

Portugal

Vieira de Almeida e Associados

Pedro Simões Coelho, Ricardo Seabra Moura & Pedro Bizarro

1. THE HISTORY OF HEDGE FUNDS IN PORTUGAL

The history of hedge funds in the Portuguese jurisdiction is quite recent in comparison with other onshore and offshore jurisdictions, and is currently still dominated by non-Portuguese domiciled structures.

Hedge funds were originally seen by Portuguese regulators as an unusual and dangerous type of investment, mainly due to the fact that such funds were unregulated and had a high-risk profile. However, this suspicious view has increasingly softened and, even in the current post sub-prime and post-Madoff environment, the regulatory approach is more flexible than it was a few years ago. Taking into account the views expressed by several major international players, both in Europe (for example, the European Central Bank) and in the US (for instance, the Securities and Exchange Commission), the international hedge funds industry may be expected to sail under more regulated waters (there is already a clear general shift in attitude, notably concerning information disclosure rules), which will also have repercussions in Portugal.

2. HEDGE FUNDS TODAY

Hedge funds placed in Portugal are commonly collective investment schemes based in foreign jurisdictions, mainly offshore, such as the Cayman Islands, the British Virgin Islands, Bermuda or the Channel Islands. The reasons for choosing offshore jurisdictions are well known, and include, *inter alia*, the more favourable tax environment and the more flexible regulatory approach. Distribution of foreign hedge funds in the Portuguese market will be specifically addressed below.

As to the possibility of setting up a hedge fund type of structure directly in Portugal, considering the current applicable legal framework, a special mutual fund structure would have to be used, specifically alternative investment undertakings (AIU) which, under certain circumstances, could meet to some extent, but not entirely, the typical characteristics of a hedge fund.

The setting up of such a special mutual fund structure should, in our view, be required to comply with Decree-Law 63-A/2013, of 10 May 2013 (UCI Law), as well as with CMVM (*Comissão do Mercado de Valores Mobiliários*, the Portuguese Securities Market Commission) Regulation 5/2013, of 7 September 2013, which establishes regulatory provisions regarding undertakings for collective investment (UCI Regulation). The UCI Law

implements Directive 2009/65/EC on undertakings for collective investment in transferable securities (UCITS), commonly known as the UCITS IV Directive. The UCI Law and UCI Regulation additionally foresee the setting up and distribution of non-harmonised UCIs. In particular, Articles 51 *et seq.* of the UCI Regulation set out a special regime for AIUs, under which the CMVM is empowered to authorise and register such funds.

3. REGULATORY AND POLITICAL DEVELOPMENTS

Recently, the Portuguese legislator approved the UCI Law, which, among other changes to the previously applicable legal framework, implemented the UCITS IV Directive in Portugal. The UCI Law entered into force on 7 September 2013. On the same date, the CMVM enacted the UCI Regulation.

As for EU Directive 2011/61/EU, also known as the Alternative Investment Funds Manager Directive, or 'AIFMD', in spite of its implementation deadline having ended on 22 July 2013, none of the public steps usually preceding enactment (ie, public consultation, publication of draft bill, etc.) have been taken to implement it in Portugal. As was the case with the UCITS IV Directive (which original implementation deadline was 1 July 2011 and which, as we have seen, was only fully implemented in Portugal on 7 September 2013), we expect implementation of AIFMD to occur well beyond the original implementation deadline.

4. REGULATION OF ONSHORE MANAGERS/INVESTMENT ADVISERS

4.1 Regulated activities

There are no special provisions governing fund managers of AIUs. The applicable rules are those in force regarding managers of UCIs in general.

The rules regarding investment advice do not differentiate between investment advice rendered to AIUs, other UCIs or fund managers from investment advice rendered to other clients. That notwithstanding, all UCIs (including AIUs) and fund managers are deemed to be qualified investors for the purposes of MiFID.

Fund management and investment advice are regulated in Portugal in accordance with national legislative measures implementing the relevant EU Directives, ie, the UCITS (and related) Directives for fund managers and MiFID for investment advisers.

