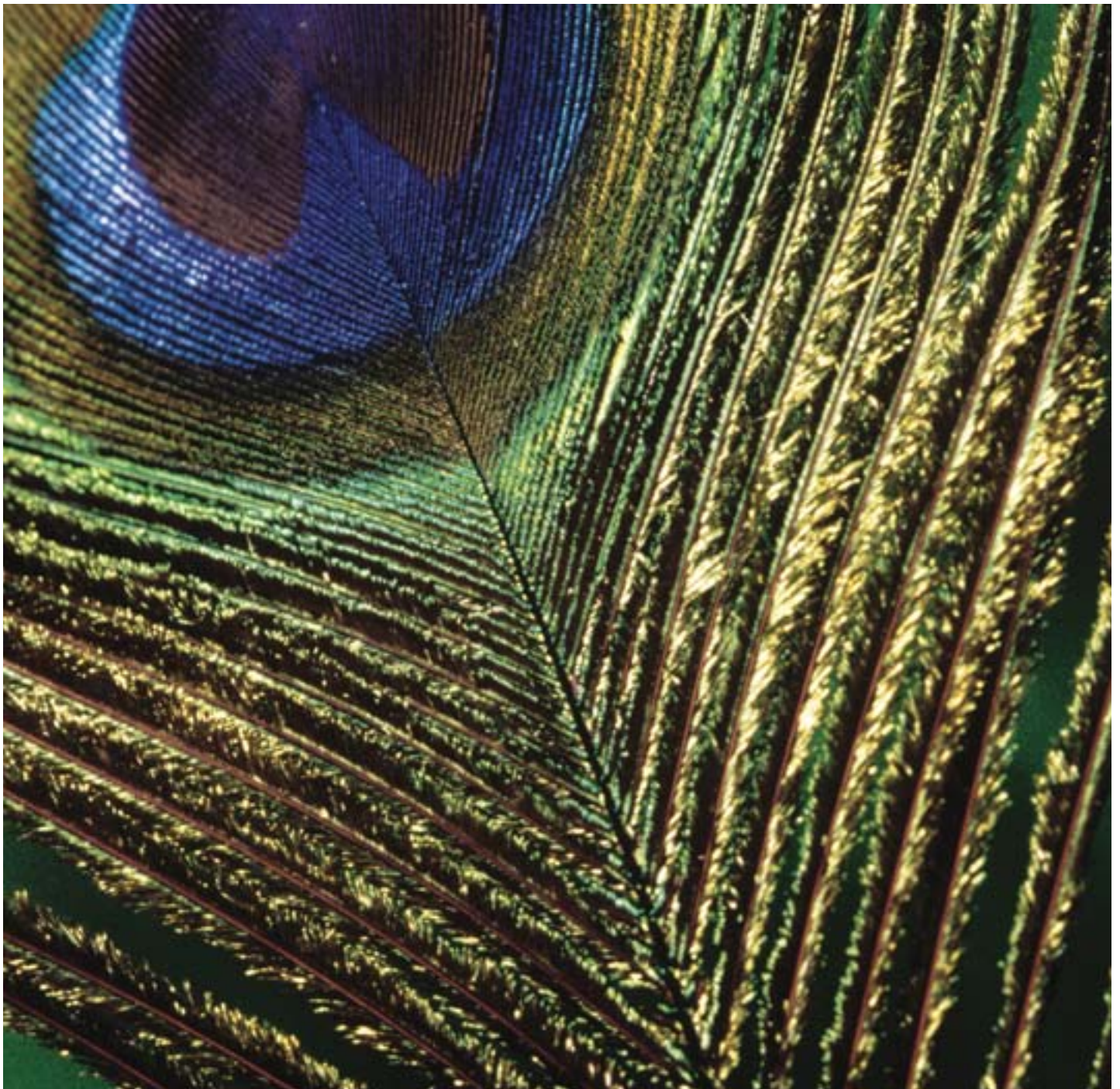
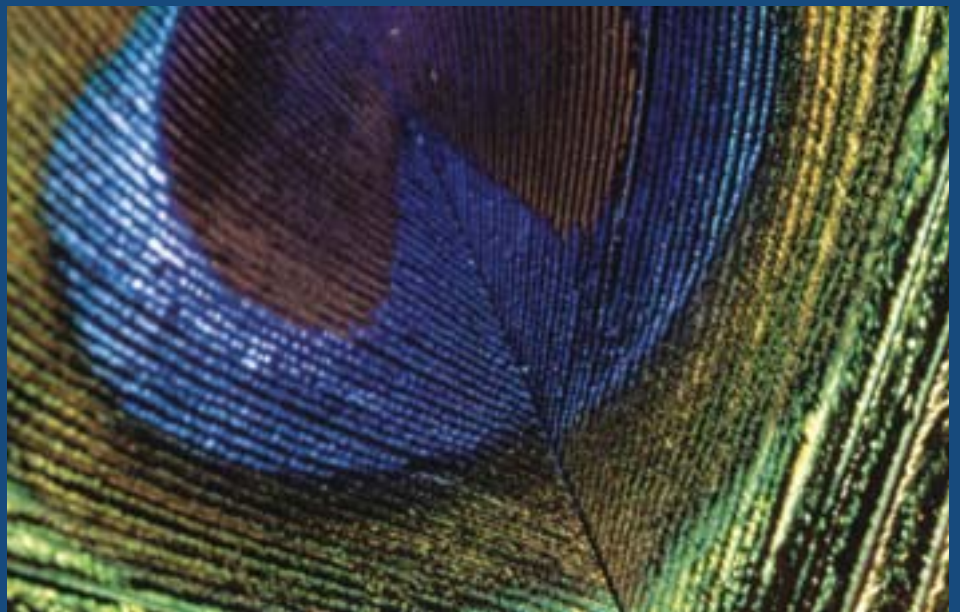


# The regulation and distribution of hedge funds in Europe

Changes and challenges





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## The regulation and distribution of hedge funds in Europe

### Changes and challenges

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PricewaterhouseCoopers' Global Alternative Investment Management  
Industry Group Contacts

# Foreword

I am pleased to present the 2005 edition of our report on the Regulation and Distribution of Hedge Funds in Europe. This is the third year that we have produced this report, which represents a key part of PricewaterhouseCoopers' commitment to thought leadership in the European hedge fund industry.

*This paper was prepared with input from hedge fund specialists of PricewaterhouseCoopers' Global Alternative Investment Management Industry Group. Compilation of such a paper, which covers up to the minute developments across many countries, requires a high degree of cross-border collaboration and thanks are due to the PricewaterhouseCoopers international network for their input.*

*While this information represents our understanding at the time of going to press, given the rapid pace of change in the European hedge fund industry, the factual data in this paper may quickly be superseded. Up-to-date advice should always be obtained regarding current regulations and fiscal rules.*

The European hedge fund industry continued its rapid growth last year. This was driven by increased demand from institutional investors together with changes made by some national regulators and fiscal authorities, to facilitate greater access to hedge fund products. In some countries, this has allowed hedge funds and products with hedge fund-like characteristics to be made more available to retail investors.

For the first time, we have included a detailed consideration of the taxation of hedge funds across the market place in Europe, as well as an overview of the various national tax regimes as they affect hedge fund managers and hedge fund investors.

Notwithstanding that regulatory progress at the pan-European level remains slow, we are of the view that the relaxation of regulatory and fiscal barriers, combined with improved corporate governance arrangements (whether enforced by regulators or adopted voluntarily by funds' boards of directors), will result in further rapid growth in the European hedge fund market over the coming years.

As always, hedge fund managers and promoters themselves have a role to play in shaping the regulatory and fiscal environment in which European hedge funds operate. Apart from being active in consulting and influencing the appropriate authorities, the industry should continue to develop best practice guidance. The implementation by funds' boards and their service providers of procedures that follow such guidance will serve to strengthen the appeal of the hedge fund sector to investors of all types.



Graham P.N. Phillips  
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London  
June 2005



# Section 1

## Current developments in the hedge fund market

The hedge fund sector continues to grow rapidly: many commentators are now estimating that global assets under management have surpassed US\$1 trillion and it is thought that European hedge funds contribute approximately a quarter of the global total, up from a fifth a year ago.

The composition of the investor base providing the flow of new money into this sector is changing: increasingly, hedge funds and hedge fund-like products are available to “mass affluent” investors and some are even available to retail investors, although access is typically via funds-of-hedge funds rather than directly into single manager hedge funds. There is also increasing interest from European institutions as they seek to balance their fiduciary responsibilities to underlying investors or stakeholders against the investment drivers of diversity and alpha returns.

Rapid growth of the asset class, the entrance of new investors to the hedge fund market, concerns about the effects of competition between prime brokers for lending and the effects of hedge funds on market stability, continue to exercise the minds of regulatory authorities across Europe. Individual national regulators have reacted in different ways and no consensus is emerging, so it is not surprising that progress at the pan-European level remains slow.

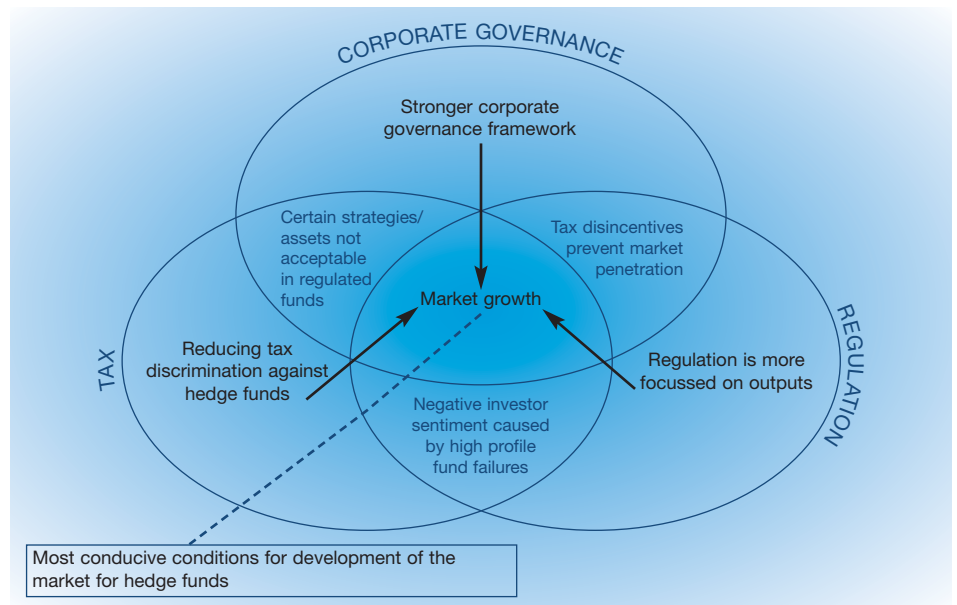
Regulation, fiscal rules or a combination of both, still limit individual investors’ participation in the sector, but the degree to which this effectively prevents access to hedge funds and hedge fund-like

products depends on which set of national rules applies to each investor and each fund. Interestingly, in some countries, regulators and fiscal authorities appear to be working towards a common agenda with respect to encouraging or discouraging investment in hedge funds. However, this is not the case everywhere in Europe.

It is not only the investor base that is changing: strategies are evolving too and the past year has seen European hedge funds adopting certain of the less common strategies already seen on the other side of the Atlantic, such as providing loan origination, trading carbon credits and investing in reinsurance assets and in deals that were previously the domain of private equity houses.

Choice of investment strategy does not only affect the regulatory categorisation of the fund and therefore to who it can be distributed, but it can also affect the tax treatment of the fund. For new funds, thought is required at the development phase to ensure that an appropriate tax structure is in place to achieve optimal tax treatment at both the fund and investor levels. The chosen structure must be capable of withstanding challenge from fiscal authorities who, like their regulatory counterparts, are showing

## Diagram 1: Influences on the development of the market for hedge funds



an increasing understanding of, and interest in, the hedge fund sector.

Another effect of regulators' interest in the sector is the increased recognition by hedge fund boards of directors of their responsibilities to shareholders and the attention that they need to pay to governance arrangements, particularly with regard to their monitoring of the services provided to the fund by third parties, including the investment manager. Given that failure to control operational risk has contributed to many hedge fund failures, this is an encouraging sign and one that will no doubt be applauded by investors, who are naturally concerned that there should be responsible stewardship of their money.

The above diagram illustrates the various influences on the development of the market for hedge funds. Where all three influences converge, we expect that the market for hedge funds will be at its most conducive for growth.

So where is European hedge fund regulation heading? We expect that the model that will develop over the longer

term is one where the market for hedge funds and hedge fund-like products will be determined by regulations that map investor classes against levels of risk inherent in the investment proposition. We consider it likely that this mapping will be based on "outputs", for example, a promised rate of return to shareholders, rather than "inputs", being how the investment portfolio is structured to deliver outputs. However, a pan-European model along these lines is a long way off and we do not envisage that a retail market for hedge funds comparable with the market that already exists for mutual funds in Europe will develop in the foreseeable future.

Despite this, hedge fund managers and promoters have an important role to play in shaping the future regulatory landscape by, for example, responding to regulators' consultation papers and making use of industry-wide representation through bodies such as AIMA. The industry should also consider setting voluntary standards in such areas as control of operational risk, valuations and fund corporate governance.



