# Private Equity

*Contributing editor*
**Bill Curbow**

2019

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# Private Equity 2019

*Contributing editor*
**Bill Curbow**
**Simpson Thacher & Bartlett LLP**

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# Preface

## Private Equity 2019

Fifteenth edition

**Getting the Deal Through** is delighted to publish the fifteenth edition of *Private Equity*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

**Getting the Deal Through** provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on the British Virgin Islands, Canada, Colombia, Egypt and Thailand. The report is divided into two sections: the first deals with fund formation in 22 jurisdictions and the second deals with transactions in 23 jurisdictions.

**Getting the Deal Through** titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

**Getting the Deal Through** gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Bill Curbow of Simpson Thacher & Bartlett LLP, for his continued assistance with this volume

London
February 2019



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# United Kingdom

**Richard Sultman, Jennifer Maskell, Catherine Taddeï, Beth Leggate and Hannah Esslemont**

**Cleary Gottlieb Steen & Hamilton LLP**

## Formation

### 1 Forms of vehicle

**What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?**

The two most common legal vehicles in use within the United Kingdom (UK) for private equity funds are English limited partnerships (ELPs) and Scottish limited partnership (SLPs) formed pursuant to the Limited Partnerships Act 1907 (as amended) (LPA 1907). The ELP and SLP differ in certain key respects including separate legal personality, governing law and place of establishment. While SLPs, because of having separate legal personality, are commonly used vehicles for fund of funds, carried interest and feeder funds, ELPs are the predominant UK private investment fund vehicle. Accordingly, this chapter focuses on ELPs.

An ELP is a partnership registered in accordance with the LPA 1907 and is subject to English partnership law, which includes the Partnership Act 1890 (PA 1890) and the rules of equity and English common law applicable to ordinary (general) partnerships (to the extent not modified to the contrary by an agreement between the partners). An ELP must have at least one general partner (GP) and one limited partner (LP). To avoid being a 'qualifying partnership' for the purpose of the Companies and Partnerships (Accounts and Audit) Regulations and being subject to the requirement to file accounts with Companies House in the same way companies do under such regulations, it is becoming more common to see ELPs with a second, non-corporate GP, such as a limited liability partnership.

An ELP, unlike an SLP, does not possess separate legal personality and is not an incorporated entity or a 'body corporate'. The ELP is thus incapable of contracting in its own name or holding property in its own right. Instead, legal title to the property of an ELP is held on trust by its GP or a nominee company. The GP is responsible for managing the business of the ELP and contracts on behalf of the ELP. The GP may be a natural or corporate person. An LP's liability for the debts and obligations of the ELP is limited to the amount of the capital it contributes to the ELP, whereas the GP's liability for the debts and obligations of the ELP is unlimited. Accordingly, UK GPs of ELPs are typically corporate vehicles that shield their members from liability to third parties.

In April 2017, the Legislative Reform (Private Fund Limited Partnerships) Order 2017 (the LRO) introduced a sub-category of ELPs, private fund limited partnerships (PFLPs), and amended the LPA 1907 as it applies to PFLPs and to partners in PFLPs. The PFLP structure is designed to reduce some of the administrative and financial burdens that have had an impact on private funds using the ELP structure and it aims to make the UK an attractive and competitive domicile to private fund sponsors. An ELP may only be designated as a PFLP if it is constituted by an agreement in writing and is a collective investment scheme (as defined in section 235 of the Financial Services and Markets Act 2000 (FSMA)). These two criteria are referred to herein as 'the private fund conditions'. In this chapter, references to ELP includes references to a limited partnership that is a PFLP unless otherwise stated. See questions 2 and 5 for further detail on PFLPs.

### 2 Forming a private equity fund vehicle

**What is the process for forming a private equity fund vehicle in your jurisdiction?**

An ELP is a partnership vehicle registered in accordance with the LPA 1907 and is formed between two or more persons, at a minimum the GP and a single LP, who agree to carry on a business in common with a view to achieving a profit.

There is no prescribed form that an agreement of limited partnership must take nor is there a requirement for the document to be filed at Companies House. Indeed, there is no requirement for a limited partnership agreement (an LPA) to be written down; an LPA can be a verbal contract. However, given that the LPA 1907 and PA 1890 each contain default provisions which, in the absence of an agreement between the partners to the contrary, will be deemed to govern their relationship, the vast majority of commercial ELPs are governed by prescriptive, documented LPAs that contain contractually agreed terms between the relevant parties.

An ELP must be registered at Companies House using an application for registration of a limited partnership on Form LP5 to obtain the limited liability status conferred by the LPA 1907. The application for registration mandates that certain information be provided, including a description of the general nature of the business, the name of the partnership, the principal place of business of the partnership, the full name of each of the general and limited partners, the amount of the capital contributed by each limited partner as capital to the partnership and the form of contribution (ie, whether it is paid in cash or otherwise), the partnership's proposed term, (if any), the date of the ELP's commencement and a statement that the partnership is an ELP (and thus the liability of its LPs is limited). Form LP5 needs to be signed (or otherwise authenticated) by or on behalf of each of the general and initial limited partners and dated. The form along with a registration fee of (as at the date of publication) £20 or £100 (where same day registration is required), is to be sent to the Registrar of Companies (the Registrar) for the part of the UK in which the principal place of the ELP's business is to be situated (ie, England or Wales). Where any changes to the information supplied via Form LP5 arise, the ELP must provide the Register with a statement on Form LP6 specifying the nature of the changes within seven days of the changes occurring. There is no cost associated with notifying the Register of such a change; however, failure to notify will result in the GP being liable to a daily default fine of (as at the date of publication) £1 for the duration of the default. There is also an obligation to advertise in the London Gazette (the Gazette) when an LP becomes a GP or an LP assigns its interest in the ELP. These changes will only become effective once the advertisement has been made.

Once an ELP is registered, the Registrar will issue a certificate of registration. This certificate includes the ELP's name and registration number and represents conclusive evidence that the ELP came into existence on the date of registration. A register of ELPs is maintained by the Registrar.

A PFLP can be registered at Companies House using Form LP7. The information required to complete the application for registration is the same as that for an ELP except that, unlike in a Form LP5, PFLPs do not have to register the nature of the partnership business, the amount of each limited partner's capital contribution and the term of the PFLP. Form LP7 also includes a confirmation that the partnership meets the private fund conditions. Once registered as a PFLP, the Registrar will



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issue either a certificate of registration and a certificate of designation as a PFLP or a combined certificate instead of two separate certificates. An existing ELP may choose to apply for PFLP status by providing certain information on Form LP8, including the name of the partnership, the principal place of business of the partnership and the name and signature of each general partner to confirm that the partnership meets the private fund conditions (as described in question 1). Once designated, the Registrar will issue a certificate designation that is conclusive evidence that the PFLP was designated on the date stated in the certificate. An ELP that becomes a PFLP will not be able to return to ELP status as it may not satisfy the aforementioned criteria for an ELP with respect to declaration and contribution of capital. Changes to the Form LP7 or Form LP8 must be notified In the same manner as changes to a Form LP5, with the exception that PFLPs are not required to advertise changes in the GP or LP composition (except for the case of a GP becoming an LP where the requirement remains) with the Gazette.

In December 2018, the Department for Business, Energy and Industrial Strategy published its response (the Response) to comments received on its April 2018 consultation paper on reform of limited partnership law (the Consultation) (which sought views on ways in which the law might be modernised and on how the risk of misuse of limited partnerships can be limited). The Response outlines the government's intention to expand the information currently required of limited partnerships on applications for registration to include contact information for all limited and general partners, the date of birth and nationality of all limited and general partners that are natural persons and also a standard industrial classification code, identifying the limited partnership's business. Any changes to the information listed in the foregoing sentence will also have to be registered and confirmed in a confirmation statement (see question 3 for further detail). The government intends to introduce a transitional period and mechanism to enable all existing UK limited partnerships to submit the additional information. The government also intends to request information upon application about a limited partnership's connection to the UK, by:

- retaining a principal place of business in the UK;
- continuing some legitimate business activity in the UK; or
- having a service address in the UK with an agent that is registered with an AML supervisory body.

