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ASSOCIATION

AIFMD Essentials

Brussels, December 2010


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Note: Each Chapter includes specific sections on the impact of the Directive on Fund-of-Funds and on Investors (Primary contributor: Amanda McCrystal).

1. Foreword

Private equity and venture capital is now a regulated industry at EU level, and it is the right moment for all practitioners to begin developing their understanding of what that entails. The Alternative Investment Fund Managers Directive ("AIFMD") is new legislation, creating a harmonised set of rules for fund marketing and the management of private equity, venture capital and other alternative investment funds in Europe. The Directive, which has been subject to great change since the Commission's hastily drafted proposal of April 2009, has now been adopted by the Member States and the European Parliament, and after a difficult 18-month preparatory phase, there is now more certainty as to the principles within this new regulatory framework. Some of the most threatening proposals to the industry and to the European economy have been improved, such as potentially damaging obligations for portfolio companies, as well as the treatment of non-EU managers and funds. The AIFMD as it now stands is a compromise text which on the one hand imposes significant cost and unwarranted requirements on private equity and venture capital fund managers but on the other hand takes the first steps to creating a European single market for the industry.

Many of the provisions of the Directive require further clarification and a significant amount of detail is left to be defined through implementing measures in connection with the 'Level 2' phase. These implementing measures will need to be agreed and adopted by the Commission and the new European Securities and Markets Authority (ESMA), with the Directive taking effect in early 2013. It will not be possible to assess the full impact of the Directive on the private equity and venture capital industry until these implementing measures have been put in place. During this period, our industry will continue to constructively engage with policymakers to ensure the interpretation of rules is in the very best interests of European businesses and investors. We are well positioned to do so, with EVCA operating at an EU level, national associations engaging in their respective capitals, and everyone co-ordinated by our industry's Public Affairs Executive.

It is still too early to fully encompass the practical implications of the AIFMD, and many of the important technical details are not yet clear, but this briefing document highlights the main points of relevance to our industry from a dense and complex Directive, so that all practitioners can begin to build their knowledge of what it will entail.

I hope you find this useful.

Best wishes,

Uli Fricke
EVCA and PAE Chairwoman 2010-2011

2. Executive Summary

This Executive Summary deals with the following questions:

1. Who will be covered?
2. Will there be an opt-in regime for the EU marketing passport for those funds that fall below the *de minimis* threshold (EUR 100/500 million)?
3. What about grandfathering of existing funds?
4. What will be the ongoing compliance requirements for AIFM under the Directive?
5. Increased transparency has been one of the key objectives of the Directive. How has this been translated in the final version of the Directive?
6. At a certain point of time the Directive required a certain lock-in period for AIF investments. Is this still the case?
7. No EU AIFM will be allowed to market EU AIF to professional investors in the EU unless it has been authorised in accordance with this Directive. Will professional investors be allowed to invest at their own initiative?
8. What about the non-EU managers? Will they be able to market their funds?
9. When is the EU passport expected to be available for third country AIFM and what will then happen to the national private placement regimes?

1. Who will be covered?

All alternative investment fund managers ("AIFM") operating in Europe:

- EU AIFM which manage alternative investment funds ("AIF") (both EU and non-EU AIF);
- Non-EU AIFM which manage EU AIF;
- Non-EU AIFM which market AIF in the EU (both EU and non-EU AIF).

AIFM managing only AIF, which are not leveraged and without redemption rights during a period of five years, with cumulative AIF under management of below EUR 500 million will be exempt from the Directive.

However, these AIFM will need to be registered in their home Member State and will be subject to reporting requirements in their home Member State regarding the main instruments in which they trade, their investment strategy, the principal exposures and most important concentrations of AIF they manage.

These AIFM are expected to be allowed to continue cross-border marketing subject to national provisions.

2. Will there be an opt-in regime for the EU marketing passport for those funds that fall below the *de minimis* threshold (EUR 100/500 million)?

Yes. Those funds will have an opportunity to opt in under the Directive but will then be bound by all of its provisions as there is no lighter regime for smaller funds opting for the passport.

3. What about grandfathering of existing funds?

AIFM will need to submit an application for authorisation, and take all necessary measures to comply with the Directive, within one year of the final transposition date (expected to be in early 2013).

Two grandfathering clauses have been foreseen for closed-ended funds:

- AIFM managing existing closed-ended funds which do not make any additional investments after the final date of transposition by Member States (early 2013) will be allowed to continue to manage such AIF without authorisation under this Directive;
- AIFM managing closed-ended funds whose subscription period for investors has closed prior to the entry into force in 2011 and which expire at the latest in 2016 will only have to publish an Annual Report and, where relevant, will have to comply with the additional portfolio company requirements (Articles 26 to 30).

