Global Regulations – Impact on Asia

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Summary

1. General Solicitation and Bad Actor Rules

2. Volcker Rule

3. Alternative Investment Fund Managers Directive (AIFMD)

4. OTC Reforms

5. Foreign Account Tax Compliance Act (FATCA)

General Solicitation and Bad Actor Rules

Regulation D: Amendments permitting “general solicitation” in private placements

Under new Rule 506(c), private funds may be **offered** without restrictions on publicity so long as they are **sold** only to accredited investors

Rule 506(c) requires “**reasonable steps to verify**” that all purchasers are accredited investors and final rule includes a safe harbour

Final release confirms that a Rule 506(c) offering with general solicitation will not be considered a “public offering” under Section 3(c)(1) or 3(c)(7) of the US Investment Company Act

Final release pushes back on investment company industry lobbying, begs off mutual fund-style content restrictions on advertising by private funds engaged in general solicitation

Proposing Release: Proposed new requirements for Rule 506(c) offerings

Rule 503:	New Form D disclosure and filing requirements – general solicitation methods; steps to verify accredited investor status; advance and closing filings
Rule 507(b):	One-year disqualification for failure to file Form D bars future Rule 506 offerings until one year after required filings are made
Rule 509:	Legend and content requirements for general solicitation materials, including risk disclosure and current information requirements for performance data
Rule 5101:	Temporary requirement to submit general solicitation materials to SEC no later than the date of first use
Rule 156:	Sales literature anti-fraud guidance extended to private funds, whether or not they engage in general solicitation under Rule 506(c)

Bad Actor Rules

Disqualifies offerings involving certain felons and other "bad actors" from Rule 506 exemption

Applies to disqualifying events occurring after effective date of the Bad Actor provisions

Procedures issuers can implement to confirm they are not disqualified:

Issuer must exercise reasonable care in making factual inquiries

SEC may expand scope of Bad Actor rules across other exemptive rules

Issuers must still disclose matters that would have triggered disqualification but occurred before effective date

Asking directors, executive officers and 20%+ shareholders and any other covered persons to:

- complete questionnaires
- provide representations

May rely on Rule 506 if issuer unaware of facts that would be basis for disqualification but can establish that it exercised reasonable care

Volcker Rule

Volcker Rule

Prohibits banking entities from

- Proprietary trading
- Owning, sponsoring or having certain interests in or relationships with covered funds (hedge funds, private equity funds, retail/mutual funds)

Implementing regulations will become effective on 1 April 2014 and banking entities have until 21 July 2015 to fully conform existing operations with new requirements

- 3% exemption – in connection with provision of asset management services to customers
- Solely outside the US (SOTUS) exemption
- Securitisation exemption
- Prime brokerage exemption

Exemptions:

SOTUS Exemption

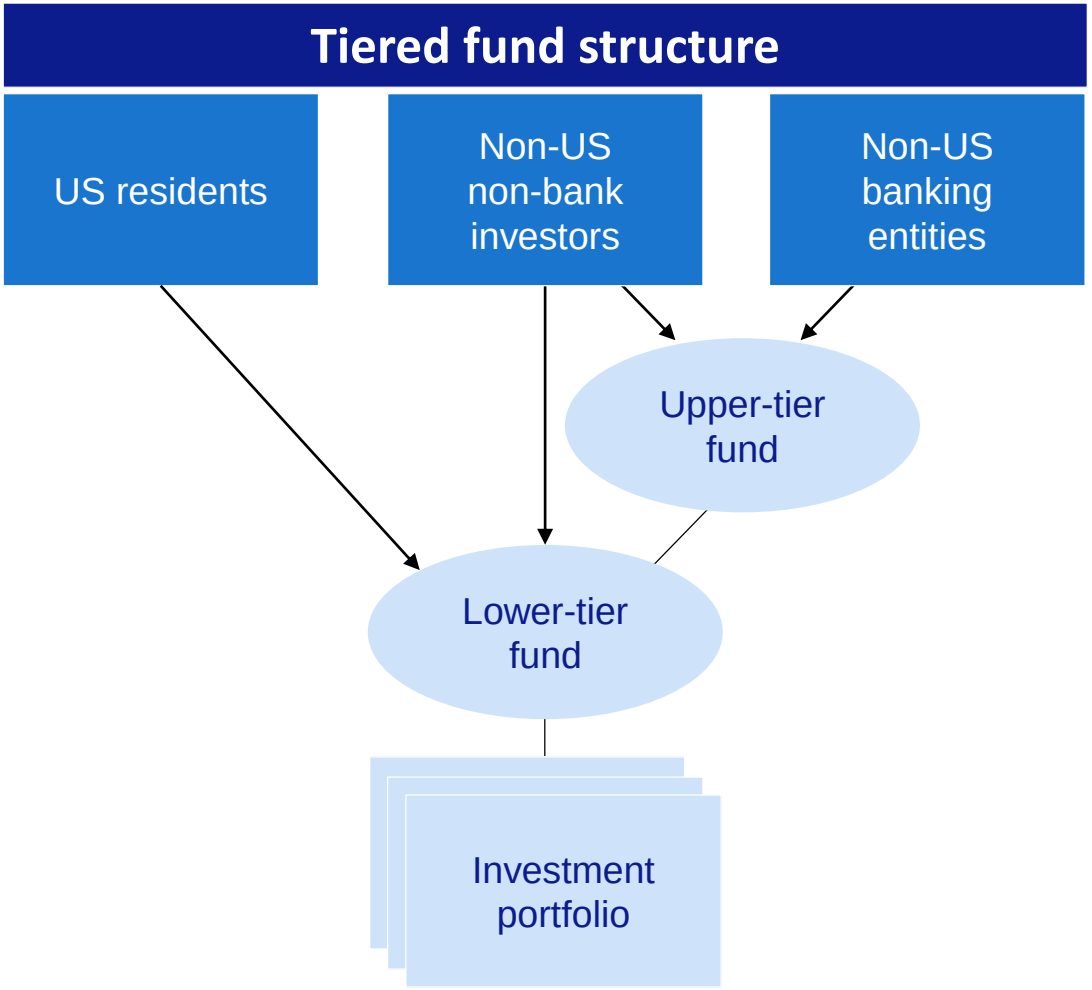
Non-US banking entity: the banking entity is not organised, or controlled by a banking entity that is organised, under the laws of the US