In the Response, the government also indicated its intention to make it mandatory for presenters of new applications for registration of limited partnerships to demonstrate that they are registered with an AML supervisory body, and to provide evidence of this on the application form.

### 3 Requirements

**Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?**

An ELP must have a principal place of business in England or Wales at the time of its initial registration under the LPA 1907. This is usually achieved by having a UK-based GP. Following initial registration there appears to be no obligation on the ELP to maintain a connection with the UK or conduct business in the UK. Consequently, a number of ELPs retire their initial, English GP and have foreign GPs. In the Consultation, the government sets out its belief that it is vital for limited partnerships registered in the UK to maintain some demonstrable link to the UK. The Response outlines the government's intention to request information about an ELP's connection to the UK upon application for registration (see question 2) and on an ongoing basis. Any change in an ELP's principal place of business or the way in which it demonstrates its ongoing connection to the UK will be required to be notified to the Registrar. The Financial Conduct Authority (FCA) confirmed that an ELP's principal place of business is regarded as the equivalent of a registered office when determining whether an ELP is established in the UK for the purposes of Directive 2011/6/EU on Alternative Investment Fund Managers (the AIFMD).

The LPA 1907 does not expressly require ELPs to prepare accounts and the obligations on the partners contained in the PA 1890 to render true accounts and full information on all things affecting the partnership to any partner are subject to any agreement between the partners to the contrary. Typically, the form and contents of the ELPs' financial statements are provided for in the LPA. Unless the ELP is a 'qualifying partnership' under the Companies and Partnerships (Accounts and Audit) Regulations 2013 (the Accounts Regulations) the ELP is not required to file a copy of its accounts with Companies House. Subject to any contrary agreement between the partners, the PA 1890 requires the books of the partnership to be kept at the partnership's place of business or at its principal place of business if it has more than one. In the Consultation, the government expressed interest in views on whether there is a case for all limited partnerships to be required to prepare accounts and reports in line with the requirements for private companies. Based on the evidence submitted, the Response notes that the government does not consider the case has been made for this requirement. However, it intends to introduce a requirement for all limited partnerships to file a confirmation statement at least every 12 months for the purpose of confirming all details on the register are correct (a requirement that is already mandatory for SLPs).

An ELP is not required to appoint a local secretary, or local service providers such as an administrator or custodian unless the ELP is an 'alternative investment fund' (an AIF) as defined under the AIFMD, and its 'alternative investment fund manager' (AIFM) as defined under and for the purposes of the AIFMD is an EU full scope AIFM, in which case its AIFM is required to be authorised under the AIFMD and comply with all substantive requirements under the AIFMD including the requirement to ensure that the ELP appoints an independent depositary (from a list of permissible types of firms or institutions) who shall be established in the same European Economic Area (EEA) member state as the EEA AIF (although until 22 July 2017, regulators had the discretion to allow such depositary to be established in another EEA member state). The AIFMD depositary shall perform specific functions and shall have certain responsibilities pursuant to the AIFMD. A 'depo-lite' may also be required by regulators in certain EEA member states (such as Germany and Denmark) when a non-EEA AIFM registers in such EEA member states for marketing purposes under article 42 AIFMD.

### 4 Access to information

**What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?**

Members of the public can access and request copies of information filed with the Registrar including Forms LP5 and LP7 (for registering a limited partnership) and LP6 and LP8 (for making changes to a limited partnership). As noted in question 2, changes to the partner composition of an ELP must be notified to the Registrar. An ELP that qualifies as an AIF and is managed by an EEA AIFM or marketed in the EEA by a non-EEA AIFM will be subject to certain reporting to the relevant regulator (the EEA regulator where the EEA AIFM is authorised or in the case of a non-EEA AIFM, where a non-EEA AIFM is registered for marketing purposes). Although information filed with the FCA for authorisation and registration purposes must generally be kept confidential (subject to limited statutory exceptions), certain EEA regulators may give access to certain information filed for registration purposes.

Since April 2016, certain UK legal entities are obliged to maintain a register of persons with significant control (a PSC register). Although this obligation does not apply to ELPs, SLPs are required to maintain a PSC register that is accessible to the public.

With effect from 1 January 2016, UK 'financial institutions' (as defined for the purposes of the OECD's Common Reporting Standard (CRS) and so including many ELP fund vehicles) are required to undertake due diligence on their investors and account holders and, from January 2017, to report such information to the UK tax authorities (HMRC). The information is exchanged with tax authorities in other countries and enables the UK to meet its obligations under bilateral information exchange agreements that implement the CRS. Implementation of the CRS has also occurred in a number of other jurisdictions, although the US has not yet implemented the rules. As of November 2018, the UK had automatic exchange relationships with over 60 jurisdictions.

Council Directive (EU) 2018/822 (amending Directive 2011/16/EU) (DAC 6), which came into force on 25 June 2018, imposes obligations on EU intermediaries (including, among others, law firms, accounting



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firms and banks) and, in some cases, taxpayers, to disclose certain information on cross-border transactions to the relevant tax authority if certain 'hallmarks' are met. The scope of DAC 6 is extremely broad and it is anticipated that it will require disclosure of a wide range of arrangements. At present, there is uncertainty as to how the rules will apply, including how they will apply to transactions involving private equity funds. Each EU member state must implement DAC 6 into domestic law by the end of 2019. The first disclosures under DAC 6 will be required in 2020, applying to any reportable arrangements taking place on or after 25 June 2018.

### 5 Limited liability for third-party investors

**In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?**

The LPA 1907 provides that an LP who takes part in the management of the business of an ELP will lose its limited liability and will become liable for the debts of the partnership during the period of their involvement as a GP. An LP may at any time, without forfeiting its limited liability, inspect the ELP's books and may examine the state of the business and may 'advise with' other partners on such matters. In contrast to limited partnership legislation in other jurisdictions such as Jersey and Guernsey, the LPA 1907 does not specify which activities will not constitute an LP's participation in the management of the business of the limited partnership. Care needs to be taken when considering the LP's rights under the LPA and participation by LPs in advisory committees to ensure that the LP does not fall within the scope of 'management', especially in the context of LPs having a representative on an ELP's advisory committee. LPs will typically ask the GP's legal counsel to provide a legal opinion stating that the LP's participation as an LP pursuant to the applicable LPA and (as the case may be) its representative participation as a member of the advisory committee will not endanger such LP's limited liability. The LRO helpfully contains a non-exhaustive 'white list' of activities that an LP in a PFLP may undertake without being considered to take part in the management of the business and therefore without losing its limited liability, such as:

- taking part in a decision about:
  - the variation of, or waiver of a term of, the partnership;
  - whether the general nature of the partnership business should change;
  - whether a person should become or cease to be a partner; and
  - whether the partnership should end or the term of the partnership should be extended;
- appointing a person to wind up the partnership;
- reviewing or approving a valuation of the partnership's assets;
- discussing the prospects of the partnership business;
- consulting or advising with a general partner or any person appointed to manage or advise the partnership about the affairs of the partnership or about its accounts;
- taking part in a decision regarding changes in the persons responsible for the day-to-day management of the partnership;
- appointing or nominating a person to represent the limited partner on a committee, authorising such a person to take any action in that capacity that would not involve taking part in the management of the partnership business if taken by the limited partner, or revoking such an appointment or nomination; and
- taking part in a decision approving or authorising an action proposed to be taken by a general partner or another person appointed to manage the partnership, including in particular a proposal in relation to:
  - the disposal of all or part of the partnership business or the acquisition of another business by the partnership;
  - the acquisition or disposal of a type of investment or a particular investment by the partnership;
  - the exercise of the partnership's rights in respect of an investment;
  - the participation by a limited partner in a particular investment by the partnership; and
  - the incurring, extension, variation or discharge of debt by the partnership.

