



Guide to
Funds in the
Isle of Man

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PREFACE

The Isle of Man's low tax status, political and economic stability and proximity to the key markets of Europe make it a compelling and cost-effective alternative for the domicile of investment funds. With a wide range of fund service providers and a sophisticated professional and banking infrastructure, the Island offers a solution for all fund promoters. The Island prides itself on its "can-do" business environment and the close co-operation between public and private sectors has resulted in a flexible, well-regulated funds sector that meets the expectations of promoters and the concerns of key investors.

As you would expect of a common law jurisdiction, the Isle of Man offers a full range of vehicles for use as fund structures, including open-ended investment companies, protected cell companies, limited partnerships and unit trusts. These are considered in more detail in this Guide.

The Isle of Man has a well-founded reputation as a premier jurisdiction in terms of regulation and achieves a balance between, on the one hand, providing a business friendly environment and, on the other hand, meeting international standards of financial supervision. A number of independent assessments of the Island's regulatory framework have been conducted over the years which verify the Island's status, the most recent being the Review of the British offshore financial centres commissioned by the Chancellor Alistair Darling and undertaken by Michael Foot, which is currently taking place.

The Isle of Man has a full suite of fund options ranging from fully regulated, retail-focused "authorised schemes" to private fund arrangements that fall wholly outside the scope of regulation. Between these extremes are a range of unapproved funds that are subject to varying degrees of structural regulation. These funds are the main categories of Isle of Man funds and are not subject to prescriptive regulation, but all generally involve the appointment of an Isle of Man licenceholder and provide certain safeguards for investors.

It is recognised that this Guide will not completely answer detailed questions which clients and their advisers may have. It is intended to provide a sketch of the subject matter covered. The Guide is, therefore, designed as a starting point for a more detailed and comprehensive discussion of the topic.

Appleby
Douglas, Isle of Man
October 2009

1. Constitutional Position

The Isle of Man is a self-governing dependency of the British Crown. It does not form part of the United Kingdom.

By long-established constitutional convention, the Isle of Man has complete autonomy in relation to domestic affairs, including taxation and business law. The Island is not a member state of the European Union. Under Protocol 3 to the Act of Accession, whereby the United Kingdom became a member state, EU rules only apply to the Isle of Man in relation to a limited range of matters. Accordingly, EU directives on tax harmonisation, company law and financial services do not apply in the Isle of Man. Tynwald, the Island's parliament, has been in existence for over 1,000 years and is the world's oldest continuously functioning parliament. The Island also has an independent Court system, including a High Court and a locally based appellate court; the final court of appeal for the Isle of Man is the UK Privy Council. The Island is a common law jurisdiction and its legal traditions draw heavily on those of England; English case law is of high persuasive authority in the Isle of Man. This legal stability gives the jurisdiction the commercial legal certainty long associated with the English legal system, combined with the flexibility of an international finance centre.

2. Flexibility of Legal Form

As you would expect of a common law jurisdiction, the Isle of Man offers a full range of vehicles for use as fund structures, including open-ended investment companies, protected cell companies, limited partnerships and unit trusts. These are considered in more detail below.

3. Companies—Traditional and Modern

Corporate vehicles remain the most popular legal form for collective investment. The Island's Companies Act 2006 created a new stand-alone corporate vehicle, which represents the gold-standard for international special purpose vehicles. Minimal administrative requirements, flexible capital structure and limited disclosure requirements are counter-balanced by the Island's well-respected regime for the regulation and supervision of registered agents.

For those whose tastes are more conservative, the Island's long-established conventional companies draw heavily on English legislative traditions, but without the more prescriptive requirements associated with companies incorporated in metropolitan jurisdictions.

All Isle of Man corporate vehicles can be structured as open-ended investment companies i.e. companies that allow investors the flexibility to redeem their shares before the winding up of the company. Open-ended investment companies are regarded as collective investment schemes for the purposes of Isle of Man law. Closed-ended investment companies, which don't provide this flexibility, are outside the scope of Isle of Man funds regulation.

