



From private placement to AIFM distribution

The new way to sell alternative investment funds

Paola Liszka Draper
Senior Manager
Advisory and Consulting
Deloitte

Isabel Ferreira
Analyst
Advisory and Consulting
Deloitte

After many intensive and controversial debates, the Alternative Investment Fund Managers Directive (AIFMD) finally became reality and entered into force on 21 July 2011. As one of the first member states, Luxembourg transposed the Directive into national law within the two year deadline in July 2013.

AIFMD provides the framework within the European market for the cross-border distribution of Alternative Investment Funds (AIFs). The key challenge is to understand the practicalities of how to comply with the Directive while continuing to raise capital.

General overview

In a nutshell, AIFMD regulates the access of Alternative Investment Fund Managers (AIFMs) to EU-domiciled investors. Contrary to the UCITS Directive, AIFMD does not regulate the product itself, i.e. the AIF, but the managers, the AIFM. Key objectives of AIFMD are to extend appropriate regulation and oversight to all alternative actors; to improve financial stability by monitoring systemic risk, to create a European market for alternative investments via passports for management and marketing activities and, perhaps most importantly, to increase transparency for the protection of the end investors.

The scope of AIFMD is far-reaching and applies to EU domiciled AIFMs (EU AIFMs) managing AIFs and non-EU domiciled AIFMs (non-EU AIFMs) managing and/or marketing AIFs within the European Union. AIFMD can be considered as encompassing AIFMs of all types of AIFs that are not covered by the UCITS Directive, thereby impacting private equity funds and hedge funds, real estate funds and retail non-UCITS funds marketed to any

investors, be they professional or retail, and resident in the European Union. As ever, the Directive provides for some exemptions relating to specific thresholds and the exclusion of certain types of vehicles.

AIFMD offers new opportunities while at the same time bringing an array of challenges, certainly in the world of private equity and real estate having to transition from a relatively unregulated environment to a highly regulated framework within a few years. AIFMs are now not only subject to more scrutiny in areas such as authorisation, valuation, remuneration, liquidity and risk, but must also comply with operational rules, delegation and capital requirements, conduct of business rules as well as being subject to detailed reporting and investor disclosure requirements. The extent of these topics therefore touches almost all aspects of the alternative investment world.

One of the key aims of the Directive is to introduce a harmonised framework in terms of distribution. Since the end of the AIFMD transition period on 21 July 2014, 'private placement' in the pre-AIFMD sense of selling to EU-domiciled investors without informing the EU host state regulators of your intentions, is no longer possible. As of this date, all marketing and distribution activities can only take place subject to prior notification and approval of the relevant regulators.

AIFMD, like UCITS, has introduced the notion of a passport enabling AIFMs to offer their management services and market their AIFs to professional investors throughout the European Union. For the purposes of AIFMD, professional investors are those that are defined as professional clients under MiFID. Hence, marketing to retail clients is not governed by the rules of the EU marketing passport. Currently the passport is only open to EU AIFMs managing and marketing EU AIFs, but it is hoped that this passport may be extended towards the end of 2015 following ESMA's positive opinion. In the meantime, EU AIFMs wishing to market non-EU AIFs as well as non-EU AIFMs wishing to market either EU or non-EU AIFs within the European Union must comply with the National Placement Regimes (NPR). These NPRs are non-harmonised, vary in complexity depending on the 'gold plating' requirements imposed by the individual Member State Regulators and must be assessed on a case-by-case basis.

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The EU marketing passport

The major benefits of the EU marketing passport are twofold in that firstly Member States are not officially permitted to 'gold-plate' the rules set down by AIFMD and secondly that the authorisation process is harmonised at EU level both in terms of documentation requirements and time to market.

For EU AIFMs, there are two distinct routes to follow when submitting notifications of intention to market AIFs on a cross-border basis to professional investors in the different Member States: Article 32 AIFMD for EU AIFMs wishing to market EU-domiciled AIFs in accordance with the EU marketing passport and Article 36 AIFMD for those EU AIFMs wishing to market non-EU domiciled AIFs. In both cases, the notifications must be submitted and relevant approvals received before any marketing and distribution activities may commence in the individual Member States. It is up to the EU AIFM to ensure it understands and complies with the local regulations in each Member State as to what constitutes permissive marketing and distribution activities.