The government has indicated that the white list is intended to cover, in particular, employees of the GP who are invested in the PFLP themselves as LPs and institutional or high-net-worth investors who take a strong interest in the fund, including LPs who are on an LP advisory committee. The white list is not exhaustive and the creation of the white list does not mean that the activities on the list are permissible for LPs by right. The white list also does not intend to enable limited partners in PFLPs to carry out activities that would otherwise not be permitted under the LPA.

In contrast to the limited partnership legislation of other typical fund formation jurisdictions such as Jersey and the Cayman Islands, the LPA 1907 does not permit a partner to draw out or have its capital returned to it during the lifetime of the ELP. A partner that draws out or receives back a part of its capital shall be liable for the debts and obligations of the limited partnership up to the amount so drawn out or received back. The effect of this provision is that the partner potentially remains liable to recontribute to the partnership an amount up to the amount of the capital withdrawn. Clearly, this prohibition on returning capital to partners during the life of an ELP is impractical in the context of a private equity fund. The fund needs to be able to distribute the proceeds of investments. Consequently, a partner's commitment to an ELP is typically structured such that amounts contributed by partners are separately classified as an initial capital contribution (typically a nominal sum) made upon admission to the ELP (which will not be returned until the ELP is dissolved), with the remainder of a partner's commitment being structured as an advance or 'loan' to the ELP, which is subsequently drawn down by the GP as and when needed to fund investments and partnership expenses and is repaid to the partners from the proceeds generated by investments. This split of a partner's commitment into capital and loan advances represents an idiosyncrasy unique to UK partnership law. The government recognised that this restriction on the return of a partner's capital contribution creates unnecessary complexity and impracticality in the context of private equity fund structuring. As such, under the LRO, an LP of a PFLP is not required to make a capital contribution, though the option will remain (for example, there may be tax or regulatory advantages in other jurisdictions). Capital that is contributed to a PFLP is withdrawable and there is no requirement to declare capital contributions to the Registrar. Where a limited partnership was formed before the implementation of the LRO, capital contributed before any redesignation as a PFLP will be treated as under the former regime; capital contributed after the limited partnership is redesignated will then be treated in accordance with the new regime.

### 6 Fund manager's fiduciary duties

**What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?**

The concept that every partner in a partnership owes a duty of good faith is a cornerstone of the English law on partnerships and applies equally to partners in an ELP as to partners in an ordinary partnership. Subject to any agreement to the contrary, a non-partner manager of an ELP who exercises discretionary management functions will also owe fiduciary duties to the partners of the ELP.

The courts have found that in addition to any specific contractual obligations owed, there is an overarching duty to act in good faith and to act in a fair and honest manner with your partners. GPs are under an obligation to act in the best interests of the ELP; where a GP has not obtained the prior permission of its partners, it must account for any benefit derived from an transaction involving the partnership and must not act in a manner which is contrary to the best interests of the partnership including obtaining a secret profit of personal advantage or allowing its interests to conflict with duties owed to his or her partners. LPs in ELPs have a duty to render accounts and account for profit from competing businesses (although this duty is typically disapplied in the LPA). LPs in PFLPs do not have the same duty.

The scope of certain fiduciary duties may be modified or potentially even excluded under English law. It is unclear, however, whether fiduciary duties can be completely excluded under English law. Such



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a limitation or exclusion must be within the limits imposed under the common law and under relevant legislation. In any event, it is likely to be commercially unacceptable to LPs for a GP to attempt to exclude fiduciary duties. Certain duties, such as the duty to act honestly and in good faith, are considered inherent within English partnership law. Moreover, it is not possible under English law to exclude liability for deliberate breach of fiduciary duty, fraud or bad faith.

The GP of an internally managed ELP or the external AIFM of an ELP, who is authorised in an EEA member state as an AIFM will also have to comply with the specific duties applicable to it under the AIFMD, including the duty to act honestly, with due skill, care and diligence and fairly, the duty to act in the best interests of the AIF or the investors of the AIF they manage and the integrity of the market, the duty to employ effectively the resources and procedures that are necessary for the proper performance of their business activities, the duties to treat all AIF investors fairly, disclose preferential treatments and take all reasonable steps to avoid conflicts of interest.

### 7 Gross negligence

**Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?**

Under English law there is no recognised concept of 'gross negligence' as distinct from 'ordinary negligence'. The concept typically arises in contractual drafting whereby the GP will seek to limit or exclude liability to the partnership for losses arising as a result of the GP's ordinary negligence and LPs will seek to ensure that the indemnity granted to the GP, any fund manager or any of their respective affiliates for losses or damages caused as a result of their actions does not extend to gross negligence. Gross negligence implies a level of severity greater than ordinary negligence and modern case law indicates that, where a contract expressly refers to gross negligence, the courts of England and Wales will typically seek to understand the parties' intention behind the use of the term gross negligence as distinct from ordinary negligence. The term is a matter of interpretation and its meaning will depend, each time, on the wording and context of the contract as a whole. The courts have thus far not provided a definitive determination of the concept of gross negligence under contract law as distinct from negligence, however, it has previously been found that gross negligence is clearly intended to represent something more fundamental than failure to exercise proper skill. Certain practitioners have sought to include a specific definition of gross negligence within certain contractual documentation governed by English law or have sought to define the concept by reference to the meaning given under the law of a foreign jurisdiction, such as the law of the state of Delaware.

### 8 Other special issues or requirements

**Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?**

The legislation underpinning ELPs (the LPA 1907 and the PA 1890) does not provide for the conversion of a foreign fund into an ELP. Practically, such conversion would have to be effected by the creation of a new ELP and the transfer or contribution of assets from the existing foreign fund to the GP of the ELP or a nominee, in each case to hold on trust for the ELP given the ELP's absence of separate legal personality. The vast majority of terms governing an ELP can be determined contractually by the parties through a documented and prescriptive LPA. Given the limited statutory application to ELPs, an ELP can be established on substantially the same terms as those applying to foreign limited partnerships.

Notwithstanding the above, there are certain idiosyncrasies in the LPA 1907 that are not found in equivalent foreign limited partnership legislation. Such quirks will need to be accommodated in the LPA of an ELP. For instance, as noted above, the prohibitions on returning capital to partners during the life of an ELP (excluding PFLPs) contained in the LPA 1907 leads to a bifurcation of a partner's commitment to an ELP into a small, nominal capital contribution and a much larger 'loan' that is advanced to the partnership. Secondly, for certain tax purposes ELPs have, in the past, typically been structured so that the GP receives a 'priority profit share' that is then 'on-paid' to the fund manager, rather than the fund manager receiving a management fee from the ELP; see questions 21 and 23 for further information and reasons why this arrangement may now become less common.

### 9 Fund sponsor bankruptcy or change of control

**With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?**

Under the LPA 1907, the death or bankruptcy of an LP will not cause the automatic dissolution of an ELP. Insolvency or winding-up provisions are commonly included in the LPA to provide for an orderly dissolution of an ELP. If the GP becomes insolvent, many LPAs give LPs the ability to appoint a new GP or terminate the ELP. Given that GPs have unlimited liability for the debts of an ELP under LPA 1907, ELPs are typically structured so that the GP is a corporate vehicle with limited liability and the fund manager is a separate entity affiliated with the GP, so as to prevent the fund manager being held liable for the debts of the ELP.

A fund manager based in the UK that provides portfolio and risk management functions to funds qualifying as AIFs, is required to be authorised by the Financial Conduct Authority (the FCA) as an AIFM pursuant to the AIFMD. A UK asset manager who is not acting as an AIFM of the ELP but provides advisory, management or other regulated services as a sub-adviser or delegate of the AIFM or operates individual managed accounts will be required to be authorised by the FCA under the Markets in Financial Instruments Directive II (MiFID II).