## Section 2

# Pan-European regulatory developments

### European regulatory framework

There is increasing interest in hedge funds from the pan-European authorities. For example, a response to the report by the European Parliament's Committee on Economic and Monetary Affairs on the "Future of Hedge Funds and Derivatives" (the Purvis report, October 2003) is due in Summer 2005. The European Commission will also comment on the conclusions of its Asset Management Forum, which, it has recently been reported in the financial press, will include consideration of whether a new pan-European regulatory framework for hedge funds is desirable.

Indications are that the European Commission is not keen to introduce new legislation but may seek to make small but significant alterations to the UCITS and MiFID Directives to embrace hedge funds. They could, for example, ask the Committee of European Securities Regulators (CESR) for advice on situations where hedge funds could be considered suitable as an investment recommendation by an adviser.

The underlying problem, which none of the regulators are grasping, is that many hedge funds, although operating as unauthorised vehicles, are inherently less risky in investment terms than many long-only UCITS.

What is required is for UCITS rules to be deconstructed into:

- structural and operational features that bring investor protection –

for example, authorisation of the investment manager, requirement to have a depository with oversight responsibilities, and rules on NAV/pricing; and

- investment constraints that protect investors – these are currently defined by investment and borrowing powers, but in the future should be defined by agreed risk measures.

Such an approach would allow investors to choose the amount of operational risk that they are prepared to accept in a fund structure separately from the investment risk they are prepared to bear.

The proposals by CESR on UCITS-eligible assets suggest that regulators are fixated by the legal definition of transferable securities rather than considering the economic effect of various instruments. So progress at a pan-European level may be rather slow.

### Retailisation of hedge funds and hedge fund-like products

With the hedge fund industry's rapid expansion in recent years, there has also been an extension of the industry's target market, with greater access to retail investors across Europe. Greater regulatory hurdles have accompanied the retailisation of the market; however, a number of countries are leading the way in increasing the accessibility of hedge funds and hedge fund-like products to retail investors. Retail access to date has

A number of countries are leading the way in increasing the accessibility of hedge funds and hedge fund-like products to retail investors... Notwithstanding this, the vast majority of European hedge funds remain accessible only via private placements with a sizeable minimum investment.

mainly been through funds-of-hedge funds, although wrapper products linked to underlying hedge funds dominate in certain markets. Notwithstanding this, the vast majority of European hedge funds (whether by number or by assets under management) remain accessible only via private placements with a sizeable minimum investment. Finalisation of what eligible assets are allowed under UCITS III is likely to have a big impact on the further development of a market for hedge fund-like products aimed at retail investors.

In the UK, despite the general premise in local regulation that hedge funds should not be promoted to the public, there are a number of hedge fund-like products that are aimed at, and promoted to, the retail market in the UK. These have typically been structured as UK listed companies which act as ISA-able wrappers for a fund-of-hedge funds providing hedge fund exposure. Several large investment management firms have already launched such products.

A fund with certain hedge fund-like characteristics can now be authorised by the Financial Services Authority (FSA) as either a Qualified Investor Scheme or a non-UCITS retail scheme. To date neither route has been used extensively, however, the HM Revenue & Customs (HMRC) has now clarified that these vehicles will generally be taxed in the same manner as authorised unit trusts and OEICs, so we expect to see more of these vehicles coming to market in the near future. At the time of going to press, we are aware of several new funds aimed at retail investors, some of which are intending to list on AIM (the junior

market in the UK), which will apparently fall under one of these regulatory categories. One example that we have seen requires a minimum monthly investment of only £250.

The FSA has confirmed that it will be publishing a further review of the promotion and distribution of hedge funds in the UK. This may result in some relaxation in the rules for hedge fund promotion.

Germany has a general prohibition on retail distribution of single manager hedge funds; however, indirect routes are available to retail investors such as structured notes linked to underlying hedge funds. The situation is similar in Switzerland, where funds-of-hedge funds are also accessible to retail investors. In Luxembourg, retail investors have access to hedge funds, provided the funds are approved by the local regulator. Last year, the Irish regulator abolished its minimum investment limits for Irish retail investors in funds-of-hedge funds. France is also easing access to retail investors with a minimum investment threshold of €10,000 for funds-of-hedge funds.

Overall, as investors are seeking new products to achieve a better and more transparent balance between performance and risk, we expect retail demand for hedge funds and hedge fund-like products to increase. In the face of such demand, it is to be hoped that the regulatory barriers to marketing to retail investors will continue to be eased, but most regulators across Europe still appear to be treading carefully.

Certain hedge fund-like strategies... will no longer be available to managers of UCITS funds should CESR's draft advice as it currently stands be adopted by the European Commission.

### Practical aspects of UCITS III implementation

The implementation of UCITS III across the European Union (EU) offers the possibility of a pan-EU "passport" for hedge fund-like products launched by hedge fund managers and established institutions alike, provided that such products satisfy the UCITS Directive.

The availability of such a passport should significantly reduce the barriers to cost effective retail cross-border distribution of such products by limiting the regulatory burden associated with the need to ensure compliance with different sets of regulations issued by a plethora of national regulators.

In practice however, regulators across the EU have so far shown differing interpretations of the UCITS III Directives, especially in relation to transitional implementation rules, the definition of eligible assets and other practical issues, the net result being confusion and delay.

This lack of a common approach has resulted in the European Commission issuing various recommendations, including those issued in April 2004 on the use of derivatives in UCITS III products, in an attempt to introduce a level playing field throughout the EU.

In a more recent development on the same aspect of UCITS III implementation, the European Commission has requested technical advice from CESR on the clarification of which "eligible assets" may be held as investments by UCITS III funds. On 18 March 2005, CESR published a consultation paper containing draft advice, in particular on the eligibility of structured financial instruments, money market instruments which are not dealt on a regulated market and (subject to certain constraints) credit derivatives.

It is likely that the European Commission will follow CESR's final recommendations. Certain hedge fund-like strategies – including some

employed by existing UCITS funds – will no longer be available to managers of UCITS funds should CESR's draft advice as it currently stands be adopted by the European Commission. Managers of hedge fund-like products should seek to continue to influence CESR as the advantages afforded by an EU-wide passport are significant.

### Prudential regulation in the European Economic Area

Asset managers operating in the European Economic Area (EEA) are required by their regulators to comply with the capital adequacy rules based on the European Union's Capital Adequacy Directive (CAD). For hedge fund managers in the EEA, national regulators generally require that the equivalent of 13 weeks expenditure is maintained as liquid capital.

CAD is to be amended by the Capital Requirements Directive which is due to be passed by the European Parliament in 2005 for implementation in 2007. The basic requirement for most hedge fund managers is likely to remain, however additional capital may be required to meet any special risks faced by individual hedge fund managers.

Supervision by national regulators within the EEA also applies at a consolidated level where a regulated firm is part of a financial group in the EEA, although waivers may be available from the general requirement to maintain specified levels of capital for the group as a whole.

The Financial Conglomerates Directive is being implemented in 2005 and will extend the consolidated supervision regime to include parent companies and fellow subsidiaries outside the EEA and groups that include an insurance company. It remains unclear how, in practice, European regulators will seek to impose any additional capital - or systems and controls - requirements on such groups.

MiFID... will require EU member states to amend conduct of business rules. Areas affected are likely to include best execution and compliance arrangements.

## Conduct of Business Rules in the European Economic Area

The conduct of business rules with which hedge fund managers operating in the EEA must comply are currently based on the EU's Investment Services Directive (ISD). The ISD contains only high-level requirements and there has been considerable variation in the manner in which national regulators have applied detailed conduct of business rules.

The Markets in Financial Instruments Directive (MiFID) is likely to be implemented in April 2007 and will require EU member states to amend their conduct of business rules. Areas affected are likely to include best execution and compliance arrangements. In addition, the provision of investment advice becomes a core activity affecting distribution right across Europe.

## EU Savings Directive

The key aim of the EU Savings Directive, which will be fully implemented by 1 July 2005, is the exchange of information between EU member states on cross-border payments of interest to individuals. The Savings Directive requires that local paying agents report (or withhold tax on) relevant payments to EU-resident individual investors, which could include distributions and redemptions from hedge funds that are invested in fixed income products.

Many of the offshore jurisdictions that have traditionally attracted investors wishing to retain their privacy have also agreed to implement the Savings Directive<sup>1</sup> and equivalent reporting/withholding obligations will also apply to paying agents located in these jurisdictions.

Recent interpretations by a number of European and offshore tax authorities such as the UK, Guernsey, Ireland and Switzerland suggest that more hedge funds than previously thought will fall outside the scope of the Savings

Directive. However, managers will still need to identify which of their funds are likely to be affected, identify the relevant paying agent(s) in their operational structure, and ensure that appropriate steps are taken to address the Savings Directive. This includes communication with investors about the status of the fund under the Savings Directive.

## Data Protection issues

Data protection regulations are designed to protect the privacy of personal information relating to individuals. As hedge fund products become more widely available to individuals, getting data protection compliance right is becoming more challenging.

Under EU data protection laws, there is an overriding duty to process personal data fairly and lawfully, which means obtaining the consent of the individuals unless certain other conditions can be satisfied. Additionally, individuals must be kept informed of how their personal data is being used and to whom it is being disclosed. Processes must be put in place by all those who handle data relating to hedge funds to allow individuals to access their personal data upon request.

The role of the different parties involved in the operational structure of any hedge fund must be considered from a data protection perspective to determine which parties may be required to comply with EU legislation and what contractual documentation must be put in place. For example, the fund administrator must be contractually bound to implement appropriate measures to protect the data against loss or damage, and to ensure that it acts only on the instructions of appropriately authorised persons.

Generally, EEA-based transferors of personal data may only transfer such data to transferees in other EEA countries or to countries which are deemed to have in place legislation providing an adequate level of protection to personal data, for example Switzerland. Therefore, where

<sup>1</sup> For example, British Virgin Islands, the Cayman Islands, Guernsey, Jersey and the Isle of Man. Bermuda has not agreed to implement the Directive.

## As hedge fund products become more widely available to individuals, getting data protection compliance right is becoming more challenging.

any party, for example, an offshore administrator, to whom data may be disclosed is not located in the EEA or in a jurisdiction with equivalent protection, consideration must be given to methods of how this restriction can be overcome.

The USA is not deemed to have legislation providing adequate protection, however, a specific exemption is available: the European Commission has approved the US “Safe Harbor” scheme and no breach will be committed by an EEA-based transferor who transfers personal data to a US-based transferee who has signed up to these arrangements.

Similarly, where a transferee is located in any other non-EEA country with domestic legislation that has not been deemed to provide adequate protection, it is possible for the transferor to avoid committing a breach by requiring the transferee to enter into a contract based on the European Commission’s standard contractual clauses, which are designed to bring the level of protection up to an acceptable level.

As a result of some disparity in the implementation of national data protection laws across the EU (including the ten countries that acceded to the EU in May 2004), data protection requirements are more onerous in some countries than in others. In particular, security and registration requirements can vary significantly between member states.

### Freedom of Information

In a separate development, the UK’s Freedom of Information Act 2000 (FOIA) has significant implications for the confidentiality of commercially sensitive data held by public authorities. Under the FOIA, a general statutory right for third parties to be given access to information held by any public authority in the UK came into being on 1 January 2005.

Managers of hedge funds, regardless of their own domicile or that of the funds that they manage, will need to consider carefully if any of their UK investors fall within the FOIA’s definition of “public authority”. This is very broad and includes both central and local government, as well as other public bodies in the UK such as government agencies and some quasi-autonomous governmental organisations, otherwise known as “quangos”. Importantly, these bodies’ associated pension funds may also be subject to the FOIA and some of these may have a portion of their assets invested in hedge fund products.

Hedge fund managers whose funds are invested in by UK public authorities need to consider how to limit the risk that the FOIA’s access rights create, for example by limiting the amount of information provided and/or by specifying any sensitive information as confidential, in order to take advantage (as far as possible) of certain exemptions that are available under the FOIA.

## Section 3



# Current developments in the taxation of hedge funds, hedge fund managers and hedge fund investors

As most participants in the hedge fund industry will be aware, there is no harmonised tax treatment of hedge funds, hedge fund-like products and hedge fund investors within the European Union and no pan-European proposals for tax harmonisation on the horizon.

However, there is broad pressure by industry bodies for removal of tax barriers for investment in UCITS funds which may have follow-on implications for hedge fund investment.

### Taxation of hedge funds

In terms of the taxation of a domestic hedge fund itself, no jurisdiction has established a specific tax regime to cater for domestic hedge funds or hedge fund-like products, relying instead on the existing tax regime. Typically, hedge funds are either:

- taxed at concessionary rates or tax exempt at the fund level in the same manner as other collective investment schemes, provided certain criteria are satisfied; or
- treated as tax transparent such that tax is levied at the investor level.

### Taxation of investors

Each territory has implemented its own tax treatment of hedge fund returns for each investor class. In some territories, the tax treatment of hedge fund investors

is the result of a considered review by the local tax authorities. In many other territories, there is no specific tax regime for the treatment of hedge fund returns, largely due to the fact that they are a relatively new investment vehicle for most investor classes. Therefore, general local tax principles apply or the return may be taxed in a similar manner to returns from other collective investment schemes, for example, UCITS funds.