For an Article 32 marketing passport notification, the EU AIFM must first submit a notification to its home state regulator in respect of each EU AIF that it intends to market. The notification comprises the documentation and information set out in Annex IV AIFMD. Once submitted, it is the responsibility of the home state regulator of the EU AIFM to transmit the filing(s) to the relevant host state regulators where the AIFM intends to market its EU AIF. As the home state regulator of the EU AIFM is the only point of contact for such filings, the EU AIFM does not need to communicate with the different host state regulators, thereby significantly simplifying the authorisation process.

Once the home state regulator of the EU AIFM has received the file, they have 20 working days to review and transmit the complete notification file to the host state regulator where it is intended that the EU AIF be marketed. Upon transmission of the notification file to the host state regulator, the home state regulator notifies the EU AIFM of the transmission date thereby allowing the EU AIFM to commence marketing activities in the relevant host Member State as of this date. If, however, the notification file is either incomplete or not compliant with AIFMD, the home state regulator reserves the right to reject the notification and to effectively restart the process.

In the event of a material change to any of the information or documents submitted with the initial Article 32 notification, the EU AIFM must inform its home state regulator at least one month in advance before the implementation of a planned change or immediately after the implementation of an unplanned change. If pursuant to a planned change, the EU AIFM's management of the EU AIF or the EU AIFM would no longer comply with AIFMD, the home state regulator will notify the EU AIFM without delay that the planned change cannot be implemented. The non-respect of these rules may result in the express prohibition of marketing of the EU AIF.

Although Member States are officially not allowed to impose stricter rules on EU AIFMs when marketing EU AIFs to professional investors, it is clear that some Member States have imposed 'gold-plating' requirements for EU AIFMs to market EU AIFs in their countries. France, for example, requires the appointment of a centralising agent based in France for all EU AIFMs which are not domiciled in France. Other Member States, such as Germany, France and Austria, require proof of payment of the initial notification fees to be included as part of the notification file.

Another point is that although Annex IV AIFMD states the requirements for the notification, several Member States have issued their own template notification letters, which although are in the spirit of Annex IV AIFMD, require differing levels of information. Some Member States require detailed information on the specific marketing arrangements that will be undertaken in their jurisdiction whereas others appear to accept more generic statements. Some notifications require the EU AIFM to sign the notification letter, others do not. Differences have also been noted in the treatment of filings by the Member State Regulators.

The UK FCA, for example, appears to have taken a stricter interpretation in that any 'gold-plating' information such as a proof of payment should not form part of the notification file and that it is up to the EU AIFM to communicate such information directly to the host state regulators. Others, for example the Luxembourg CSSF and Irish CBI, require that these 'local gold-plating requirements' form part of the notification files.

As ever, although AIFMD intended a harmonised passporting process, it is clear that small yet often significant details in the practical implementation make all the difference. Despite these variations, the process can be considered as relatively straightforward in comparison to the requirements of Article 36 notifications (EU AIFM with non-EU AIFM) and Article 42 notifications (non-EU AIFM marketing AIFs) under the national placement regimes.



The national placement regimes

Currently the marketing passport is only open to those AIFMs domiciled in the EU who manage EU AIFs. Hence, if an EU AIFM wishes to manage and market non-EU AIFs within the European Union, the EU AIFM must make separate applications (AIFMD Article 36 notifications) for each non-EU AIF to be marketed to the individual host state regulators. Similar individual applications will need to be made by non-EU AIFMs wishing to manage and market either EU or non-EU AIFs across Europe (AIFMD Article 42 notifications).

Unfortunately, contrary to the harmonised marketing passport, notifications made under AIFMD Articles 36 and 42, also known as National Placement Regimes (NPR), are driven by the (strict) rules of the individual Member States in which it is intended to market. These rules vary in complexity depending on the 'gold plating' requirements imposed by the individual Member State regulators. Each anticipated application must be assessed on a case-by-case basis in accordance with not only the local applicable rules in the targeted jurisdiction, but also the domicile of both the AIFM and the AIF.

