

AIFM Directive Adopted

The European Parliament adopted the Alternative Investment Fund Managers Directive (“AIFM Directive”) on 11 November 2010. Among other things, the AIFM Directive contains new rules on the marketing of alternative investment funds in the EU.

Background

The AIFM Directive was first introduced in response to calls for greater regulation of Alternative Investment Fund Managers (“AIFMs”). An AIFM includes any legal or natural person whose regular business is to manage one or more alternative investment funds (“AIF”), such as hedge funds and private equity funds. An AIF is defined as a collective investment undertaking (other than a UCITS fund) that raises capital from a number of investors and invests in accordance with a defined investment policy, for the benefit of those investors.

Much uncertainty has surrounded the AIFM Directive as it has evolved over the past eighteen months. Now that consensus has been reached, the alternative investment fund community can prepare for its implementation in 2013.

Impact

The AIFM Directive will apply to all EU AIFM, which manage one or more AIFs, irrespective of where the AIFs are domiciled. The AIFM Directive will also apply to all non-EU AIFM, which manage one or more AIFs domiciled in the EU or market one or more AIFs in the EU. An AIF that is self-managed, i.e. does not appoint a third party manager, will itself be considered as the AIFM. The AIFM Directive has different effects depending on whether the AIFs or the entity that is the AIFM is established within or outside the EU.

Exemptions

The Directive provides for a lighter regime for AIFM where the cumulative AIFs under management fall below a threshold of €100 million. If the AIF is not leveraged and has a lock-in period of five years or more, this threshold is raised to €500 million. Consequently, those AIFM will not be subject to full authorisation but to a registration in their home Member State. Such smaller AIFM will, however, be permitted to ‘opt in’ to the provisions of the Directive.

The AIFM Directive expressly exempts segregated managed accounts, funds managed by public sector entities supporting social security or pension systems, such as certain sovereign wealth funds, or family office vehicles that invest without raising external capital.

Requirements

Authorisation

AIFMs must be authorised under the AIFM Directive by the competent regulatory authority of their home state. Conditions for authorisation include:

- Initial capital: self-managed AIF must have at least €300,000, AIFM managing one or more AIF must have at least €125,000;
- Own funds: where the value of the portfolios of AIF managed by the AIFM exceeds €250m, additional own funds are required;
- Personnel: the persons conducting the business of the AIFM must be of sufficiently good repute and sufficiently experienced in relation to the investment strategies pursued by the AIF.

Operating Conditions

The AIFM is required on an ongoing basis to:

- employ effectively the resources and procedures that are necessary for the proper performance of its business activities;
- take all reasonable steps to avoid conflicts of interests and to identify and manage any conflicts of interest to prevent them from adversely affecting the interests of the AIF and its investors;
- comply with all applicable regulatory requirements so as to promote the best interests of the AIF, its investors and the integrity of the market;
- have sound remuneration policies and practices in place that are consistent with and promote sound and effective risk management;
- implement adequate systems to identify, measure, manage and monitor all risks relevant to each AIF investment strategy;
- employ an appropriate liquidity management system for each AIF it manages.

Organisational Requirements

Each AIFM must ensure that, for each AIF that it manages, appropriate and consistent procedures are established so that a proper and independent valuation of the assets of the AIF can be performed in accordance with the AIFM Directive and the applicable national and AIF rules.

The AIFM Directive imposes conditions on the delegation of AIFM functions to third parties.

Depositaries

All AIFMs will be required to ensure that the funds they manage appoint an independent and qualified depositary, which will be responsible for overseeing the fund's activities and ensuring that the fund's cash and assets are appropriately protected. The depositary must be located as follows:

- For EU AIF, the depositary must be established in the home Member State of the AIF;
- For non-EU AIF, the depositary must be established in the third country where the AIF is established, or in the home Member State of the AIFM managing the AIF, or, as the case may be, in the Member State of reference of the AIFM managing the AIF.

Depositaries will be held to a high standard of liability in the event of a loss of assets and the burden of proof will reside with the depositary. The AIFM Directive requires that if a depositary legally delegates its tasks to others, it must provide a contract which allows the AIF or AIFM to claim damages against the entity to which the tasks are delegated. This is intended to ensure that at no point in the chain will liability be irretrievably lost. The European Parliament also secured a requirement that the AIF investors concerned must be informed about the potential delegation of liability and the reasons for this. These new rules are likely to create additional operational and compliance burdens for depositaries.