4. What will be the ongoing compliance requirements for AIFM under the Directive?

The Directive will impose stringent requirements on the operations of AIFM. These will include:

- **Capital requirements**

  An AIFM managing external funds will have to maintain initial capital of EUR 125,000. A self-managed AIF will be required to maintain initial capital of EUR 300,000.

  Whilst self-managed AIF may not be subject to minimum own funds requirements, an AIFM managing external AIF will have to maintain own funds equal to the higher of:

  (i) one-quarter of fixed annual overheads; and

  (ii) 0.02% of the amount by which the total value of portfolios under management exceeds EUR 250 million, subject to a cap of EUR 10 million.

  Own funds must be invested with a view to short-term availability, and may not be invested speculatively.

- **Depositaries**

  For each AIF it manages, AIFM will need to ensure that a single depositary is appointed.

- **Valuation**

  AIFM will need to establish appropriate and consistent procedures for the valuation of the assets of each AIF under management.

- **Remuneration**

  AIFM will have to put in place remuneration policies and practices for those categories of staff whose professional activities have a material impact on the risk profiles of the AIF they manage. These should be consistent with and promotesound and effective risk management.

  Furthermore, AIFM will need to include aggregate information on remuneration in the Annual Reports.

5. Increased transparency has been one of the key objectives of the Directive. How has this been translated in the final version of the Directive?

The Directive imposes extensive disclosure requirements on AIFM in general, and includes some additional requirements for AIFM when the AIF under management acquire major holdings or control of EU companies.

General transparency requirements include – for each EU AIF an AIFM manages and for each AIF it markets in the EU:

- an audited Annual Report;
- specific disclosure to investors including the AIF's investment strategy and objectives; and
- reporting to competent authorities including the actual risk profile of the AIF and the main categories of assets in which the AIF is invested.

Additional requirements have been set regarding portfolio companies in case of acquisition and in case of control (more than 50% of voting rights for non-listed companies; reference to the Takeover Directive for issuers), including the obligation to inform the company and its shareholders of the AIF's intentions with regard to the future business of the company and the likely repercussions on employment and conditions of employment.

6. At a certain point of time the Directive required a certain lock-in period for AIF investments. Is this still the case?

No. While a lock-in period was indeed proposed during the debate, such a provision has been rejected by EU legislators. The Directive does contain certain provisions intended to prevent asset stripping of private equity portfolio companies.

More specifically, the Directive imposes the same Second Company Law restrictions on distributions, capital reductions, share redemptions and/or purchases of own shares by controlled portfolio companies during the first two years of an AIF's ownership that today in many Member States only apply to public companies.

7. No EU AIFM will be allowed to market EU AIF to professional investors in the EU unless it has been authorised in accordance with this Directive. Will professional investors be allowed to invest at their own initiative?

Professional investors established in the EU will be able to continue to invest in AIF at their own initiative, irrespective of where the AIFM and/or the AIF is established. This is subject to requirements applicable to them pursuant to laws and regulation in their jurisdiction of incorporation.

8. What about the non-EU managers? Will they be able to market their funds?

Yes, initially under the national private placement regimes with some additional conditions, and later through the EU passport.

9. When is the EU passport expected to be available for third country AIFM and what will then happen to the national private placement regimes?

It is expected that the EU passport for third country AIFM will be introduced two years after the transposition of the Directive (approximately in 2015). This should be followed three years later (approximately as from 2018) by a potential phasing out of the national private placement regimes.

Readers are directed to the Definitions on page 48, which includes details of many of the technical terms used in the Directive and in this briefing document.

3. Scope

The Directive generally covers the management and marketing of a diverse range of AIF, including real estate funds, hedge funds and private equity funds (venture capital, growth capital and buy-out), irrespective of whether such AIF are open-ended or closed-ended, listed or unlisted, feeder funds or master funds.

The Directive introduces a harmonised European regulatory framework for fund managers as opposed to the underlying AIF and, as a consequence, funds and different types of fund vehicles may still be regulated and supervised at national level. It is also possible for national regulators to impose stricter requirements going beyond those laid down in the Directive with respect to AIFM exempted from the scope of the Directive.

The so-called *de minimis* exemption relevant for AIFM managing smaller funds will serve to exempt many venture capital fund managers from application of the Directive. This is useful for this asset class in light of the fact that many of the requirements, such as the need to appoint a depositary, will lead to significant and increased unnecessary and unjustified burden. It is worth noting, however, that smaller fund managers will not be able to benefit from the useful internal passport without opting in to the full set of legislative requirements. The possibility of introducing positive measures including a "lighter passport" should be further addressed in order not to further hamper the efficiency of the European venture industry.

General

The AIFMD aims to provide for a harmonised European regulatory framework for alternative investment fund managers ("AIFM").

The Directive applies to entities established in a Member State of the EU which manage one or more alternative investment funds ("AIF") - irrespective of where the AIF is established. In addition, the Directive applies to managers that are established outside the EU to the extent they manage AIF established within the EU, or market AIF to investors domiciled in the EU.

