

Alternative Investment Fund Managers Directive (AIFMD) Frequently Asked Questions (FAQs)



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Managing rapid change to maintain competitiveness is a vital skill in the investment funds industry.

The drafting of the Alternative Investment Fund Managers Directive illustrates this point. Having followed over 18 months of drafting and redrafting of proposals, the path leading to the final draft with the ongoing dialogue over differing approaches has been long and difficult. Continual change of position may have made it difficult to keep up and questions do arise, particularly as a result of there being several contrasting versions.

We have therefore compiled some frequently asked questions and provided you with their answers.

Scope

In a nutshell, what is the AIFMD?

The AIFM-Directive is a European Union Directive which is due to be transposed into European Union Member States' national law by 2013. It seeks to regulate the previously lightly regulated investment fund sector, in particular hedge funds, private equity funds and real estate funds.

Essentially, all non-UCITS come within the scope of the AIFMD unless they fall under the exception clause (less than EUR 100 million or less than EUR 500 million unleveraged and which do not grant investors redemption rights for a period of 5 years following the date of constitution of each AIF).

Following the recent financial crisis the Alternative Investment Fund Managers Directive seeks to regulate and harmonise EU and non-EU AIF Managers acting within the EU. It is important to note that the AIFMD is not regulating AIFs but rather the Managers of these funds.

Who is subject to the AIFMD?

All alternative investment funds managers established in the European Union, whether they manage EU or non-EU AIF, are subject to the AIFMD. The AIFMD also governs the marketing in the EU of AIF managed by an AIFM established outside the EU. It is important to note that a non-EU AIFM marketing outside of the EU a non-EU fund which invest in EU equities does not come within the scope of the AIFMD, as this would involve product regulation and the AIFMD is regulating the AIF managers.

The alternative investment funds under AIFMD cover all the main investment funds other than UCITS. This includes the Luxembourg specialized investment funds (SIF) governed by the Luxembourg law of 13 February 2007 and the Luxembourg investment companies in risk capital (SICAR) governed by the law of 15 June 2004, funds set up under Part II of the law of 17 December 2010 on Undertakings for Collective Investment, unless they fall under the general exceptions:

- less than EUR 100 million
- or less than EUR 500 million unleveraged and which do not grant investors redemption rights for a period of 5 years following the date of constitution of each AIF

These types of vehicles may also be able to benefit from an exemption based on their investment policy or the size of their assets.

Can an Alternative Investment Fund be distributed to EU retail investors?

The EU Passport introduced by the AIFMD allows an AIFM to market the shares of an AIF to professional investors - by contract the marketing of AIF to retail investors remains in the discretion of each Member State. E.U. Where Member States permit the marketing of AIF to retail investors they can impose stricter requirements.

Can an EU feeder AIF with a non EU master AIF benefit from the European passport under the AIFMD?

A feeder fund only has access to the EU Passport if the master fund has the ability to obtain the EU Passport itself. A feeder AIF is defined as an AIF investing at least 85% of its assets into another AIF (the master AIF).

Is it compliant with the AIFMD if a Luxembourg management company delegates its portfolio management functions for an Alternative Investment Fund to a US AIF Manager?

Despite the delegation, the Luxembourg management company should be considered as the AIFM under the AIFMD, responsible for the compliance with the AIFMD as the case may be.

The US AIF manager must however be supervised in the US and be submitted to the Luxembourg management company's due diligence check.

Is it compliant with the AIFMD if a US management company delegates its portfolio management functions for an EU Alternative Investment Fund to an EU AIF Manager?

Despite the delegation, the U.S. management company should be considered as the AIFM under the AIFMD, responsible for the compliance with the AIFMD as the case may be.

In the case where the E.U. AIFs are distributed in the E.U.:

The U.S. management company will have to comply with the AIFMD requirements, i.e.:

- Voluntary submission of the AIFM to the directive;
- Monitoring by third country regulator.

In addition, the third country where the AIFM is established, the U.S. in the case at hand, must fulfill the following conditions: •AML standards

- Existence of information exchange agreement
- Tax information exchange standards
- Reciprocal access to markets

In the case where the E.U. AIFs are not distributed in the E.U.:

We understand that in such a case, the U.S. management company will not have to comply with the AIFMD being not subject to the latter.

Organisational requirements

Does an Alternative Investment Fund marketed in the European Union to institutional investors need to be managed by an EU AIFM?

