareholder servicing or distribution arrangements.

Closed-ended retail funds

Closed-ended funds are typically organised in the same manner as open-ended funds. Unlike open-ended funds, closed-ended funds can issue preferred stock subject to certain conditions.

Investment and borrowing restrictions

9. Describe the investment and borrowing restrictions to which retail funds are subject.

Open-ended retail funds

Mutual funds are subject to many restrictions on investments under the ICA, including:

- Limitations on the maximum investment in a single issuer for diversified funds:
  - in relation to 75% of its assets, a diversified fund cannot invest more than 5% of those assets in a single issuer and cannot acquire more than 10% of the outstanding voting securities of a single issuer;
  - the remaining 25% of the diversified fund's assets are not subject to this limitation and can be invested in a single issuer.

  These limitations do not apply to US government securities and securities of other investment companies.
- Restrictions on transactions with affiliates.
- Limitations on investments in other investment companies, securities-related businesses and illiquid securities.
- Additional restrictions on portfolio quality, diversification, maturity and liquidity for money market funds.

A fund must also disclose in its registration statement its investment policy in relation to certain matters, such as the purchase and sale of real estate and commodities. These investment policies cannot be changed without shareholder approval.

A mutual fund is limited in its ability to borrow money. A mutual fund cannot issue senior securities, which the ICA defines as any:

- Bond, debenture, note or similar obligation constituting a security and evidencing indebtedness.
- Stock of a class having priority over any other class as to distribution of assets or payment of dividends, except for bank borrowings.

A mutual fund can borrow money from a bank, but must maintain certain asset coverage in relation to these borrowings. The SEC is of the view that certain trading practices and derivative instruments must be covered either by asset segregation or offsetting transactions.

Closed-ended retail funds

Closed-ended funds are generally subject to the same restrictions as mutual funds. However, a closed-ended fund can issue a senior debt security and a senior equity security, subject to asset coverage requirements.

10. Can the manager/operator place any restrictions on the issue and redemption of interests in retail funds?

Open-ended retail funds

A manager/operator can place restrictions on the issue of interests in retail funds. For example, a fund can:

- Close a fund (or share class) to new purchasers.
- Establish minimum investment amounts.
- Impose front-end, level or deferred sales charges.
- Limit the distribution channels through which shares are sold.
- Limit the ability of frequent traders to purchase shares or otherwise limit the number of exchanges an investor can make within a specified period.

A mutual fund cannot suspend redemptions except under unusual circumstances (such as when the New York Stock Exchange is unexpectedly closed or trading is restricted, or the SEC has declared an emergency). However, it can impose a redemption of up to 2%.

Closed-ended retail funds

Closed-ended fund shares are not redeemable at the shareholder's option. However, a closed-ended fund can:

- Impose a sales charge on its initial sale of shares.
- Repurchase its shares, including at a price other than NAV.

11. Describe any restrictions on the rights of participants in retail funds to transfer or assign their interests to third parties.

Open-ended retail funds

There are no statutory restrictions on mutual fund investors' rights to transfer or assign their rights to third parties. However, most investors seeking to dispose of their shares either:

- Redeem them.
- In the case of ETFs, sell them on an exchange.

Closed-ended retail funds

There are no statutory restrictions on closed-ended fund investors' rights to transfer or assign their rights to third parties. However, most investors seeking to dispose of their shares sell them on an exchange.

Reporting requirements

12. Describe the periodic reporting requirements to:

- **Investors.**
- **Regulators.**

Open-ended retail funds

- **Investors.** Mutual funds must deliver the following reports to investors:
  - a prospectus or summary prospectus;
  - supplements to the fund's prospectus;
  - annual and semi-annual reports;
  - annual privacy notices; and
  - certain tax information.
- **Regulators.** Mutual funds must file the following reports, among others, with the SEC:
  - annual updates to the fund's registration statement on Form N-1A;
  - supplements to the fund's prospectus;
  - annual and semi-annual reports on Form N-CSR, containing the fund's financial statements and certified by the fund's CEO and CFO;
  - semi-annual reports on Form N-SAR, containing certain regulatory information;
  - quarterly reports on Form N-Q, containing portfolio holdings information and certified by the fund's CEO and CFO;
  - annual reports on Form N-PX regarding the fund's proxy voting record; and
  - in relation to money market funds, Form N-MFP, containing information regarding a money market fund's portfolio holdings.