It is important to bear in mind that, as this Directive aims to regulate the management as well as marketing of AIF rather than the funds themselves, AIF and their respective structures can still, in addition, be regulated and supervised at national level.

Alternative investment funds

AIF are defined in the Directive as collective investment undertakings, or compartments thereof:

- which raise capital from a number of investors;
- with a view to investing it in accordance with a defined investment policy for the benefit of those investors;
- which are not covered by the UCITS Directive.

Family office vehicles, and similar vehicles which invest the private wealth of investors without raising external capital, are not deemed to be AIF in accordance with the Directive.

Even AIF which are not diversified are covered by the Directive. The fact that the investment policy of an entity is limited to the acquisition of a single asset, including shares or units in another AIF, does not exclude it from the scope of application of the Directive.

Self-managed AIF

Where the legal form of the AIF permits internal management (for example, a corporate AIF managed by its board of directors), and where the AIF's governing body chooses not to appoint an external manager (i.e. a legal entity other than the AIF), the AIF itself can be considered the manager of the AIF (self-management) and accordingly can be authorised as an AIFM under the Directive. In the case of self-managed AIF, each AIF will need to be authorised on a fund-by-fund basis.

Exemptions

There are exemptions for supranational institutions, like the World Bank, the International Monetary Fund (IMF), the European Investment Bank (EIB) and the European Investment Fund (EIF); national central banks; national, regional and local governments and bodies or other institutions which manage funds supporting social security and pension systems; and IORPs (Institutions for Occupational Retirement Provision) insofar as they do not manage AIF.

The Directive also does not apply to:

- certain securitisation special purpose vehicles;
- the management of employee participation and saving schemes;
- holding companies, which are defined as companies carrying out a business strategy or strategies through their affiliates in order to contribute to their long-term value. Where a holding company is not both listed (on a regulated market in Europe) and operating for its own account, it must demonstrate through its annual report or other official documents that it is not established for the main purpose of generating returns for its investors by means of divestment of its subsidiaries or affiliates[1].

The following managers are also exempt from the Directive:

- managers whose only investors are their parent undertakings, their subsidiaries or other subsidiaries of their parent undertaking, provided that none of those investors itself is an AIF (intra group exemption[2]);
- managers that directly or indirectly (through a company with which the manager is linked by common management or control, or by a substantive direct or indirect holding) (a) manage AIF portfolios whose assets under management, including any assets acquired through the use of leverage, in total do not exceed EUR 100 million, or (b) manage portfolios of AIF whose assets under management in total do not exceed EUR 500 million when the portfolio consists of AIF that are not leveraged and have no redemption rights exercisable during the first five years following the initial closing of such AIF (*de minimis* exemption).

For the purposes of the *de minimis* exemption, leverage is defined as any method by which the manager increases the exposure of an AIF it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or otherwise. According to the Directive[3], leverage at the level of the portfolio company is not intended to be included.

The *de minimis* exemption might cover non-EU AIFM subject to national placement rules.

1. We believe that "holding company" is defined in this way for anti-avoidance reasons and that it is not intended to bring typical acquisition structures into the definition of an AIF.
2. The intra group exemption generally means that managers of captive funds are exempt from the Directive.
3. Recital 14.

Impact on Investors

No EU investor (professional or not) is subject to the AIFMD in its capacity as an investor. The AIFMD only deals with the authorisation of AIFM, i.e. managers, and the compliance burden falls squarely on them.

Professional investors established in the EU will be able to continue to invest in AIF at their own initiative, irrespective of where the AIFM and/or the AIF is established. However, reference is made in the Directive to existing requirements applicable to them pursuant to laws and regulation in their jurisdiction of incorporation.

However, it cannot be excluded that certain professional investors may amend their internal investment guidelines or policies to invest only in funds managed by AIFMD-compliant AIFM.

Impact on Fund-of-Funds (FoF)

Authorisation is required under the Directive if a FoF manager intends to either manage or market an AIF within the EU. The authorisation is applied to the FoF manager, as the AIFM in this context. Investments that are then made by that AIF into underlying funds are determined to be investments made by the FoF in its capacity as an investor, not as a manager. A FoF is, therefore, investing at its own initiative and may choose those investments in underlying funds accordingly, and outside of compliance with the AIFMD.

So a FoF may invest in funds managed by managers that are not authorised under the AIFMD, including those smaller managers that may fall below the size threshold exemptions.

Please also note the specific marketing rules applicable to EU feeder AIF in Chapter 6.

