
AIFMD: The story so far

The Alternative Investment Fund Managers' (AIFM) Directive passed through the European Parliament in November last year, and is now in the Level II stage, where the Directive will be implemented via a series of European regulations, as well as transposition into national law. The Directive will not come into force until 2013 and elements of it may change as it undergoes the process – it is currently being looked at by both national regulators and the new pan-European regulator, ESMA. However, the broad shape of the legislation is known, and this note takes stock of the current state of the Directive.

Scope of the Directive

The Directive will apply to managers of an Alternative Investment Fund (AIF), in the following circumstances:

- EU AIFM who manage EU or non-EU AIF;
- Non-EU AIFM who manage EU AIF: and
- Non-EU AIFM who market their AIF in the EU

As PE funds fall within the definition of an AIF, the Directive will apply to managers of these funds that fall within the categories above, except where the total funds under management by the AIFM fall below a threshold of €500mn (without leverage) or €100mn (with leverage). In these instances, the AIFM will benefit from a partial exemption from the full requirements of the Directive. However, non-EU managers will only be able to market their funds (using the passport described below) if they choose to apply the Directive fully. There is also an exemption for certain close-ended AIF in run-off or with a limited life.

Non-EU AIF marketing their funds in the EU

Where a non-EU AIFM manages a non-EU fund, it will not be required to be regulated through the Directive if it is marketing that fund through individual national private placement regimes. These national regimes will continue until at least 2018.

Non-EU AIFM will also be able to market their funds across the EU via a passport system – which will be in place in June 2015. In order to gain access to the passport, the fund will be required to be fully regulated under the AIFMD.

Impact of the Directive

The AIFMD contains a number of different obligations on AIF, including restrictions on the ways in which they are able to market their funds, requirements to hold capital and register with a depositary, and disclosure requirements. These will impact not just fund managers themselves, but those who invest in such funds – particularly, retail investors. The key features of the Directive are:

Marketing

AIFM will be allowed to market their funds to professional investors via national private placement regimes, or via the passport for non-EU AIFMs. However, they will not be permitted to market to retail investors unless the AIFM is

‘managed in accordance with the Directive.’ The main effect of this appears to be that non-EU AIFM will not be able to market their funds to retail investors in the EU between 2013 and 2015, as they will not be able to be ‘managed in accordance with the AIFM’ through the passport during this time.

Capital requirements

Where an AIF is externally managed by an AIFM [(meaning that the AIF isn’t managed by itself)], the AIFM must maintain initial capital of €125,000, as well as own funds equal to the higher of:

- One quarter of fixed annual overheads, including salaries, guaranteed bonuses and rent; or
- 0.02% of the amount by which the total value of portfolios under management exceeds €250mn, subject to a cap of €10mn.

This initial capital and own funds must be invested in liquid assets or assets readily convertible to cash in the short term, and may not be used to invest in speculative positions.

Remuneration

Remuneration of an AIFM’s senior staff – including carried interest – will be subject to new rules, requiring a remuneration policy consistent with, and which promotes, sound and effective risk management.

Reporting requirements

There are a number of reporting requirements within the Directive, including some which are private equity specific:

- An AIFM must prepare an Annual report for each EU AIF it manages or non-EU AIF it markets in the EU. The report must be provided to the relevant EU competent authorities, as well as to investors on request.
- An AIFM must notify must make notification of its voting rights to its relevant regulator when it acquires voting rights of 10/20/30/50/75% of a non-listed company, either singularly or in conjunction with another AIF.
- When an AIFM acquires control of a non-listed company (voting rights of greater than 50%), it must make additional disclosures to its regulator, the company and its shareholders.

Depositary

AIFM will be required to maintain an external depositary to safeguard the assets of the fund, and to prevent further ‘Madoff-style scandals’. This depositary will be a European bank, or another European financial institution regulated via MiFID or UCITS, though there are provisions in the Directive for private equity funds to use certain other types of professional service provider. The depositary will be required not only to hold the assets of the AIF, but also undertake further duties, such as ensuring the accuracy of the valuations the AIF places on its assets.

Non-EU AIF will not be required to maintain a depositary unless they are an EU AIFM managing a non-EU AIF through national private placement regimes, or are marketed by a non-EU AIFM through the passport.

Leverage

AIFM will be required to set leverage limits on the AIF that they manage. However, the Directive makes clear that this requirement is not intended to catch leverage entered into at the private equity portfolio company level. Therefore, this requirement should have little impact on the leverage used in private equity transactions.

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