### Tax barriers to investment

Our 2005 research revealed that there have been significant initiatives by various local tax authorities to remove tax barriers to the distribution of foreign hedge funds, notably by Austria, Denmark and Germany. This is largely due to the pressure that industry bodies, the European Commission and the developing body of EU case law (which attacks the provision by local tax authorities of tax incentives to domestic funds) have placed on EU finance ministers in relation to the reduction of tax discrimination against foreign UCITS funds.

## There have been significant initiatives by various local tax authorities to remove tax barriers to distribution of foreign hedge funds.

However, in many countries, tax still remains either a direct or indirect barrier to hedge fund distribution. For example, Ireland, Italy and Portugal all have rules that tax investments in foreign hedge funds less favourably than investments in domestic hedge funds; and Austria, Germany and the UK have local laws that require foreign funds to comply with local administrative requirements. To the extent that such local requirements are overly burdensome to the fund promoter, they may constitute indirect discrimination against foreign funds.

Figure 1 highlights the tax barriers to distribution of foreign hedge funds to various investor classes when compared to the tax treatment of domestic hedge funds.

Another area of tax discrimination that is often overlooked by investors and fund promoters is the tax credit systems in a number of EU territories. Many EU tax credit systems allow withholding tax and domestic credits to flow through to domestic investors or funds only, such that a local investor investing in domestic assets via a foreign fund may suffer full withholding tax rates.

Surprisingly, results from several territories indicate that investing in a foreign hedge fund could actually be more tax effective than investing in a domestic hedge fund if the foreign hedge fund investment attracts the operation of a 'participation exemption' which results in investors being exempt from income and/or capital gains tax if the investment is above a certain threshold. In practice, this benefit may not often be obtained given the investment sizes required to access the participation exemption.

Historically, investors resident in countries where direct investment was restricted by regulation or was inefficient from a tax perspective, sought to invest in hedge funds via wrapper instruments such as structured notes issued by banks (with performance tied to the underlying fund). As regulators increasingly allow investors to invest directly in either

domestic or foreign hedge funds (especially via funds-of-hedge funds), and as tax barriers to investment are removed, one might expect that investment via tax wrapper products would decrease. However, the results of our research revealed that in some countries investing via a wrapper structure may achieve a better tax return for the investor (for example, by obtaining capital gains tax treatment which in some countries is more beneficial) or ease the administrative burden of complying with local reporting requirements. Therefore, the use of wrappers is still worth considering when marketing hedge funds to investors.

### VAT

There is a concept in VAT legislation that carrying on a business through an agency can give rise to a VAT establishment for that business in the EU member state where the agent is located. Our research has confirmed that this concept is generally not applied by the tax authorities to domestic fund managers of foreign hedge funds, and therefore foreign hedge funds are not brought onshore for VAT purposes by virtue of the activities of a domestic fund manager.

The 6th VAT Directive allows for management services to special investment funds as defined by EU member states to be exempt from VAT. It would appear that in EU member states such as Austria, Denmark, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Sweden, if onshore hedge funds are correctly structured, investment management services could fall within the scope of this exemption. Therefore, when setting up a domestic hedge fund, consideration should be given to the location of both the hedge fund and its investment manager as it may be possible to arbitrage the VAT treatment of management services cross-border.





## Section 4

# Country by country overview: Regulation of hedge funds and taxation of hedge fund investors at May 2005

### EUROPE

#### AUSTRIA

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##### Regulation

- Domestic and foreign funds-of-hedge funds may be distributed to both retail and institutional investors in Austria. Austrian regulation prevents the launch of domestic single-manager hedge funds. Foreign single-manager hedge funds may be distributed to retail and institutional investors, subject to approval from the FMA (Financial Market Authority). This approval is conditional upon certain features of the fund; for example, a fund undertaking uncovered short selling would not be approved.
1. The foreign hedge fund has appointed a local tax representative to calculate deemed income distributions on an annual basis and has provided the Oesterreichische Kontrollbank (OeKB) with this information four months after the financial year end; and
  2. Net interest income figures are provided on a daily basis to the OeKB, and the fund confirms to the Austrian Ministry of Finance that they have been calculated and published in accordance with Austrian tax law.

##### Taxation

- In December 2004 a new law was passed that eliminated the different tax treatment of income from foreign and domestic funds. From 1 July 2005, Austrian banks will deduct a final 25% withholding tax on distributions and deemed distributions from foreign funds (calculated by a local tax representative) such that they will be taxed on the same basis as domestic funds provided that the following requirements are met:
1. Therefore, individual investors are subject to tax on income<sup>1</sup> distributions and deemed income distributions from hedge fund investments at the rate of 25%<sup>2</sup> (provided the foreign fund has appointed a local tax representative and complies with information reporting requirements). Capital gains realised on the disposal of equities are taxed at an effective rate of 5% whilst capital gains on the disposal of bonds are tax free.

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<sup>1</sup> Dividends, interest and ordinary income less expenses.

<sup>2</sup> This will be a 25% final withholding tax if there is a local depository.



- If individual investors dispose of interests in the fund within one year of acquisition, the gain is subject to progressive income tax as speculative income (up to a maximum rate of 50%).
- Corporates, banks and insurance companies are taxed at 25% on both income and capital gains from hedge fund investments. Special rules could apply for insurance companies. However, realised capital gains of domestic funds are only taxable for corporate investors when distributed; the total realised gains of foreign funds are taxable even if they are not distributed.
- Austrian pension funds are exempt from tax in Austria.

- The safeguard tax of 1.5% that was deducted by the Austrian depository bank if an Austrian investor held shares in a foreign hedge fund will also not apply if the above conditions are met.
- If a foreign fund has not appointed a local tax representative, it will be treated as a “black fund” and all investors (except pension funds) will be subject to unfavourable lump sum taxation whereby all distributions received plus the higher of:

(i) 10% of the last redemption price in the calendar year; or

(ii) 90% of the difference between the first and the last redemption price in the calendar year,

will be subject to 25% tax.

- If foreign funds do not appoint an Austrian tax representative, the Austrian investor will now be able to provide the tax authorities with information on deemed distributed income to avoid lump sum taxation (previously such information could only be provided by an Austrian tax representative officially appointed by the fund), although it is very difficult for the individual to calculate these figures.

## BELGIUM

### Regulation

- Hedge funds cannot be publicly distributed to retail investors in Belgium. Access to hedge fund-like products for retail investors is limited to UCITS III funds which may, for example, invest in hedge funds or an index of hedge funds, subject to certain diversification requirements.
- Foreign and domestic hedge funds may be distributed to investors willing to subscribe a minimum of €250,000.

### Taxation

- Individuals and pension funds investing in foreign hedge funds (which are non-transparent) are taxed at 25% or subject to 15% withholding tax. Capital gains are exempt from tax unless individual investors hold investments for speculative purposes.
- Corporates, banks and insurance companies are taxed on income and capital gains from hedge funds at 33.99% on an accruals basis. Pension fund investors in domestic hedge funds are not taxed.
- As noted above, direct investment by retail investors in domestic hedge funds is currently not allowed. Accordingly, indirect investment via wrapper instruments is used. The specific tax treatment depends on the type of wrapper.



## DENMARK

### Regulation

- Foreign hedge funds are required to obtain approval from the Danish Financial Supervisory Authority for distribution. Proposals currently before the Danish Parliament, if enacted, would permit the creation of domestic hedge funds, subject to approval and licensing by the Danish FSA.

### Taxation

- New legislation<sup>3</sup> is expected to be enacted in June 2005 (to apply from 1 January 2005) which will result in the taxation of investors in domestic and foreign funds effectively being aligned (i.e. removal of tax discrimination against foreign funds).
- Under the new rules, individual investors, corporates, life and general insurance companies will be taxed on dividend distributions and unrealised capital gains<sup>4</sup> (individuals up to 59%, others 28%).
- Pension funds and life insurance companies are subject to a special pension tax regime and taxed at a rate of 15% on the net yields from investment on a mark-to-market basis. Special rules ensure that life insurance companies are not subject to double taxation.

<sup>3</sup> Bill introduced into Parliament in February 2005 which contains new rules for investments in funds and certain 'investment companies'.

<sup>4</sup> Taxed on the difference between the value of the shares at the beginning of the year and the end of the year.

<sup>5,7</sup> Where a fund structured as a company would be a tax treaty resident or a company referred to in the Parent/Subsidiary Directive, then a portion of the dividend may be tax exempt and a portion taxed as income at 28%.

<sup>6</sup> Non-Finnish funds with characteristics similar to special common funds will be treated as a special common fund for Finnish tax purposes.

## FINLAND

### Regulation

- Both domestic and foreign hedge funds may be distributed to "professional investors". In the case of foreign funds marketing to non-professional investors in Finland, a licence must be obtained from the Financial Supervision Authority.

### Taxation

- Individual investors are taxed annually on their portion of the realised income of a hedge fund structured as a partnership at either 28% or progressive rates. If a hedge fund is structured as a (special) common fund, the investor is taxed at 28% on distributions or redemptions. If a non-Finnish hedge fund is structured as a company (that is similar to a Finnish company form) the return is taxed as a dividend generally at progressive rates when received<sup>5</sup>.
- Corporates, pension funds, banks and insurance companies are taxed annually on their portion of the realised income of the hedge fund structured as a partnership. Where the hedge fund is structured as a (special) common fund, these investors are taxed at 26% upon distribution or redemptions<sup>6</sup>. If a non-Finnish hedge fund is structured as a company (that is similar to a Finnish company form) the return is taxed as a dividend and generally taxed at 26% when the dividend is received<sup>7</sup>.

## FRANCE

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### Regulation

- In December 2004, the Autorité des Marchés Financier (AMF) issued new regulations affecting how domestic hedge funds and hedge fund-like products regulated as either Authorised Funds with Simplified Investment Rules (OPCVM Agréés a Regles d'Investissement Allégées – ARIA) or Contractual Mutual Funds (OPCVM Contractuels) under the Financial Securities Act of 2004 may be marketed to different categories of investors including retail investors.
- There are three types of ARIA fund:
  1. 'Simple funds' are subject to certain rules relating to diversification of holdings and may leverage up to 200% of net assets. Investors with a minimum net worth of €1 million or a minimum of one year of relevant work experience are subject to a minimum investment threshold of €10,000. Other individual investors are required to make a minimum investment of €125,000.
  2. 'Leveraged funds' are subject to identical rules regarding diversification and minimum investment thresholds as Simple funds, but may leverage up to 400% of net assets.
  3. 'Fund-of-alternative funds' may leverage up to 200% of net assets and are required to invest in a minimum of 16 underlying funds. Where investors are provided with a guarantee of capital preservation, there is no minimum investment threshold. Otherwise, there is a minimum investment threshold of €10,000.
- Contractual Mutual Funds are not subject to rules relating to diversification of holdings or a limit on the amount of leverage they may employ. Investors with a minimum net worth of €1 million or a minimum of one year of relevant work experience are subject to a minimum investment threshold of €30,000. Other individual investors are required to make a minimum investment of €250,000. To operate Contractual Mutual Funds, investment managers must be pre-approved by the AMF.

### Taxation

- The new French legislation referred to above mainly deals with regulatory issues. Currently, the taxation rules are applied based on the existing OPCVM taxation principles (French UCITS), which provide for tax exemption at the level of the fund (tax transparency). New tax provisions are likely to be implemented in the next couple of years to specifically address the taxation of hedge funds.
- Individuals are taxed on receipt at marginal income tax rates (up to 56%); or on capital gains at 27% (including social contributions).
- Corporates, banks and insurance companies are taxed on receipt of dividends and taxed annually on the liquidation value of the shares (on a mark-to-market basis). Generally, pension funds may benefit from total tax exemption on capital gains and suffer a maximum 24% taxation on other income.
- French investors in foreign funds are normally taxed on the same basis depending upon the French tax analysis of the fund's status.



## GERMANY

### Regulation

- The Investment Act 2004 has introduced a new regime covering both single-manager hedge funds and fund-of-hedge funds. single manager funds, both domestic and foreign, may not be publicly distributed. Foreign funds-of-hedge funds may be publicly distributed in Germany once registered with the regulator, the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin). Registration will only be granted in cases where BaFin considers that home state regulation is effective and the home state regulator is prepared to co-operate satisfactorily with BaFin.
- In certain cases, BaFin has imposed licencing requirements on offshore issuers of wrapper products and SPV structures for rendering cross-border banking commission services. The future development of this practice is still unclear.
- The Investment Act 2004 and subsequent decrees allow for the cross-border appointment of prime brokers and fund administrators within the EU for domestic single-manager funds. Additionally, German regulations allow asset management functions to be delegated to investment managers established outside Germany within the EU or in third countries, provided they are subject to effective home state supervision.
- Based on the final decree of the German insurance regulator, Anlageverordnung (AnIV), insurance companies may invest up to 5% of committed assets in domestic hedge funds and funds-of-hedge funds, and in EEA-domiciled hedge funds and funds-of-hedge funds that are subject to supervision in their home country. Additionally, insurance companies may invest in hedge funds indirectly via regulated mixed funds, which can invest up to 10% of their net asset value in domestic and foreign

single-manager hedge funds. Indirect investments in hedge funds are also possible via wrapper products issued by EEA-domiciled hedge funds and funds-of-hedge funds.

