

A large, golden, spherical structure resembling a globe or a complex network of interconnected lines, set against a blue sky background.

Global Regulatory Roundup For Hedge Fund Managers – Q1 2014

This Quarterly Global Regulatory Roundup provides a general overview of key regulatory developments that may be relevant to Prime Finance's hedge fund clients. It does not purport to include all regulatory developments. The information contained in this communication is for informational purposes only and is not intended to be, and shall not constitute, legal, regulatory, tax or investment advice. You are responsible for independently reviewing and evaluating all information provided herein. Please consult your independent legal, tax, accounting and/or other professional advisors for more information.

Some Key Takeaways for Q1:

- **Broader Definition of "Knowledgeable Employee"**: More hedge fund employees may be able to participate as an investor in your fund.
- **FATCA**: The IRS just announced that the April 25th deadline for fund managers to register their offshore funds and offshore master funds with the IRS and obtain GIIN #s has been extended to May 5th. This 10-day extension buys fund managers some extra time to be included on the first FFI List if they meet the new May 5 registration deadline. Have you applied for a GIIN # and appointed a Responsible Officer to comply with FATCA?
- **EMIR**: If applicable, apply for your LEI # for EMIR reporting if you have not done so already.
- **SEC Examinations**: If you are an RIA and have not been examined by the SEC in the past 3+ years, be prepared that you may be up for an exam in 2014.
- **IRS**: The IRS extended the duration of Forms W-8 that would have expired on December 31, 2013 to December 31, 2014.

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Some Important Dates to Note in Q2 2014:

- April 1: **Volcker Rule** effective date.
- April 6: The **UK HM Revenue & Customs' (HMRC)** legislation is scheduled to be effective today and will tax as employees certain individual LLP members who are in substance employees of the LLP despite being admitted as members of the LLP.
- May 1: The **CFTC's** no action relief dated December 21, 2013 expires on May 1 for fund managers that are registered as CTAs and hold SEF memberships. As of May 1, such fund managers are required to preserve voice recordings related to the trading of commodity interests.
- May 5: Offshore funds need to register with the IRS before this date in order to be included in the initial IRS Foreign Financial Institution ("FFI") List.
- May 15: Package transactions are to be executed on SEFs unless the **CFTC** issues further temporary relief, which is possible.
- June 30: FFIs must enter into FFI agreements with the IRS by this date to be **FATCA** compliant.
- July 1: New investor on-boarding policies and procedures will need to be put in place by July 1st to be **FATCA** compliant. Note that investment advisers do not need to register if they do not hold clients' assets and have no accounts to report to the IRS. The IRS has added a Certified Deemed Compliant FFI category for such entities.
- Q2-Q3: The **U.S. Department of Labor** may release a new definition of "Fiduciary." This definitional change could potentially raise new ERISA issues.
- Q2-Q3: The **U.S. SEC** will re-evaluate the definition of "accredited investor" in accordance with Dodd-Frank.

Please consult with your legal counsel as your existing fund documents should be reviewed and updated to include additional FATCA disclosures such as: investor due diligence, reporting, withholdings, risk factors, cost allocations and compulsory redemptions for recalcitrant investors. If FATCA compliance obligations are delegated to the fund administrator, the administration agreement may need to be amended to expand the scope of services provided.

Important Announcements

The SEC Expands the Definition of "Knowledgeable Employee"

On February 6, the SEC's Division of Investment Management issued a no-action letter that expands and modifies prior guidance on who can qualify as a "knowledgeable employee" pursuant to Rule 3c-5 under the Investment Company Act of 1940 (the "40 Act"). In general, Rule 3c-5 permits a knowledgeable employee of a private fund to invest in the fund without counting toward the 100-person limit or meeting the qualified purchaser criteria as required by Sections 3(c)(1) and 3(c)(7), respectively, of the 40 Act. Historically, the "knowledgeable employee" test was interpreted very narrowly but this no-action relief gives certain employees at hedge funds the opportunity to invest in the fund where these individuals otherwise might not meet the net worth thresholds.

See: <http://www.sec.gov/divisions/investment/noaction/2014/managed-funds-association-020614.htm>

SEC Issues Guidance for Multi-Manager Funds on Advisory Fees

On March 12, the SEC's Division of Investment Management issued guidance for multi-manager funds that clarify when such funds should seek shareholder approval for fee and subadvisor changes.