4.2 Recent regulatory developments

Further to UCITS IV, the UCI Law also implemented Commission Directive 2010/43/EU, the UCITS IV implementing Directive as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company. As a result, Portuguese rules governing many aspects of a fund manager's existence and activities were brought in line with European rules, including those in relation to:

- (a) the minimum number of independent directors and independent members of the supervisory board;

- (b) applicable own funds requirements (please see section 4.4, Licensing requirements, below);
- (c) investments made for a fund manager's own portfolio, which now focus more on term and less on rating, ie, investment in mid- and long-term instruments have now been restricted, but previously applicable rating requirements have been eliminated;
- (d) carve-outs to the general prohibition that a fund manager's employees and corporate officers who take and/or implement investment decisions work for another fund manager;
- (e) the ability of fund managers to subcontract investment management functions to other authorised fund managers (please see section 6.3, Subcontracting, below);
- (f) possibility of the fund managers using the voting rights inherent to an investment fund's holdings in a company in favour of anti-takeover amendments to that company's by-laws, although subject to additional measures of control, including a requirement to justify voting options; and
- (g) the limitations applicable in relation to the issuance of joint investment orders by more than one fund managed by the same fund manager (please see section 4.4, Licensing requirements below).

Also, the previous legal framework had, since 2010, made reference to the possibility of UCIs being incorporated as companies, which could either be managed by a fund manager or be self-managed. Possibly due to the lack of specific regulation for these companies, the corporate model was not used under the previous legal framework. However, both the UCI Law and the UCI Regulation have attempted to close this loophole, so an opportunity may appear in the market for self-managed corporate structures.

4.3 Registration requirements

The main object of investment fund management companies must be the management of one or more UCIs. Secondly, such companies may also market Portuguese or foreign investment funds and may be authorised to provide discretionary and individual financial instruments portfolio management services, venture capital management services, real estate investment funds management services and investment advisory services relating to the aforementioned assets.

Under Portuguese law, fund managers have to be registered with two different regulators. The bulk of the regulatory and supervisory role is performed by the CMVM, which is also in charge of regulating and supervising the UCIs themselves. However, the Bank of Portugal retains some power, which is often exercised jointly with the CMVM.

In the case of closed-ended UCIs, fund management activities may also be undertaken by certain types of credit institutions (such as banks), which have at least up to €7,500,000 in own funds. However, most large Portuguese banks prefer to have a fund manager incorporated within the group to carry out their fund management business.

4.4 Licensing requirements

In order to be continuously authorised to carry out its activities, a Portuguese fund manager is subject to several requirements.

The own funds requirements of fund managers are subject to Directive 2006/49/CE, as amended (also known as the Capital Requirements Directive). As such, they may not be lower than a quarter of its preceding year's fixed overheads or, if the fund manager is in its first year of activity, the overheads estimated in its business plan, as reviewed by the relevant regulator. This requirement may be waived by the relevant Home State regulator.

Other than the minimum limit set out in the Capital Requirements Directive, fund managers are also subject to the limits set out in Article 7 of UCITS IV, as implemented by the UCI Law. This includes the additional own funds requirement when the aggregate portfolio value exceeds €250,000,000 (equivalent to 0.02% of that excess amount), the €10,000,000 cap and the regulator's (in this case, the Bank of Portugal's) power to demand remedy or termination of activities if the fund manager's own funds drop below a certain amount (in this case, €125,000).

If a fund manager is authorised to provide other services (such as managing real estate investment funds or venture capital funds), the prudential requirements relevant to such activities shall apply in addition to the above.

Fund managers (except for credit institutions) shall not:

- (i) take or grant loans, or provide guarantees, on their own behalf;
- (ii) invest on their own behalf in UCIs, except money market and treasury UCIs (as defined in the UCI Law, which excludes mid and long-term instruments) managed by other fund managers;
- (iii) invest on their own behalf in any other financial instruments, except money market instruments (as defined in the UCI Law, which excludes mid and long-term instruments);
- (iii) acquire real estate property which is not required for performing its services or in excess of its own funds; nor
- (iv) carry out short-selling activities on its own behalf. As regards short selling on behalf of UCIs under management, special attention should be given to any applicable regulatory provisions on short-selling – in the Portuguese context, some regulatory restrictions and limitations currently apply.