### Taxation

- A new tax law governing the taxation of fund investors came into effect at the end of 2003. It applies to all funds with year ends after 31 December 2003 and classifies the funds as either transparent or non-transparent, depending on the fund's level of tax reporting. The new tax rules abolish the prior discrimination against foreign funds.
- The most noteworthy tax reporting obligation for German and foreign funds is that a tax transparent fund has to determine income/capital gains under German tax law.
- Funds will only be treated as tax transparent if:
  - the fund calculates taxable income in accordance with German law;
  - the fund calculates and publishes distributed and accumulated income;
  - the fund obtains a tax certificate; and
  - the fund files tax returns with the German authorities upon request.
- A tax adviser, an auditor or comparable professional has to certify that the fund's German tax reporting is in line with German tax law. There are penalties for incorrect reporting.
- In March 2005, the German tax authorities published the third draft version of a decree on the taxation of investment funds and the required compliance with reporting requirements which determine whether a fund (domestic or foreign)

can be treated as tax transparent. The final version of this important decree of, at present, more than 100 pages, is expected at the end of May 2005.

- Dividend, interest and other income (less expenses) generated by an accumulating fund will accrue to the German investor as a deemed distribution at the business year-end of the transparent fund. Capital gains generated by an accumulating fund do not accrue to the investor as part of the deemed distribution.
- Individual investors are taxed on distributed/accumulated income generated by the hedge fund at marginal income tax rates between 15% and 42%. Income from dividends generated by the fund is 50% tax free. Capital gains from the sale/redemption of hedge fund investments by individual investors are tax free after a one-year holding period.
- Corporates and banks are taxed at 25% on distributed/accumulated income generated by the hedge fund. The same tax rate applies to capital gains from the sale/redemption of hedge fund investments. However, there is an exception: dividends and capital gains from long equity investments generated by the fund are 95% tax-free at the investor level, whether distributed by the fund or realised by the investor upon sale/redemption of the investment in the hedge fund.
- Pension funds and insurance companies are taxed at 25% on distributed/accumulated income generated by the hedge fund. Capital gains from the sale/redemption of hedge fund investments are fully taxable.

## GIBRALTAR

### Regulation

- Investors who hold non-transparent funds at the end of the calendar year are subject to punitive lump-sum taxation irrespective of the fund's actual income or capital gains.

The investor in an accumulating non-transparent fund is taxed on 70% of the positive increase between the first and the last NAV of the fund in the calendar year. At least 6% of the last NAV of the fund in the calendar year is taxable, even if the fund NAV decreased during the calendar year. The tax rates are the same as mentioned above.

- No domestic or foreign hedge fund or funds-of-hedge funds may currently be marketed publicly in Gibraltar.

### Taxation

- Individual investors investing into hedge funds and funds-of-hedge funds are taxed, on a receipts basis, at a tax rate of up to 45%. Capital gains are exempt.
- Banks, insurance companies (non-life business) and corporates are taxed on income from hedge fund investments at the rate of 35% unless 'exempt company' status<sup>8</sup> is adopted.

## GREECE

### Regulation

- Domestic funds are regulated according to their legal form, however, Greek legislation effectively prevents the establishment of domestic hedge funds. For distribution of foreign hedge funds, the regulations applicable to all non-UCITS funds will apply, i.e. distribution is subject to the granting of a license by the Capital Markets Committee and marketing to the public in Greece may only be performed through banks, insurance companies or investment services companies acting as representatives. This restriction does not apply to distribution by private placement which is outside the scope of the regulatory framework.

### Taxation

- Individuals are taxed based on a tax scale ranging from 15% (for income exceeding €9,500) to 40% (for income exceeding €23,000). Individual investors are not taxed on income and capital gains from UCITS funds. For non-UCITS funds, in the absence of any special provision, the taxation will depend on the legal form of the fund (but generally it is expected that the respective income would be fully taxable at the rates above).
- Corporates, banks and insurance companies are taxed on income and capital gains from UCITS funds at 32% (reducing to 25% in 2007) when the respective income and gains are distributed by the above entities. Special rules determine how taxation may be deferred by allocating the profit which is not distributed to a special tax reserve. Pension funds are exempt from tax, although special rules may apply depending on the type of pension fund.



<sup>8</sup>Exempt company status is available until 2010 for existing companies; 2007 for new companies.

## GUERNSEY

### Regulation

- There are very few restrictions in Guernsey in respect of distributing hedge funds to local investors.
- Qualified Investor Funds (QIFs) are subject to a “light touch” regulatory regime. QIFs, which are available only to professional investors, have existed for some time now.
- The QIF regime has recently been made even less onerous: regulated administrators can now “self-certify” funds, allowing regulatory approval to be achieved in three days. As the regulatory burden falls on administrators, there is an onus on them to ensure that appropriate due diligence procedures are in place.

### Taxation

- Individual investors investing into hedge funds are taxed, on a receipts basis, at the rate of 20% on income. Capital gains are exempt.
- Banks, insurance companies (non-life business) and corporate entities are taxed on income from hedge fund investments at the rate of 20% on a receipts basis. Pension funds are not taxed. Capital gains are exempt.



## IRELAND

### Regulation

- The Irish Financial Services Regulatory Authority (IFSRA) continues to streamline the hedge fund approval process: there is no longer a requirement for IFSRA to pre-approve prime brokerage documentation provided that the fund’s legal advisors certify compliance with IFSRA’s requirements for such documentation.
- It is expected that IFSRA will soon finalise its rules regarding the use of prime brokers, such that Qualified Investor Funds (QIFs) will be allowed to hold all their assets with a prime broker rather than a custodian and Professional Investor Funds (PIFs) will be able to place their assets with prime brokers up to a limit of 140% of the fund’s borrowings from the prime broker. Any balance of assets held with the same prime broker will be required to be segregated from the prime broker’s own assets in a separate custody account and subject to a separate custodian agreement.
- A new Investment Funds, Companies and Miscellaneous Provisions Bill will soon be enacted. Firstly, the Bill provides the general legal framework for the establishment of Common Contractual Funds (CCFs) which will allow for a new type of investment vehicle – the non-UCITS CCF. Secondly, it introduces segregated liability at sub-fund level for investment companies; and thirdly, it allows for cross-investment between sub-funds of investment companies.
- For Irish-domiciled funds, limits on the minimum subscription for retail fund-of-hedge funds have been waived.

- Irish company law is to be amended to allow investment companies to produce their accounts using US GAAP, Canadian GAAP, or Japanese GAAP in addition to UK/Irish GAAP or IFRS which is currently permitted.

### Taxation

- Individual investors in hedge funds are subject to tax on income at 20% and capital gains at 23% on a receipts basis. If the hedge fund is located in a country outside the EU and with no double tax agreement with Ireland (non-EU/non-DTA), individual investors will be taxed at 42% (plus 5% social insurance) on income and gains on a receipts basis (gains on disposal of units in a fund which has been designated by the Irish Revenue as a “distributing fund” are liable to capital gains tax at 40% and are not liable to social insurance).
- Corporate investors in hedge funds are subject to tax on trading income at 12.5%, non-trading income at 25% and capital gains at either 12.5% or 23% (on a receipts basis). If the hedge fund is located in a non-EU/non-DTA country, corporate investors will be taxed on capital gains at 40% (qualifying distributing funds) or 25% (non-distributing funds) on a receipts basis.
- Bank and insurance company investors in hedge funds are subject to tax on income and capital gains at 12.5% on a mark-to-market basis. Pension fund investors are tax exempt.
- Legislation introduced in the 2004 Finance Act effectively ensures that locating the investment management activity of a hedge fund in Ireland does not give rise to an Irish tax exposure for the fund.

## ISLE OF MAN

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### Regulation

- There have been no recent changes to the regulatory environment in the Isle of Man.
- Administration of Professional Investor Funds (PIFs) must be carried out in the Isle of Man. However, PIFs are not subject to any further Manx regulations.
- Foreign funds may be administered in the Isle of Man without being subject to Manx regulation.

### Taxation

- Investors are not subject to tax in the Isle of Man.
- The local tax regime is under review. With effect from 6 April 2006, it is expected that all companies (excluding licensed banks) will be subject to tax at 0%.

## ITALY

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### Regulation

- The only recent changes to the regulatory environment in Italy has been the issue in April 2005 by the Bank of Italy of regulations implementing the transitional provisions of the amending UCITS Directives.
- Domestic and foreign hedge funds are required to be authorised by the Bank of Italy.
- The CONSOB (Commissione Nazionale per le Società e la Borsa) regulates the distribution of foreign and domestic hedge funds. Distribution to individual investors is restricted by way of a €500,000 minimum investment requirement and by the fact that no public marketing is allowed.
- Domestic hedge funds are required to appoint an Italian bank or an Italian branch of a bank incorporated in another EU member state as a depository bank.

### Taxation

- Individual investors in domestic hedge funds are not subject to tax on income from capital<sup>9</sup>. For individuals investing in foreign hedge funds, income is subject to tax at progressive rates from 23-43%<sup>10</sup>.
- Corporates, banks and insurance companies investing in domestic hedge funds are subject to corporation tax of 33% (with a tax credit of 15% on income from capital)<sup>11</sup>. Corporates, banks and insurance companies receiving income from foreign funds are subject to tax at 33%. Banks and insurance companies may also be subject to regional tax under certain circumstances on hedge fund income.
- Pension funds are subject to tax at 12.5%.

## JERSEY

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### Regulation

- Following recent changes, Expert Funds can now be self-certified by regulated service providers rather than being authorised individually by the regulator, as was previously the case.
- We expect that there will be moves over the next 18 months towards a similar self-certification process for foreign funds.
- A Code of Practice is expected to be published next year which will require hedge fund managers located in Jersey to have Professional Indemnity Insurance in place and to maintain liquid capital of three months' annualised expenditure in addition to the current £25,000 capital requirement.

### Taxation

- Individual investors investing into hedge funds are taxed, on a receipts basis, at the rate of 20% on income. Capital gains are exempt.
- Banks, insurance companies (non-life business) and corporate entities are taxed on income from hedge fund investments at the rate of 20% on a receipts basis. Pension funds are not taxed. Capital gains are exempt.
- The local tax regime is under review but no changes are expected to the taxation of hedge funds. It is proposed that local trading companies will be taxed at 0% and there is a proposal to tax regulated financial service providers at 10% from 2009 (although it is not expected that this will apply to local fund managers).

<sup>9</sup> Income from capital broadly corresponds to the increase in the net asset value of the fund accrued during the period of ownership of the units. Proceeds arising from the disposal, the redemption or the distribution of income in the hands of individual investors (that hold the units other than in connection with a business activity) qualify as income from capital. Any income received in excess of capital qualifies as miscellaneous income and is subject to substitute tax at a rate of 12.5%.

<sup>10</sup> A withholding tax at a rate of 12.5% may be levied by Italian authorised intermediaries upon collection as advance payment of total tax due from individuals, corporates, banks, insurance companies and pension funds.

<sup>11</sup> The tax credit relates to the 12.5% substitute tax suffered at the fund level.



## LUXEMBOURG

### Regulation

- Retail investors and pension funds can invest in hedge funds and funds-of-hedge funds domiciled in any country, provided that the fund is approved by the Commission de Surveillance du Secteur Financier (CSSF) for public offering. Only funds which are subject to home state supervision which the CSSF deems to be adequate will be approved.
- New rules were enacted in July 2004 which allow foreign funds to list on the Luxembourg stock exchange.
- The imminent implementation of the CSSF's circular on the use of derivatives in UCITS III funds, is expected to encourage the development of hedge fund-like products.
- Authorised hedge fund managers operating in Luxembourg are not required to obtain authorisation for each new fund that they launch.

### Taxation

- Individual investors are taxed on receipt on income and net capital gains from hedge fund investments at their progressive tax rates up to a maximum of 39.95%.
- Banks, insurance companies<sup>12</sup> and corporate entities are taxed upon receipt on income and capital gains from hedge fund investments at the rate of 30.38%. The EU Parent/Subsidiary Directive may be available in respect of investments in EU hedge funds and funds-of-hedge funds but would need to be considered on a case-by-case basis.
- For pension fund investors, income and capital gains from hedge fund investments are included in their taxable base; however, pension schemes generally are tax neutral.

<sup>12</sup> Special rules apply for unit linked insurance contracts.

## MALTA

### Regulation

- Since the introduction of various financial services legislation in 1994 (including the Investment Services Act), and in particular since Malta's accession into the EU in May 2004, Malta is emerging as an alternative domicile for both hedge funds and hedge fund managers.
- Hedge funds may not be marketed to retail investors in Malta although Malta's entry into the EU in May 2004 means that UCITS funds (which may have certain hedge fund-like characteristics) are eligible for a "passport" enabling them to be marketed in other EU member states.
- Hedge funds are typically established as Professional Investor Funds (PIFs). It is also possible for a fund established overseas to transfer its domicile to Malta and apply to be registered as a PIF.
- There are two categories of PIFs which are available to different types of individual investor (as well as corporates and trusts):
  1. Qualifying Investors: there are various criteria to be met to be classified as a qualifying investor, however, the main criteria is that the investor must have more than \$1 million of net assets and that the minimum initial investment is at least \$100,000 (or equivalent in another currency).