An AIF marketed in the E.U. to institutional investors (or to any well-informed investors) needs:

- Either to be managed by an E.U. AIFM,
- Or to be managed by a non-E.U. AIFM which complies with the AIFMD, i.e. the country where the AIF is established must fulfill 4 conditions :
 - AML standards (FATF/GAFI)
 - Existence of information exchange agreement between home country and the EU member state
 - Tax information exchange standards
 - procal access to markets (the non-E.U. AIFM shall voluntarily submit itself to the AIFMD and must be monitored by third country regulator)

Can a UCITS management company also act as an AIFM?

Authorised managers of a UCITS are entitled to request to be authorised as AIFM and vice versa, subject only to complying with any relevant additional requirements for the new authorisation.

Can a MiFID firm act as an AIFM?

MiFID firms that fall into the scope of the AIFM will need to submit an application to re-authorise as an AIFM. The scope of MiFID services that AIFM can undertake is narrower and includes:

- Non-core services: comprising:(i) investment advice; (ii) safe-keeping and administration in relation to shares or units of collective investment undertakings; (iii) reception and transmission of orders in relation to financial instruments; and
- Individual portfolio management: Management of portfolios of investments, including those owned by pension funds and institutions for occupational retirement provision in accordance with Article 19(1) of Directive 2003/41/EC, in accordance with mandates given by investors on a discretionary, client-by-client basis;

Can an AIF have multiple AIFM (for example an EU AIFM and a non-EU AIFM)?

Each AIF managed within the scope of the AIFMD shall only have one single AIFM, responsible for the compliance with the requirements of the AIFMD.

Valuation

Does an EU AIFM need to appoint an external valuator?

The AIFM must appoint a valuator either legally or functionally independent, hence the valuator does not need to be external to the extent that it can be evidenced that he is functionally independent. However, should no external valuator be appointed, the competent authority of the E.U. Member State may require the AIFM to have its valuation procedures and / or valuations verified by an external auditor.

Leverage

Is there any leverage limitation for the AIFs marketed in the EU?

Any AIFM managing one or more AIF using leverage will have to provide the competent authorities of its home Member State regular information concerning its leverage.

The concerned Member State regulator will inform the ESMA of the leverage limits disclosed and the latter may decide to limit the level of leverage used if it considers that the leverage employed by an AIFM may pose a substantial risk to the stability and integrity of the financial system.

Depositary

Does an AIF need to appoint a depositary in its home country?

For an E.U. AIF:

A depositary of an EU AIF must have registered office in the E.U. Member State of the AIF for the first 4 years and thereafter any EU Member State.

For a non-E.U. AIF:

A depositary of non-E.U. AIF managed by an authorised AIFM must have a registered office in the E.U., unless:

- The regulator of the AIFM and the third country of domiciliation of the AIF has signed a cooperation agreement;

- The third country of the AIF is subject to an effective prudential regulation and supervision;
- The depositary is contractually liable to the AIFM and investors of the AIF;
- The third country of the AIF meets the FATF/GAFI standards on money laundering and terrorist financing;
- The AIFM's home state has signed an OECD model tax convention agreement with the third country of domiciliation of the AIF; and
- The depositary is a bank or an entity of the same nature as those authorised to act as such in the E.U.

Can the depositary be the same entity charged with the risk management functions of the Alternative Investment Fund?

The depositary of an AIFM shall not be in charge of the risk management function the portfolio management or the liquidity management functions.

Delegation

May an EU AIFM delegate the portfolio management to an asset manager based outside of the European Union?

An E.U. AIFM may only delegate the portfolio management of its AIF to an authorised AIFM to manage an AIF of the same type, hence such delegation is subject to the supervision of the AIFM by its home country regulator.

In addition, the third country where the AIFM is established must fulfill the following conditions:

- AML standards

- Existence of an information exchange agreement
- Tax information exchange standards
- Reciprocal access to markets

Risk management

Are the risk management requirements under AIFMD similar to those for UCITS?

The main provisions governing the risk management under AIFMD are inspired by the risk management regulations governing the UCITS, accordingly we assume that the risk management requirements will be similar to those for UCITS, however the AIFMD is not detailed enough to answer this question with certainty. Therefore, this question will be reviewed in light of the level 2 directive (ESMA guidance is expected November 2011 and the Commission final draft expected Q2 or Q3 2012).

Reporting/disclosure requirements

Are the reporting and disclosure requirements lighter under the AIFMD than those required for UCITS?