4. Protected Cell Companies

Both conventional and new 2006 Act companies can be established in the Isle of Man in the form of protected cell companies or "PCCs". Once a novel idea, these vehicles are now an established feature of the international investment landscape. By segregating the interests of both investors and other stakeholders, such as leverage providers, within each cell, PCCs provide a low-cost and quick-to-launch means of creating legally robust new sub-funds. PCCs are ideal for use both in multi-class/single manager structures and in multi-manager offerings.

5. Limited Partnerships

Private equity specialists have always appreciated the flexibility offered by limited partnerships, but these vehicles have recently gained favour with managers of other asset classes, particularly property. Being tax transparent under Isle of Man law, these vehicles offer considerable opportunity for efficient cross-border tax planning whilst continuing to allow investors the benefit of limited liability.

Isle of Man limited partnerships also benefit from a flexible legal framework. There is minimal statutory overlay in relation to the operation of an Isle of Man limited partnership. The legislation offers the flexibility to return capital prior to the winding up of the partnership and, in order to provide comfort to investors, sets out a “white-list” of activities that will not result in limited partners being regarded as involved in the management of the partnership and thereby prejudicing their limited liability status, which includes advising the general partner. Limited partnerships are regarded as collective investment schemes for the purposes of Isle of Man law.

6. Unit Trusts

Last but not least among the most popular fund structures available in the Isle of Man is the unit trust. The Isle of Man follows England in its trust law. As a result, the concept of the trust arrangement has been an integral part of the Island’s legal framework since its jurisprudence began. As a fund vehicle, the unit trust arrangement offers huge flexibility and the security of knowing that the arrangements are not a matter of public record.

After being associated for many years with retail long-only equity investment, unit trust arrangements came to prominence more recently in connection with tax-driven UK property investment structures. Having done so, they are now an increasingly being used in a range of investment scenarios as promoters take advantage of the opportunities they afford for structuring investors’ returns.

7. Regulatory Environment

The Isle of Man has a well-founded reputation as a premier jurisdiction in terms of regulation, achieving a balance between, on the one hand, providing a business friendly environment and, on the other hand, meeting international standards of financial supervision. A number of independent assessments of the Island’s regulatory framework have been conducted which verify the Island’s status. The most comprehensive of these was the assessment carried out by the IMF which was completed in November 2003, but they have also included the positive assessment by the Financial Stability Forum of May 2000 identifying the Island as a ‘category 1’ jurisdiction, and confirmation as a co-operative jurisdiction from the FATF in 2000. The IMF is due to publish a further report following an inspection visit to the Island in September 2008. It has been reported that the draft copy of the IMF report praises the Island’s financial regulation, financial stability and anti-money laundering legislation.

The Review of the British offshore financial centres commissioned by the Chancellor Alistair Darling and undertaken by Michael Foot is currently taking place. The focus of the review is working with the financial centres to analyse their assessment of the risks flowing from the current and forecast macro-economic environment. The visits and discussions undertaken so far have been fact finding. The review continues and Mr Foot is expected to deliver his final report in the last quarter of 2009. The Island’s Chief Minister, Tony Brown, recently stated that no specific concerns about the Isle of Man have been identified so far. The Island was able to provide the review with information about its internationally recognised standards on regulation and tax as well as an overview as to how its diverse economy is performing during the global downturn. The Island’s progress on signing 14 tax information exchange agreements, placing it firmly on the OECD’s ‘white list’ of jurisdictions that have substantially implemented internationally agreed tax standards, was welcomed by the review.

The Isle of Man has worked hard to ensure that it is not regarded as a tax haven with harmful tax practices and its inclusion on the most recent OECD white list in April 2009 is recognition of its efforts. It also demonstrates that the Isle of Man is a co-operative and transparent international financial services centre which takes its international responsibilities very seriously.

By being pro-active and entering into tax information exchange agreement with other jurisdictions, the Island is currently ahead of the game and a number of its competitors.

Regulation of fund managers and administrators, and of collective investment schemes, is undertaken in the Isle of Man by the Financial Supervision Commission or “FSC”. As well as a framework for the regulation and supervision of financial services providers, the Island has adopted extensive regulatory measures to prevent money laundering and the financing of terrorism.

8. Regulatory Framework

The establishment and operation of investment funds in the Isle of Man is governed principally by the Collective Investments Scheme Act 2008 (“CISA”) and the Financial Services Act 2008 (“FSA”) and any orders made thereunder.