## NETHERLANDS

### Regulation

- 2. Experienced Investors: these are defined as persons having the expertise, experience and knowledge in the acquisition/disposal of funds of a similar risk profile to which the proposed PIF in question relates. The minimum investment threshold is \$20,000.
  - There are no restrictions on the investment powers of a PIF and they may not use leverage.
  - The Malta Financial Services Authority (MFSA) has committed to process applications for the authorisation of PIFs within seven working days, provided all relevant documentation has been provided and that all functionaries are based and regulated in a "Recognised Country".
- Foreign hedge funds can be authorised for distribution in the Netherlands subject to the same rules as ordinary investment funds, which are required to obtain a licence prior to being distributed beyond a restricted group or beyond a group of professional investors. The Netherlands Authority for the Financial Markets (AFM) will grant such a licence subject to certain requirements being met. These include consideration of whether the fund is subject to adequate supervision elsewhere. The AFM has determined that currently only a limited number of countries provide adequate supervision.
  - An amended version of the Act on the Supervision of Investment Institutions (Wet toezicht beleggingsinstellingen - WTB) will become effective in July 2005. The main effects on hedge funds and their managers will be as follows:
    1. Domestic hedge fund managers will be required to obtain a licence from the AFM and may then launch new hedge funds without the vehicles being required to obtain an individual licence.
    2. Foreign hedge fund managers may only obtain a licence where the AFM has determined that home country supervision is adequate.
  - It is anticipated that the Act on Financial Services (Wet financiële dienstverlening - WFD) will become effective in early October 2005. This will require providers of various types of financial services to obtain a licence from the AFM. Hedge fund managers will not be required to obtain a second licence in addition to the one required by the amended WTB. Legal entities and natural persons making offers of shares in hedge funds or providing advice to

the public on hedge funds will be required to obtain a licence under the WFD.

- In 2003, legislation was published which subjects funds to rules of conduct regarding conflicts of interest, client acceptance and integrity. Separate rules have also been introduced for certain investment vehicles including hedge funds.

### Taxation

- Individual investors are deemed to receive a notional yield of 4% on hedge fund investments which is taxed at the rate of 30%. Distributions of actual income and gains are not taxable.
- Banks, insurance companies and corporate entities are taxed on income and capital gains from hedge fund investments at the corporate tax rate of 31.5% (2005 rate). A participation exemption may be available in respect of investments in EU hedge funds and funds-of-hedge funds that exceed a shareholding of 20%.
- Capital duty will be abolished from 1 January 2006.





## NORWAY

### Regulation

- Under current regulations, foreign hedge funds may only be actively promoted in Norway with the permission of the Norwegian Financial Supervision Authority (FSA). We are not aware of any foreign hedge fund that has been granted permission by the FSA to be promoted in Norway.
- The Ministry of Finance has issued a consultation paper proposing to allow hedge funds to be marketed to professional investors. The consultation period ended in April 2005. Currently, the Securities Fund Act prohibits the solicitation of subscriptions in hedge funds, from both individuals and legal entities.

### Taxation

- Individual investors will be subject to tax at 28% on income and capital gains on a receipts basis from hedge fund investments structured as corporate vehicles. From 1 January 2006 a component of the return (3.3% of cost price) will be tax exempt.
- Hedge funds structured as partnerships will be treated as tax transparent in Norway and all classes of investors will be subject to tax on income and gains at 28%.
- Corporate investors in EEA hedge funds structured as corporate vehicles will be exempt from tax on dividends received and gains on shares under participation exemption rules regardless of the level of holding or the time period for which the shares have been held. Losses will not be tax deductible.
- For corporate hedge funds outside the EEA, the participation exemption for capital gains will only apply where the shareholder holds 10% or more of the capital and voting rights of the fund. In addition, the Participation Exemption will not be available where the hedge fund is situated in a low tax country.

## PORTUGAL

### Regulation

- The Portuguese Stock Market Commission (CMVM) introduced new rules in October 2003 governing Special Investment Funds (SIFs). Short selling, leveraging, investment concentration and use of derivatives are permitted in SIFs but are subject to limits.
- Fewer rules apply than with mutual funds, but certain rules are still applicable to SIFs, for example, those relating to authorisation by the CMVM and transparency.
- Portuguese hedge fund managers seeking to launch funds which do not qualify as a SIF (for example foreign funds) need to request authorisation from the CMVM in order to manage such funds.

### Taxation

- Individual investors into domestic hedge funds are exempt from tax, unless the income is connected with commercial, industrial, or agricultural activity which is taxed at marginal rates, but withholding tax up to 25% is imposed at the fund level. Capital gains are taxed at 10%, unless gains are connected with commercial, industrial, or agricultural activity which are treated as taxable profits taxed at normal rates.
- Individual investors in foreign hedge funds are subject to tax at marginal rates up to 40%, although distributions by paying agents located in Portugal are taxed at 20%. Capital gains are taxed at a flat rate of 10%.
- Corporates, banks and insurance company investors in domestic hedge funds are taxed on income and capital gains (up to 27.5%). Income derived from a foreign fund is treated as taxable profit. Pension funds are exempt from tax and may reclaim withholding tax and any tax paid by the fund.
- Foreign investors in domestic hedge funds are taxed on capital gains.

## RUSSIA

### Regulation

- Hedge funds products are not currently regulated in Russia. Hedge fund products may only be marketed by way of private placement.
- A proposed new legislative framework for derivatives will require major modifications to existing legislation. Currently, derivative transactions are treated as gambling contracts. The banking sector (domestic and foreign) has prepared a “concept paper” detailing its thoughts on how it would like to see the legislation develop.

### Taxation

- Individual investors in a domestic unit investment fund (UIF)<sup>13</sup> are taxed at a rate of 13% on distributed income and capital gains. Corporate entities, banks and insurance companies are taxed at a rate of 24% on income distributable by an UIF and capital gains. Pension funds are taxed at a rate of 24% on income and capital gains.
- For foreign hedge funds, individuals are taxed on dividend income at a rate of 9% (13% on other income). For corporate entities, banks and insurance companies, dividend income is taxed at 15% (subject to double tax treaty relief) and other income at 24%. Pension funds are taxed at 24%. Capital gains are taxed at 24%.



## SPAIN

### Regulation

- A draft Royal Decree was issued in 2004 laying out a framework for the regulation of domestic single-manager hedge funds and funds-of-hedge funds. Whilst the draft is lacking in detail, we expect that domestic hedge funds will be available to expert investors once the final legislation has been implemented.
- The public marketing of foreign hedge funds in Spain will continue to be difficult as there have been no changes to the restrictions on public marketing of non-UCITS products in Spain. The Comisión Nacional del Mercado de Valores (CNMV) has a certain level of discretion over authorising the distribution of such funds in Spain and is likely to refuse permission to funds domiciled in countries where local regulation is deemed to be inadequate.

### Taxation

- Individual investors in foreign hedge funds are taxed on income and capital gains at rates of 15-45%. The tax treatment of investors in foreign fund-of-hedge funds will depend on the legal status of the vehicle and whether the fund is resident in a black listed tax haven jurisdiction.
- Corporates, banks and insurance companies are taxed at 35% on both income and capital gains. Pension funds are not subject to tax. There are different tax rules for the taxation of investment in hedge funds depending on: a) the legal status of the hedge fund; b) its fiscal residence; c) the specific accounting guidelines applicable to ordinary corporations or to each type of institutional investor; d) choices the institutional investors may make for accounting purposes; and e) regulatory approvals for marketing in Spain.

## SWEDEN

### Regulations

- Approval from the Swedish Financial Supervisory Authority (FSA) is required prior to distributing foreign hedge funds in Sweden. Registration takes two months and is only granted if certain requirements are met, including that the foreign hedge fund is subject to adequate home state supervision.
- Domestic funds are required to obtain a licence from the FSA.
- Swedish funds-of-hedge funds are now permitted to invest in foreign hedge funds and may be marketed to retail investors.
- Single-manager hedge funds may be distributed to retail investors.

### Taxation

- Individual investors are taxed, on a receipts basis, on income and capital gains from hedge fund investments at the rate of 30%.
- Banks and insurance companies (non-life business) are taxed on income and capital gains from hedge fund investments at the rate of 28% on an accruals basis (although they may elect for a receipts basis).
- Other corporate entities are taxed on income and capital gains from hedge fund investments at the rate of 28% on a receipts basis.

<sup>13</sup> Hedge funds are not developed in Russia. A UIF is the most developed fund type and is not specifically a hedge fund.

## SWITZERLAND

### Regulation

- Future changes include new laws for Collective Investment Schemes (affecting hedge funds and hedge fund managers) which will replace current regulation, perhaps as early as 2007. The major changes include the introduction of:
  1. a qualified investor concept;
  2. new legal forms for funds (e.g. Swiss SICAVs);
  3. dual approval (i.e. products and asset managers/promoters of Swiss collective investment schemes would all need to be authorised);
  4. a prime broker concept (with foreign prime brokers being acceptable); and
  5. a simplified prospectus.
- The proposed changes would eliminate the current requirement for a written contract covering the sale of interests in single-manager hedge funds or funds-of-hedge funds.
- Hedge fund managers are not currently regulated unless they are the formal fund management company (“Fondsleitung”) of Swiss investment funds or a regulated bank or securities dealer, although this is expected to change. The Federal Banking Commission is currently considering regulating hedge fund managers under existing rules relating to securities dealers as an interim measure.
- The approval process for the distribution of EU-domiciled products in Switzerland is relatively straight-forward.
- Retail investors may invest in the shares of funds-of-hedge funds which are closed-ended non-regulated listed investment companies. IFA-regulated

open-ended Swiss hedge funds or funds-of-hedge funds and foreign hedge funds approved for distribution in Switzerland may be sold to retail, high net worth and institutional clients. Hedge funds that are not approved in this manner can be sold to high net worth and sophisticated investors via private placement or in connection with a discretionary management contract but may not be publicly marketed.

### Taxation

- Individual investors in domestic distributing hedge funds are taxed on a receipts basis, with a tax refund for any withholding tax (35%) levied by the fund on the distribution. The applicable tax rate for individual investors for this income is between 25% and 55%, depending on the canton where the individual investor is resident. Individual investors in domestic accumulating funds are taxable on deemed income distributions. Capital gains distributed/accumulated by funds are tax exempt provided sufficient information is provided to Swiss tax authorities and the investment is held as a private asset.
- Corporate, pension fund, bank and insurance company investors in domestic distributing funds are taxed on income and capital gains distributed. The average applicable tax rate is between 16% and 25%, depending on the canton where the company is domiciled and on a possible special tax status of the company. Accumulated income is not subject to tax on an unrealised basis. Pension funds may be exempt from income tax if certain conditions are satisfied.
- Individual investors in a capital gain-oriented foreign fund-of-hedge funds (transparent for Swiss tax purposes



on a federal level<sup>14</sup>) that derive 98% of income from capital gains are deemed to derive capital gains, which are not subject to income tax. Investors in other funds-of-hedge funds are taxed as if the investors had a direct investment in the underlying funds.

- Income of foreign hedge funds that are organised in non-corporate form (e.g. tax transparent) are taxed at the investor level<sup>15</sup>.
- Any distributions from corporate foreign hedge funds, which are not treated as transparent for Swiss tax purposes, are treated as dividend income in the hands of corporate and individual investors. Corporate investors may be able to apply for participation relief if certain conditions are satisfied.

<sup>14/15</sup> Most of the Swiss cantons follow the conditions of the federal law with respect to the transparent tax treatment of the fund

## UNITED KINGDOM

### Regulation

- The UK introduced revised rules for authorised funds in early 2004. These rules introduce two new classes of authorised fund in addition to the existing UCITS funds. The two new fund types are “non-UCITS retail schemes”, aimed at the retail consumer and expanding the range of eligible assets to include property and gold, and “Qualified Investor Funds”, aimed at institutional/expert investors with minimal restrictions as to eligible assets and gearing.
  - The revised regime for authorised funds, including UCITS, does permit the use of derivatives for investment purposes and short selling, providing the “short” is liquid and can be cash settled or is covered by long positions with return profile that is highly correlated to that of the short position. Restrictions on gearing mean that not all the characteristics of a hedge fund can be fully employed in an authorised scheme but, nevertheless, hedge fund-like products can now be promoted to retail customers.
  - To date, the uncertainty surrounding the tax treatment of the new classes of authorised funds has restricted those seeking to utilise the new investment powers that these funds offer. Now that the tax position has become clear (there will be no separate tax regime for the two new classes of authorised fund – existing tax rules that apply to authorised funds will apply), it is likely that we will see an increasing number of these funds seeking authorisation from the FSA. However, the further consultation paper emanating from the CESR regarding Eligible Assets for UCITS schemes may restrict in future the ability of the FSA to authorise some of the more innovative fund structures coming to the market at present.
  - In parallel with the liberalisation of the authorised fund environment, the FSA is increasing its focus upon the hedge fund industry in general. It has announced that a further discussion paper will be published in the summer of 2005 where, following its review of the sector in general, it will again consider the appropriateness or otherwise of permitting hedge funds to be actively promoted.
  - Notwithstanding the uncertainty surrounding the use of certain instruments, the UK has seen the emergence of hedge fund products and activity appears to be increasing. UCITS III funds that offer returns that track hedge fund indices and non-gearred long/short funds have been launched and there are examples of hedge funds that are listed on the various London exchanges.
- non-UCITS funds will generally be taxed in the same manner as authorised unit trusts and OIECs.
- Investment in a foreign hedge fund is likely to constitute an interest in an offshore fund. This means that UK resident investors would prefer the foreign hedge fund to obtain UK distributor status in order to safeguard the tax treatment of realised capital gains.
  - HMRC has recently announced new anti-avoidance rules where an investor holds a substantial interest in a Qualified Investor Scheme. Further consultation on the possible extension of the anti-avoidance rules to investors who hold a substantial interest in any type of authorised fund will take place in the future.