  Mutual funds may be required to make periodic filings with state securities regulators.

Closed-ended retail funds

- **Investors.** Closed-ended funds must deliver the same periodic reports to investors as mutual funds (*see above, Open-ended retail funds: Investors*). A closed-ended fund's annual report typically includes the information that otherwise would be required in an updated Form N-2.
- **Regulators.** Closed-ended funds must file the same periodic reports with the SEC as mutual funds (*see above, Open-ended retail funds: Regulators*). A closed-ended fund's annual report on Form N-CSR typically includes the information that otherwise would be required in an updated Form N-2.

Tax treatment

13. Describe the tax treatment for:

- **Funds.**
- **Resident investors.**
- **Non-resident investors.**

Open-ended and closed-ended retail funds

- **Funds.** Funds typically seek to qualify as regulated investment companies under the IRC. A regulated investment company is not subject to federal income tax at the fund level on income and gains from investments that are distributed in a timely manner to investors.
- **Resident investors.** Generally, for federal income tax purposes, a fund's distribution of investment income and short-term capital gains is taxable as ordinary income. Distributions of net capital gain (that is, the excess of net long-term capital gains over net short-term capital losses) that are properly designated by the fund as capital gain dividends are taxable as long-term capital gains.

  Distributions of income and capital gains may be subject to state and local taxes.

  Any gain resulting from an exchange or redemption of fund shares is generally subject to tax as a capital gain.
- **Non-resident investors.** In general, dividends (other than capital gain and exempt-interest dividends) paid to a shareholder that is not a US person within the meaning of the IRC are subject to withholding of US federal income tax at a rate of 30% (or any lower applicable treaty rate).

Top marginal federal income tax rates to the end of 2010 are 35% for ordinary income and short-term capital gain, and 15% for long-term capital gains. Tax rates for 2011 and beyond are currently the subject of much government debate in the US.

Reform

14. Please summarise any proposals for the reform of retail fund regulation in your jurisdiction. Please also summarise any litigation or enforcement action relating to fund regulation in your jurisdiction.

Recent legal changes potentially affecting retail funds include:

- The adoption of amendments to the rules governing money market funds, which are meant to reduce the risks associated with a money market fund's portfolio.
- The proposal of a new rule and related amendments to replace Rule 12b-1 under the ICA, which would limit cumulative sales charges paid by an investor.
- The Supreme Court's ruling in *Jones v Harris Associates LP (130 S.Ct. 1418 (U.S. 2010))*, which established the standard governing claims of excessive fees under the ICA.

HEDGE FUNDS: OVERVIEW

15. Please give a brief overview of the hedge funds market in your jurisdiction. (How developed is the market? Has it been active in the past year?) Please highlight the changes in market practice in the last year, including any changes to investment strategies being pursued and the terms of investment.

The US hedge fund market is well developed and actively populated by many managers, funds and high net worth and institutional investors. US hedge fund managers also manage significant assets of non-US investors. According to HedgeFund.Net, total industry assets reached an estimated US$2.338 trillion as of September 2010.

During 2010, hedge funds as a whole experienced mixed performance. There were more hedge funds formed than in 2009, but formation remained below historic high levels. There was also significant seeding activity and a re-emergence of funds of funds. Many managers pursued macro and long/short investment strategies.

Legislation and regulation

16. What are the key statutes and regulations that govern hedge funds in your jurisdiction? What regulatory bodies are involved in regulating hedge funds?