9. Categories of Fund

The Isle of Man has a full suite of fund options ranging from fully regulated, retail-focused “authorised schemes” to private fund arrangements such as “exempt schemes” that fall wholly outside the scope of regulation. Between these extremes are a range of unapproved funds that are subject to varying degrees of structural regulation. These are the main categories of Isle of Man funds and are not subject to prescriptive regulation, but all generally involve the appointment of an Isle of Man licenceholder and provide certain safeguards for investors.

a. International Schemes

An international scheme under schedule 2 to the CISA is defined as a fund established in the Isle of Man which is not an authorised scheme or an exempt scheme. International schemes may not be promoted to the general public in the Isle of Man. The FSC introduced this category of fund to provide for flexibility of product and to encourage innovation.

With the exception of “full” international schemes, this fund type is not subject to any form of approval or authorisation process and can generally be established fairly quickly and in a cost effective manner. Full international schemes must be managed or administered by an Isle of Man licenceholder (the FSC must approve this appointment) and appoint a custodian who is either an Isle of Man licenceholder or authorised to act in either the UK, Guernsey or Jersey. Regulations for full international schemes contain some investment restrictions and mandatory information to be inserted into constitutional documents.

The specialist fund, qualifying fund and professional investment funds are all forms of international scheme, although they do have their own regulatory structure, as detailed in this brief. Regulatory requirements are less onerous than for a full international scheme.

b. Specialist Fund or ‘SF’

The SF has been specifically created to meet the demands of the alternative investment community and their institutional investors. The Isle of Man understands that the promoter of, and advisers to,

hedge funds need a jurisdiction and a product that provides maximum flexibility and future-proofing in a fast-moving international investment environment.

(i) Asset Management

There are no regulatory restrictions on the types of investments that a SF can make and no restrictions on the trading strategies that can be employed by its manager or adviser. There are no regulatory limits on the borrowings or leverage that a SF may undertake.

A SF must receive (either directly or indirectly) investment advice or management services from an entity that the SF's governing board considers is suitable to undertake such function. In assessing this, the regulated status of that person should be taken into account.

(ii) Regulated Administrator

A SF must appoint a regulated fund administrator to perform its core administration requirements, including transfer agency work, valuations, pricing and fund accounting services. The administrator may be an Isle of Man regulated administrator or alternatively, an appropriately regulated fund administrator based in a jurisdiction that the FSC regards as providing an acceptable level of regulation and mutual assistance arrangements.

(iii) Governance and Board Composition

A SF must have an independent non-executive director on the board. In addition, where a SF has appointed an overseas administrator regulated in another acceptable jurisdiction (see above), the board of directors must include an Isle of Man resident individual who is either licensed as a fiduciary or working for a licensed fiduciary services provider.

(vi) No Regulatory Pre-approvals

There is no requirement for any pre-approval to be sought from the FSC or any other body, nor are Isle of Man licensed administrators required to obtain any specific approval or consent to act in relation to any particular SF. This means that a SF can be launched quickly and without any risk of regulatory delays.

(v) Target Investors / Minimum Subscription

A SF must have a minimum initial investment requirement of at least US\$100,000, which is policed by the administrator. The SF is not intended to be a vehicle for retail investment. It is designed to facilitate the establishment and operation of sophisticated alternative investment funds and, accordingly, is aimed squarely at institutional and super-high net worth investors. Prospective investors must certify that they are sufficiently experienced to understand the risks associated with an investment in the SF in question and must fall into one of the categories of permitted investor. Broadly speaking, these cover institutional investors, affiliates of the fund's promoters and managers and individuals with a net worth in excess of US\$1M.

(vi) Offering Document

Every SF is required to have an offering document. The board of directors of the SF must all sign a statement in respect of the offering document in which they acknowledge that they are responsible for the contents of the offering document and for ensuring that it is updated as appropriate. There are only a limited number of prescribed statements to be included in the

offering document of a SF. By and large the content of a SF's offering document is a matter for its board of directors, subject to an overriding requirement that the offering document should accurately set out all material information to enable a prospective investor to make an informed investment decision. The SF is also required to have an investor application form that contains certain prescribed statements including a certification by the investor that he meets the target investor requirements (see above).