In developing its fund management services, the fund manager shall carry out all actions and transactions required for the proper execution of the investment policy. The fund manager and its corporate bodies shall act independently and solely in the interest of unitholders, with high diligence and professional competence.

Each UCI shall be considered a client of the fund manager, and fund managers shall be organised so as to prevent and mitigate possible conflicts of interests. The fund manager shall give preference to the UCI's interests over its own interests, the interests of its parent company or group and the interests of the members of its corporate bodies. All UCIs under management

shall be treated equally and transparently. The possibility to issue joint orders on behalf of more than one UCI exists only in limited circumstances, notably if: (i) it is unlikely that the joint issuance will adversely affect any UCI; and (ii) the fund manager adopts an issue policy which provides for a fair allocation of the orders, namely in terms of price and volume. In any case, the fund manager shall proportionately allocate the respective assets and costs.

If the fund manager is also authorised to perform discretionary and individual portfolio management services, it may not invest all or part of a client's portfolio in the UCIs it manages, except with the relevant client's prior consent, which may be provided in general terms.

4.5 Taxation issues for managers

4.5.1 Taxation of fund managers

The income or gains obtained by the fund managers are included in their taxable income and are subject to a corporate tax rate of 25% applicable on taxable income, to which a municipal surcharge (*derrama municipal*) of up to 1.5%, over the unitholder's taxable profits, may be added. A state surcharge (*derrama estadual*) at the rate of (i) 3% on the part of the taxable profits between €1,500,000 and €7,500,000, and (ii) 5%, on the part of the taxable profits exceeding €7,500,000, will also apply. The fund managers are jointly liable for tax debts deriving from the AIUs which are under their management.

4.5.2 Taxation of AIUs

Income tax

Income other than capital gains made in the Portuguese territory is taxed at the applicable withholding tax, as if such income were obtained by an individual resident in the Portuguese territory, or, for income not subject to withholding tax, at a flat rate of 25% in each case on the net value made each year. The tax is payable by the management company by the end of April of the following year. If such income is obtained outside of the Portuguese territory it is taxed at a flat rate of 25%, except if it results from bond, equity or investment fund holdings in which case it will be taxed at a flat rate of 20% in each case on the net value obtained each year.

If the income derives from capital gains, whether or not obtained in the Portuguese territory, it is taxed under the same conditions that would apply to individuals resident in Portuguese territory, at a rate of 25% on the positive difference between the capital gains and capital losses of each year.

5. DISTRIBUTION OF HEDGE FUNDS IN YOUR JURISDICTION

5.1 Licensing requirements, if any

This is one area where the UCI Law and the UCI Regulation are not as clear as the previous legal and regulatory framework. Our interpretation of the wording of the new legal and regulatory provisions leads us to understand that some private placement exemptions (namely, with regard to offers made exclusively to qualified investors) still apply. However, the elimination of

certain explicit provisions to that effect justifies a more cautious approach, at least until there is a chance to observe the CMVM's approach to this issue.

Closed-ended funds

With the exception of open-ended UCIs and the distribution of foreign funds, any placement of a fund in Portugal needs to be made with regard to the PSC (Portuguese Securities Code), specifically, whether it counts as a public offering of securities.

An offering will be deemed to be public whenever it is:

- (i) addressed to undetermined addressees in Portugal;
- (ii) made together with the gathering of investment intentions or marketing campaigns; or
- (iii) addressed to at least 150 non-qualified investors domiciled or established in Portugal.

Should the offering be addressed exclusively to qualified investors, it will not be qualified as a public offer. Qualified investors include, *inter alia*, credit institutions, investment companies, insurance companies, UCIs and respective management companies and other financial institutions. Additionally the regime does not apply where the nominal value or the minimum subscription amount per investor equals at least €100,000.