The Advisers Act is the primary source of law applicable to hedge fund managers. The Advisers Act imposes substantive requirements on advisers and empowers the SEC to regulate advisers' activities. In addition to the statutes described in *Question 2*, hedge funds and their managers are subject to other federal and state laws, including the:

- Employee Retirement Income Security Act 1974, which governs the management of pension money.
- Commodity Exchange Act 1974 (CEA), which regulates hedge funds and their managers if the fund invests in commodities and futures contracts.
- Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which, among other things:
  - substantially alters the registration and reporting schemes under the Advisers Act;
  - places new restrictions on banks;
  - imposes new requirements on over-the-counter derivatives markets and transactions.

See also *Question 27*.

Hedge funds are typically eligible for an exemption from certain federal securities laws, including the ICA and Securities Act (*see Question 19*).

17. How are the following areas regulated (if at all) in relation to hedge funds:

- **Risk.**
- **Valuation and pricing.**
- **Systems and controls.**
- **Insider dealing and market abuse.**
- **Transparency.**
- **Money laundering.**
- **Short selling.**

- **Risk.** Several federal regulators, including the Financial Stability Oversight Council, the Federal Reserve Board of Governors, the Commodity Futures Trading Commission (CFTC) and the SEC, monitor systemic risk of financial institutions including hedge funds (*Dodd-Frank*). Fund offering documents typically list risk factors related to an investment in the fund.
- **Valuation and pricing.** The SEC emphasises valuation and pricing. Funds generally value securities in accordance with US generally accepted accounting principles (GAAP).
- **Systems and controls.** All registered advisers must adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules (*Advisers Act*).
- **Insider dealing and market abuse.** Hedge fund managers must not engage in market manipulation and insider trading (*Securities Act, Exchange Act* and *Dodd-Frank*). Registered advisers must adopt and implement written policies and procedures designed to prevent insider trading.
- **Transparency.** Limited reporting of public securities holdings is required (*see Question 21*). In addition, the SEC can require additional reporting, including rules for the assessment of systemic risk (*Dodd-Frank*) (*see below, Short selling*).
- **Money laundering.** Most hedge fund managers maintain some sort of anti-money laundering programme, although they are not required to do so.

  In addition, the anti-fraud rules of the Advisers Act apply to all US advisers, regardless of registration status (*see Question 22*).
- **Short selling.** The SEC must prescribe rules requiring monthly public disclosure of certain information relating to short sales (*Dodd-Frank*). Dodd-Frank also prohibits "a manipulative short sale of any security". The SEC has also adopted a rule requiring stock exchanges to pause trading in certain stocks if the price moves 10% or more in a five-minute period. The compliance date was recently extended to 28 February 2011. Separately, issuer's securities cannot be sold short within a restricted period before purchasing the same securities in the issuer's secondary public offering (*Rule 105, Regulation M*).

Marketing

18. Who can market hedge funds? Are there differences between local funds and foreign funds?

Persons who sell interests in hedge funds must be registered as broker-dealers, subject to certain limited exemptions for issuers who market their own securities.

19. To whom can hedge funds be marketed? Are there differences between local funds and foreign funds?

Interests in hedge funds are generally offered to US persons under a private placement exemption under the Securities Act.

Regulation D of the Securities Act

An offering may be exempt from registration if sales are restricted to accredited investors, generally defined as:

- Persons with a net worth of US$1 million (with spouse) or annual income of US$200,000 (US$300,000 with spouse).
- Businesses and other entity investors with total assets of US$5 million.

The definition of accredited investor was recently amended to delete the "value of the primary residence" from net worth.

Regulation S of the Securities Act

Interests in non-US hedge funds may be exempt from registration if offers and sales are made outside the US to non-US investors.

Investment Company Act

Hedge funds typically operate under one of the following exemptions from ICA registration:

- Interests are privately-offered to, and held by, fewer than 100 US beneficial owners qualifying as accredited investors.
- Interests are only privately-offered to qualified purchasers, generally:
  - persons with US$5 million in investments;
  - companies or other institutions with US$25 million in investments;
  - persons investing solely on behalf of qualified purchasers.