### Taxation

- Individual investors are taxed at up to 32.5% on dividends from non-transparent hedge funds. Individual investors will also be subject to tax on non-dividend income and capital gains up to 40%.
- Corporates<sup>16</sup> are subject to 30% tax on income derived from a hedge fund. For corporate investors, the return from a foreign hedge fund may be taxed on an annual mark-to-market basis in certain circumstances, in which case the offshore fund rules (see below) do not apply. Pension fund investors are exempt from tax.
- Open ended investment companies and authorised unit trusts are taxed at 20% on income, but are not subject to tax on capital gains on disposal of investments. Unauthorised unit trusts are taxed at 22% on income. The HMRC has recently clarified that qualified investor schemes and retail



<sup>16</sup>Special rules apply to qualifying investments held by life insurance companies in offshore hedge funds

## USA

### Regulation

- Rules in the U.S. generally require investment advisers to register with the SEC if they manage the assets of U.S. clients. There are certain exemptions from registration for advisers which manage the assets of fewer than 15 clients (or for U.S.-domiciled advisers that manage less than \$25 million). The rules for counting the number of clients have recently been revised to count each investor in a fund as a client rather than counting each fund as a client. This rule change takes effect on 1 February 2006 and will require many more advisers to register with the SEC. Advisers who have their principal place of business outside the United States (“Offshore Advisers”) only need to count their U.S. resident clients (determined at the time of initial investment) towards this 15 client threshold.
- An Offshore Adviser that is required to register with the SEC because it advises 15 or more U.S.-resident clients would be subject to the SEC’s books and record-keeping requirements and will be subject to routine examination by the SEC. For the purposes of determining whether the Offshore Adviser is subject to certain other rules, including the compliance rule, custody rule or proxy voting rule, the Offshore Adviser is permitted to count each non-U.S. domiciled private fund (and not the underlying investors) as its client. If an Offshore Adviser only advises non-U.S. domiciled private funds and has no other U.S. clients, it would generally not be subject to these other rules.

### Taxation

- Domestic funds are generally structured as fiscally transparent entities for U.S. tax purposes. Investors in a fiscally transparent fund

are treated as earning the income that is derived by the fund. Also, the income earned by a fiscally transparent fund retains its character at the level of the investors. Therefore, individuals, corporates, banks and insurance companies investing in a fiscally transparent foreign domiciled fund are taxed on the income (including capital gains) derived by the fund on an accruals basis regardless of whether such income is distributed.

- The income is taxed at graduated rates, with the highest rate being 35%. However, certain types of qualified dividends and long-term capital gains are taxable to the individual investors at 5% or 15% rate depending on their income tax bracket.
- When investors dispose of their holdings in a fiscally transparent fund, capital gains may arise to the extent that the tax base of the investors in the fund (adjusted for the income allocable to the investor over the life of the fund and contributions and distributions) is different from the amount realised. For non-fiscally transparent foreign funds, there is, generally, no tax on current income or capital gains earned by the fund with respect to a particular investor, unless such an investor makes a QEF<sup>17</sup> election with respect to such fund. There are certain procedural requirements that have to be satisfied by the fund and certain information statements need to be provided in order for an investor to make a QEF election. If a QEF election is made, the investors are taxable on an accruals basis on the income that is earned by the fund.
- If a QEF election is not made, tax is imposed on any gain realised on disposition of an interest in, or certain



distributions from, a non-fiscally transparent fund. This tax is increased by a deferred tax amount. In general terms, the computation of the deferred tax amount attempts to subject a portion of the gain realised on a distribution or sale attributable to each year of the holding period to an interest charge and the tax at the highest applicable income tax rate in effect for that year.

- Pension funds are not subject to tax on capital gains or income unless there is unrelated business taxable income.

<sup>17</sup> Qualified electing fund.

## OTHER TERRITORIES

### BAHAMAS

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#### Regulation

- Under the Investment Funds Regulations 2003, foreign domiciled funds wanting to establish a distribution channel in the Bahamas must appoint a representative who must be approved by the Securities Commission of the Bahamas.
- Consideration is being given to exempt investment managers that manage investment funds that are licensed or registered under the Investment Funds Act 2003 from registration under the Securities Industry Act.

#### Taxation

- Investors and funds are not subject to tax in the Bahamas.

### BERMUDA

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#### Regulation

- The move towards licensing administrators is ongoing: draft rules have been issued and implementation is expected over the next year. The proposals cover all administrators in Bermuda, not just fund administrators and will include minimum capital requirements, reporting requirements and an annual audit requirement.

#### Taxation

- Investors and funds are not subject to tax in Bermuda.

### CAYMAN ISLANDS

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#### Regulation

- The Cayman Islands remains a popular domicile for hedge funds. Cayman-domiciled funds are typically not allowed to market their shares/units to individuals resident in the Cayman Islands.

#### Taxation

- Investors and funds are not subject to tax in the Cayman Islands.

### NETHERLANDS ANTILLES

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#### Regulation

- A hedge fund domiciled in the Netherlands Antilles can be incorporated as a limited liability company, a private limited liability company or a Netherlands Antilles private limited liability company, all of which are subject to supervision by the Central Bank of the Netherlands Antilles.

#### Taxation

- Netherlands Antilles private limited liability companies are exempt from taxation.
- Individual investors, resident in the Netherlands Antilles, are deemed to receive a notional yield of 4% on hedge fund investments (held through a non-Antilles investment company or a Netherlands Antilles exempt company), which is taxed at the rate of 32.5% (in case of 5% shareholding or more in the hedge fund) or at maximum 50.7% (in case of shareholding lower than 5% in the hedge fund). Distributions of actual income and gains are not taxable.
- Banks, insurance companies and corporate entities are taxed on income and capital gains from hedge fund investments at a profit tax rate of 34.5%. A 95% participation exemption may be available in respect of investments of 5% or more in foreign hedge funds, or 5% or more in Netherlands Antilles exempt companies or investments in hedge funds with a cost price of at least ANG1,000,000 (approximately US\$561,798). Insurance companies may also opt for a special regime under which only the premium income is subject to profit tax.





## SOUTH AFRICA

### Regulation

- Hedge funds are currently unregulated and hence cannot be marketed to retail investors. Going forward, it has been proposed that there should be no access restrictions to regulated fund-of-hedge funds, provided that the fund is invested in regulated funds, whereas access to single manager hedge funds should continue to be restricted. It is expected that restrictions on the marketing of unregulated funds will remain.
- While hedge funds remain unregulated, the Financial Services Board (FSB) is drafting regulations in this area. These are likely to focus on regulating the manager as opposed to the funds' investments. The proposed regulations should allow for single manager hedge funds and funds-of-hedge funds. It is still unclear if a regulated fund-of-hedge funds would be permitted to invest in an unregulated hedge fund. The FSB has indicated that its main priority is establishing a regulatory framework for domestic funds. The draft regulations, when published, should give a better indication of the FSB's approach towards foreign funds, however, speculation suggests that investment in foreign funds could be limited to those funds which are domiciled in FSB-approved jurisdictions such as Ireland, the UK and the Channel Islands.
- New legislation introduced under the Financial Advisory and Intermediary Services Act of 2002 (FAIS) requires all persons rendering financial advisory and intermediary services to be licensed by the FSB. At present, the Act does not cover the distribution of hedge funds. The Act is expected to be amended to provide for additional categories of products in order to incorporate the hedge fund industry. Additionally, a distinct code of conduct and more stringent 'fit and proper' requirements for financial

advisers licensed to distribute hedge funds are expected with an emphasis on relevant experience and qualifications.

### Taxation

- Generally, domestic hedge funds are operated as tax transparent partnerships with investors participating as limited partners and subject to tax on income and gains on an accruals basis.
- Individual investors are taxed on income and 25% of capital gains at marginal rates up to 40%. Companies, banks and insurance companies (except certain funds) are taxed on income and 50% of capital gains at 29%, while pension funds are taxed on certain streams of income (interest, certain dividends and net rental income) at 18%.
- Investors in corporate foreign hedge funds are taxed on income derived by the foreign fund. Capital gains on disposal of interests in foreign hedge funds are subject to tax.
- Investors in a non-corporate foreign hedge funds are taxed on their share of the fund's income and expenditure.
- The Revenue Service is waiting for the regulations referred to above to be published before determining the appropriate tax treatment for domestic hedge funds. To date it is unclear whether existing unregulated domestic hedge funds would obtain any tax relief upon conversion to an approved legal structure under the pending regulations if asset transfers are required.
- It is also unclear whether domestic hedge funds will be treated in a similar manner to other collective investment schemes which are effectively treated as tax transparent at the fund level, with investors only being subject to tax when income is declared or when units are redeemed.

Table 1: The availability of hedge funds and funds-of-hedge funds to investors by country at May 2005

Country	Single manager hedge fund			Fund-of-hedge funds			Minimum investment amount?	Average time taken to set up a fund
	Domestic?	EU-domiciled?	Other domiciles?	Domestic?	EU-domiciled?	Other domiciles?		
Austria	X	✓	✓	✓	✓	✓	€nil	Approximately 4-6 months
Bahamas	✓	✓	✓	✓	✓	✓	N/A	Professional funds – three days. Recognised foreign funds – one day. SMART Funds – for an approved template will vary between 2 days and one week. Standard funds – four weeks.
Belgium	X	X	X	X	X	X	N/A	N/A
Bermuda	✓	✓	✓	✓	✓	✓	\$nil (retail) \$100,000 (institutional)	2 days if the manager has a presence in Bermuda; up to 5 days otherwise.
Cayman Islands	✓	✓	✓	✓	✓	✓	\$50,000 (Cayman-regulated funds) \$nil (retail)	1 day for Cayman-regulated funds.
Denmark	✓	X	X	X	X	X	DKK 50,000	6-8 weeks from filing all required documents with the Danish Financial Supervisory Authority.
Finland	✓ <sup>1</sup>	✓	✓	✓	✓	✓	FIM nil	2-3 months. <sup>2,3</sup>
France	✓	✓	✓	✓	✓	✓	€10,000 for funds-of-hedge funds. Generally either €125,000 or €250,000 for single manager funds.	Once the manager is authorised by the Autorité des Marchés Financier (AMF), it may take a further 3 to 6 months to set up a single manager hedge fund.
Germany	✓	✓ <sup>5</sup>	✓ <sup>5</sup>	✓	✓	✓	€nil	Domestic hedge funds and fund-of-hedge funds: 3-6 weeks. <sup>4</sup> Foreign fund-of-hedge funds: maximum 4 months. <sup>5</sup>
Gibraltar	X	X	X	X	X	X	N/A	N/A
Greece	X	X	X	X	X	X	N/A	N/A
Guernsey	✓	✓	✓	✓	✓	✓	Depends on type of investors the fund is marketed to and the type of fund.	Regulatory approval has been reduced to three days for Qualifying Investor Funds.
Ireland	✓	✓	✓	✓	✓	✓	€125,000 Single-manager hedge funds <sup>6</sup>	6 to 8 weeks.
Isle of Man	✓	✓	✓	✓	✓	✓	£nil	2 weeks.
Italy	✓	X	X	✓	X	X	€500,000	6-8 months.
Jersey	✓	✓	✓	✓	✓	✓	\$nil or \$100,000 <sup>7</sup>	3 days.
Luxembourg	✓	✓	✓	✓	✓	✓	€nil	2-3 months.
Netherlands	✓	✓	✓	✓	✓	✓	€nil	3-6 months. <sup>8</sup>
Netherlands Antilles	✓	✓	✓	✓	✓	✓	\$nil	2 to 4 weeks.
Norway	X	X	X	X	X	X	N/A	N/A
Portugal	✓	✓	✓	✓	✓	✓	€15,000 or €30,000 <sup>9</sup>	1 to 2 months for a straightforward fund; longer for more complex funds.
Russia	X	X	X	X	X	X	N/A	N/A
South Africa	✓	✓	✓	✓	✓	✓	ZAR nil <sup>10</sup>	No regulatory time period, but current structures can be complex to avoid being classified as a collective investment scheme.
Spain	X <sup>11</sup>	X	X	X	X	X	N/A <sup>12</sup>	N/A <sup>13</sup>
Sweden	✓	✓	Possibly	✓	✓	Possibly	SEK nil	Domestic hedge funds: up to six months from completing the application. Other domiciles: approximately two months.
Switzerland	✓	✓	✓	✓	✓	✓	CHF nil	3-9 months. <sup>14</sup>
United Kingdom	✓	✓	✓	✓	✓	✓	£250 to £250,000	2-6 months.
USA	✓	N/A	✓	✓	N/A	✓	\$nil	No specified time as funds are generally <sup>15</sup> formed through a partnership agreement among the parties in a private offering.