For an AIFMD Article 36 notification, as the AIFM is EU domiciled, it is worth noting that Member States are free to decide if they allow EU AIFMs to market non-EU AIFs to professional investors via the NPR and whether to impose stricter rules than those laid down by the AIFMD. One exception relates to depositary requirements in that an EU AIFM marketing a non-EU AIF is able to apply a so-called 'depositary lite' regime in accordance with AIFMD Article 21.

For an AIFMD Article 42 notification, again it is up to the Member States to decide if they will permit non-EU AIFMs to access the NPR and they are fully entitled to impose stricter rules on the non-EU AIFMs in respect of marketing EU and/or non-EU AIFs in their territories. Although non-EU AIFMs are not fully subject to compliance with AIFMD, for the purposes of NPR notifications, the non-EU AIFM must fully comply with four key AIFMD requirements: Article 22 (submission of annual report), Article 23 (Disclosure to Investors), Article 24 (Reporting obligations to competent authorities) and as appropriate AIFMD Articles 26 to 30 (acquiring control of non-listed companies and issuers).

Successful NPR notifications are not only dependent on compliance with these Articles, but also have to be compliant with the local applicable rules in the targeted jurisdiction.

In practical terms, the AIFMD does not provide much guidance for NPR in terms of the content of the notification filing including 'gold-plating' requirements, timelines for approval of filings or how to notify host state regulators in terms of significant changes to the initial notifications. Our experience has shown that the NPR differs widely between jurisdictions. In Luxembourg and the UK for example, NPR notifications are generally approved within a few days of submission to the Luxembourg CSSF or the UK FCA. Other countries, including Belgium, Finland and Ireland, have not issued any guidance as to the timing. Denmark, for example, anticipates approval within three months but reserves the right to extend the period by an additional three months. Germany takes between two and eight months for approval depending on the domicile of the AIFM/AIF and whether master-feeder structures are in place. In almost all cases, the AIFM must await official approval of the Member State regulator before commencing any marketing activities.

When looking at the notification requirements themselves, some regulators have issued specific notification forms for NPR submissions, amongst others Denmark, Ireland, Luxembourg and United Kingdom. Some regulators require detailed notification filings with multiple documents, others are happy to receive a completed notification form with no requirement to include any documentation. Some regulators will accept electronic submissions, others require hard copy submissions.

The administrative burden faced by the AIFMs that are unable to access the passport is complex and that is even before entering into the detailed 'gold-plating' requirements. Focusing just on the depositary requirements in accordance with AIFMD Article 21, current indications are that for example Germany, Denmark and Ireland would permit a 'depositary lite' regime for both Article 36 and Article 42 notifications. Austria, on the other hand, would permit a 'depositary lite' regime for Article 36 notifications, but would require full compliance with Article 21 (depositary) for Article 42 notifications.

In addition to the local requirements for both NPR notifications, appropriate cooperation agreements for the purpose of systemic risk oversight and in line with international standards must also be in place between the competent authorities of the Member States where the AIFs are to be marketed and the supervisory authorities where the AIF/AIFM is domiciled or established. These agreements are established to ensure an efficient exchange of information between the various regulators. Another point to note is that the third country where the non-EU AIFM/AIF is established is not listed as a non-cooperative country and territory by the Financial Action Task Force.

Many articles in the media often mention the ongoing possibility of continuing to raise assets via so-called reverse solicitation or reverse enquiry. Although theoretically this may be conceivable, it should not be considered as a de facto strategy for raising capital in Europe as it requires real complexity in demonstrating the absence of marketing activities vis-à-vis the end investor. Again as is so often the case with AIFMD, regulators provide little or no clarity for such strategies and therefore they should only be considered having carried out extensive research on a case-by-case, jurisdiction-by-jurisdiction approach. What may work in one EU Member State may not work in another.

In conclusion, although the introduction of AIFMD brings with it an array of challenges, it is worth noting that ESMA recently published a consultation paper asking for feedback on whether the passporting regime should be extended to the management and/or marketing of AIFs by non-EU AIFMs and to the marketing of non-EU AIFs by EU AIFMs. We now await the issuance of ESMA's advice to the European Commission, anticipated by 22 July 2015, to see what happens next.