Commodity Exchange Act

The following may be required to register as commodity pool operators and commodity trading advisors with the Commodity Futures Trading Commission (CFTC), and become members of the National Futures Association (NFA):

- Managers that engage in futures and commodities transactions.
- Managers that engage in other derivatives transactions under Dodd-Frank.

CFTC registrants and NFA members must comply with various disclosure, record keeping and reporting requirements, as well as with other regulations.

Assets portfolio

20. Who holds the portfolio of assets? What regulations are in place for its protection?

Registered advisers must engage a qualified custodian (such as a bank, registered broker-dealer or other financial institution) to hold client assets. Managers are exempt from requirements to deliver quarterly account statements, provide notice of the qualified custodian or arrange for surprise audits, if they both:

- Engage an independent public accountant registered with, and subject to regular inspection by, the Public Company Account Oversight Board to perform an annual audit.
- Distribute financial statements prepared in accordance with GAAP within 120 days (or 180 days for funds of funds) of the end of the fund's fiscal year.

Additional rules apply when an affiliate acts as qualified custodian.

Requirements

21. Describe the key disclosure or filing requirements (if any) that must be done by the fund (for example, in relation to the prospectus or offering memorandum and side letters).

Funds and their advisers must make public filings of the following, among other things:

- Ownership in public companies above certain specified thresholds set out in the Exchange Act.
- Certain exchange traded equity securities, equity options/warrants, shares of closed-ended funds and convertible debt securities (only for advisers qualifying as institutional investment managers with discretion over US$100 million in those securities).
- Certain large positions.
- Form D filings to disclose initial and annual sales of fund interests in the US.
- Filings with states under Blue Sky laws.
- Filings with the Internal Revenue Service.
- Form ADV (see *Question 22*).

Offering memoranda and side letters are not required to be filed with the SEC but are subject to review by the SEC on examination.

22. What are the key requirements that apply to managers/operators of hedge funds? Are there differences between local funds and foreign funds? Can a foreign manager manage a local fund?

All hedge fund managers are subject to Advisers Act anti-fraud provisions. US private fund managers with assets under management above US$150 million generally must register with the SEC (*Dodd-Frank*) (*see Question 27*). Managers with separate account clients typically must register with the SEC if they have assets under management above US$100 million. Registration subjects an adviser to various requirements including those relating to custody, advertising, personal trading, record keeping and proxy voting.

Advisers not subject to registration under the Advisers Act may be subject to state registration requirements. Advisers that engage in futures transactions may also be subject to registration under the CEA.

Non-US advisers can manage assets of US investors. However, depending on the nature and extent of their US activities, non-US advisers may be required to register with the SEC or otherwise be subject to the Advisers Act in certain respects.

Legal vehicles and structures

23. What are the main legal vehicles used to set up a hedge fund and what are the key advantages and disadvantages of using these structures? What are the participants' interests in the fund called (for example, share or unit)?

US funds are typically structured as Delaware limited partnerships or LLCs. These vehicles afford investors limited liability while providing the manager with broad authority (*see Questions 24 and 25*). Typically, the fund also enters into a separate management agreement with the manager. Investor interests are referred to as limited partnership interests or membership interests.

The typical structures include:

- A master-feeder structure where both of the following invests in a master fund as feeder funds:
  - a Delaware limited partnership or LLC;
  - a non-US corporation.

  The non-US corporation and the master fund are generally organised in a tax-efficient jurisdiction, such as the Cayman Islands. US taxable investors typically invest in a US feeder fund, and non-US investors and US tax-exempt investors typically invest in a non-US feeder fund. The main benefit of a master feeder structure is having a single pool of assets to manage.
- A parallel fund structure where the manager manages a Delaware limited partnership or LLC, and a non-US corporation, side by side. The non-US corporation is generally organised in a tax-efficient jurisdiction, such as the Cayman Islands. The parallel fund structure allows the manager to make different investments for the US fund and the non-US fund based on tax or other considerations.

