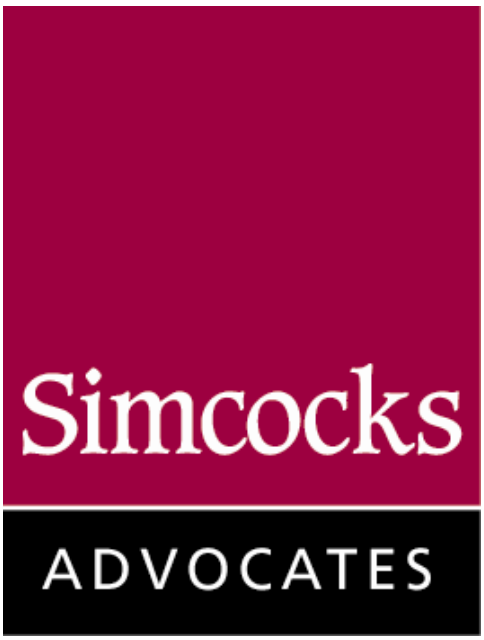

Collective Investment Schemes or Mutual Funds

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Collective Investment Schemes or Mutual Funds

The Isle of Man is recognised throughout the world as a leading international business centre and holds a AAA credit rating from Moodys and AA+ by Standard & Poor, based on the Isle of Man's robust financial position and stable outlook.

Collective investment schemes (mutual funds) in the Isle of Man are regulated by the Collective Investment Schemes Act 2008.

The Isle of Man Financial Supervision Commission (FSC), the regulatory authority on the Isle of Man responsible for collective investment schemes, is committed to applying international standards of regulation and supervision across all areas of its work in order to maintain the integrity of the Isle of Man's financial system.

The fund vehicle may be an open ended investment company (OEIC), a limited partnership or a unit trust.

An OEIC vehicle could be either a company incorporated under the Companies Acts 1931 – 2004 or the Companies Act 2006. The latter have become the "vehicle of choice" because of their simplicity of administration.

The fund's offering document or prospectus must accurately set out all material information which is relevant for the purpose of making an informed judgement about whether to invest in the fund.

All funds will have a governing body: the board of directors of the fund in relation to an OEIC, the board of directors of the general partner in relation to a limited partnership or the board of directors of the trustee in relation to a unit trust. In addition, their operation will in most cases require the appointment of other functionaries and in some cases such appointment may be mandatory.

There are three categories of Isle of Man collective investment schemes – see below: regulated (Authorised Funds, Regulated Funds and Recognised Funds), registered (Specialist Funds and Qualifying Funds) and unregulated (Exempt Schemes).

There have also in the past been other types of fund not mentioned below (for example, Experienced Investor Funds, Full International Schemes) but these have largely been superseded (although existing funds have been permitted to continue) and are not dealt with here.

The Isle of Man imposes no stamp duty and no capital or inheritance taxes. Fees payable by collective investment schemes (other than Exempt Schemes) to Isle of Man administrators and investment managers are exempt from Isle of Man value added tax (VAT).

Authorised Funds

Authorised funds are formally authorised and may be marketed to the general public in the Isle of Man. They are subject to prescriptive regulation: for example, the types of fund that are eligible for authorisation are prescribed - securities funds, money market funds, property funds, various derivatives funds, feeder funds, umbrella funds, etc. A detailed discussion is beyond the scope of this note.

Authorised schemes are retail-focused and may be sold directly to the general public in the Isle of Man and in the United Kingdom, Jersey, Guernsey and Ireland. Arrangements are also in place with Hong Kong, Australia and Japan.

They benefit from an Isle of Man investor compensation scheme.

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Regulated Funds

As its name suggests, the Regulated Fund is subject to a relatively high level of oversight by the FSC of the fund itself, its Board and its functionaries. Its launch is a reflection of the importance now placed on appropriate regulatory oversight for funds.

Certain mandatory "health warnings" and information must be included in the fund's offering document or prospectus and promotional materials and there are clear requirements in relation to auditing and the provision of accounts.

The FSC will review the fund prior to launch and will also review changes to the fund, its functionaries and documentation thereafter. Furthermore, certain notifications must be made to the FSC, including breaches of the regulatory requirements.

As a result of this regulatory structure, Regulated Funds are permitted to describe themselves as such.

Crucially, the Irish Stock Exchange has confirmed that Regulated Funds are suitable for listing without complying with the usual €100,000 investment threshold.