Generally, a public offering in Portugal will require prior approval by the CMVM (or passporting into Portugal from another EU member state) of a prospectus in accordance with the provisions of the PSC and the EU Prospectus rules. In the case of non-EU approved prospectuses, these may also be recognised in the Portuguese jurisdiction, provided that the document complies with the international guidelines set forth by international organisations of securities supervisors and that the information requirements established by the PSC and Regulation No 809/2004/EC (the Prospectus Regulation) are duly met. Placement services shall be provided by a financial intermediary (for instance, a bank) registered for such purpose with the CMVM, which may have certain information and care duties towards the investors (such as suitability and adequacy tests).

All marketing materials must be previously approved by the CMVM. Such materials should include complete, not misleading, updated, simple, objective and lawful information and state where the relevant offering documentation (such as the prospectus) may be obtained. Additionally, they are subject to the general requirements on advertising.

It should also be noted that in July 2009, CMVM Regulation 1/2009 (later replaced by CMVM Regulation 2/2012, dated November 2012) on complex financial products entered into force, requiring prior approval of an informative document by the CMVM for the placement of complex financial products with non-qualified investors (ie, non-institutional investors). The qualification financial instruments as complex financial products can often be assessed only on a case-by-case basis.

Open-ended funds

Prior to the entry into force of the UCI Law, placement in Portugal of open-

ended Portuguese or foreign UCIs required an assessment of whether such placement could qualify as ‘distribution’ (*comercialização*), a concept which was usually construed as excluding two of the most significant private offer exemptions: the one relating to the number of investors and the ‘qualified investors only’ exemption.

Now, the concept of distribution set out in the UCI Law does not discriminate between public and private offers. However, distribution of AIUs exclusively to qualified investors is expressly exempt from CMVM approval, and distribution which complies with other private placement exemptions may be free from the need to comply with some otherwise applicable information and documentation requirements.

Open-ended UCIs may be distributed by their respective fund managers and custodians, by financial intermediaries (such as banks) registered with the CMVM for public offerings placement or reception and transmission of orders, or by special entities authorised pursuant to the UCI Regulation. Distributors should possess adequate material and technical means to pursue their activity and employ specially trained personnel for the performance of the activities at stake, as well as have information and care duties as identified above.

If the relevant open-ended UCI is not domiciled in Portugal, the distributor shall file a set of documents with the CMVM pursuant to the applicable approval procedure. This procedure is quite straightforward with regard to UCITS, because the CMVM has no discretion to refuse the distribution of the relevant fund in Portugal, provided that all necessary documents have been duly filed with the home country regulator. However, hardly any hedge funds qualify as UCITS.

To issue its authorisation for the distribution of an AIU in the Portuguese jurisdiction, the CMVM must be provided with a number of documents including: the respective fund documents (full and simplified prospectuses, management regulation or the articles of association); the latest annual (and, if subsequent, semi-annual) fund accounts; a certificate from the competent authority of the AIU’s home jurisdiction stating that the AIU is validly constituted and active under the applicable law and supervised by such jurisdiction’s competent authority with the purpose of ensuring the protection of investors; and the distribution agreement. A number of additional documents may also be required by the CMVM to this effect, such as the law governing the activity of the AIU. The CMVM may request that relevant documents be translated into Portuguese.

Apart from these requirements, which are specifically set out in the UCI Regulation, the CMVM may determine that additional information is necessary for the evaluation of the suitability of the AIU for distribution in Portugal. Approval will in these cases be subject to a discretionary decision by the CMVM, which may refuse to authorise distribution on grounds that the relevant AIU does not provide Portuguese investors with the same level of protection that national AIUs do, or that Portuguese UCIs may not be marketed in the relevant AIU’s home state.

Any marketing materials must be previously approved by the CMVM and

follow the guidelines set out for closed-ended funds, including (if applicable) those relating to complex financial products.

5.4 Taxation issues for investors

5.4.1 Investors of AIUs

(a) Personal income tax

Resident

A personal income tax (PIT) exemption applies whenever income payments (which includes income earned with the redemption of the units) to a resident beneficiary fall outside the scope of a commercial, industrial or agricultural activity.

Income payments to a resident beneficiary where such income is comprised within the scope of its commercial, industrial or agricultural activity is not subject to withholding taxes and is qualified as profits or gains.