## Table 1: Notes

Finland	<ol style="list-style-type: none"> <li>1. Hedge funds are formed as Special Funds (usually Special Common Funds).</li> <li>2. The Financial Services Authority (FSA) must be notified or a licence must be obtained when marketing mutual funds or special common funds.</li> <li>3. Under the Mutual Funds Act, UCITS funds may commence marketing their units two months after the submission of the relevant notification, unless the FSA has special cause to prohibit the commencement of marketing.</li> </ol>
Germany	<ol style="list-style-type: none"> <li>4. The average time for authorisation depends on the complexity of the investment strategy and the product structure.</li> <li>5. Only via private placement.</li> </ol>
Ireland	<ol style="list-style-type: none"> <li>6. Minimum investment amounts have been abolished for retail funds-of-hedge funds. Minimum investments are €125,000 for Professional Investor Funds (PIFs) and €250,000 for Qualified Investor Funds (QIFs).</li> </ol>
Jersey	<ol style="list-style-type: none"> <li>7. There is no minimum investment for professional or institutional investors or investors with a net worth above \$1 million. Otherwise the minimum investment is \$100,000.</li> </ol>
Netherlands	<ol style="list-style-type: none"> <li>8. Approval period stated is for funds established in an EU country or in a non-EU country in which there is adequate supervision according to the Authority for the Financial Markets (AFM). The AFM has determined that currently only a limited number of countries meet this criterion, including the United States.</li> </ol>
Portugal	<ol style="list-style-type: none"> <li>9. Minimum investment amount depends on the type of investments that the fund makes.</li> </ol>
South Africa	<ol style="list-style-type: none"> <li>10. The Financial Services Board has issued a discussion paper to assist in drafting the new hedge fund regulations. The paper asks whether an amount of ZAR250,000 should be considered reasonable as a minimum investment amount in a single-manager hedge fund and suggests that regulated funds-of-hedge funds might have no minimum investment amount.</li> </ol>
Spain	<ol style="list-style-type: none"> <li>11. Domestic hedge funds and funds-of-hedge funds will be feasible following the final adoption in 2005 of the draft legislation circulated by the Ministry of Finance.</li> <li>12. Under the new draft legislation, the minimum investment will be €100,000 for retail and institutional domestic hedge fund-like products.</li> <li>13. Under current legislation there is a standard three-month period for authorisation of mutual funds. The time requirements for hedge funds may be longer depending on whether the information and documentation provided by the managers/promoter meets the requirements of the regulator.</li> </ol>
Switzerland	<ol style="list-style-type: none"> <li>14. Authorisation of simple fund-of-hedge funds by an existing manager/promoter usually takes less time than more complex (multi-strategy multi-manager products or single manager funds) or products from managers/promoters who are new to the Swiss fund market.</li> </ol>
USA	<ol style="list-style-type: none"> <li>15. The relatively recent introduction of registered hedge funds and funds-of-hedge funds has permitted sale to a much wider investment base. These funds must be registered with the Securities and Exchange Commission and can take at least 90 days to process. Additionally, management of these registered funds would require registration by the investment adviser.</li> </ol>

Table 2: Channels for distribution of hedge funds by country at May 2005

Country	Main marketing channels							Summary of regulations currently governing distribution of hedge fund products and significant non-tax barriers to development of new distribution channels	Restrictions on location of key service providers?
	Banks	Fund distribution companies	Via wrappers	Private placements	Investment managers	Other regulated financial services institutions	Non-regulated financial intermediaries		
Austria	✓	✓	✓					If a foreign hedge fund qualifies as an investment fund within the meaning of the Austrian law, public distribution will require the permission of the Austrian Financial Market Authority (FMA). Such permission will not be granted where the fund undertakes uncovered short selling or if investors may be called upon to make additional contributions.	X
Bahamas				✓	✓			Distribution may only be to entities/individuals who are not resident for exchange control purposes.	✓ <sup>1</sup>
Belgium	✓		✓	✓				Domestic legislation effectively prevents the establishment of domestic hedge funds. Public distribution of foreign hedge funds and funds-of-hedge funds is not permitted.	X
Bermuda	✓			✓	✓			Distribution to retail investors is governed by the Collective Investment Scheme Act.	✓ <sup>2</sup>
Cayman Islands	✓			✓				Cayman-domiciled funds are generally not available to retail investors in the Cayman Islands.	✓ <sup>3</sup>
Denmark	✓				✓			FSA approval is required for non-UCITS funds and funds domiciled outside the EEA. No licence is required to distribute domestic hedge funds, although the FSA should be informed before marketing commences.	X
Finland	✓	✓			✓			The Mutual Funds Act on Common Funds governs the distribution of Common Funds and Special Common Funds (domestic hedge funds are generally formed as SCFs). The Securities Market Act governs distribution of non-Finnish funds that are available only to institutional investors and no marketing licence is required. The FSA must be notified prior to the commencement of marketing of UCITS funds. Non-EU mutual funds marketing their units to non-professional investors must obtain a licence from the FSA.	X
France		✓	✓	✓	✓			Hedge funds and hedge fund-like products regulated as either Authorised Funds with Simplified Investment Rules (OPCVM Agréés a Regles d'Investissement Allégées – ARIA) or Contractual Mutual Funds (OPCVM Contractuels) under the Financial Securities Act of 2004 and may be marketed to different categories of investors including retail investors.	X <sup>4</sup>
Germany	✓ <sup>5</sup>					✓	✓ <sup>6</sup>	Single-manager hedge funds may not be distributed to retail investors. Fund-of-hedge funds, whether foreign or domestic, may be distributed to retail investors with the permission of BaFin. <i>Wrapper products</i> Generally, aside from the duty to publish a prospectus, publicly distributed wrapper products are not subject to direct supervision. However, it has recently been debated whether offshore issuers of such products are required to comply with licensing requirements applying to the cross-border provision of banking services.	✓ <sup>7</sup>
Gibraltar								None.	✓ <sup>8</sup>
Greece				✓				Domestic funds are regulated according to their legal form, however Greek legislation effectively prevents the establishment of domestic hedge funds. All non-UCITS funds seeking to distribute to retail investors are required to obtain a licence from the Capital Markets Committee. Distribution of foreign hedge funds tends to be by private placement only and outside the scope of the regulatory framework.	X
Guernsey	✓	✓	✓	✓	✓	✓	✓	No significant barriers noted.	X
Ireland	✓ <sup>9</sup>			✓		✓ <sup>10</sup>		Hedge funds domiciled outside Ireland which are seeking to market publicly in Ireland, must be approved by the Irish Financial Services Regulatory Authority.	✓ <sup>11</sup>
Isle of Man		✓	✓ <sup>12</sup>	✓	✓			Hedge funds can be distributed worldwide, subject to the rules of the territory in which they are being sold.	✓ <sup>13</sup>
Italy				✓				Authorisation to establish domestic hedge funds (single-strategy and fund-of-hedge funds) is granted by the Bank of Italy, who must approve the fund's constitutional documents. Hedge funds may not be offered publicly in Italy.	✓ <sup>14</sup>
Jersey				✓				If marketed within Jersey, a Distributor Permit may be required. However, if a Manager Permit is already held, this may be relied upon instead.	X <sup>15</sup>
Luxembourg	✓					✓		Hedge funds domiciled outside Luxembourg seeking to market to the public in Luxembourg must be approved by the Commission de Surveillance du Secteur Financier (CSSF). Only funds which are subject to adequate prudential supervision in their country of origin will be approved.	X

Table 2: Channels for distribution of hedge funds by country at May 2005

Country	Main marketing channels							Summary of regulations currently governing distribution of hedge fund products and significant non-tax barriers to development of new distribution channels	Restrictions on location of key service providers?
	Banks	Fund distribution companies	Via wrappers	Private placements	Investment managers	Other regulated financial services institutions	Non-regulated financial intermediaries		
Netherlands			✓		✓	✓		The Act on the Supervision of Collective Investment Schemes or 'ASCIS' provides licence requirements for investment vehicles.	✓
Netherlands Antilles				✓				Domestic-domiciled funds are generally not available to retail investors in the Netherlands Antilles.	
Norway				✓				Under current regulations, hedge funds may only be actively promoted in Norway with permission of the Norwegian Financial Supervision Authority.	X
Portugal	✓							<p><i>Domestic/EU-domiciled fund</i> Special Investment Funds (SIFs) may be distributed only to specific investors as defined in their constitutional documents. CMVM may refuse to authorise the distribution of SIFs to certain investor types if it has concerns that a fund will not adequately protect investors.</p> <p><i>Non-EU-domiciled fund</i> Non-EU domiciled funds are also required to be authorised by CMVM prior to distributing publicly in Portugal. Authorisation will not be granted where the fund does not provide adequate protection to investors or where it is proposed that marketing of the fund will not conform to the rules applicable to UCITS.</p>	✓ <sup>16</sup>
Russia				✓				Hedge funds may only be distributed by private placement.	X
South Africa			✓ <sup>17</sup>		✓			Hedge fund managers are not currently allowed to actively solicit investments into their funds. The current restriction on marketing covers foreign hedge funds sold in South Africa as well. Pending regulations are likely to provide for the distribution of hedge funds under the FAIS act, as a specific category of product with specific rules incorporated in a code of conduct, governing the marketing of the funds. These will probably include strict fit and proper requirements for investment advisers. Under the proposed regulations, hedge funds marketed to the public will be regulated under the Collective Investments Control Act.	X
Spain	✓			✓	✓	✓ <sup>18</sup>		Under Spanish draft legislation on hedge fund products to be adopted in 2005: - domestic hedge funds will only be available to institutional investors; - domestic fund-of-hedge funds will be available to retail investors; - marketing of foreign hedge funds in Spain will be subject to prior authorisation by the CNMV.	✓ <sup>19</sup>
Sweden					✓			Activities aiming to further the sale of any product or service in Sweden, including securities and fund shares, are subject to the provisions of the Swedish Marketing Practices Act.	✓ <sup>20</sup>
Switzerland	✓	✓	✓		✓	✓		There are no restrictions for retail investors to invest in shares of closed-ended non-regulated listed investment companies (fund-of-hedge funds), IFA-regulated open-ended Swiss hedge funds or fund-of-hedge funds and foreign regulated hedge funds approved for distribution in Switzerland can be sold to retail, high-net-worth and institutional investors. Alternatively, banks and other professional asset managers can distribute hedge funds and fund-of-hedge funds based on a discretionary management contract with clients. Distributors of IFA-regulated funds are generally either a FBC-regulated institution or must obtain the FBC's approval as a distributor prior to commencing distribution. Hedge funds and fund-of-hedge funds not approved for distribution in Switzerland may only be sold to investors by private placement or in connection with a discretionary management contract.	✓ <sup>21,22</sup>
United Kingdom	✓		✓	✓	✓			Hedge funds should not be promoted to the public. However, there are a number of hedge fund products that are aimed at, and promoted to, the retail market in the UK. These have typically been structured as UK-listed companies which are fund-of-funds with some hedge fund exposure.	X
USA				✓				<p>In the USA, marketing rules governing hedge funds are covered by:</p> <p>(1) The rules of the SEC, which govern much of the activities of investment advisors (2) State/Blue Sky regulations (3) The rules of the NASD, which regulate the offering of hedge funds by registered representatives of broker dealers who offer hedge funds.</p> <p>The majority of hedge funds and funds-of-hedge funds are sold via private placements, however funds may register with the SEC and be offered more widely.</p>	X

**Table 2: Notes**

Bahamas	<b>1.</b> Foreign funds must appoint a representative in the Bahamas who is approved by the Securities Commission.
Bermuda	<b>2.</b> The custodian and administrator must be located in Bermuda for Bermuda-domiciled retail funds, although the Bermuda Monetary Authority (BMA) may grant exemptions or permit services to be sub-contracted outside Bermuda in certain circumstances. No restriction exists for institutional funds, if service providers are considered “fit and proper” by the BMA.
Cayman Islands	<b>3.</b> Funds registered with the Cayman Islands Marketing Authority (CIMA) are required to appoint a local CIMA-approved auditor.
France	<b>4.</b> The custodian must be located in EU.
Germany	<b>5.</b> Banks may distribute overseas hedge funds by issuing wrapper products. <b>6.</b> Only fund-of-hedge funds may be distributed by non-regulated financial intermediaries. <b>7.</b> For domestic funds, both the investment manager and custodian bank are required to be located and regulated in Germany.
Gibraltar	<b>8.</b> The custodian, investment manager and trustee must be registered in Gibraltar and must be regulated.
Ireland	<b>9.</b> Private banks only. <b>10.</b> Brokers. <b>11.</b> Irish-domiciled hedge funds must appoint an Irish trustee/custodian and fund administrator and perform certain other tasks in Ireland.
Isle of Man	<b>12.</b> Wrapper products issued by insurance companies only. <b>13.</b> Day-to-day operations of Professional Investor Funds and Experienced Investor Funds must be carried out in the Isle of Man.
Italy	<b>14.</b> The depository bank for Italian hedge funds must be located in Italy, however this could be an Italian bank or a branch of an EU bank located in Italy.
Jersey	<b>15.</b> Where the fund falls under the Expert Funds regime.
Portugal	<b>16.</b> Domestic funds must appoint a local bank or a branch of an EU bank as custodian. It is possible for the investment management of domestic funds to be performed outside Portugal where regulation in the home country is deemed by the Portuguese regulator to be of an acceptable level.
South Africa	<b>17.</b> Wrapper products distributed by insurance companies.
Spain	<b>18.</b> ISD firms only. <b>19.</b> Domestic funds must appoint a local bank or a branch of an overseas bank in Spain as custodian.
Sweden	<b>20.</b> Funds must have a domestic paying agent for the settlement of subscriptions, redemptions, distributions.
Switzerland	<b>21.</b> Domestic hedge funds and fund-of-hedge funds subject to the Investment Fund Act (IFA) must appoint a local custodian bank and a local administrator. <b>22.</b> Foreign hedge funds and funds-of-hedge funds approved for distribution are required to appoint an approved representative and a domestic paying agent for the settlement of subscriptions, redemptions and distributions.