SOTUS: the activity or investment occurs solely outside the US, which requires –

- no US decision to invest in or sponsor the covered fund
- no US booking of investment or sponsorship transaction
- no US financing for the investment or sponsorship

US resident prohibition: no ownership interest in the covered fund is offered for sale or sold to a resident of the US (where “resident of the US” = “US person” under US SEC Regulation S)

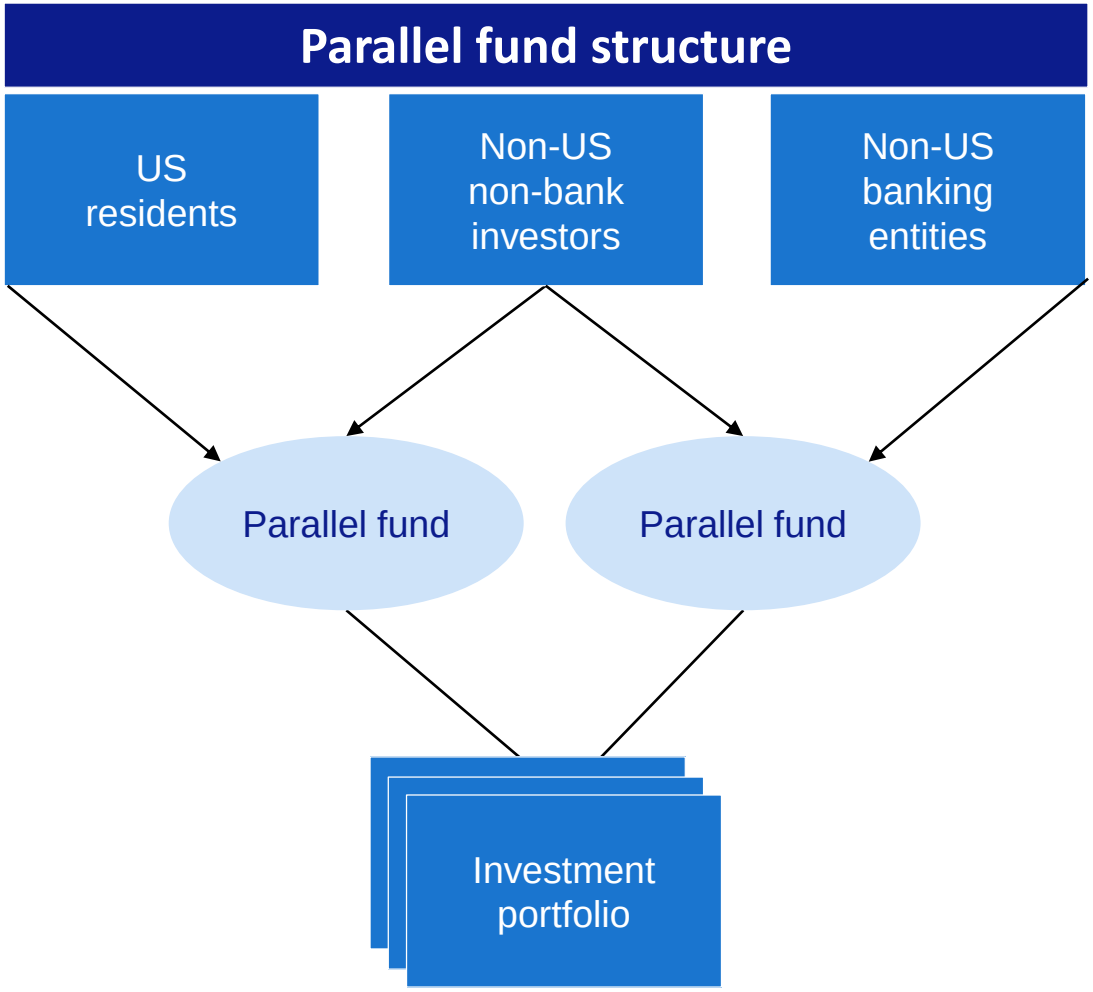
Structuring around the US resident prohibition