See: <http://www.sec.gov/divisions/investment/guidance/im-guidance-2014-03.pdf>

SEC Examination Priorities For 2014

On January 9, the SEC announced its exam priorities for 2014. Note that the "Never-Before Examined Advisers" (i.e., RIAs that have not been examined by the SEC within the past 3+ years) will be a priority for the SEC. On February 20, the SEC sent letters to such fund managers that outlined particular topics of focus, including: Compliance Program; Filings/Disclosure; Marketing; Portfolio Management; and Safety of Client Assets.

Newer RIAs that registered with the SEC post-Dodd-Frank also have a 25% chance of being subject to a "Presence Exam" which is considered a more limited scope, risk-based exam.

See: <http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf>

<http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540814042>

<http://www.sec.gov/about/offices/ocie/nbe-final-letter-022014.pdf>

FINRA Announces Its Regulatory and Exam Priorities for 2014

On January 2, FINRA published its 2014 Regulatory and Examination Priorities Letter. Specific areas of focus include, but are not limited to:

- suitability issues;
- offerings, IPOs and private placements involving general solicitation under new SEC Rule 506(d) and private placement due diligence practices;
- fraud in microcap and low-priced OTC securities;
- funding and liquidity risks; and
- AML controls.

See: <http://www.finra.org/Industry/Regulation/Guidance/CommunicationstoFirms/P418700>

<http://www.finra.org/web/groups/industry/@ip/@req/@guide/documents/industry/p419710.pdf>

New IRS Forms Released (FORMS W-8 and W-9)

- The IRS has issued revised versions of Forms W-9, W-8BEN (for individuals), W-8ECI and W-8BEN-E (for entities).
- New Form W-8IMY (for intermediaries) is expected in the not-too-distant future.
- As stated above, the IRS extended the duration of Forms W-8 that would have expired on December 31, 2013 to December 31, 2014.

See: <http://www.irs.gov/Forms-&-Pubs/Current-Forms-&-Publications>

ESMA Requests Clarification on Definition of Derivatives Under EMIR

On February 14, ESMA wrote to the European Commission (EC) to ask for a single Europe-wide definition of a derivative or derivative contract. ESMA said the lack of a common definition prevents the full application of EMIR. This gives temporary relief for market participants who have struggled to meet the new obligation to report derivatives trades to a registered Trade Repository. In particular, ESMA singled out FX forwards, spot FX and physically settled commodities forward contracts. Until such clarification is provided, ESMA understands that national regulators will not implement EMIR for contracts that are not clearly identified as derivatives contracts across the EU.

See: <http://www.esma.europa.eu/news/ESMA-asks-Commission-clarify-derivative-definition-under-MiFID-EMIR?t=326&o=home>

http://www.esma.europa.eu/system/files/2014-184_letter_to_commissioner_barnier_-_classification_of_financial_instruments.pdf

EMIR Reporting Requirement Effective as of February 12

On February 12, the EMIR reporting requirement came into effect. EMIR requires all counterparties to derivatives to report all derivative contracts (OTC and exchange traded) to a trade repository. To date, there are six trade repositories registered in the EU.

See: <http://www.esma.europa.eu/page/Registered-Trade-Repositories>

Please consult with your legal counsel and consider updating your form subdocs with the updated tax forms. Also note the new tax forms for FATCA due diligence purposes.

ESMA Releases EMIR Q&A

The day before EMIR was set to take effect, ESMA released a Q&A and provided further details on trade reporting. ESMA acknowledged it will take time for both reporting firms and trade repositories to properly incorporate this further guidance.

See: <http://www.esma.europa.eu/content/QA-VI-EMIR-Implementation>

Pending HMRC Partnership Tax Changes for Salaried Members of UK LLPs

The UK HM Revenue & Customs' ("HMRC") legislation is scheduled to be effective on April 6 and will tax as employees certain individual LLP members who are in substance employees of the LLP despite being admitted as members of the LLP ("Salaried Members"). The Salaried Member rules only apply to UK limited liability partnerships and not to general partnerships or to limited liability partnerships formed outside of the UK, even if they are operating in the UK.

See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264620/4_Partnerships.pdf

Please consult with your UK fund counsel and tax advisor if you need to amend, among other things, your fund documents or LLP organizational documents.