Such authorised UK AIFMs and asset managers will also be subject to the UK statutory regime for change in control of UK authorised firms, which is set out in Part XII of FSMA and supplemented by FCA change in control rules. These requirements require any person seeking to acquire 'control' in a UK authorised AIFM or asset manager to obtain the prior consent of the FCA before doing so. Failure to obtain the FCA's consent is a criminal offence. 'Control' for these purposes broadly encompasses any acquisition of 10 per cent of shares or voting power, or significant influence over the management of the AIFM or asset manager (the threshold may be 20 per cent for some AIFMs, depending on the type of licence). The application process requires the submission of detailed information and can take two to six months. A change of control may also likely qualify as a material change to the conditions for initial authorisation of a UK AIFM and require a specific notification with the FCA.

## Regulation, licensing and registration

### 10 Principal regulatory bodies

**What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the regulators' audit and inspection rights and managers' regulatory reporting requirements to investors or regulators?**

ELPs are not in and of themselves regulated entities. Instead, the focus of UK fund regulation is on the fund manager. As noted in question 9, UK-based fund managers that provide portfolio and risk management functions to AIFs are required to be authorised by the FCA as AIFMs. The AIFMD imposes substantive regulatory obligations on AIFMs, including rules relating to internal capital adequacy requirements, regulatory and investor reporting, ensuring that each AIF it manages appoints a depositary and restrictions on remuneration of employees of the AIFM, among others. As FCA authorised and regulated entities, UK AIFMs are subject to the FCA's conduct of business rules and general FCA principles of business, including the requirement to deal with the FCA in an open and cooperative manner.



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There is a lighter AIFMD regulatory regime for sub-threshold AIFMs, meaning AIFMs that manage portfolios of AIFs which, in aggregate, do not exceed €100 million or, in the case of AIFs that are unleveraged and have no redemption rights exercisable within the first five years of the AIF (ie, typical private equity funds), €500 million. To the extent an AIFM manages assets on behalf of AIFs that combine both these types of AIF, the aggregate threshold of €100 million should be applied when determining whether an AIFM can be classified as a sub-threshold AIFM. While sub-threshold AIFMs do benefit from a lighter touch regulatory regime under the AIFMD, they are not able to take advantage of the AIFMD marketing passport, meaning that they have to comply with the individual national private placement regime (NPPRs) of each EEA member state. NPPRs are not uniformed across the EEA member states and are particularly onerous in some of them. For this reason, many sub-threshold AIFMs have decided to 'opt up' to full-scope AIFM status.

AIFMs that operate individual managed accounts and provide related services such as investment advice will need additional permissions from the FCA for these activities and are subject to additional regulatory requirements (derived from MiFID II) in connection with these activities. Depending on the AIFM's regulatory classification, additional regulatory requirements under MiFID II potentially include requirements to comply with provisions on transaction reporting, transaction recording, product governance, trade transparency and client classification rules.

The FCA relies heavily on authorised firms to provide information to it but reserves the right to visit, inspect and evaluate the compliance of authorised firms, typically through thematic reviews (which focus on specific industries, for instance, asset management or retail banking), or as part of its general supervisory remit. The FCA is also able to take action at a firm-specific level where it has specific concerns about a particular regulated entity. Some larger or higher risk firms (or both) are also proactively supervised by the FCA on a 'relationship managed' basis.

While the FCA is the primary regulator of UK-based fund managers, other regulators such as the Prudential Regulation Authority (PRA) may have regulatory oversight of certain large investment firms that pose prudential risks to the economy. AIFMs that are part of the same group as these entities or banks may be subject to prudential supervision on a consolidated basis by the PRA.

### 11 Governmental requirements

**What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?**

An FCA authorised AIFM must notify the FCA of its intention to market an ELP to investors domiciled or with a registered office in the UK. If such AIFM wishes to market an ELP on a cross-border basis into other EEA member states under the AIFMD marketing passport, the AIFM must notify the competent authority of the EEA member states into which the AIFM wishes to 'passport' the ELP and the FCA will in turn transmit this information to the competent authorities of the relevant EEA member states. The AIFMD marketing passport is not available to FCA authorised AIFMs that manage AIFs that are not registered in an EEA member state (for instance, a Cayman exempted limited partnership). In this circumstance, the FCA authorised AIFM will need to comply with each relevant EEA member state's NPPR (where available) in the same way that an AIFM not based in an EEA member state would be required to.

### 12 Registration of investment adviser

**Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?**

UK-based entities providing portfolio and risk management to AIFs are required to be authorised and regulated by the FCA as AIFMs (see question 10). Authorisation as an AIFM incorporates permission for the provision of investment advice in connection with the AIFs for which the manager carries on portfolio and risk management functions. Provision of investment advice in connection with investments other than AIFs managed by the AIFM is a separate regulated activity, as is the management of individual portfolio accounts. Entities carrying on portfolio management, providing investment advice in relation to investments other than AIFs managed by them, or arranging deals in investments (including funds) other than in connection with AIFs, must be authorised by the FCA to provide these services and regulated by the FCA on an ongoing basis, in compliance with the rules applicable under MiFID II.

The process for becoming authorised by the FCA, either as an AIFM or an asset manager, is a lengthy and resource-intensive exercise. FCA authorised entities are subject to a significant volume of rules, including the FCA Principles for Businesses and the FCA's Conduct of Business rules. The FCA requires that persons proposing to carry out controlled functions on behalf of an FCA authorised firm have to be 'fit' and 'proper' to carry out such functions. Such functions include acting as a chief executive, director or partner, money laundering reporting officer and chief compliance officer of an FCA authorised firm. Such persons must be approved by the FCA to perform the controlled functions in question and are subject on an ongoing basis to the FCA's Code of Conduct for Approved Persons and the Statement of Principles for Approved Persons. The FCA needs to be satisfied that persons proposing to carry out controlled functions on behalf of an FCA authorised firm have adequate knowledge and experience to carry out such functions. In recent years, the FCA has placed special emphasis on the integrity and honesty of persons carrying out controlled functions within the financial services industry, in a bid to improve the culture of regulated firms generally. This has resulted in the implementation of new rules for senior management and other key staff within banks and it is anticipated that similar reforms will be implemented for AIFMs and other investment firms from 2019.

### 13 Fund manager requirements

**Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?**

See questions 10 and 12.

### 14 Political contributions

**Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.**

There are no UK rules or regulations (other than rules applicable generally in the UK in relation to political donations, (as well as general UK anti-bribery laws)) that oblige a private equity fund's manager or investment adviser to disclose political contributions made by it.

### 15 Use of intermediaries and lobbyist registration

**Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities. Describe any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities.**

There are no UK rules that restrict or oblige a private equity fund's manager or investment adviser to disclose the engagement of placement agents, lobbyists or other intermediaries in the marketing of a private equity fund to public pension plans and other governmental entities, although the FCA may require details of placement agents and marketing activity as part of its supervisory remit. In addition, where an AIFM seeks to market an AIF to UK investors, the FCA's notification form for this purpose requires disclosure to the FCA of the identity of any placement agents engaged to market the fund to UK investors. In addition, article 23 AIFMD requires EEA authorised AIFMs or non-EEA AIFMs



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marketing to EEA investors to disclose certain information prior to closing, including the identity of service providers, which may include an appointed placement agent. Such disclosures are typically included in the private placement memorandum. Even when these requirements do not apply, the fact that a placement agent has been engaged (and the placement agent's identity) is usually disclosed in the private placement memorandum of the relevant fund or separately disclosed to investors in responses to due diligence questionnaires. These more detailed responses increasingly include detailed disclosure of the basis on which the placement agent or lobbyist is remunerated.