The Regulated Fund has the following principal characteristics:-

- Regulated status.
- Minimum subscription set by the directors.
- No investor criteria or qualifications except as set by the fund itself.
- Prior to launch and the making of material changes, draft documentation, agreements and information must be submitted to the FSC for approval. If a decision or a request for additional time for consideration is not received from the FSC within three months, approval will be deemed to have been given. The manager must submit copies of the final executed documents to the FSC within 10 working days of launch.
- The offering document must clearly set out the fund's investment objectives and a number of investment restrictions relating to risk spreading, risk management, gearing through the use of options, warrants, futures or other similar instruments, hedging, borrowing and liquidity are mandated. The principle is generally that restrictions do not apply where the terms of the policy concerned and the risks thereof are clearly disclosed.
- Certain regulatory statements must be prominently displayed, together with a statement to the effect that the fund is deemed to be regulated by the FSC.
- Except where disclosed (including risks) in the offering document, valuations must take place at least monthly.
- Directors must be vetted by the FSC and there must be at least one Isle of Man resident individual director. Corporate directors are, however, permitted for companies incorporated under the 2006 Act.
- The fund must appoint a manager who is licensed in the Isle of Man with FSC permission to act for the fund.
- The fund must also ensure that it receives relevant advisory or discretionary management services. The asset manager or investment adviser appointed need not be regulated but the directors must satisfy themselves that they are suitable and in making such assessment must take account of their regulatory status and that of any person providing investment services to them.
- The fund must appoint a fiduciary custodian regulated in the Isle of Man, the United Kingdom, Ireland, Luxembourg, Jersey or Guernsey, or otherwise acceptable to the FSC.

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- An Isle of Man qualified auditor must be appointed. Audited annual financial statements must be distributed to investors no later than six months after the fund's financial year-end.
- The directors, manager and custodian are responsible proper operation fund.
- In particular the directors, manager and custodian have certain duties to submit reports to the FSC: for example, if the fund is not being properly operated; if the applicable regulations are not being complied with; if a director or the auditor is removed or resigns; or if financial statements are late or the accounts are qualified by the auditors.
- The directors and manager must submit an annual compliance declaration to the FSC.
- The manager must ensure adequate procedures and controls are in place and notify the custodian of material lapses.

Recognised Funds

There two types of recognised funds: (i) schemes authorised in designated countries; and (ii) individually recognised schemes.

Schemes Authorised in Designated Countries.

A fund which is managed in and authorised under the law of a designated country or territory outside the Isle of Man may apply to the FSC to be recognised as a recognised scheme. At present, the United Kingdom, Luxembourg, Ireland, Jersey and Guernsey have been designated by the FSC. In including a country or territory in the list, the FSC must be satisfied that adequate protection is afforded to participants.

The fund's prospectus must comply with certain FSC requirements and, in particular, must contain the name and address of a person in the Isle of Man authorised to accept service of notices and other documents on the fund's behalf.

Individually recognised schemes.

A fund which is managed in a non-designated country or territory outside the Isle of Man may also apply to the FSC to be recognised as a recognised scheme. The FSC may make a recognition order if, among other things: (i) the fund affords adequate protection to participants; (ii) the arrangements for the fund's constitution and management are adequate; (iii) the fund's functionaries are fit and proper to act.

The fund must have a representative in the Isle of Man who is licensed in the Isle of Man and has power to act generally for the fund and to accept service of notices and other documents on its behalf.

Specialist Funds

The Specialist Fund was created to meet the demands of the alternative investment market. Although not by any means exclusively targeted at the hedge fund market, the Specialist Fund is intended to provide hedge fund promoters with a product providing maximum flexibility in the fast-moving international investment environment.

It has the following principal characteristics:-

- The minimum subscription per investor is US$100,000 or currency equivalent.
- The fund may accept investments only from Specialist Investors, defined as institutions and professional investors (including government and public authorities), corporations with assets available for investment of not less than $1-million and individuals with a self-certified net worth (excluding principal residence) of not less than $1-million.

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- Investors are required to certify that they are Specialist Investors, that they are sufficiently experienced to understand the risks associated with an investment in the fund, that they have read and understand the offering document and accept the risks and that they have taken independent advice where appropriate.
- Where the investor is investing on behalf of another person or is a life assurance company investing assets comprised within its long term business fund, it is required to obtain appropriate confirmations from the underlying party/ policyholder.
- With the exception of a Specialist Fund constituted as a unit trust, the fund's governing body must include at least one non-executive director who is independent of the promoter; and where the administrator is not in the Isle of Man, that director must be an Isle of Man resident individual who is regulated under relevant Isle of Man fiduciary service provider legislation. Special provisions apply in relation to unit trusts.
- The governing body of a Specialist Fund is responsible for ensuring that a suitable asset manager and/or investment adviser is appointed. Such asset manager or investment adviser is not expressly required to be regulated, but in making its appointment, the governing body is required to take into account the regulated status of the service provider concerned as well as that of any person providing investment services to it.
- The governing body is also responsible for ensuring that the fund's offering document accurately sets out all material information and that the fund is operated in accordance with its constitutional documents and offering document. The offering document must contain certain prescribed matters such as the definition of "Specialist Investor" and certain standardised risk warnings.
- An administrator regulated in the Isle of Man or a jurisdiction accepted by the FSC as imposing an appropriate standard of regulation must be appointed.
- There is no express requirement to appoint a custodian but the fund's offering document must contain a description of the arrangements for the custody of its assets.
- An Isle of Man qualified auditor must be appointed. Audited annual financial statements must be distributed to investors no later than six months after the fund's financial year-end.