Registration of exempt managers and opt-in rights

Smaller private equity and venture capital ("PE/VC") managers that are exempted from the Directive on the basis of the *de minimis* exemption must nonetheless register with the competent authority in their home Member State. On registration, the manager must provide the regulator with details of the funds it manages and their investment strategies, and once registered the manager must regularly provide its regulator with information on the main instruments in which it trades, its principal exposures and the most important concentrations of AIF it manages to allow the competent authority to monitor systemic risk. If the manager no longer complies with the *de minimis* exemption, it must notify its regulator and seek authorisation under the Directive within 30 calendar days. This implies that those countries that today do not have a national regulation will have to put one in place by the final transposition date for those managers below the EUR 500 million threshold. Furthermore, it is important to note that the Directive does not restrict the right of Member States to subject AIFM exempted from the Directive to stricter requirements.

While smaller managers below the threshold will not benefit from the internal market passport granted by the Directive (i.e. to manage and market funds freely across the EU), it is expected that they will be allowed to continue cross-border marketing subject to national law in each jurisdiction, albeit to additional conditions as imposed by this Directive[4]. They will also have an opportunity voluntarily to become authorised under the Directive to benefit from the passporting rights, but that would mean compliance with the full Directive, as there is no "light touch" opt-in regime for smaller managers.

Impact on Investors

Depending upon investors' own internal investment guidelines and policies, investors may invest in funds managed by exempted managers. Investors will be able to check that those managers have registered as required with the competent authorities of their Member States.

Threshold calculations will be specified further by the Commission in a delegated act which will notably have to deal with those assets under management which occasionally exceed/fall below the threshold.

Impact on FoF

The Directive requires a single authorised AIFM for each AIF. This suggests that the compliance is at the FoF level, not at the underlying manager level. Furthermore, investments made by a FoF in underlying funds are made in its capacity as an investor, not as a manager and, therefore, fall outside of the AIFMD scope. The FoF, therefore, may be permitted to invest in underlying funds managed by non-compliant managers. This would have the benefit of maintaining investment in those funds managed by managers that may not themselves be capable of compliance with the AIFMD.

As drafted, the FoF manager is the authorised AIFM, not the underlying managers. Therefore, it should be of no consequence whether or not an underlying manager is operating under a threshold exemption. That underlying manager does, of course, need to inform its own investors, including a FoF, of any changed status. An underlying manager deciding to forego the threshold exemption and opt-in to the entire AIFMD may incur additional costs, which may alter the investment model on which basis the FoF made its original investment.

4. Although not expressly stated, it is expected that this will continue to be the case also when the national private placement regimes will be withdrawn in 2018 (subject to the extension of the Passport to non-EU AIFM and AIF at that point).

Transposition and Grandfathering

The Directive will enter into force following its publication in the Official Journal of the European Union (expected to be in early 2011) and will have to be implemented into national law within two years from that date (expected to be in early 2013)[5].

In general, EU-based AIFM will need to submit an application for authorisation, and take all necessary measures to comply with the Directive, within one year of the transposition date.

There are specific grandfathering rules for:

- **Public AIF**

  The marketing provisions of the Directive do not apply to the marketing of AIF shares or units that are subject to a current offer to the public under a prospectus that has been drawn up and published in accordance with the Prospectus Directive before the transposition deadline as long as this prospectus is valid.

- **Closed-ended fully invested AIF**

  AIFM which manage existing closed-ended AIF that do not make any additional investments after the transposition deadline can continue to manage such AIF without authorisation under this Directive.

  As most PE/VC funds have an investment period of five years this would imply that most PE/VC funds raised five years before the transposition deadline, i.e. before early 2008, would be exempt. All other existing funds, and funds which are raised as from today, will need to be compliant as managers as from the transposition date even if not being marketed at transposition date.

- **Closed-ended fully subscribed AIF**

  AIFM which manage closed-ended AIF whose subscription period for investors has closed before the entry into force of the Directive and whose fund term expires at the latest three years after the transposition deadline (i.e. funds which will terminate by 2016), may continue to manage such AIF without needing to submit an application for authorisation or needing to comply with the Directive except for the annual report requirements and, where relevant, the transparency and anti-asset stripping provisions in relation to EU portfolio companies.

  As most PE/VC funds have a fund term of at least ten years (i.e. raised before 2006), this provision will be useless for most PE/VC as they have a better exemption under the preceding paragraph (closed-ended fully invested).

Impact on Investors

There will be uncertainty between 2011 and 2013 as to exactly how the AIFMD will be applied. Once the AIFMD is implemented across the EU in 2013, it is possible that limited partner agreements may require amendment in regard to those AIF managed by an AIFM that do not qualify for grandfathering exemption and which may have been formed after 2008.

For those AIFM subject to the grandfathering provisions and those yet to apply for authorisation, investors will need to check the register of competent authorities accordingly, and be clearly aware of the domicile of the AIFM (and the AIF) in which they either invest or are seeking to invest.

5. Note that the timeline for third country AIFM/AIF is different. Please see Chapter 8 (page 44).

Impact on FoF

FoF managers will need to consider whether the status of any of their existing funds will require that manager to seek authorisation, and at what stage. The authorisation submission deadlines are likely to be staggered.