US resident prohibition requires that US residents not be offered or sold ownership interests in ***"the covered fund"***

What if US residents are offered and sold ownership interests in a separately organised covered fund?

Structuring around the US resident prohibition (cont'd)



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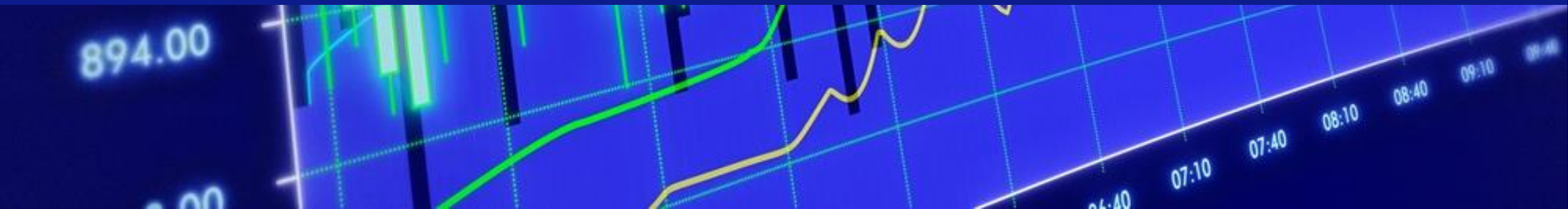
Alternative Investment Fund Managers Directive (AIFMD)



AIFM Directive: What is an AIF?

What is an AIF	What is not an AIF
Broadly defined as: ■ Collective investment undertaking ■ Raises capital from a number of investors ■ With a view to investing capital in accordance with a defined investment policy for the benefit of investors ■ Which is not a UCITS	■ Holding companies (Art.2(3)(a)) ■ Occupational retirement funds (Art. 2(3)(b)) ■ Supranational institutions – e.g. ECB (Art. 2(3)(c)) ■ National Central Banks – e.g. BoE (Art. 2(3)(d)) ■ National and local governments (Art. 2(3)(e)) ■ Employee participation / savings schemes (Art. 2(3)(f)) ■ Securitisation special purpose entities (SSPEs) (Art. 2(3)(g)) ■ Joint ventures (Recital 8) ■ Family offices (Recital 7)

AIFM Directive: The current position

- EU member states were to have implemented the Directive by 22 July 2013
  - 15 member states met this deadline
  - States still waiting for parliamentary approval: Bulgaria, Italy, Romania and Spain
  - States still drafting: Belgium, Finland, Greece, Hungary, Lithuania, Poland, Portugal and Slovenia
  - Estonia has only partially implemented the AIFM Directive
- EU firms that want to manage or market funds in Europe have to be authorised under the AIFM Directive
- Non-EU managers will trigger the AIFM Directive only if they market to EU investors
- July 2013 – July 2014: 12-month grace period granted by some EU member states (but not France)

Qualification for grace period	EU member states
Relevant AIF must have been marketed in the jurisdiction prior to 22 July 2013	Germany
AIFM must have marketed a fund in the relevant jurisdiction prior to 22 July 2013	Germany, Finland, Netherlands, Sweden
AIFM must have marketed a fund in the EEA prior to 22 July 2013	UK, Ireland
Unknown	Italy, Norway, Spain

AIFM Directive: Grace period

If grace period is available:

comply with existing private placement rules

AIFM Directive obligations should not apply during the grace period

If grace period does not apply (the “Article 42 conditions”):

marketing **only** possible if manager complies with private placement rules in investor jurisdiction (as at present)

EU member state may impose pre-marketing regulatory consent or notification requirement

regulatory cooperation arrangement must be in place between manager's and/or AIF's jurisdiction and investors' jurisdictions

transparency and anti-asset stripping requirements in Articles 22-24 and 26-30 apply

Marketing issues under the AIFM Directive

Meaning of “marketing”:

interpretations differ among EU jurisdictions, although UK FCA has indicated that there should at least be registration under Article 42 where there is a PPM being sent to investors

all marketing efforts relating to the AIF ⟷ firm offer of AIF interest, structure finalised and subscription possible