### 16 Bank participation

**Describe any legal or regulatory developments emerging from the recent global financial crisis that specifically affect banks with respect to investing in or sponsoring private equity funds.**

Since the financial crisis there have been a high number of legal and regulatory developments that may directly or indirectly affect banks' ability or appetite for sponsoring or investing in private equity funds. The EU prudential framework under the Capital Requirements Directive and Capital Requirements Regulation (CRD IV) contains capital and liquidity requirements associated with fund investments, which are potentially of direct relevance.

CRD IV, the fourth iteration of the EU's prudential framework rules, was adopted in July 2013 and has applied since January 2014. CRD IV aims to implement Basel III within the EU, as well as EU-specific reforms on remuneration and governance. The rules under CRD IV governing capital treatment of private equity investments are highly complex and depend upon (among others) the extent of the bank's participation in a particular fund and in funds generally, as well as the type of fund. The starting position is that private equity investments must be deducted from capital, although this is subject to some limitations and more favourable capital treatment may in some cases be available for certain venture capital investments above certain participation thresholds. Private equity investments that are not deducted from capital must generally be risk weighted at 150 per cent under the 'Standardised Approach' (for less sophisticated banks) or at 370 per cent or (for sufficiently diversified funds) 190 per cent under the 'Internal Ratings Based' approach (for more sophisticated banks). Recent proposals from the EU authorities published in November 2016 indicate that the future capital treatment of risk-weighted fund investments will depend increasingly on the types of underlying fund investments and the level of transparency for banks on the underlying investments.

CRD IV also introduced quantitative requirements on liquidity, which will impose a liquidity cost on banks' holdings in funds for which commitments may be called within 30 days or less. Future changes to CRD IV will also result in the implementation of quantitative requirements on leverage and stable funding (anticipated to become effective from 2019), which may also result in increased costs associated with private equity investments.

A further issue for banks and the funds in which they invest is the potential for banks' liabilities (which could include liabilities to funds) to be 'bailed in' in the event that the bank becomes subject to a statutory resolution process under the Bank Recovery and Resolution Directive (BRRD). This may include the write down or conversion into equity of banks' unsecured liabilities. Article 55 of the BRRD requires that liabilities within the scope of the BRRD's bail-in powers, but governed by the law of a third country, include a contractual term stating that the liability may be subject to write-down and conversion powers of the relevant resolution authority (in this case the Bank of England). Carve-outs may apply, however, for some liabilities where certain criteria (including impracticability) are met.

## Taxation

### 17 Tax obligations

**Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.**

A private equity fund formed as an ELP should not normally be treated as a separate taxable entity for UK tax purposes. There should therefore be no UK withholding taxes on distributions to investors and the ELP should not be subject to UK tax on income and gains from its investments. Instead, for UK tax purposes, investors in the fund should be regarded as holding their proportionate share of the fund's income and gains as determined in accordance with the fund's profit sharing arrangements. UK taxable investors will be subject to UK tax on their allocations from the fund in accordance with their personal tax positions.

### 18 Local taxation of non-resident investors

**Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?**

Generally speaking, the investment strategy of most private equity funds is such that they should be regarded as carrying on an investment business rather than trading for UK tax purposes (though the strategy of some funds is less clear in this regard). Provided the fund is regarded as investing rather than trading for UK tax purposes non-UK resident investors should not, except in relation to UK land (see below), be subject to UK tax on their proportionate share of income and gains of the fund unless the non-UK resident investor holds its interest in the fund in connection with or for the purposes of a trade carried on by it in the UK through a UK branch, agency or permanent establishment.

Assuming that draft legislation in Finance Bill 2019 is enacted, from 6 April 2019 non-UK resident investors will be subject to UK capital gains tax (or, in the case of companies, corporation tax on chargeable gains) on the disposal of interests in UK land, and the disposal of shares and certain other interests in 'property-rich' companies (those that derive at least 75 per cent of their value from UK real estate), where the person making the disposal holds, or has held in the past two years, a 25 per cent or greater interest in the company. The taxable gain will be limited to the proportion of the gain arising from 6 April 2019 onwards, unless the taxpayer elects otherwise. The draft legislation also includes an exemption for gains arising from certain disposals of interests in UK property rich companies where the property is used for the purposes of a qualifying trade.

The draft legislation also contains a separate regime for UK property-rich collective investment vehicles, including real estate investment trusts, collective investment schemes and alternative investment funds.

Otherwise, a non-UK resident investor should only be subject to UK tax in respect of its participation in the fund to the extent of any UK tax deducted at source from UK source income (such as interest), if any, received by the fund. Investors resident outside the UK may be entitled, with regard to UK tax deducted from their apportioned share of any UK source income, to the benefit of any double taxation agreement between their country of residence and the UK.

The fund may be required to file a UK partnership tax return and non-UK resident investors will be required to provide basic details to the fund and register with the UK tax authorities in order to comply with any such requirement. Certain simplifications in respect of filing requirements were made in 2018: for returns from the 2018-19 tax year onwards, partners need not provide a UK tax reference if they are not chargeable to UK tax in the relevant period, the partnership did not carry on a trade, profession or UK property business in the relevant period and the whole of the relevant period is one in which the partnership is required to report information about the partner under certain international information reporting regimes. The Finance Act 2018 also included legislation intended to clarify certain other aspects of



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partnership taxation, including legislation dealing with the situation where partnerships have partners that are themselves partnerships.

**19 Local tax authority ruling**

**Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?**

It is not typical for private equity funds or their participants to obtain rulings from HMRC in relation to their treatment. There are no special rules applicable to investors in a UK private equity fund. However, it should be noted (as discussed in question 21) that the UK government has introduced rules specifically focused on the taxation of carried interest holders and those who perform investment management services for the fund.

**20 Organisational taxes**

**Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?**

There are no such organisational taxes payable by ELPs.

**21 Special tax considerations**

**Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.**

Carried interest arrangements for UK private equity sponsors have typically been structured using a carry limited partnership (referred to as the Carry LP, often an SLP), which is admitted as an ELP partner. Each participant's share of carried interest is delivered through an interest in the Carry LP. Accordingly, historically, subject to points in relation to the taxation of employees mentioned below, the UK taxation of participants in the Carry LP generally followed that which would apply to any other UK-resident investor in the fund. The carry participants' share of the fund's income and gains would be subject to UK income or capital gains tax according to the nature and character of the carried interest receipt (ie, whether it represented income – such as dividends or interest – or capital gains from investment realisations) and the individuals' personal circumstances. However, the UK tax landscape applicable to private equity fund executives has changed significantly in recent years.

In April 2015, the UK government introduced the disguised investment management fee rules which, broadly speaking, charge to tax as income everything arising to an individual who is providing investment management services in the UK to a collective investment scheme unless the amounts fall within legislative exemptions for carried interest or genuine arm's-length co-investment. These changes were focused on structures designed to 'stream' part of what was in effect the regular management fee from the fund to the management team so that it was received by individuals as a profit share from the underlying fund (and so potentially subject to capital gains tax – the highest marginal rate of which applicable to carried interest is currently 28 per cent – as opposed to income tax – the highest marginal rate of which is currently 45 per cent). The rules are intended to ensure that 'management fee' type remuneration received by fund managers, in whatever form, should be subject to income taxation.

For those elements of remuneration that remain subject to capital gains tax (see above) additional rules were introduced in July 2015 to remove the benefit of 'base-cost shift'. This was an arrangement by which UK-resident recipients of carried interest could, broadly, reduce the amount of their taxable capital gains by reference to costs borne economically by other investors. Furthermore, for non-domiciled UK tax residents the chargeable gain will now be treated as UK source to the extent the individual performs his or her investment management services for the relevant fund in the UK, meaning that, to the extent of their UK activities for that fund, such persons may be subject to capital gains tax on carried interest whether or not remitted to the UK.