In particular for FoF, it must be clarified what "invested" means for the purposes of the grandfathering rules. If it means that the FoF actually has fully contributed its commitments towards the target funds, FoF would never benefit from the grandfathering rule. "Invested" should therefore relate to the FoF "commitments"; in other words, the relevant date should be the date when they have closed their investment period and committed to all target funds.

Level 2

The European Commission must adopt implementing measures to specify the procedures for AIFM choosing to opt-in to the Directive. Furthermore, the Commission must adopt measures specifying how to calculate the *de minimis* thresholds and how to treat AIFM whose assets under management, including any assets acquired through use of leverage, in one and the same calendar year occasionally exceed and/or fall below the relevant threshold, as well as the registration and reporting obligations that these AIFM must comply with.

4. Registration and Authorisation Process

The Directive provides that no AIFM should be allowed to manage an AIF unless it has been authorised in accordance with the Directive (subject to a transitional regime for non-EU based fund managers). An authorised AIFM will need to comply with the conditions for authorisation at all times. The authorisation granted is valid for all Member States.

General

The following AIFM will need to become authorised in accordance with the Directive:

- EU AIFM which manage EU or non-EU AIF (whether or not they market them in the EU); and
- from 2015:
    - non-EU AIFM which manage EU AIF (whether or not they market them in the EU); and
    - non-EU AIFM which market non-EU AIF in the EU via the passport.

An authorised AIFM will need to comply with the conditions for authorisation at all times.

Requesting an authorisation - Information to be submitted

The "competent authority" responsible for authorising an AIFM is the national regulator of the Member State in which the AIFM has its registered office (or, if it is a non-EU AIFM, in the AIFM's Member State of reference – see Chapter 8 below). The regulator must inform ESMA on a quarterly basis of authorisations granted (or withdrawn), and ESMA will keep a central public register of all authorised AIFM.

An applicant AIFM must submit to the competent authority substantive information both regarding the AIFM and the AIF it intends to manage.

The information concerning the AIFM includes information designed to facilitate the regulator's assessment of the suitability of the shareholders or members of the AIFM, and to establish whether the persons conducting its business are fit and proper. It will also need to include a program of activity setting out the organizational structure of the AIFM, including information on how the AIFM intends to comply with its obligations under the Directive (such as conflicts of interest, risk management, liquidity management, valuation or delegation of functions, to name just a few). Finally, it must include information concerning the firm's remuneration policies and practices for those categories of staff whose professional activities have a material impact on the risk profiles of AIF they manage, and information concerning the arrangements made for delegation and sub-delegation of functions to third parties. Limitations and requirements on delegation apply only to the delegation of management functions. Delegation of supporting tasks, such as administrative or technical functions performed by the AIFM as a function of its management tasks, are not subject to specific limitations.

The information concerning the AIF comprises information about (among other things) each fund's investment strategy, the AIFM's policy as regards the use of leverage, the risk profiles and other characteristics of the AIF which the AIFM manages or intends to manage, including information about the Member State or third country in which they are established or are expected to be established, the fund rules or instruments of incorporation of each AIF the AIFM intends to manage, and information on the depositary.

Authorisation procedure

Before authorising an AIFM that is affiliated with an entity supervised by the competent authorities of another Member State, the competent authority must consult with the competent authority of the other Member State concerned.

The competent authority of the applicant AIFM must inform the AIFM in writing within three months of the submission of a complete application whether or not authorisation has been granted. An application may be deemed complete even if part of the information detailed, concerning the AIF or the AIFM, has still not been submitted[6]. The three-month period may be extended for up to three additional months if the regulator considers it necessary, and after having notified the AIFM accordingly.

The authorisation granted is valid for all Member States.

The regulator granting the authorisation may restrict its scope, in particular as regards the investment strategies of the AIF which the AIFM is allowed to manage.

The competent authority of the home Member State of an AIFM must not grant an authorisation unless it is satisfied that:

- the AIFM has sufficient initial capital and own funds (see Chapter 5);
- the AIFM will be able to fulfill the conditions of the Directive;
- the persons who effectively conduct the business of the AIFM are of sufficiently good repute and sufficiently experienced;
- the AIFM's shareholders are suitable; and
- the head office and the registered office of the AIFM are located in the same Member State.

The competent authority must refuse authorisation where the effective exercise of its supervisory function is prevented by any of the following:

- close links between the AIFM and other natural or legal persons;
- the legal regime in a third country governing one or more such persons; or
- difficulties involved in the enforcement of such legal regime.

Impact on Investors

The AIFMD may in fact reduce the background checks required by an investor as the AIFMD is intended to have the effect of standardising authorisation to the extent that it may be assumed that if a manager is authorised under the AIFMD, then it has met and continues to meet all the compliance requirements of the AIFMD. An investor wanting to invest with regulated entities, therefore, needs only to check the register of the competent authority to determine whether a manager is authorised or not.