(vii) Flexible Custody Arrangements

There are no prescriptive requirements for the appointment of a custodian to a SF, although the arrangements for custody of the assets must be disclosed in the offering document.

(viii) Accounting and Audit Requirements

A SF must prepare annual financial statements in accordance with either international accounting standards or UK GAAP, which must be audited by a qualifying auditor (broadly, a member of a relevant professional body of accounts, such as the Institute of Chartered Accountants in England & Wales, with a permanent place of business in the Isle of Man, with appropriate professional indemnity insurance to a level of at least £20M). Audited financial statements must be distributed to investors within 6 months of the end of its financial year. It is expected that SF regulation will be extended in the near future to allow for the use of US GAAP.

c. Qualifying Funds or “QIF”

With no mandatory minimum subscription, the Qualifying Fund is a more regulated vehicle than the SF and amongst other things, is required to appoint a custodian.

(i) Asset Management

As with the SF, there are no regulatory restrictions on the types of investments that a QIF can make and no restrictions on the trading strategies that can be employed by its manager or adviser. Similarly, there are no regulatory limits on the borrowings or leverage that a QIF may undertake.

A QIF must receive (either directly or indirectly) investment advice or management services from an entity that the QIF's governing board considers is suitable to undertake such function. In assessing this, the regulated status of that person should be taken into account.

(ii) Regulated Manager

A QIF must appoint a regulated fund manager to undertake administration of the fund and to be responsible for determining whether the fund is and continues to be managed and operated in accordance with the fund's constitutional and offering documents. The manager must be an Isle of Man licenceholder.

(iii) Governance and Board Composition

A QIF must have an independent non-executive director on the board and at least one Isle of Man resident person.

(iv) No Regulatory Pre-approvals

There is no requirement for any pre-approval to be sought from the FSC or any other body, nor are Isle of Man licensed managers required to obtain any specific approval or consent to act in relation to any particular QIF.

(v) Target Investors / Minimum Subscription

There is no minimum initial investment requirement for investors in a QIF. Target investors are regarded as non retail, must be sufficiently experienced to understand the risks associated with an investment in the QIF, and fall within at least one of several categories of qualifying investor (which includes persons whose ordinary business or professional activities includes holding or disposing of investments, or the giving of investment advice, service providers to the QIF, trustees of employment benefit or executive incentive schemes or trusts).

(vi) Regulated Promoter Requirement

A QIF is required to appoint one or more promoters who prepares or distributes (or who arranges the same) the offering document or associated marketing material. The promoter must either be licensed in the Isle of Man or an acceptable jurisdiction. Alternatively, instead of appointing a regulated promoter, the QIF may engage a regulated financial adviser (RFA) to advise investors on the suitability of investment in a QIF, provided (i) the RFA must sign a declaration to that effect in respect of each investor and (ii) the manager of the QIF must oversee the promotion of the fund and satisfy itself that the adviser is indeed an RFA.

(vii) Offering Document

Every QIF must have an offering document. The board of directors of the QIF must all sign a statement in respect of the offering document in which they acknowledge that they are responsible for the contents of the offering document and for ensuring that it is updated as appropriate. As with the SF, a limited number of prescribed statements must be included in a QIF's offering document and there is an overriding requirement that the offering document should accurately set out all material information to enable a prospective investor to make an informed investment decision.

The investor application form must contain certain prescribed statements including a certification by the investor that he meets the target investor requirements.

(viii) Flexible Custody Arrangements

A QIF must appoint a custodian who is either licensed in the Isle of Man or in a jurisdiction that is acceptable to the FSC. The governing body of the fund is responsible for ensuring that each appointed custodian is appropriately experienced to provide services to the class of assets to which it is appointed. The FSC is shortly expected to introduce revised provisions whereby the governing body and manager of a QIF will be responsible for appointing a suitable custodian, without reference to the FSC on the question of jurisdiction.