The New Hong Kong Companies Ordinance Takes Effect as of March 3, 2014

The new Companies Ordinance seeks to achieve four main objectives: (i) enhancing corporate governance; (ii) facilitating business; (iii) ensuring better regulation; and (iv) modernizing the law. The Companies Registry has launched a website to help companies comply with the new Ordinance and get familiar with the new forms required for filings. The majority of the provisions in the existing Companies Ordinance were repealed.

See: http://www.cr.gov.hk/en/companies_ordinance/index.htm

On January 6, the Companies Registry issued four circulars and four guidelines to help companies prepare for the commencement of the new Companies Ordinance on March 3. The twelve pieces of subsidiary legislation which provide for the relevant technical and procedural matters in the new Companies Ordinance will also become effective on March 3. According to the Companies Registry, the goals are to strengthen Hong Kong's competitiveness as a corporate domicile and enhance its status as a major international business and financial center.

See: <http://www.cr.gov.hk/en/publications/docs/ec1-2014-e.pdf>

<http://www.cr.gov.hk/en/news/highlights.htm#151>

New Opportunities for Hedge Funds to Raise Chinese Capital

A new pilot program, the Qualified Domestic Limited Partner Program (QDLP Pilot Program), may signal the beginning of a shift in how and under what circumstances international fund managers are permitted to raise money from Chinese investors for the first time. This marks a milestone in the development of China's financial system because it permits foreign hedge funds to raise RMB capital in China from Chinese individuals and companies.

See: <http://www.pwc.com/gx/en/asset-management/asset-management-insights/qdlp-china-hedge-fund-managers.jhtml>

Regulatory Updates and Clarification

CFTC Issues Relief From SEF Trading for Package Transactions

On February 10, the CFTC issued a no-action letter for "packaged transactions" in connection with the "Made Available to Trade" transactions. The relief extends only until May 15, which many market participants claim is not enough time to resolve the issue. For purposes of the relief, a "package transaction" is a transaction involving two or more instruments:

- that is executed between two counterparties;
- that is priced or quoted as one economic transaction with simultaneous execution of all components;

SEF representatives predict curve trades and swap spreads will have CFTC protection lifted from mid-May if they contain a leg that is subject to SEF requirements. More complex packages, however, may see CFTC relief extended.

- that has at least one component that is a swap that is made available to trade and therefore is subject to the CEA section 2(h)(8) trade execution requirement; and
- where the execution of each component is contingent upon the execution of all other components.

It is unclear whether the CFTC is inclined to extend such relief beyond May 15; however, industry experts predict the CFTC is not likely to extend the safe harbor for the less complex of these products from the SEF-trading mandate.

See: <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/letter/14-12.pdf>

<http://www.risk.net/risk-magazine/news/2333889/sef-rules-expected-to-catch-swap-packages-from-mid-may>

The SEC Releases an Updated FAQ for Form PF

The SEC released an updated FAQ for Form PF on February 12 which addresses topics such as parallel managed accounts, valuation of a fund's borrowings, reporting of outstanding derivative positions and reverse repos.

See: <http://www.sec.gov/divisions/investment/pfrd/pfrdfaq.shtml?cldee=Z2FyeS5ibHVtQGNpdGkuY29t>

<http://www.sec.gov/divisions/investment/imannouncements/im-info-2014-1.pdf>

ISDA Publishes 2014 Credit Derivatives Definitions

On February 21, ISDA announced the publication of the 2014 ISDA Credit Derivatives Definitions that contain the basic terms used in the documentation of most credit derivatives transactions. This revised version supersedes the 2003 version but does not automatically apply.

See: <http://www.isda.org/publications/isdacredit-deri-def-sup-comm.aspx>

<http://www.reuters.com/article/2014/02/21/ny-isda-idUSnBw215674a+100+BSW20140221>

FATCA Goes Live on July 1

FATCA's first effective date is July 1, 2014 which means that withholding begins on this date for US source income unless an FFI Agreement is in place. The objective of this US regulation is to reduce US tax evasion by US individuals and entities who invest directly in offshore accounts or indirectly through the ownership of non-US entities. To meet its objective, FATCA imposes a 30% withholding tax on any US source withholdable payment made to non-compliant Foreign Financial (FFIs) and Non-Financial Foreign Entities (NFFEs). In general, FFIs are required to register with the IRS and either agree to certain terms under an 'FFI Agreement' or comply with local laws provided to facilitate compliance with FATCA under an intergovernmental agreement (IGA) between the US government and their country of operation.