Additionally, in April 2016 the UK government introduced legislation (the 'income-based carried interest' rules) to restrict the capital gains tax treatment of carried interest and other performance linked rewards received by UK residents and other individuals performing investment management services in the UK through a UK permanent establishment. This reflects a policy objective that capital gains tax treatment should be restricted to performance-linked rewards arising from long-term investment activity only. Under the new rules carried interest arising on or after 6 April 2016 can only be fully eligible for capital gains tax treatment (where such treatment would otherwise be available) if the average weighted holding period (AWHP) of the investments by reference to which the carry is calculated exceeds 40 months. If the AWHP does not exceed 36 months, all of the carried interest will be treated as 'income based carried interest' (subject to income tax and self-employed individuals' national insurance contributions). If the AWHP is between 36 and 40 months, a graded scale of eligibility for capital gains tax treatment will apply. Complex rules apply the AWHP test differently in certain circumstances, including in relation to direct lending funds, funds that invest in controlling and significant stakes of unquoted trading businesses, venture capital and real estate funds and in respect of carried interest arising in the early years of the fund.

Carry participants who are employees (or members of a UK limited liability partnership (LLP) who are regarded as employees for UK tax purposes) are generally subject to the UK's 'employment related securities' regime in respect of their carried interest. Under these rules, charges to UK income tax and national insurance contributions can arise if the amount paid for the carried interest is less than its 'unrestricted market value' at the time of its acquisition (ie, ignoring restrictions placed on the interest). The British Private Equity and Venture Capital Association (BVCA) and HMRC have, however, agreed a memorandum of understanding (MOU) with respect to the application of these rules to carried interest. If the carried interest arrangements relating to the fund are consistent with those in the MOU, HMRC will accept that the unrestricted market value of the carried interest acquired by an employed participant is equal to the amount actually paid for such interest (often nominal), assuming the interest is acquired on formation of the fund. Such participants should not then be subject to employment income taxation on the acquisition of the carried interest or in respect of their returns. Where, owing to the particular carry arrangements, the MOU is not thought to provide sufficient comfort, participants can also make a joint tax election with their employer (known as a section 431 election) the broad effect of which is to ensure future carry returns should not be subject to employment income taxation. Employed carried interest participants are outside the current scope of the income based carried interest rules discussed above.

Those involved in the structuring of fund sponsor incentives should also be alive to the two partnership anti-avoidance regimes introduced by the UK government in 2014, namely the LLP 'salaried member rules' and the legislation concerning the allocation of profits and losses in partnerships with mixed individual and non-individual members.

One other recent consideration for some UK general partners relates to the fact that they are often loss-making in the early years of a fund when their management fee expense exceeds the income generated through their profit share. Those losses have traditionally been useful in sheltering tax in later years when the profit share from the fund exceeds management fees. However, under rules having effect from April 2017, there is a restriction on the set-off of carried-forward losses, permitting them only to be set against 50 per cent of total profits exceeding an annual allowance of £5 million. The UK government has confirmed, following discussion between the BVCA and HMRC on the impact of these provisions on UK general partners, that no exclusion from the restrictions for the losses of UK general partners will be introduced. A possible workaround the BVCA has identified, for new funds or existing funds that are able to reorganise their structure for future years, is that if the ELP itself were to appoint the manager and pay the management fee directly to the manager (with the UK general partner not receiving a priority profit share), the UK general partner would no longer make profits or losses to which the rules would apply (but note the VAT consequences discussed in question 23).

**22 Tax treaties**

**Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.**

In relation to the fund itself, an ELP is not typically able to rely on UK tax treaties as it is not a taxable entity for UK tax purposes. The UK does, however, have an extensive network of tax treaties with various jurisdictions that may be relevant in relation to downstream investment



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structuring including in relation to assets that generate UK source income. The availability of treaty relief for entities owned by investment funds should, however, be considered in light of the amendments to double tax treaties to be introduced by the OECD's multilateral instrument, discussed in question 23.

### 23 Other significant tax issues

**Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?**

Typically, in the UK, private equity funds do not qualify as special investment funds, the management of which is exempt from VAT. Investment management (and, if applicable, advisory) fees may therefore be chargeable to UK VAT (at 20 per cent). However, (as discussed above) ELPs have, in the past, generally been structured so that the GP receives a priority profit share (not subject to VAT on first principles) rather than a management fee, with a separate investment manager receiving a management or advisory fee that is paid out of the GP's profit share (though see the discussion of the restrictions on carried-forward losses introduced in April 2017 in question 21: funds with a UK general partner may now wish to have the ELP itself paying a management fee, with the UK general partner not receiving a priority profit share). The ELP is typically then organised with a GP in an 'offshore' jurisdiction (such as Delaware or Jersey) so that such fee may be paid outside the scope of VAT or, alternatively, the UK fund manager and its UK subsidiary (acting as the GP of the fund) form a VAT group with the result that there is no supply between those entities for VAT purposes. Where the 'offshore' GP route is followed, it is of course necessary to maintain sufficient substance in the chosen jurisdiction and to consider the GP structure in light of the Accounts Regulations (see question 3).

Where a UK general partner receives no priority profit share and the management fee is instead paid directly by the ELP (see the discussion of the restrictions on carried-forward losses in question 21), that fee would be subject to VAT, unless the ELP and the manager are in the same VAT group and, as a result, there is no supply between those entities for VAT purposes.

In certain circumstances, a written instrument of transfer relating to an interest in an ELP may be subject to UK stamp duty where the interest is being transferred by way of sale. The amount of stamp duty payable should be limited to 0.5 per cent of the market value of any stock or marketable securities held by the fund.

Readers may be aware that the global tax landscape is in a state of change in light of the OECD's Base Erosion and Profit Shifting (BEPS) project. The UK government has already implemented UK laws designed to address certain practices that form the subject of the project (such as the 'diverted profits tax', the 'hybrid mismatch' rules and a limit on corporate interest expense deductions). In November 2016, the OECD also published a multilateral instrument (MLI) designed to enable all OECD countries to meet the treaty-related minimum standards that were agreed as part of the final BEPS package, including changes to the manner in which the entitlement to benefit from double tax treaties is determined and permanent establishments are recognised. The MLI has now been signed by at least 80 countries and entered into force in the UK on 1 October 2018. The MLI has effect in relation to a particular treaty where it has also come into force for the other country which is party to the treaty, and will apply to these treaties with effect from January 2019 for withholding taxes, and April 2019 for corporation tax, income tax and capital gains tax. It will be important to consider the MLI and other BEPS related legal changes in relation to both fund and downstream investment structuring and management.

Also of note for funds investing in the UK are some changes that have been made to the UK's participation exemption for the sale of 'substantial shareholdings' (the SSE). The changes include relaxation of the SSE rules where the UK entity making the disposal is owned (directly or indirectly) by 'qualifying institutional investors' (including pension schemes, sovereign wealth funds and certain UK authorised and retail funds).

A further tax-related law in the UK that funds and their portfolio companies need to be aware of and react to is the introduction from the end of September 2017 of new criminal offences for failure to prevent the criminal facilitation of tax evasion. The new law can expose UK companies and partnerships (and some non-UK companies and partnerships) to unlimited fines, and ancillary orders such as confiscation orders, if their employees, agents and some service providers criminally facilitate UK or non-UK tax evasion while acting in their capacity as employee, agent or service provider. Since the offences are 'strict liability' in nature (ie, they do not require any knowledge or intention), it will be important to ensure that steps are taken to access the defence of having reasonable prevention measures in place.

## Selling restrictions and investors generally

### 24 Legal and regulatory restrictions

**Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.**

Except for publicly listed funds (see question 29 for more details), private equity funds are typically offered to a limited number of sophisticated, largely institutional investors in the UK by way of private placement.

The term 'marketing' is defined under the AIFMD as 'a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union'. Marketing activities conducted by placement agents are considered to be carried out 'on behalf' of an AIFM and therefore are caught by the AIFMD marketing rules and restrictions.