6. An application will be deemed complete if the AIFM has at least submitted information on the persons effectively conducting the business of the AIFM; the identities of the AIFM shareholders or members; the remuneration policies and practices as defined above; the AIF's investment strategies including the types of underlying funds (in case of FoF) and the AIFM's policy as regards the use of leverage, and the risk profiles and other characteristics of the AIF it manages or intends to manage, including information about the Member States or third countries in which they are established or are expected to be established; where the master AIF is established if the AIF is a feeder AIF; and a programme of activity setting out the organisational structure of the AIFM, including information on how the AIFM intends to comply with its obligations under the Directive as set out above.

Impact on FoF

In regard to FoF manager in their capacity as a manager of AIF, such a manager would be defined as an AIFM and would need authorisation to manage and market these funds. There is however nothing in the AIFMD which prevents a FoF from managing separate client accounts and such activity would not require any additional AIFMD authorisation. Care needs to be taken as to the investment structure of such separate client accounts as there are specific provisions related to structures that are deemed to be feeder funds.

FoF managers will need to plan their marketing plans and timetables carefully as they will not be permitted to conduct any marketing prior to being authorised. There are two things here of which to be mindful:

1) that the authorisation may take up to six months; and

2) that the competent authorities may restrict the scope of the authorisation (see above). If this were the case, then it is possible that a manager would have to reconsider and amend the FoF investment strategy, requiring fund documents to be amended accordingly. A re-application to the competent authorities would then be necessary.

It will be important that a FoF carefully considers the identity of the manager it proposes to authorise. If the AIFM is a globally-based firm with international subsidiaries and branches, it should consider which entity is the preferred authorised entity and identify any delegation requirements that choice may involve. So, for example, if the EU subsidiary of a non-EU manager is authorised to perform portfolio management services, but its non-EU parent undertakes risk management, then that manager must consider which of those two entities will be the authorised manager. The manager should notify its competent authority of any delegation to the other entity for the provision of the second core function.

Changes after authorisation has been granted

The AIFM must notify its competent authority of any material changes to the conditions for initial authorisation. The competent authority then has one month (which may be extended by another month), to oppose the changes or impose restrictions. If no opposition is expressed or restrictions imposed, the AIFM may effect the changes.

Withdrawal of authorisation

The regulator may withdraw an AIFM's authorisation if the AIFM:

- has not made use of it within twelve months;
- has expressly renounced it;
- has ceased activity for the prior six months;
- obtained the authorisation by making false statements or by any other irregular means;
- no longer fulfills the conditions under which the authorisation was granted; or
- has seriously or systematically infringed the provisions of the Directive.

In addition, a competent authority may withdraw the authorisation issued to an AIFM as a matter of national law. The authorisation granted to AIFM, where the AIFM is authorised to perform discretionary portfolio management on a client-by-client basis (in addition to managing AIF), may also be withdrawn if they no longer comply with the requirements of the Capital Adequacy Directive.

Impact on Investors

In the event of an AIFM consulting to make any material changes that could result in the AIFM either having its authorisation withdrawn or restrictions imposed on it, then investors would need to be informed by that manager that its authorisation had been withdrawn or altered. The investor would need to consider whether any such development affected its own internal investment criteria or policy.

Impact on FoF

The FoF manager must remain mindful that it must communicate any material changes to its internal organization to its competent authority. It must inform its investors of any resulting changes to or withdrawal of its current authorisation.

UCITS entities & MiFID investment firms

For UCITS-authorised management companies wishing to become authorised as AIFM, the Directive provides a lighter regime concerning the information to be submitted by the management company, to avoid duplication. Similarly, the capital requirements described in Chapter 5 only apply in part.

Investment firms authorised under MiFID are not required to obtain authorisation under the Directive in order to provide MiFID investment services (such as individual portfolio management) in respect of AIF. However, a MiFID investment firm is not permitted to manage AIF (as defined in the Directive) on the basis of its MiFID authorisation. In addition, limitations are imposed on the ability of MiFID firms (directly or indirectly) to offer or place units or shares of an AIF with EU investors: this service can only be provided if and to the extent that the AIF units or shares can be marketed in the EU in accordance with the Directive.

Activities of an externally appointed AIFM

An externally appointed AIFM can only engage in the activities listed in Annex I of the Directive (being the primary activity of risk management and portfolio management in relation to one or more AIF, plus certain ancillary activities), the management of UCITS (if authorised to do so under the UCITS Directive) and certain MiFID-type investment services such as individual portfolio management (if authorised by its home Member State).

To be authorised, AIFM must provide both core services (risk management and portfolio management) listed in Annex I of the Directive.