Capital gains arising from the transfer of units obtained by Portuguese tax resident individuals will be taxed at a special tax rate of 28%, levied on the positive difference between the capital gains and capital losses realised on the transfer of securities and derivatives of each year, except if the resident beneficiary chooses to aggregate the income received, in which case it will be subject to progressive income tax rates of up to 48%. In this case, a surcharge of 3.5% applies in 2013 to the net income that exceeds €6,790 per individual, with a deduction based on the number of dependents. Additional surcharges of: (i) 2.5% on the part of income between €80,000 and €250,000; and (ii) 5% on the part of the income in excess of €250,000, also apply in 2013. In this case, the tax withheld is deemed a payment on account of the final tax due.

Non-resident

Income payments to a non-resident beneficiary without a permanent establishment in the Portuguese territory are exempt from PIT.

Capital gains obtained by a non-resident beneficiary without a permanent establishment in the Portuguese territory will be, as general rule, exempt from PIT. However, this exemption shall not apply if the non-resident beneficiary is domiciled in a blacklisted jurisdiction pursuant to Ministerial Order no. 150 of 13 February 2004, amended by Ministerial Order no 292/2011 of 8 November.

(b) Corporate income tax

Resident

Investment income payments to a resident entity are not subject to withholding tax and are qualified as taxable profit for corporate income tax (CIT) purposes. Such income is included in its taxable income and is subject to a corporate income tax rate of 25%, to which a municipal surcharge of up to 1.5% over the unitholders taxable profits, may be added. A state surcharge at the rate of: (i) 3% on the part of the taxable profits between €1,500,000 and €7,500,000; and (ii) 5% on the part of the taxable profits exceeding €7,500,000, will also apply.

Tax withheld at the level of the fund, in proportion to the units, will qualify as a payment in advance of the final tax bill of the resident entity.

Capital gains will be included in the taxable income of the resident entity and are subject to a corporate income tax rate of 25%, to which a municipal surcharge of up to 1.5% (over that entity's taxable profits) may be added. A state surcharge at the rate of: (i) 3% on the part of the taxable profits between €1,500,000 and €7,500,000; and (ii) 5% on the part of the taxable profits exceeding €7,500,000, will also apply.

Non-resident

A CIT exemption applies whenever the income arising from the units is distributed or made available to a non-resident entity without a permanent establishment in Portuguese territory.

Capital gains made by a non-resident entity without a permanent establishment in the Portuguese territory with the transfer of units of participation in national hedge funds are, as a general rule, exempt from CIT.

The exemption does not apply if the non-resident entity without a permanent establishment in Portuguese territory is held, directly or indirectly, in more than 25 per cent by resident entities, or if the entity is domiciled in a blacklisted jurisdiction pursuant to Ministerial Order no 150 of 13 February 2004, amended by Ministerial Order no 292/2011 of 8 November.

5.4.2 Investors in foreign hedge funds

(a) Personal income tax

Resident

Investment income payments made to resident individuals are subject to personal income tax. If there is a Portuguese resident paying agent, tax shall be withheld at the current final withholding rate of 28%, unless the relevant resident elects to include it in his/her taxable income, subject to tax at progressive rates of up to 48%. In this case, a surcharge of 3.5% applies in 2013 to the net income exceeding €6,790 per individual, with a deduction based on the number of dependents. Additional surcharges of: (i) 2.5% in relation to income between €80,000 and €250,000; and (ii) 5% in relation to income in excess of €250,000, also apply in 2013. In this case, tax withheld is deemed a payment on account of the final tax due. Investment income paid or made available to accounts opened in the name of one or more account holders acting on behalf of one or more unidentified third parties is subject to a final withholding tax rate of 35%, unless the relevant beneficial owner(s) of the income is/are identified, in which case the tax rates applicable to such beneficial owner(s) will apply.

Whenever investment income payments are not subject to Portuguese withholding tax (ie, whenever there is no Portuguese resident paying agent), the income obtained will be subject to tax at progressive rates of up to 48%, as well as to the aforementioned surcharges.