The Specialist Fund can be said to be lightly but effectively regulated by the FSC. On the one hand, the promoter, the asset manager and the investment adviser are not required to be regulated; the administrator is not required to be based in the Isle of Man; and the constitutional documents and offering document of a proposed fund are not required to be submitted to the FSC for pre-vetting. This allows for the quick and flexible establishment of funds.

On the other hand, the FSC operates an effective (but realistic and pragmatic) regulatory regime via a series of reporting requirements imposed on key participants in the operation of the fund, including the governing body and the administrator. This allows regulatory intervention where appropriate or, again where appropriate, consultation with the parties concerned with a view to solving any problems or issues which may arise without adversely affecting the interests of investors.

Qualifying Funds

The Qualifying Fund is a rather more heavily regulated vehicle targeted at the non-retail investor. The intention is to provide promoters of this type of fund with a flexible product which nonetheless retains a significant degree of "light touch" regulation, principally through the requirement that distribution be via "regulated financial adviser distribution" or

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"regulated promoter distribution" (see below), that a custodian be appointed and that key participants make periodic reports to the FSC.

It has the following principal characteristics:-

- Qualifying funds are open to investment from investors who self certify that they are Qualifying Investors i.e. that they have the expertise, experience and knowledge adequately to appraise the investment. In addition, one of the following methods of distribution must be employed:

  Regulated Financial Adviser Distribution. The investor must have been advised about the suitability of the investment by a regulated financial adviser.

  Regulated Promoter Distribution. The fund must have a promoter licensed in the Isle of Man or in an acceptable jurisdiction. The regulated promoter may appoint a financial adviser in the Isle of Man or another jurisdiction to advise investors on the suitability of the investment. The regulated promoter must assess the financial adviser as being acceptable on the basis of licences held in the relevant jurisdictions, competence in relation to the fund, etc.
- Institutions and professional investors (including government and public authorities) may also invest.
- Where the investor is investing on behalf of another person or is a life assurance company investing assets comprised within its long term business fund, it is required to obtain appropriate confirmations from the underlying party/ policyholder.
- Unlike the Specialist Fund but like the Regulated Fund, there is no general minimum subscription laid down but a minimum subscription appropriate for each fund must be determined by the fund and its manager.
- With the exception of a fund constituted as a unit trust, the governing body must include (i) at least one non-executive director who is independent of the promoter and (ii) at least one Isle of Man resident natural person (can be the same person). Special provisions apply in relation to unit trusts.
- The fund must appoint a manager licensed in the Isle of Man. The manager is responsible for (i) the conduct and administration of the fund and (ii) determining whether the fund is being operated in accordance with its constitutional and offering documents. The manager is required to satisfy itself that the certifications in relation to investors being Qualifying Investors are in place.
- The offering document must contain certain prescribed matters such as the definition of "Qualifying Investor" and certain standardised risk warnings.
- Like a Specialist Fund, the fund must ensure that a suitable asset manager and/or investment adviser is appointed. Any asset manager or investment adviser must be approved by the manager.
- The fund must appoint one or more custodians. Each custodian must be appropriately experienced in providing services to the class of assets for which it will provide services; must be a different person from the manager; and must be regulated in the Isle of Man or in a jurisdiction accepted by the FSC as imposing an appropriate standard of regulation.
- An Isle of Man qualified auditor must be appointed. Audited annual financial statements must be distributed to investors no later than six months after the fund's financial year-end.

  As is appropriate for its target market, the Qualifying Fund is rather more heavily regulated than the Specialist Fund. But the Qualifying Fund has the same quick and flexible establishment procedure as the Specialist Fund.

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Exempt Schemes

The Exempt Scheme is not subject to regulation by the FSC; rather, it is regarded as a private arrangement.

It has the following principal characteristics:-

- The fund's constitutional documents must prohibit offerings to public anywhere in the world.
- There must be fewer than fifty participants.
- Under certain circumstances, the manager, administrator, custodian or trustee of an exempt scheme, if any, need not be licensed in the Isle of Man.
- Otherwise, there are no specific requirements as to permitted investors, permitted investments, financial statements, functionaries, etc.
- The exempt fund may have an offering document but none is required.

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