Managers can also provide advice to investors through separately-managed accounts.

24. What are the advantages and disadvantages of using onshore and offshore structures?

Onshore

Onshore structures permit pass-through tax treatment for US taxable investors. Disadvantages include:

- Taxation of income that may not have been actually received.

- Potential adverse tax consequences for US tax-exempt investors and for non-US investors.

Offshore

Offshore structures permit avoidance of potentially adverse tax consequences for US tax-exempt investors and non-US investors (including avoidance of US tax filing requirements for non-US investors). Disadvantages include:

- Potentially adverse passive foreign investment company and controlled foreign corporation tax treatment for US taxable investors.
- Information reporting requirements.

Tax treatment

25. Describe the tax treatment for:

- **Funds.**
- **Resident investors.**
- **Non-resident investors.**

- **Funds.** There is no entity level tax on domestic/onshore funds, so long as they are not treated as publicly traded partnerships (which may be taxable as corporations in certain circumstances). An offshore fund formed as a non-US corporation or partnership that is taxed as a corporation for US income tax purposes is subject to:
  - net-basis US tax and an additional branch profits tax on the fund's share of income that is effectively connected with a US trade or business (ECI) conducted by the fund;
  - US withholding tax on US corporate dividends and certain other US source income that is not ECI;
  - from 2013, a US withholding tax on a broad range of US-source withholdable payments unless, in general, the fund enters into a withholding/reporting agreement with the US Treasury.
- **Resident investors.** A taxable US investor reports on its own tax return its distributive share of the fund's annual taxable income or loss, regardless of whether distributions are received. The tax character of the income or loss also generally passes to the investor.
- **Non-resident investors.** Non-US investors and US tax exempt entities typically invest through an offshore corporation, generally to avoid:
  - US tax on ECI;
  - unrelated business taxable income on the part of the US tax exempt entities.

For the relevant tax rates, see *Question 13*.

Restrictions

26. Can participants redeem their interest? Are there any restrictions on the right of participants to transfer their interests to third parties?

Investors can usually redeem periodically (that is, monthly or quarterly) with prior notice. Redemptions may be subject to lock-up periods, fees, gates, suspensions and reserves.

Transfers are typically restricted and require prior approval by the general partner or manager.

Reform

27. Please summarise any proposals for the reform of hedge fund regulation in your jurisdiction. Please summarise any litigation or enforcement action relating to fund regulation in your jurisdiction.

Dodd-Frank was signed into law on 21 July 2010. It:

- Effected sweeping changes to the overall US regulation of the financial services industry, including hedge funds.
- Was enacted with the purpose of preventing future financial crises.

Dodd-Frank places new restrictions on banks, known as the Volcker Rule, that limit a bank's ability to trade its own capital and invest in hedge funds and private equity funds.

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Areas of practice. Investment funds and investment advisers.

Recent transactions

- Advising investment advisers, broker-dealers, and open-ended and closed-ended funds.
- Advising clients on the organisation of hedge funds, private equity funds and funds of funds (both registered and unregistered), with a particular emphasis on non-US sponsors offering products and services in the US.

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Areas of practice. Investment funds and investment advisers.

Recent transactions

- Focusing on regulatory and transactional matters relating to the financial services industry.
- Ongoing representation of investment advisers, open-ended and closed-ended funds and their trustees, and hedge funds and other private investment vehicles.
- Working with clients to structure investment products.
- Representing public and private companies in the financial services and other industries in a variety of matters, including debt and equity offerings, mergers and acquisitions and investment transactions.

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Qualified. New York, 1997

Areas of practice. Private investment funds and investment advisers.

Recent transactions

- Advising institutional and individual managers worldwide on the most advantageous ways to form, structure and re-organise hedge funds and other private funds.
- Advising clients on matters affecting their ongoing operations, including compensation structures and related profit-sharing arrangements, and regulatory and compliance matters.
- Advising global financial services firms and global alternative investment management companies on the launch of feeder funds, institutional seed investments and managed account arrangements.