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DISPELLING THE AIFMD RUMOUR MILL: TEN THINGS A US INVESTMENT ADVISER NEEDS TO KNOW ABOUT AIFMD

INVESTMENT FUNDS

The EU Alternative Investment Fund Managers Directive (AIFMD) came into force in July 2013, and European managers are currently working through a one-year transition phase with a view to full compliance by July 2014.

However, it is not just European investment managers that need to think about the Directive; the regulations also affect US advisers who seek to raise capital in Europe, even for non-European funds.

So, what do you need to know about AIFMD?

DOES THE AIFMD APPLY TO ME?

If you are raising money in the EEA, then "Yes", parts of the Directive do apply to you. Although many provisions of AIFMD only affect alternative investment fund managers (AIFMs) based in Europe, certain requirements are also applicable to US advisers managing alternative investment funds (AIFs) which are marketed in the EEA (i.e., the European Union, Iceland, Liechtenstein and Norway). Switzerland, which has its own rules, is not an EEA country.

A further distinction is made between European funds and non-European funds (such as Cayman Islands and Delaware). Most US advisers will be marketing non-European funds to European investors, so this note is primarily aimed at this larger category.

CAN I MARKET USING THE AIFMD PASSPORT?

You may have heard of the AIFMD passport, which allows funds approved in one member state to be marketed to professional investors in another on a single market basis. Unfortunately the passport is currently only available to European managers managing European funds. It may be opened up to non-European managers in 2015.

This means that US advisers are required to fall back on private placement. There is no pan-European private placement regime and each member state has its own rules when it comes to distributing funds within its borders.

WHAT DOES "MARKETING" MEAN?

"Marketing" is defined narrowly in AIFMD and is generally interpreted to mean distributing an AIF's final or close-to final offering document and subscription agreement to prospective investors. Consequently, conducting "pre-marketing" in the EEA, such as a face-face investor presentation, will not necessarily bring you within the scope of AIFMD.

However, in addition to AIFMD, as each EEA member state has its own national private placement rules, activities considered "pre-marketing" under AIFMD may still constitute a regulated activity under local laws (such as a Financial Promotion in the UK). Further, many member states have varied their private placement rules in the light of AIFMD, and we would therefore caution against an unfettered marketing trip without having taken steps to ensure that at least the relevant marketing material is compliant with the new rules.

Note also that AIFMD is extra-territorial when it comes to marketing, so a sale to, say, a Dutch pension fund in Switzerland, would still need to be compliant.

HOW DO I COMPLY WITH THE REQUIREMENTS OF THE DIRECTIVE FOR US ADVISERS?

If you market an AIF in the EEA, you will be subject to certain minimum disclosure and reporting obligations:

- Annual reports must be made available to regulators in each target member state and to EEA investors.
- A mandatory and prescriptive list of pre-sale and periodic post-sale disclosures to EEA investors will apply.
- Regular reports must be made to the relevant regulators on, among other things, the main instruments and markets, liquidity and risk profile of the AIF. Unfortunately there is no single EEA recipient for these reports. They must therefore be made to the regulators in each state in which you successfully make a sale.

In addition, if, individually or jointly, you acquire control of a non-listed company (other than an SME), you will be subject to certain further disclosure obligations and "asset stripping" restrictions.

Member states are free to "gold plate" their private placement rules, so you may be required to provide even more information than required under AIFMD.

WHAT ABOUT "REVERSE SOLICITATION"?

An investment in a fund made at the initiative of an investor (a so-called "reverse solicitation") is not considered "marketing" for purposes of AIFMD and is therefore out of scope entirely. So, theoretically, it is possible to continue to raise capital in the EEA in this manner without complying with the AIFMD disclosure requirements described above.

Whether an investment truly came about as a result of a reverse solicitation is a question of fact and should be carefully considered on a case-by-case basis. For example, we would caution that participating in a systematic Cap-Into programme is unlikely to constitute a reverse solicitation. Moreover, while it may be helpful for investors to sign a disclaimer stating that they initiated the investment, this representation will not in itself be definitive evidence of the fact, although it is, of course, very helpful. We anticipate that this subject will receive a lot of regulatory attention in the future.

ARE THERE ANY OTHER EXEMPTIONS?

Many smaller managers will be able to avail themselves of the "sub-threshold" limitation whereby the scope of AIFMD is limited if:

a. your total assets under management, in relation to open ended, leveraged funds, do not exceed €100m; or

b. your total assets under management for closed ended, unleveraged funds do not exceed €500m.

Note that the threshold applies at the level of the manager on a combined AUM basis.

In practice, many hedge fund managers will consider the sub-€100m threshold as too low and will voluntarily comply with AIFMD's requirements in full in any event. The sub-threshold category therefore is most obviously beneficial to smaller private equity managers (who will generally fall within category (b)).

Yet even if you do fall within the sub-threshold carve out, it will not necessarily help. At best, it will limit your requirement to comply with the disclosure and annual reporting regulations. Most states ignore the carve-out when it comes to registering the offer and many will require additional disclosure in any event.

DO I NEED A DEPOSITARY?

Non-European managers managing non-European funds will not be required to appoint a depositary or comply with the "depositary light" regime (whereby one or more entities are required to undertake the functions of a depositary). However, local private placement regimes may "gold plate" this basic position. For example, if it is your intention to market into Germany, you will be required to register as an AIFM and appoint a depositary light regime for your Cayman fund prior to receiving approval.

DO I NEED TO RESTRICT STAFF COMPENSATION IN ANY WAY?

The AIFMD remuneration guidelines will not generally apply to US advisers (although they could apply to US sub-adviser delegates of European fund managers). Note, however, that one of the disclosure requirements for all managers, including US-based advisers, is to disclose to investors in the annual report the amount of remuneration paid by the AIFM to its staff. Many US advisers are currently working with their counsel and accountants to determine the extent of such disclosure.

IS AIFMD RETROSPECTIVE?

No. If you are not marketing your fund, then you do not need to comply with EEA, even if you have EEA investors in your fund. Compliance is triggered by the act of marketing in the EEA marketing after that date.

WHAT DO I DO NOW?

Most US advisers will not be managing a European fund and so AIFMD will have a limited impact. However, as there is no pan-EEA private placement regime and as member states have applied the transitional provisions differently, you should approach any up-coming marketing trip with caution. At the very least, you should ensure that you understand the private placement regime in each target jurisdiction and whether or not the offer or marketing needs to be registered prior to the sale. You should also take steps to ensure that any marketing material and the offering documents contain the appropriate AIFMD disclosures.

CONTACT DETAILS

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