Permitted ancillary services include administration, marketing, and activities related to the assets of AIF, being those services necessary to meet the fiduciary duties of the AIFM, such as facilities management, real estate administration, advice to undertakings on capital structures and industrial strategy, advice and services related to mergers and acquisitions, and other services connected to the management of the AIF and the companies and other assets it has invested in.

Role of ESMA

The role of ESMA is two-fold:

(i) from a regulatory perspective, ESMA may develop:

  (a) draft technical standards relating to the specific information to be provided by the applicant AIFM to the competent authority of the Member State, including the program of activity;

  (b) draft implementing technical standards to determine standard forms, templates and procedures for the provision of information by the applicant AIFM to the competent authority of the Member State; and

  (c) draft regulatory technical standards dealing with the requirements applicable to shareholders and members with qualifying holdings as well as obstacles which may prevent effective exercise of the supervisory functions of the competent authorities;

(ii) from a transparency perspective, ESMA will act as a central repository of information concerning AIFM by

  (a) keeping a central register (to be made available in electronic format)

  (b) identifying each AIFM authorised under the Directive; and

  (c) maintaining a list of the AIF managed and/or marketed in the EU by such AIFM and the competent authority for each such AIFM.

Furthermore, powers have been delegated to the Commission to adopt the draft regulatory standards to be developed by ESMA.

5. Ongoing Compliance Requirements

The Directive covers the management of a very diverse range of AIF, and makes only limited distinction between AIF belonging to different alternative asset classes. The requirements laid out in the Directive, such as disclosure, use of depositaries, and capital adequacy, with limited exception are the same irrespective of the nature of the AIF under management.

This means that some of the requirements are not specifically tailored to the business model of private equity and venture capital. Existing AIFM will have to carry out an analysis of the extent to which they have to adapt their business for it to comply with the requirements of the Directive.

General Principles

The Directive introduces certain general principles that AIFM must comply with on an on-going basis.

The AIFM shall:

- act honestly, fairly and with due skill, care and diligence in conducting its activities;
- act in the best interests of the AIF or the investors of the AIF and the integrity of the market;
- have and employ effectively the resources and procedures that are necessary for the proper performance of its business activities;
- take all reasonable steps to avoid conflicts of interests and, when they cannot be avoided, to identify, prevent, manage, monitor and where relevant, disclose those conflicts in order to: (a) prevent them from adversely affecting the interests of the AIF it manages and the AIF's investors; and (b) ensure that the AIF it manages are fairly treated;
- comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of the AIF or the investors of the AIF and the integrity of the market (i.e. not only those deriving from the Directive);
- treat all AIF investors fairly.

No investor in an AIF may obtain a preferential treatment unless this is disclosed in the AIF rules or instruments of incorporation.

These general requirements are basically a codification of principles that are consistently applied within the private equity and venture capital industry and systematically reflected in fund documentation. The compliance by AIFM with these general requirements will now be supervised outside the investor collective (by regulators) and the Commission has been empowered to adopt measures to specify the criteria to be used by the relevant regulators to assess compliance by AIFM with these obligations.

Disclosure to Investors

An AIFM must, for each EU AIF it manages and for each AIF it markets in the EU, make available to investors the following information before they invest in the AIF and on any subsequent change, including, but not limited to, a description of:

- the investment strategy and objectives of the AIF, the types of assets which the AIF may invest in, techniques it may employ and associated risks, any investment restrictions, types and sources of leverage permitted and associated risks, the maximum level of leverage which the AIFM may employ on behalf of the AIF;
- the main legal implications of the contractual relationship entered into by the investor;
- the identity of the AIFM, the AIF's depositary, auditor and any other service providers;
- a description of any delegated management function and any safekeeping function delegated by the depositary, and any conflicts of interest that may arise from the delegation;
- the AIF's valuation procedure and pricing methodology;
- all fees, charges and expenses and the maximum amounts thereof which are directly and indirectly borne by the investors;
- the latest net asset value of the AIF and historic performance information (where available); and
- any preferential treatment for individual investors, the type of investors that are granted preferential treatment, and their links (if any) to the AIF and the AIFM.

Impact on Investors

A standardised approach to the presentation of this information would make it easier for investors to check that they have received the required information. There is a timing challenge here as any preferential terms are generally negotiated during the marketing of an AIF, so it is possible that one investor has committed to investment prior to preferential terms being negotiated with another investor.

Impact on FoF

A key point FoF managers should be aware of is the requirement to make all of this information available to investors before they make their investment. This presents a practical difficulty where any preferential terms must be disclosed to all investors prior to their investment. This requirement does not take into consideration the timing of fund closings nor the possibility of one investor having committed to investment prior to preferential terms being negotiated with another investor.

Annual Reports

The AIFM must prepare an annual report in respect of each EU AIF it manages and each AIF it markets in the EU. This must be completed no later than six months following the end of the financial year (or possibly within four months for AIF subject to the Transparency Directive, e.g. listed AIF – see below). The annual report must be provided to:

- investors, on request; and
- the home Member State competent authority of the AIFM and, where applicable, of the AIF.