Reverse solicitation:

risk of relying on reverse solicitation differs among EU jurisdictions

common for managers to use subscription documents to support their reliance on reverse solicitation

AIFM Directive: Implications of being an AIFM

Managing an AIF is a licensable activity under AIFMD and requires licensing as an AIFM

Limitation on licence

- may only be licensed to conduct a very limited range of other licensable activities
- e.g. an AIFM could not also be a bank, but could act as a manager of accounts or as an investment adviser

Partial exemptions:

- AIFM which manage AIF:
  - with assets of EUR100 million or less; or
  - with assets of EUR500 million or less, where AIF not leveraged and no redemption rights for first 5 years
- limited registration requirements apply to AIFM of small AIF

What are the main obligations of an AIFM?

Capital	■ an AIFM must have initial capital of at least EUR125,000 ■ where the value of assets under management of an AIFM exceeds EUR250 million, the AIFM must have an additional amount of capital
Principles	■ subject to a number of general conduct of business principles, e.g. act honestly, with due skill, care and diligence and fairly in the conduct of activities
Remuneration	■ required to impose certain restrictions on the remuneration of certain personnel, e.g. senior management, risk takers and control functions
Conflicts / risk / liquid management	■ required to have robust conflicts, liquidity and risk management policies and processes

Implications of being an AIFM

Delegation	■ cannot delegate the majority of its activities without risking its regulator finding that it is no longer an AIFM ■ portfolio management can only be delegated to appropriately regulated third parties
Transparency	■ must prepare an annual report in respect of each AIF and report to investors and relevant authorities
Leverage	■ AIFM's regulator has powers to control the use of leverage by the AIFM
Depositary	■ obliged to ensure that a depositary is appointed in respect of each AIF it manages ■ only certain types of entities can be appointed as depositaries (e.g. banks) and the AIFM cannot act as the depositary ■ the assets of the AIF must be entrusted to the depositary for safe-keeping ■ the depositary must oversee the process for sale and redemption of fund units and oversee NAV calculation

OTC Reforms

"All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements."

G20 Pittsburgh, September 2009

US and EU OTC Derivatives Regulations

Title VII (Wall Street Transparency and Accountability) of Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 (Dodd-Frank Act)

- Effective from 21 July 2010
- Registration requirements for Swap Dealer and Major Swap Participants
- Entity-Level and Transaction-Level Requirements
  - Swap Clearing
  - Swap Data Reporting
  - Swap Exchange Trading
  - Business Conduct Rules
- Margin for uncleared swaps

Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (previously known as European Market Infrastructure Regulation) (EMIR)

- Came into force on 16 August 2012
- Clearing
- Reporting
- Risk Mitigation
- Margin for uncleared swaps

ISDA Documentation

Dodd-Frank

March 2013 Dodd-Frank Protocol

Facilitates compliance with internal business conduct rules for SD and MSP

September 2013 DFP2 to EMIR Top Up Agreement

Amends certain provisions of March 2013 Dodd Frank Protocol and adopts certain provisions of the July 2013 EMIR Protocol

ISDA 2013 DF Agreement for Non-U.S. Transactions (November 2013)

Allow market participants to enter into selected provisions of the August and/or March Dodd-Frank Protocol that are relevant to transactions which occur outside of the US (in part or in whole)

EMIR

2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (July 2013)

Facilitates compliance with portfolio reconciliation and dispute resolution (as required under the risk mitigation obligations); contains disclosure waiver to facilitate trade reporting

2013 EMIR NFC Representation Protocol (March 2013)

Facilitates compliance with the clearing and risk mitigation obligations by requiring counterparties to provide representation on their status as a non-financial counterparty

Standard Amendment Agreement for Timely Confirmations (March 2013)

Allows counterparties to agree to the timely confirmation of their trades as part of their compliance with the risk mitigation obligations

FATCA

FATCA

New reporting and withholding regime

- Imposes 30% withholding tax on payments made to foreign financial institutions (FFIs)
- Unless FFI agrees to provide information to US IRS about customers and investors
- FFI may be otherwise deemed FATCA compliant if intergovernmental agreement (IGA) in place with the US
- Model 1 IGA: instead of reporting directly to the US, FFIs report to home tax authorities which then transmit information to the US

Grandfathering rules

- Transactions entered into prior to 1 January 2014 outside FATCA rules for the term of the facility

Implications for fund managers and trustees

- May be characterised as FFI if investing primarily in securities, funds, commodities and derivatives
- Third party providers may rely on certifications from funds to determine FATCA obligations
- Financial accounts generally belong to fund, not paying agent, therefore fund will bear ultimate responsibility
- FFI should register with US IRS as participating FFI no later than 25 April 2014
- Effective date is 1 July 2014

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