Transparency

One of the aims of the AIFM Directive is to enhance the transparency of AIFMs and the AIFs that they manage. The new transparency requirements cover disclosure to investors prior to investment, reporting obligations to competent authorities and detailed disclosures in AIF annual reports.

Marketing in Europe

The AIFM Directive establishes a framework to regulate the offer or placing of shares or units in an AIF. It introduces a European "passport" under which authorised AIFMs can market EU AIFs to professional investors throughout the EU, subject to a notification procedure. The passport for EU AIFM marketing EU AIF comes into effect with the AIFM Directive (early 2013).

The AIFM Directive as adopted will enable non-EU AIFM to market to investors across the EU without first having to seek permission from each Member State and comply with different national laws. Non-EU AIFM will only obtain a passport if the non-EU country in which they are located meets minimum regulatory standards and has agreements in place with Member States to allow information sharing. There will be at least a two year time lag before a passport is available for EU AIFM marketing non-EU AIF or for non-EU AIFM marketing any AIF in Europe.

While it was a concession that national private placement regimes permitted were retained under the AIFM Directive, it is intended, in the long-term, to abolish such national regimes and replace these with European marketing passports.

The below table summarises the marketing framework under the AIFM Directive:

		EU AIFM	Non-EU AIFM
EU AIF	Passport	Following authorisation and notification under the AIFM Directive, AIFM may market EU AIF to professional investors in other Member States (from 2013)	To avail of passport, AIFM must obtain authorisation from competent authority of its Member State of reference and comply in full with the AIFM Directive and specific cooperation conditions (from 2015)
	Private Placement	N/A	AIFM may market EU AIF to professional investors in any Member State under its national private placement rules subject to complying with conditions laid down in the AIFM Directive (existence of cooperation arrangements, tax information exchange etc.) (until 2018*) (from 2015, the AIFM must be authorised)
Non-EU AIF	Passport	Subject to complying in full with the AIFM Directive and specific conditions (existence of cooperation arrangements, tax information exchange etc.), authorised AIFM may market non-EU AIF to professional investors in other Member States (from 2015)	Where an authorised AIFM is in full compliance with the AIFM Directive and the country in which the AIF is located satisfies certain conditions relating to cooperation and tax information sharing, the AIFM will be able to exercise passport rights in marketing its fund in the same way as an EU AIFM (from 2015)
	Private Placement	Authorised AIFM may market a non-EU fund in any Member State under its national private placement rules subject to full	AIFM may market a non-EU fund in any Member State under its national private placement rules provided that

		compliance with the AIFM Directive certain conditions (existence of cooperation arrangements, certain depositary requirements etc.) (until 2018*)	it complies with the transparency provisions of the AIFM Directive (until 2018*)
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* If the new European Securities and Markets Authority advises that it is appropriate to do so, the AIFM Directive contains provisions to facilitate the abolition of the private placement regime five years after the AIFM Directive comes into force (2018).

The AIFMD does not, however, prevent unsolicited approaches by EU investors to non-EU AIFMs. Nor does it prohibit EU investors from investing in AIFs managed by AIFMs where there has been no approach by the AIFM, even if the AIFM does not satisfy any of the requirements set out in the AIFM Directive.

Target Investors

Marketing to retail investors (i.e. non-professional investors) is defined by each Member State in its own territory and they can impose stricter requirements than those for professional investors as long as Member States do not favour domestic AIF over non-domestic AIF.

Private Equity Funds

The European Parliament insisted from the outset on the need to combat asset stripping. Accordingly, the AIFM Directive contains provisions which limit distributions and capital reductions within the first two years that a company is taken over by a private equity investor. Private equity investors will also have to comply with detailed information and disclosure requirements particularly regarding information on the planned strategy for the company.

Timeline

Below is a summary of the expected timeline for the AIFM Directive:

- AIFMD will come into force in early 2011;
- AIFMD to be transposed into local law in early 2013;
- Passport regime for EU AIFMs of EU AIF will commence in early 2013;
- Passport regime for non-EU AIFMs and non-EU AIF will commence in early 2015; and
- Private placement regime may end in 2018.

The new European Securities and Markets Authority and the European Commission will now work on preparing AIFM Directive guidelines and implementing legislation.

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