Given that marketing has to be either 'at the initiative or on behalf of the AIFM', contact initiated by investors should not, by definition, be considered marketing and therefore should not be subject to the AIFMD marketing restrictions. The concept of 'reverse solicitation' is recognised in the AIFMD and by European regulators. However, there is no definition of or specific guidance on this concept at European level and the approaches taken by regulators at member states level differ from jurisdiction to jurisdiction. The FCA applies a narrow concept of marketing and has provided a helpful guidance specifying that a confirmation from the investor that the offering or placement was made at its initiative should normally be sufficient to demonstrate a reverse solicitation, unless it is used to circumvent the application of the AIFMD.

The definition of marketing under the AIFMD also provides for investors being 'offered' units in AIFs. This has given rise to the question of what activities are permissible before an AIFM is deemed to be 'marketing', within the scope of the AIFMD. It would be impractical for AIFMs to have to comply with the AIFMD before they have been able to gauge whether there is any investor appetite for their fund in a particular EEA member state. The concept of 'pre-marketing', like reverse solicitation, is a nebulous concept and each AIFMD regulator takes a differing view. In the UK, for instance, where the concept of marketing is narrow, it is generally permissible for AIFMs to discuss an AIF with investors and distribute pitch books, draft fund documents (such as a draft LPA and draft private placement memorandum) until such fund documents are substantially final without being considered 'marketing' and therefore triggering the application of the AIFMD. However, most other EEA member states have a broader concept of marketing and marketing starts as soon as any type of communication is circulated to potential investors that identifies the fund and its strategy.

The European Commission has published legislative proposals for a regulation and a directive amending the current regulatory frameworks for cross-border distribution of funds within the EEA. While the proposals are in principle designed to ensure a level playing field among different categories of funds, and to facilitate the cross-border distribution of funds, they have the potential to create the opposite effect for non-EEA funds and fund managers by limiting the scope of permitted 'pre-marketing'. The European Commission intends to address the current diverse approach to what activities constitute 'pre-marketing' across member states by defining that term within the amended AIFMD, and by setting out a series of conditions under which an EEA AIFM can engage in pre-marketing activities. It is unfortunate, however, that the Commission has chosen to pursue harmonisation in line with the most restrictive of the current national approaches and to introduce this as the mandatory benchmark across the EEA by defining pre-marketing as a 'direct or indirect provision of information on



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investment strategies or investment ideas by an AIFM or on its behalf to professional investors domiciled or registered in the Union in order to test their interest in the AIF which is not yet established'. This would mean that non-EEA AIFMs would be considered marketing at a far earlier stage in the fundraising process and would be required to register under NPPRs having only had a limited opportunity to gauge interest from EEA investors.

In addition to the foregoing, an AIFM will have to register for marketing purposes for an investor to whom it has pre-marketed within the preceding 18 months and pre-marketing activities need to be documented and the documents provided upon request to the competent authorities. The proposals also contain further provisions to specify that investments made by professional investors in an established AIF following the permitted pre-marketing or an AIF managed or marketed by the EEA AIFM that had engaged in pre-marketing of a not-yet established AIF with similar features, shall be considered the result of marketing. While it was already market practice to consider that pre-marketing a specific fund to investors precludes subsequent reliance on reverse solicitation with respect to that fund, the proposal would also preclude any reverse solicitation with respect to any fund with the same or a similar strategy as the one that was the subject of the pre-marketing. This would appear to restrict the availability of reverse solicitation for any investors in prior funds, which tends to be a key source of genuine reverse enquiry requests. This proposed change has the potential to limit further the ability of non-EEA AIFMs to reach investors in 'closed' jurisdictions (with no viable NPPR) for which reverse solicitation is currently the only access route.

It should be noted that the financial promotion rules contained in the FSMA and the Financial Services and Markets Act (Financial Promotions) Order 2005 apply to fund marketing activities. The financial promotions rules are wide in scope and cover communications, in the course of business, of an inducement or invitation to engage in investment activity. The financial promotions rules are separate to the AIFMD. However, an authorised or registered AIFM will be considered as compliant with such rules where it markets an AIF to professional investors in accordance with the AIFMD. Any marketing to retail investors will need to comply with additional domestic restrictions. These rules will therefore apply in situations where an AIFM relies on reverse solicitation and may apply in the context of pre-marketing situations under the AIFMD.

## 25 Types of investor

**Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).**

There are no UK restrictions on the types of investor that may participate in private equity funds although some investors may be restricted under the terms of their constitution or by capital or liquidity constraints. See question 24 for information on marketing restrictions.

## 26 Identity of investors

**Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity funds (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?**

Upon registration of an ELP at Companies House, certain information, including the full name of each of the general and limited partners and the amount contributed by each LP as capital to the partnership and the form of contribution (if applicable), must be filed with the Registrar on Form LP5 or Form LP7 (as applicable). Where any changes to this information occur, Form LP6 must be filed with the Registrar. There is also an obligation for ELPs to advertise in the Gazette when an LP transfers its interest to another person or when a GP becomes an LP. The change is only effective once the advertisement has been made. PFLPs are not required to advertise in the Gazette when an LP transfers its interest but are required to advertise a GP becoming an LP (note, however, that the change is not conditioned on the advertisement having been made). The LRO disapplied section 36 of PA 1890 (rights of persons dealing with firm against apparent members of firm) with respect to PFLPs. See question 9 for information on when there is a substantial change of control, question 4 for tax-related reporting requirements and question 2 for the information relating to investors which must be filed with Companies House.

## 27 Licences and registrations

**Does your jurisdiction require that the person offering interests in a private equity fund have any licences or registrations?**

As discussed in question 10, under the AIFMD, each AIF has to have an AIFM and UK AIFMs are required to be authorised and regulated by the FCA. Marketing under the AIFMD is an activity that is considered as being an AIFM's function performed by or on behalf of the AIFM and an EEA AIFM that is authorised under the AIFMD to manage and market an AIF (and comply with all substantive requirements under the AIFMD) can then market the EEA AIF in other EEA member states using the AIFMD marketing passport. Non-EEA AIFMs cannot become fully AIFMD authorised and benefit from the AIFMD marketing passport and can only market under NPPRs and need to register individually with the regulator in each EEA member state under article 42 AIFMD before starting marketing in such EEA member states. In addition, the marketing of interests in private equity funds in the UK as intermediary or placement agent may constitute a regulated activity, such as arranging deals in investments. This requires the person offering such interests to have the appropriate regulatory permissions from the FCA. Fund managers should ensure that any placement agent engaged as part of a fundraising effort is appropriately regulated and has the correct regulatory permissions. See question 24 for further detail on marketing.

## 28 Money laundering

**Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in a private equity fund or the individual members of the sponsor.**

The Department of Business, Energy and Industrial Strategy (BEIS) is responsible for transposing the section of the Fourth Money Laundering Directive (MLD4) which relate to increased transparency of corporate beneficial ownership information through, inter alia, the introduction of the PSC regime. Although the obligation to maintain a PSC register does not apply to ELPs, SLPs are required to maintain a PSC register and a UK corporate GP will similarly be required to maintain a PSC register. MLD4 expanded the pre-existing requirement on entities to carry out customer due diligence when establishing a business relationship, carrying out occasional transactions amounting to €15,000 or more or the transfer of funds exceeding €1,000. MLD4 introduced a stricter standard for customer due diligence than is currently in force, as there will no longer be an automatic presumption that entities regulated for money laundering purposes and domiciled in the UK, in member states of the EU or equivalent jurisdictions are deemed to be low risk (and so subject to reduced customer due diligence measures).

Firms are required to maintain adequate records of documents gathered in compliance with customer due diligence obligations for a period of five years following the end of the business relationship or the date of the occasional transaction.

If in the course of business, a fund manager becomes aware or suspects that a customer is engaged in certain activities that are linked to money laundering, it must report this to the UK National Crime Agency. The Fifth Money Laundering Directive (MLD5), which aims, among other reforms, to clarify further certain elements of MLD4 (regarding approach to high risk countries, for example), to give enhanced monetary powers to national authorities and to bring virtual currencies within the scope of the regime and is required to be implemented by all EU member states by 10 January 2020.