All FFIs can register with the IRS through its online registration portal at the link below. Fund managers also should consider appointing a Responsible Officer to make the requisite FATCA certifications and monitor the due diligence process for its existing and prospective investors.

See: [http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-\(FATCA\)](http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-(FATCA))

<http://www.irs.gov/Businesses/Corporations/Summary-of-FATCA-Timelines>

US Treasury and IRS Harmonize FATCA Regulations

On February 20, the US Treasury and the IRS released new regulations to update the existing FATCA regulations and harmonize the pre-FATCA regulations with the new FATCA rules. Several key updates and highlights of the coordination rules are:

- the IRS extended the duration of Forms W-8 that would have expired on December 31, 2013 to December 31, 2014;

The anticipated implementation date of the 2014 ISDA Credit Derivatives Definitions would likely be in September 2014, assuming parties reference them in their trade documentation for new trades or amend existing documentation via a protocol.

Please consult with your fund auditors and counsel for more information on FATCA.

- the pre-FATCA rules have imported changes around client-onboarding and due diligence from FATCA (e.g., acceptance of scanned, faxed and e-mailed W-8 forms and withholding statements as long as the withholding agent does not have actual knowledge the form was sent by an entity that was not authorized to send it). Cure rules for late forms and the acceptance of affidavits of unchanged status are now also officially acceptable in certain circumstances;
- claiming treaty benefits will require a Form W-8; and
- failing to significantly reduce the number of recalcitrant account holders and payees that are non-participating FFIs is now considered an FFI Agreement default, only if it is attributable to a failure to follow the due diligence rules.

See: <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/022014%20-%20FATCA%20Fact%20Sheet.pdf>

<http://www.irs.gov/Businesses/Corporations/Information-for-Foreign-Financial-Institutions>

Cayman Islands Government Issues Release on Responsible Officer Role

On March 12, the Cayman Islands government released an advisory confirming the FATCA Responsible Officer is and will be a requirement of the IRS and is not subject to any changes from Cayman Islands legislation. Prior to this announcement, many fund managers were hoping to wait and see as there was a growing misperception that the Cayman Islands may be implementing legislation that says otherwise. This advisory also confirms that any director or officer of a Cayman fund, based anywhere in the world, can serve as its FATCA Responsible Officer to comply with FATCA.

See: <http://media.dms offshore.com/cayman-islands-government-release-responsible-officer-role/>

FATCA IGA Agreements

As of the date of this publication, 26 countries have entered into an intergovernmental agreement with the United States.

See: <http://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca-archive.aspx>

<http://www.pwc.com/us/en/financial-services/publications/fatca-publications/intergovernmental-agreements-monitor.jhtml>

CFTC and European Commission (EC) Issue Joint Statement on Harmonizing Efforts on Swap Execution Facilities (SEFs) and EU Multilateral Trading Facilities (MTFs)

On February 12, the CFTC and EC announced that they would make an effort towards harmonizing SEF and MTF regulations as contemplated under the Path Forward Statement issued in July 2013. The objective would be to allow for substitute compliance, where a foreign country's regulations would be a substitute for its own. Market participants criticize the efforts as falling short. For example, one of the two no-action letters by the CFTC provides detailed conditions which would essentially require each MTF to operate in a way that is so similar to a SEF that it might as well actually register as a SEF.

See: <http://www.cftc.gov/PressRoom/PressReleases/pr6857-14>

HMRC Publishes Updated Guidance on Disguised Employment in UK LLPs

On February 21, HMRC, UK's tax authority, published revised guidance on disguised employment relationships in UK limited liability partnerships. This Guidance was followed on March 7 by publication of revised clauses related to the Salaried Member Rules.

See: <https://www.gov.uk/government/consultations/a-review-of-two-aspects-of-the-tax-rules-on-partnerships>

FCA Releases Updated Guide to Commodity Markets Regulation

On February 27, the Financial Conduct Authority (FCA) issued a guide to how it regulates commodity markets, setting forth its views on the regulatory challenges of the commodity derivative markets and how it intends to address them.

See: <http://www.fca.org.uk/static/documents/guide-to-commodity-markets-regulation.pdf>

The Hong Kong SFC Releases an Updated FAQ on Advertising Materials of Collective Investment Schemes

On March 14, the SFC updated its FAQ on advertising materials in connection with dividend payments and distributions.