Capital gains arising from the transfer of units obtained by Portuguese tax resident individuals will be taxed at a special tax rate of 28%, levied on

the positive difference between the capital gains and capital losses realised on the transfer of securities and derivatives in each year, except if the resident beneficiary chooses to aggregate the income received, in which case it will be subject to progressive income tax rates of up to 48%, with the aforementioned surcharges also being applicable.

Non-resident

Income payments to, and capital gains made by, a non-resident beneficiary without a permanent establishment in Portuguese territory are not subject to taxation in Portugal.

(b) Corporate income tax

Resident

Capital gains will be included in the taxable income of the resident entity and are subject to a corporate income tax rate of 25%, to which a municipal surcharge of up to 1.5% (over that entity's taxable profits) may be added. A state surcharge at the rate of: (i) 3% on the part of the taxable profits between €1,500,000 and €7,500,000; and (ii) 5% on the part of the taxable profits exceeding €7,500,000, will also apply.

Non-resident

Income payments to, and capital gains made by, a non-resident entity without a permanent establishment in the Portuguese territory are not subject to taxation in Portugal.

6. OTHER POINTS RELEVANT TO HEDGE FUNDS

6.1 Fund manager and depositary liability towards unitholders

Currently, fund managers are liable towards unitholders for compliance with all applicable legal and regulatory obligations relating to the UCI, and must indemnify investors for losses caused *inter alia* by errors and irregularities in:

- (i) evaluation procedures;
- (ii) processing subscriptions and redemptions; and
- (iii) charging undue amounts.

The depositary is also liable towards investors for its own duties under applicable legal and regulatory provisions.

As financial intermediaries, fund managers, custodians and investment advisors (in their respective capacities) are also subject to misdemeanour procedures before the CMVM for most breaches of their duties under applicable law and CMVM Regulations (namely, Portuguese MiFID-implementing rules). For most infractions, sanctions range between €12,500 and €2,500,000, although they may reach €5,000,000 for particularly serious infractions. Ancillary sanctions, such as licensing restrictions and cancellations, may also apply.

6.2 Remuneration of fund managers

Fund managers are remunerated by means of a management fee, the terms of which must be set out in the fund documentation. It is standard

practice to have a flat fee, calculated as a percentage of the UCI's annual NAV, payable monthly, quarterly or within a different period. However, performance fees are allowed, combined with a high water mark. Currently, performance fees are more widely spread with respect to the management of venture capital funds, the terms of their calculation being carefully detailed in the fund's documentation. Subscription, redemption and transfer fees are also accepted, provided that such fees are clearly indicated in the relevant fund's documents. Normally such fees revert to the fund manager, but they can also revert to the fund, thereby offering an incentive for long-term investment. In any case, further fees and commissions may be set out in the fund's documentation.

6.3 Subcontracting

The fund manager may subcontract investment management and administrative functions, provided that certain principles are respected. Subcontracting is of relevance particularly where the fund manager lacks specific knowledge of local markets and thus intends to hire a local partner to assist in investing the UCI's assets in a given jurisdiction. The fund manager must periodically define the relevant investment criteria and maintain core decision-making powers inherent to its management activity. The subcontracted party must be properly qualified, and its activity must be controlled by the fund manager to assess and ensure that the interests of investors are always considered. The subcontractor is subject to the same obligations as the fund manager, but the fund manager remains liable towards unitholders (please see 'Fund manager and depositary liability towards unitholders' above). The subcontracting party may not compromise the regulatory supervision of the fund manager nor prevent the fund manager from acting in the best interests of unitholders.

Investment management shall only be subcontracted to (i) financial intermediaries authorised and registered for discretionary portfolio management services or (ii) other authorised fund managers, and may not be subcontracted to the depositary, or to any other institutions whose interests may enter into conflict with those of the fund manager or of investors. Investment management may only be subcontracted to an institution based outside of the EU if cooperation between the CMVM and the foreign state's supervisory authority is ensured.

The fund manager shall inform the CMVM of the terms of each subcontract before its execution, and the fund's documents shall identify the subcontracted party and its respective functions.