The government observed a disproportionate growth in registration of SLPs in recent years, with evidence that some of the increase may be due to SLPs being created for illicit purposes such as money laundering and terrorist financing. As noted in question 2, the Consultation



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proposed to require anyone presenting an application for registration or formation of a limited partnership to be supervised by an appropriate AML supervisory body and provide evidence of such supervision. The Response confirms this proposal, and applications from overseas will be subject to equivalent standards, and any list of overseas jurisdictions with equivalent standards will be subject to ongoing review. The government has also indicated that it will undertake further work to explore whether to require beneficial ownership information from corporate partners that do not already hold a PSC register.

## Exchange listing

### 29 Listing

**Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?**

Private equity funds are able to list on certain UK securities exchanges, for instance the London Stock Exchange's (the LSE) main market and the LSE's Special Funds Market. Although listing private equity funds is not customary, listing a fund provides a number of advantages to fund managers, such as increased distribution potential (as retail investors can invest in listed funds) and access to 'permanent capital', thus permitting fund managers to invest in long-hold assets (such as infrastructure) without having to sell investments prematurely in order to realise proceeds before the end of the fund's life. The main disadvantage to listing is the increased level of transparency required of listed funds and the increased regulatory burden – fund managers have to file publicly available accounts and comply not just with funds related legislation but also legislation applying to listed companies.

Please note that corporate entities tend to be used as listed private equity fund vehicles rather than ELPs.

### 30 Restriction on transfers of interests

**To what extent can a listed fund restrict transfers of its interests?**

Transfer restrictions are typically included in the constitutional document governing the listed fund vehicle, often alongside forced sale or redemption constructs, or both, primarily to address US securities law considerations. As a general matter, a listing on the LSE (including on the main market or in the specialist fund segment) requires that the securities not be subject to unacceptable restrictions on transfer. The UK Listing Authority has, however, historically permitted tailored restrictions (including, in the case of listed fund vehicles, in their constitutional documents) in order to permit issuers to avoid falling within onerous foreign legislative requirements.

## Participation in private equity transactions

### 31 Legal and regulatory restrictions

**Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?**

As noted in question 1, ELPs do not have separate legal personality and therefore cannot hold property in their own right or name. Consequently, legal title to the ELP's property tends to be vested in the name of the GP or a nominee company, with beneficial title vesting in the ELP.

UK-based AIFMs are also subject to the asset stripping rules under the AIFMD. Broadly speaking, the asset stripping rules prohibit capital reductions, certain distributions, share buybacks and redemptions for the first 24 months following the acquisition of control of an EEA portfolio company by an AIF managed by the UK AIFM. In practice, the rules can cause considerable difficulties and will, for instance, prohibit activities such as dividend recapitalisations taking place within the first 24 months of control of the relevant portfolio company. Attention should be paid to the structuring of investments in light of these rules.

## Update and trends

As of the date of writing, the UK will be leaving the EU on 29 March 2019 (Brexit). The UK and EU are still in the process of negotiating the terms of the withdrawal and the future of the AIFMD in the UK is dependent on the terms of such withdrawal or absence thereof. The UK government has published draft regulations to transpose the AIFMD into national law (the AIFM Regulations) so that the AIFMD may continue to operate effectively after Brexit. Assuming that Brexit will entail the withdrawal of the UK from the single market, UK AIFMs may not be able to market EEA AIFs to investors in the EEA via the marketing passport or provide services in the UK to non-UK EEA AIFs via the current passport regime. In addition, assuming cooperation arrangements are in place between the competent authorities of the UK and EEA member states in order to ensure an efficient exchange of information that allows competent authorities of the UK to carry out their duties in accordance with the AIFMD by the time Brexit is effective, UK AIFMs would have to comply with the NPPRs of EEA member states in order to market to investors or to manage AIFs in such member states. However, if such cooperation arrangements are not in place by then, UK AIFMs will not be able to manage non-UK EEA AIFs or market AIFs to non-UK EEA investors under NPPRs. With respect to EEA AIFMs marketing EEA AIFs to investors in the UK the AIFM Regulations set out a temporary permissions regime to maintain the status quo in the three years following Brexit.

As described more fully in the chapter, the UK government is proposing to introduce further transparency and related filing requirements for UK limited partnerships. It is yet to be seen how the government will actually implement such proposals and the effect this may have on the use of UK limited partnerships in private equity.

### 32 Compensation and profit-sharing

**Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.**

Full-scope AIFMs established in the UK have to comply with the FCA's AIFMD Remuneration Code (in the FCA Handbook at SYSC 19B) and the European Securities and Markets Authority's (ESMA) guidelines on sound remuneration policies under the AIFMD, which together impose extensive requirements and restrictions on remuneration policies and procedures, governance, structures and pay-outs. The aim of the rules and guidelines is to promote sound and effective risk management that does not encourage risk taking inconsistent with the risk profile of the AIFM or the AIFs it manages. Certain of the requirements apply firm-wide, while others apply only to staff with a material impact on the risk profile of the AIFM or AIFs. For these purposes, remuneration includes carried interest paid by the AIF itself but the ESMA guidelines contain a safe-harbour enabling certain of the more onerous requirements to be treated as met by an EU-style whole-fund carried interest model where carried interest paid is subject to clawback during the life of the AIF and upon liquidation.

The AIFMD requires AIFMs to comply with the remuneration requirements in a way that is proportionate to their size, internal organisation and the nature, scope and complexity of their activities and FCA guidance interpreting this proportionality principle has enabled many UK-based AIFMs to disapply the AIFMD's most onerous pay-out process rules. AIFMs within banking groups may, in addition, need to apply the remuneration requirements of CRD IV to AIFM staff who have a material impact on the risk profile of the UK consolidation group or on the CRD IV firm within that group. Where there is a conflict between the two sets of rules, the AIFMD rules take priority with the exception of the 'bonus cap', which does not feature in the AIFMD and which would nonetheless apply to the relevant staff member unless disapplication was permissible on grounds of proportionality or because of their level of pay and relative proportion of variable pay under a de minimis rule.

In December 2017, the European Commission published proposals for a directive and regulation on a new prudential framework for investment firms. The proposals aim to ensure that systemic and 'bank-like'



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investment firms are subject to key prudential requirements and corresponding supervisory arrangements that are adapted to their risk profile and business model. The proposals do not specifically address the position of AIFMs but may have an impact for AIFMs that have additional asset management permissions or are part of banking and investment groups, or both.

The proposals include remuneration and governance rules based on CRD IV and MiFID II, but unlike CRD IV, they do not currently include any requirement for a bonus cap for non-systemic or smaller and interconnected entities. However, firms will still need to consider a prudent relationship between fixed and variable pay in their own remuneration policies. If implemented, the proposals will replace the existing prudential regime set out in CRD IV. The proposals are due to come into force in mid-2019. As the European Commission is currently undertaking an extensive review of CRD IV, it remains to be seen how the prudential regime for investment firms, including the bonus cap, will be further affected.

MiFID II research and inducements requirements will apply to both full scope and most small authorised AIFMs. AIFMs providing independent investment advice or portfolio management will be prohibited from receiving and retaining any fees, commission, or monetary or non-monetary benefits from third parties. Under MiFID II such payments or benefits may be received by the AIFM but they must be passed on in full to clients as soon as possible. These requirements will not apply to any inducement considered to be a minor, non-monetary benefit.

The AIFMD also requires the AIFM to disclose, as part of each fund's annual report, the aggregate amount of remuneration paid by the AIFM, including the amount of carried interest and certain breakdowns. The annual report must be made available to the investors and the FCA upon request.

Recent changes to the UK taxation of management fees, carried interest, performance-related returns and the ability to use carried-forward losses (as discussed in question 21) should also be considered.

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