The requirements of disclosure to the investors under the AIFM Directive are higher in various respects than for UCITS, which could be explained by certain specificities of the AIF. In fact, the AIF are less regulated than UCITS, in particular regarding the use of leverage, their investment policy, the short-selling practice etc., which are key elements in the determination of the risk level. Therefore, investors may need additional information related thereto.

As for the disclosure requirements, the provisions governing the reporting requirements under AIFMD are inspired from those for UCITS while being adapted to the specificities of the AIF as aforementioned.

Regulatory technicalities

When will the directive come into force?

Twenty days after its publication in the EU official journal the AIFM Directive will come into force. It has not yet been published but is expected very soon (Q3 2011).

When will EU-passporting and non-EU passporting come into force and what does this mean?

The EU passport should be available for EU AIFM managing EU AIF as soon as the directive is implemented in 2013.

The non-EU passport may become available to non-EU AIFM and non-EU AIF managed by EU AIFM from 2015, but this is subject to the success of the EU internal passport which shall be based on an evaluation to be conducted by ESMA.

What are the marketing routes into the EU?

Private placement - The Directive permits national regulators to continue with their existing private placement regime, on the condition that that AIFM comply with the disclosure/transparency regime to investors and regulators, including the Annual Report requirements. Cooperation agreements will need to be in place between the FSA and the jurisdictions where non-UK AIF/AIFM are domiciled. I.e. for a Cayman fund there must be a cooperation agreement (containing certain minimum elements) between the UK FSA and CIMA.

The private placement route may be turned off in 2018, but this depends on a decision from ESMA.

EU Passport - The EU passport should be available for EU AIFM and EU AIF as soon as the directive is implemented in 2013, This means that AIFM will be able to market AIF across the EU on the basis of one authorisation with their home member state. The EU passport may become available to non-EU AIFM and non-EU AIF from 2015, but this is subject to an opinion from ESMA.

Offshore structures - The domicile of the non-EU AIFM/AIF must meet certain requirements as a precondition for either of the above two marketing routes.

Will it still be possible to use private placement?

Initially yes, however the future of national private placement regimes is highly dependent on the success, or not, of the passporting which shall be revealed after the ESMA review in 2018.

To what extent is this a regulatory burden? Will this lead to AIF managers moving offshore?

Existing AIFs have a grandfathering period to be able to carefully consider the implications of the AIFMD and how best to handle them. Newly created funds will need to decide upon creation who their intended investors will be and where they will be based - i.e. EU or non-EU. The AIFMD will be a regulatory burden in comparison to current practice, however this is because the sector is currently very lightly regulated and one of the key aims of the AIFM Directive is to provide greater harmonisation and regulation.

The passport regime, if successful has the potential to be a positive advantage for EU managers, particularly in the early stages prior to the non-EU passport being in place. The continued existence in parallel of national private placement regimes, accessible to third country managers and funds from outside of the EU could lead to a cost-advantage for them prior to the directive review to be conducted in 2018.

There is also the question of whether managers (or investors) will want to bear the additional regulatory costs of the directive for their funds aimed at non-EU investors. Overall there may be movement in both directions, onshore as well as offshore, but neither side seems to hold a competitive advantage over the other. Additionally some AIFMs are opting for co-domiciliation onshore and offshore.

This movement will most certainly depend on the various stakeholders' interests.

Is there any legislation similar to the AIFMD in other countries?

In the wake of the recent financial crisis, the G20 committed to ensure that "all relevant actors...are subject to appropriate regulation and oversight", which reflected the global consensus for tighter regulation of the AIF sector. Various supranational, international and national initiatives have been launched to towards achieving this goal.

In the United States of America, the Dodd-Frank Wall Street Reform and Consumer Protection Act was passed in July 2010, but not yet implemented. Like the AIFM Directive in the EU, the Dodd Frank Act was brought about as a result of the recent financial crisis. It regulates the full spectrum of financial services.

Contact



Benjamin Collette
Partner - EMEA AIFMD Leader
bcollette@deloitte.lu



Lou Kiesch
Partner - Regulatory Consulting
lkiesch@deloitte.lu



Xavier Zaegel
Partner - Capital Markets/Financial Risk Leader
xzaegel@deloitte.lu



Benjamin Lam
Partner - Private Equity & Real Estate Leader
blam@deloitte.lu



Raymond Krawczykowski
Partner - Tax Leader
rkrawczykowski@deloitte.lu



Marc Noirhomme
Directeur - Regulatory Consulting
mnoirhomme@deloitte.lu

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