(ix) Accounting and Audit Requirements

A QIF must prepare annual financial statements in accordance with either international accounting standards or UK GAAP, which must be audited by a qualifying auditor (as detailed

above under “Specialist Fund”). Audited financial statements must be distributed to investors within 6 months of fund’s financial year end.

d. Exempt Schemes

A further class of international funds, exempt schemes are Isle of Man collective investment schemes that have less than 50 investors and their relevant constitutional documents expressly prohibit the making of an invitation to the public to subscribe in any part of the world. This popular fund type is regarded as a private arrangement and is not subject to any form of regulation. Although not mandatory, an exempt scheme may appoint a manager who must be licensed to carry on investment business in the appropriate jurisdiction. However, where that manager is acting for only one exempt scheme, it is not required to be licensed by the FSC in respect of that financial services activity.

e. Closed-ended investment companies

Closed-ended investment companies fall outside the regulatory net for mutual funds. However, Isle of Man companies legislation does apply. If the fund is incorporated under the Companies Act 1931, a prospectus will need to be prepared. However, these requirements are neither prescriptive nor onerous. If the offering of shares is regarded as a private placement, the prospectus requirements under the Companies Act 1931 are disapplied. Alternatively, the fund may be incorporated under the Companies Act 2006, for which there are no prospectus requirements. Instead, the directors are obliged to ensure that any document sent to investors contains all material information required to enable them to make an informed investment decision.

Closed-ended investment companies have proved extremely popular for vehicles wishing to list on the Alternative Investment Market (“AIM”) of the London Stock Exchange. Indeed, over the past few years, the Isle of Man has become recognised as the most commonly used offshore jurisdiction for large international listings on the London Stock Exchange.

f. Other Fund Types in Brief

(i) Authorised Funds

Authorised funds may be marketed to the general public in the Isle of Man, and as a result, are subject to prescriptive regulation. They must be established as either an open-ended investment company or a unit trust. The relevant legislation prescribes the types of fund that are eligible for authorisation under the CISA, i.e. securities funds, money market funds, fund of funds, warrant funds, property funds, futures and options funds, geared futures and options funds, feeder funds and umbrella funds.

Authorised funds may also apply for recognition in the UK by virtue of the Isle of Man's designated territory status. Upon recognition, a fund may be marketed within the UK.

(ii) Recognised Funds

A recognised fund is one which is managed in or authorised from a place outside of the Isle of Man, but which may be promoted to the general public in the Isle of Man by virtue of being “recognised” by the FSC. The governing body of certain funds established in the designated territories (currently Ireland, Guernsey, Jersey and the United Kingdom) may give notice to the FSC requesting recognition and if the FSC registers no objection, will be automatically recognised within 2 months. Funds established in other countries will be subject to more rigorous scrutiny upon application.

(iii) Professional Investor Funds (“PIFS”)

PIFS are a further type of international fund and neither authorised nor approved by the FSC. Although currently available to investors who fall within a statutory definition of "professional investor", it is expected that this fund type will be phased out over the coming months and existing PIFs will be required to convert into specialist funds.

(iv) Overseas or Foreign Funds

“Overseas funds” or “foreign funds” are generic terms used to describe funds established outside the Isle of Man and that may be administered or managed in the Island. These fund types are not subject to any Isle of Man regulation or approval in the Isle of Man but will be subject to any applicable regulatory regime in their home jurisdiction. The FSC does permit a certain level of what it describes as “inwards outsourcing” for such funds, and has produced a guidance note entitled "Undertaking outsourced functions on behalf of administrators or managers of foreign collective investment schemes – "Inward Outsourcing", see further: www.gov.im/lib/docs/fsc/handbooks/guides/Cis/cis_appendixc15.pdf

10. Fund Taxation

The Isle of Man offers a tax neutral environment for fund operations. There are no capital or inheritance taxes in the Isle of Man and stamp duty does not apply. In 2006 the Isle of Man introduced a zero rate of corporate tax for most taxpayers. This means that a corporate fund vehicle will benefit from a zero rate of income tax, as will any fund management or administration business based in the Isle of Man. It follows that the Island no longer has a “tax exemption” regime and therefore fund vehicles need not go through the process for applying for exemption on an annual basis; nor are such vehicles subject to the risks associated with inadvertently ceasing to qualify for exempt status and the adverse taxation consequences that follow.

The fees levied by fund administrators and investment managers based in the Isle of Man in respect of services to collective investment schemes (other than exempt international schemes) are exempt from value added tax in the Isle of Man.

For more specific advice on Funds in the Isle of Man we invite you to contact one of the following:

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