

Summary of Alternative Investment Fund Managers Directive - AIFMD

The AIFMD (Directive 2011/61/EU) must be implemented by EU member states by 22 July, 2013. It introduces the regulation of EU domiciled Alternative Investment Fund Managers (AIFMs) who manage one or more alternative investment funds (AIFs) in the EU and AIFMs established outside the EU which manage one or more EU AIFs or which market one or more (EU or non EU) AIF in the EU. The AIFMD will be implemented by detailed implementing measures on many areas. These will be adopted by the EU Commission on the basis of advice provided by the European Securities and Markets Authority (ESMA). The level II provisions in the form of an EU Regulation (which will have direct effect) issued in December 2012.

Scope

The AIFMD catches AIFMs established in the EU which manage one or more AIFs wherever the AIFs are located, and catches AIFMs established outside the EU which manage one or more AIF established in the EU or which market one or more (EU or non-EU) AIF in the EU. Holding companies and certain securitisation SPVs are outside the scope of the AIFMD.

Authorisation and organisational requirements for AIFM

For authorisation, AIFM will be required to furnish information on the people effectively managing the business (who will be subject to fitness and probity requirements) and on the ownership of the AIFM, the planned activity of the AIFM, the characteristics of the AIF to be managed, remuneration and delegation arrangements. The AIFM will also be required to hold and retain a minimum level of capital. If an AIF is self-managed, it will have to satisfy the capital requirements of €300,000 itself. The minimum activities of the AIFMD include portfolio management and risk management.

Exemptions

AIFM managing portfolios of AIF with total assets under management less than €100m (including assets acquired through the use of leverage) or below €500m (if unleveraged and with no redemption rights for 5 years after initial investment) will be exempt from all but minor notification requirements. These AIFM would have no passporting rights under the AIFMD but will be permitted to 'opt-in' to the provisions of the AIFMD.

Passport

Authorised AIFM will be permitted to market AIF to professional investors (as defined in the Markets in Financial Instruments Directive) in EU member states, subject to some notification, and will have the right to manage AIF in other EU member states, again subject to notification requirements.

Retail investors

EU member states may allow for marketing of AIF to retail investors in their member state and may impose additional requirements for this. There will be no passporting rights for marketing AIF to retail investors. Where an EU member state allows for the marketing of AIF to retail investors in its territory, this possibility should be available regardless of the EU member state where the AIFM is established. EU member states may not impose stricter criteria on AIF established in the EU and marketed on a cross border basis than an AIF marketed domestically.

Third Country Issues

This topic is complex. In essence, AIFMD envisages non EU AIFM registering with an EU member state (from 2015) provided that the AIFM home country is not listed as a non-cooperative country and territory by FATF, has model tax agreements in place with relevant member states, and has appropriate regulatory cooperation agreements in place. EU AIFM will be able to market non EU AIF (from 2015) if the AIF home country meets these requirements. Private placement regimes will continue, subject to certain conditions, until "turned off" by the EU Commission which will only happen if and when a parallel passport regime has been introduced permitting non-EU funds to be distributed throughout Europe, subject to conditions.

Notifications to regulators

An AIFM will be required to report to its regulator on a regular basis on the principal markets and instruments in which it trades and its principal exposures and concentrations of risk. The AIFM will also be required to notify its regulator of the AIF it manages and/or markets in the EU, the assets in which the AIFs invest, liquidity arrangements, risk management arrangements and the results of stress tests. Additional disclosure obligations will apply to AIFM managing leveraged AIF and controlling stakes in companies.

Transparency

AIFM will be required to disclose to AIF investors details of the AIF's investment strategy, leverage and risk characteristics, details of the AIF's service providers, any delegation of management function, and the AIFM's liquidity management and risk management systems. For each AIF, the AIFM will

periodically disclose to investors the percentage of the AIF's assets which are subject to special arrangements, such as side pockets, arising from their illiquid nature. AIFM will be also required to disclose all fees and charges whether directly or indirectly borne by investors as well as preferential treatment provided to other investors (and the type of those other investors) by the AIFM.

Delegation

The AIFM must be able to justify the delegation. The delegate must have adequate resources and individuals performing tasks must be of good repute and experience. The AIFM must inform its home regulator of delegation. Delegation of portfolio or risk management will generally only be permitted to authorised firms who are subject to supervision and, in the case of non-EU managers, where there is a co-operation agreement between regulators.

Remuneration

AIFM must have remuneration policies and practices which do not encourage risk taking which would be inconsistent with the risk profiles of the AIF it manages. ESMA has produced guidelines on this topic.

Depositaries

In essence a depositary of an EU AIF must be located in the AIF's home member state and must be any of a credit institution with a registered office in the EU, a MiFID investment firm with its registered office in the EU, or an entity which is eligible to act as a depositary under the UCITS framework. Depositaries may delegate to sub-custodians and there is provision for an adjustment of their liability in the event of such delegation in certain limited circumstances (details of which have yet to be finalised). The position of prime brokers is also recognised. The duty of care is significantly onerous.

Valuation of Assets

The AIFMD provides that the AIFM is responsible for the valuation of assets. Valuation may be carried out by an external valuer or by the AIFM, if there is functional independence, if the remuneration policy etc ensures that conflicts of interest are mitigated and if undue influence is prevented.

Leverage

AIFM will be required to set reasonable leverage limits for each AIF. The fund leverage may be capped by the AIFM's regulator. The amount of leverage employed must be reported to regulators regularly.

Further issues

The AIFMD contains detailed provisions on AIFM managing AIF in non EU countries, conduct of business requirements, conflicts of interest provisions, risk management and liquidity management provisions and AIFM will need to establish and operate detailed processes to deal with these issues. Risk management and operating units must be functionally and hierarchically separate.

Regulatory Co-operation

EU Regulators will be required to co-operate and share information whenever necessary so as to achieve the aims of the AIFMD.

Anticipated timeline for AIFMD

- Deadline for transposition of AIFMD into national law: 22 July 2013
- EU AIFM passport introduction: July 2013
- Deadline for application for authorisation by existing AIFMs: 22 July 2014
- Non-EU AIFM passport introduction: Mid 2015 (dependent upon findings of ESMA report and the Commission adopting implementing legislation)
- End of national private placement: mid 2018 (dependent upon findings of second ESMA report and the Commission adopting implementing legislation)

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