See: <http://www.sfc.hk/web/EN/faqs/product-authorization/advertising-materials-of-collective-investment-schemes-authorized-under-the-product-codes.html#40>

Interesting Observations

The SEC's Newest Enforcement Weapon: Powerful Software

The SEC engaged Palantir Technologies to help the SEC crunch massive amounts of data. This multi-year deal, worth more than \$13 million, will help the SEC find evidence of illegal activity more quickly by linking trading records and personal contact information from paid databases with tips, complaints and referrals the agency has received. Another big-data project, known as the National Exam Analytics Tool (NEAT plus), went live on March 1. The NEAT plus tool gives examiners the ability to analyze massive amounts of trading data for brokerages and other Wall Street firms. With a \$1.35 billion budget, the SEC is calling this new technology their "secret sauce."

See: <http://uk.reuters.com/article/2014/02/26/sec-enforcement-palantir-idUKL1NOLV1LZ20140226>

Investment Adviser Due Diligence Practices

The SEC issued a Risk Alert on January 23 which highlights issues raised during the due diligence process for selecting fund managers.

See: <https://www.sec.gov/about/offices/ocie/adviser-due-diligence-alternative-investments.pdf>

Acting CFTC Chairman Mark Wetjen Gives Keynote Address at 39th Annual International Futures Industry Conference

On March 11, Acting Chair Wetjen speaks about the necessity for global harmonized derivatives regulation.

See: <http://www.cftc.gov/PressRoom/SpeechesTestimony/opawetjen-7>

CFTC Possibly Will Increase Whistleblower-Based Enforcement Actions

The CFTC has jurisdiction over the \$400 trillion swaps market, in addition to the futures market. However, its budget was only increased by \$10 million over last year's budget. The Whistleblower Office, created by the Dodd-Frank Wall Street Reform and Consumer Protection Act, operates a program through which the Commission may reward individuals who voluntarily provide original information about violations of the Commodity Exchange Act.

See: <http://www.cftc.gov/ConsumerProtection/WhistleblowerProgram/index.htm>

More Than Half of UK Fund Managers That Fall Within Scope of AIFMD Have Yet to Apply for Authorization

According to a regulatory consultancy firm, a total of 361 UK fund managers had applied to the FCA for authorization as of February 21, out of an anticipated 776. Many firms might not be ready for the July 22 deadline, notwithstanding the application submission extension earlier this year.

See: <http://www.efinancialnews.com/story/2014-03-13/aifmd-alternative-fund-managers-private-equity-hedge-funds>

Although this guide does not constitute formal guidance per se, it gives an overview of how the regulatory framework has evolved since 2007, when the FSA (the FCA's predecessor) last published such a guide.

The Risk Alert serves as a useful guideline for fund managers in their self-assessment of their supervisory, compliance or risk management systems.

EU Parliament and Council Presidency Reach Agreement on Proposals

On January 14, comprehensive rules governing financial markets were agreed to in principle by Parliament and the Council of Ministers. The most significant changes to the existing legislation would include:

- The creation of a new type of regulated trading venue for non-equity instruments, known as an “Organized Trading Facility” or “OTF”;
- Authorized firms will be required to trade derivatives which are subject to the existing clearing requirement in EMIR on a regulated trading venue, thus curtailing the OTC derivatives markets;
- Commodity derivative transactions will become subject to position limits and position reporting requirements; and
- A new regime will be introduced in respect of the provision of investment services into the EU by third-country firms which may, subject to certain conditions and eligibility criteria, allow non-EU firms to freely provide investment services to professional clients across the EU on a passported basis. This new regime may have an impact upon the future availability of the existing UK overseas person exemption.

See: http://europa.eu/rapid/press-release_MEMO-14-15_en.htm

<http://www.europarl.europa.eu/news/en/news-room/content/20140110IPR32414/html/Deal-to-regulate-financial-markets-and-products-and-curb-high-frequency-trading>

http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/141071.pdf

The Securities and Futures Commission (SFC) Reminds Corporations of its Regulatory Compliance Obligations for Cross-Border Business Activities

On January 28, the SFC issued a circular to licensed corporations of its compliance obligations for cross-border business activity and to be mindful of the SFC’s Code of Conduct, particularly with respect to maintaining effective policies and procedures and controls.

See: <http://www.sfc.hk/edistributionWeb/gateway/EN/circular/intermediaries/supervision/doc?refNo=14EC4>

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