Table 3: Regulation of hedge fund managers by country at May 2005

Country	Name of regulator	Minimum capital required to operate as hedge fund manager	Notes
Austria	Finanzmarktaufsicht (FMA)	Varies	1
Bahamas	Securities Commission of The Bahamas	\$25,000	
Bermuda	Bermuda Monetary Authority (BMA)	None	2
Belgium	Banking, Financial and Insurance Commission	N/A	3
Cayman Islands	Cayman Islands Monetary Authority (CIMA)	Cayman-domiciled investment managers must register under the Securities Investment Business Law (SIBL). An exemption from the normal US\$500,000 minimum capital requirement is available where the funds being managed are only open to institutional and high net worth investors.	
Denmark	Danish Financial Supervisory Authority	N/A	4
Finland	Financial Supervision Authority (FSA)	€169,000	
France	Autorités des Marchés Financiers (AMF)	Net equity must be maintained at a level equal to the greater of: - 25% of annualised expenditure; and - €125,000 + 0.02% of assets under management in excess of €250 million.	
Germany	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	Initial capital of at least €730,000 plus an ongoing capital requirement based on assets under management. Own funds shall at no time be less than 25% of annual operating expenses.	
Gibraltar	Financial Services Commission (FSC)	€50,000 to €750,000, depending on the nature and scope of the activities.	
Greece	N/A	N/A	
Guernsey	Guernsey Financial Services Commission (GFSC)	£10,000 of paid up share capital if no staff or premises, otherwise the higher of £25,000 and 3 months' expenditure.	
Ireland	Irish Financial Services Regulatory Authority (IFSRA)	Usually €50,000 initial capital plus 3 months of annualised expenditure.	5
Isle of Man	Financial Supervision Commission (FSC)	The greater of £75,000, or 3 months' expenditure.	
Italy	Bank of Italy; Commissione Nazionale per le Società e la Borsa	€1,000,000 (although this can be larger depending on the nature and scale of investment management activities).	
Jersey	Jersey Financial Services Commission (JFSC)	£25,000	
Luxembourg	Commission de Surveillance du Secteur Financier (CSSF)	€125,000 (Type 2 managers); €1,500,000 (Type 3 managers).	6
Netherlands	Authority for the Financial Markets (AFM) for supervision of market conduct. Dutch Central Bank for prudential supervision.	€226,890	
Netherlands Antilles	Central Bank of Netherlands Antilles	N/A	
Norway	Financial Supervisory Authority of Norway	€125,000	
Portugal	Portuguese Securities Market Commission (CMVM)	(i) € 250,000 (share capital) plus a requirement based on assets under management. (ii) € 7,500,000 (own funds) for managers of closed-ended vehicles.	7
Russia	N/A	N/A – hedge fund managers are not regulated in Russia.	
South Africa	N/A	N/A – hedge fund managers are not regulated in South Africa.	8
Spain	Comisión Nacional del Mercado de Valores (CNMV)	€300,000 plus an additional own funds requirement based on the level of assets under management.	9
Sweden	The Swedish Financial Supervisory Authority	€125,000 initial capital. In addition, capital equal to 3 months' annualised expenditure must be maintained, plus 0.02% of assets under management in excess of €250 million (up to a maximum capital requirement of €10 million).	
Switzerland	Federal Banking Commission (FBC), if regulated	CHF1–10 million, depending on assets under management, if regulated.	10
United Kingdom	Financial Services Authority (FSA)	Own funds of €50,000 plus 3 months annualised expenditure.	
USA	The Securities and Exchange Commission (SEC) and, in some cases, the Commodity Futures Trading Commission (CFTC)	None.	11

**Table 3: Notes**

Austria	<b>1.</b> The FMA is only responsible for Austrian banks and Austrian ISD firms: if a bank is the manager, the capital requirement is €5 million; if an ISD firm is the manager, the capital requirement is either €50,000 or €125,000 depending on scope of services provided.
Bermuda	<b>2.</b> Domestic hedge fund managers are not regulated in Bermuda unless they are distributing funds to residents of Bermuda, in which case they are required to be registered under the Investment Business Act.
Belgium	<b>3.</b> Hedge fund managers may only operate private hedge funds. Hedge fund managers operating such funds are subject to no specific prudential controls.
Denmark	<b>4.</b> Under current legislation, hedge funds managers are not subject to a capital requirement.
Ireland	<b>5.</b> Promoters of Irish-domiciled hedge funds must maintain minimum regulatory capital €675,000.
Luxembourg	<b>6.</b> Type 2 and Type 3 managers manage non-UCITS funds domiciled inside and outside of Luxembourg respectively.
Portugal	<b>7.</b> (i) €250,000 is the minimum share capital for a Sociedade Gestora de Fundos Mobiliários (SGFM) (one of the two types of entities that can be fund managers); additionally, SGFM are required to maintain own funds that are not less than the sum of 0.5% of the first €75 million of assets under management and 0.1% of any additional assets under management.  (ii) For closed-ended funds, the manager is required to be a credit institution. The minimum share capital of a credit institution depends on the nature of its main activity, e.g. banking, leasing etc.
South Africa	<b>8.</b> As the hedge fund industry in South Africa is currently unregulated, there is no minimum capital requirement for hedge fund managers.  The Financial Services Board (FSB) is the regulator of collective investment schemes under the Collective Investment Schemes Control Act, 2002 (CISCA). The FSB is drafting regulations for the regulation of hedge funds which will fall under this Act. The current capital requirement for a manager of a regulated collective investment scheme in securities is the greater of ZAR600,000 or 13 weeks' fixed operating costs of the scheme, plus an investment of ZAR1 million in every fund under its management (although this is reduced by ZAR100,000 for every ZAR1 million invested in the funds by independent investors) and a position risk requirement based on a percentage of the amount paid for participatory interests held by the manager in funds it manages.  A collective investment scheme managed outside South Africa must at all times have a representative office in South Africa and maintain a minimum capital amount of ZAR2 million (invested in liquid assets) in order to distribute in South Africa.
Spain	<b>9.</b> Revised capital requirements are included in the draft legislation which we expect will be adopted later in the year.  Specific enabling legislation could be adopted in the future to create additional capital requirements for domestic hedge fund managers.
Switzerland	<b>10.</b> Hedge fund managers in Switzerland are generally unregulated unless they manage a domestic hedge fund regulated under the Investment Funds Act (IFA) and at the same time act as the hedge fund's legal fund management company.
USA	<b>11.</b> Rules in the U.S. generally require investment advisers to register with the SEC if they manage the assets of U.S. clients. There are certain exemptions from registration for advisers which manage the assets of fewer than 15 clients (or for U.S. domiciled advisers that manage less than \$25 million). The rules for counting the number of clients have recently been revised to count each investor in a fund as a client rather than counting each fund as a client. This rule change takes effect on 1 February 2006 and will require many more advisers to register with the SEC. Advisers who have their principal place of business outside the United States ("Offshore Advisers") only need to count their U.S. resident clients (determined at the time of initial investment) towards this 15 client threshold.

Table 4: Taxation of hedge funds and hedge fund managers by country at May 2005

Country	Single manager fund	Fund-of-hedge funds	Hedge fund manager
Austria	Fund is tax transparent	Fund is tax transparent	Subject to corporate income tax at the rate of 25%
Bahamas	0%	0%	0%
Belgium	N/A	N/A	N/A
Bermuda	0%	0%	0%
Cayman Islands	0%	0%	0%
Denmark	Can be either tax transparent or opaque depending on form. If opaque taxed as a corporate and if transparent no tax at fund level.		Taxed at corporate rates.
Finland	Taxable at investor level if structured as a partnership. If structured as a special common fund, the fund is tax exempt.		Income and gains taxable at 26%
France	Fund is tax transparent	Fund is tax transparent	Taxed at corporate rates.
Germany	Tax exempt	Tax exempt	A German-domiciled hedge fund manager in the legal form of a corporation is taxed at a flat rate of 25% corporate tax.
Gibraltar	0% (tax exempt companies) or 35%	0% (tax exempt companies) or 35%	0%
Greece	32% (expected to fall to 25%)	32% (expected to fall to 25%)	32% (expected to fall to 25%).
Guernsey	0%	0%	0% to 20%
Ireland	Tax exempt	Tax exempt	12.5% on trading profits; 25% on non-trading income.
Isle of Man	Tax exempt	Tax exempt	Taxed at 0%
Italy	Hedge funds are subject to tax at a rate of 12.5% on the accrued management result at the year end. The general rule provides that income received by investment funds is gross of Italian withholding taxes at source or substitute taxes. The management result is computed on an accruals basis by adding all the income derived from investments (for instance, interest and dividends) to other income including capital gains on securities and positive spreads from derivative instruments. The management result yield is the difference between the ending net asset value and the closing net asset value of the fund. Income subject to Italian withholding tax at source and tax-exempt income is excluded from the management result subject to 12.5% tax.		Italian asset management companies (SGRs) are subject to corporate tax at 33% and regional tax at 4.25% (or higher rate depending on regional laws).
Jersey	0%/20% On basis the vehicle is an exempt company, no Jersey tax on foreign income and Jersey bank interest. Other Jersey income subject to tax at 20%.	0%/20% On basis the vehicle is an exempt company, no Jersey tax on foreign income and Jersey bank interest. Other Jersey income subject to tax at 20%.	20% tax on investment income or trading profits. Capital gains tax free.
Luxembourg	Tax exempt but registration duty of €1,250 and annual subscription tax of 0.01% (funds, sub-funds, funds shares dedicated to institutional investors) or 0.05% on funds NAV.	Tax exempt but registration duty of €1,250 and annual subscription tax of 0.01% (funds, sub-funds, fund shares dedicated to institutional investors) or 0.05% on funds NAV. If second tier fund is a Luxembourg fund then no subscription tax.	Profits taxed under normal corporate tax regime at 30.38% plus annual 0.5% Net Wealth Tax (on unitary value of the company); 1% capital duty upon incorporation. The management company of a sole FCP and the advisory company of a sole SICAV could benefit from an exemption from income tax and net wealth tax.
Malta	Maltese-licensed hedge funds would typically have more than 15% of their investments situated overseas. Such funds are not taxed in Malta on their income and capital gains. Other rules apply for funds having at least 85% of their investments situated in Malta.		Fund managers managing non-resident funds and local funds marketed exclusively outside Malta may qualify as international trading companies and are subject to tax at the normal corporate rate of 35% (although effective tax rate is minimal due to local imputation system).
Netherlands	Dutch funds are either transparent or subject to a special tax regime (0% corporate income tax).		Income and capital gains taxed at normal corporate rates.
Netherlands Antilles	0%	0%	Taxed at 34.5%
Norway	N/A	N/A	N/A
Portugal	Domestic hedge funds that qualify as mutual funds are treated as tax transparent. Withholding of tax at rates of between 10-25% depending on type of income by manager.	Domestic hedge funds that qualify as mutual funds are treated as tax transparent. Distributions from underlying funds exempt.	Taxed at normal corporate rate of 25% plus 10% maximum municipal surcharge.
Russia	Funds incorporated as 'units investments funds' (UIF) are not recognised as separate legal entities and are exempt from profits tax. A 2.2% property tax is payable based on the value of the fund's fixed assets by either manager or investor. Shareholder funds are subject to tax on capital gains and other income.		Taxed at 24%
South Africa	Fund is tax transparent		Corporate managers taxed at 29%.
Spain	N/A	N/A	N/A
Sweden	Realised income taxed with the exception of capital gains on shares and share based derivatives.		Taxed at 28% on an accrued income/loss basis.
Switzerland	Can be either tax transparent or opaque depending on form. If opaque taxed as a corporate and if transparent no tax at fund level.		16-25% tax on income depending on the canton the Hedge Fund Manager is domiciled.
United Kingdom	Funds organised as OEICs/AUTs taxed on trading income at 20%. Capital gains are exempt. Unauthorised unit trusts are taxed at 22%.		Corporate managers taxed at 30%. Fund managers organised as Limited Liability Partnerships taxed at Partner's marginal tax rate (up to 41%).
USA	Funds organised as tax transparent.		

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