Content of the annual report

The annual report must include:

- an audited balance sheet or statement of assets and liabilities;
- an audited income and expenditure account;
- a report on the fund's activities over the year;
- any material changes during the financial year covered in respect of the information required to be disclosed to investors pre-investment (see above);
- the total remuneration for the financial year split into fixed and variable remuneration paid by the AIFM, the number of beneficiaries and details of carried interest paid; and
- the aggregate amount of remuneration broken down by senior management and members of staff whose actions have a material impact on the risk profile of the fund.

The Commission must make further Level 2 legislation specifying the content and format of the annual report. It is therefore possible that more detailed requirements will apply but this might also be the occasion for some more tailoring as these measures shall be adapted to the type of AIF.

AIF subject to the Transparency Directive

AIF subject to the Transparency Directive may fulfil their obligation to disclose the above details by including them within the public annual report required by the Transparency Directive. In this case, that report must be available within four (rather than six) months of the end of the financial year. If such details are not covered in the public annual report they must be included in a separate report made available only to investors on request, in which case the normal six-month deadline applies.

Preparation and audit of accounting information

The accounting information in the annual report must be:

- prepared in accordance with the fund rules and in accordance with accounting standards in the AIF's home Member State or (for non-EU AIF) the country where the AIF has its registered office; and
- audited by an EU auditor or (for non-EU AIF and where permitted by Member States) subjected to an audit meeting international audit standards in force in the country where the AIF has its registered office.

No alternatives are specified for AIF without a registered office.

Impact on FoF

The practicality of meeting the timetable is necessarily driven by the underlying managers; if those underlying managers also have or take a six-month window to report, then it is challenging to expect the FoF manager to consolidate and report upon all those underlying reports within the same timeframe. Some flexibility may be necessary in order to ensure that the FoF manager does not fail to meet the mandated deadline as a result of late reporting from its underlying managers.

FoF managers should be aware that any of their existing AIF, which will not make any further investments after transposition in 2013, do not need to produce an annual report.

Those FoF managers who are managing listed or public investment companies should note that the four-month annual report publication timeframe specified by the Transparency Directive still applies.

Capital Requirements

AIFM will be required:

(i) to have a minimum amount of "initial capital" and "own funds";

(ii) to maintain qualifying professional indemnity insurance or additional own funds to cover professional negligence liability; and

(iii) to invest own funds in liquid assets or assets readily convertible to cash and not in "speculative positions".

There are two important qualifications to the standard requirements. An AIFM which only manages itself (an internally managed AIF) will be required to maintain initial capital of EUR 300,000, but will not be subject to minimum own funds requirements. An AIFM which is also authorised as a UCITS management company will only be subject to the requirements in (ii) and (iii) (as the UCITS Directive sets the initial capital and own funds requirements for this type of investment manager).

What are "initial capital" and "own funds"?

These definitions are derived from the Banking Consolidation Directive and Capital Adequacy Directive, collectively known as the Capital Requirements Directive ("CRD"). In the CRD, these concepts are used to determine which items qualify for regulatory capital of banks, other deposit takers and investment firms. "Initial capital" and "own funds" are two ways of measuring what are essentially "shareholder funds" (after deducting adjustments, e.g. for accrued losses). Certain types of preference shares and subordinated debt can be counted towards "own funds" at present, but this part of the CRD may well be amended before the Directive comes into force. Any amendment to the CRD definitions is likely to affect which items an AIFM will be entitled to include within initial capital or own funds. Changes in the CRD might even directly impact the AIFMD as far as it would be related to the cross-reference made regarding part of the own funds requirement (annual overheads).

Initial capital requirement

An internally managed AIF will be required to maintain initial capital of EUR 300,000.

An AIFM managing external funds will have to maintain initial capital of EUR 125,000.

Own funds requirement

An internally managed AIF will not be subject to minimum own funds requirements, save to the extent this is required (if at all) to cover professional negligence risks (see below).

An AIFM managing external AIF will have to maintain own funds equal to the higher of:

(i) one-quarter of fixed annual overheads[7]; and

(ii) 0.02% of the amount by which the total value of portfolios under management exceeds EUR 250 million, subject to a cap of EUR 10 million.

Member States have discretion to allow the requirement under (ii) to be reduced by up to 50% if a bank or insurer has guaranteed the balance.

Additional requirements to cover professional negligence risks

In addition to the initial capital and own funds requirements described above, external AIFM and self-managed AIF must also hold either:

- appropriate professional indemnity insurance; or
- a further amount of own funds to cover potential liability for professional negligence.

Use of own funds

Own funds must be invested in liquid assets or assets readily convertible to cash in the short term, and may not be invested in speculative positions. This restriction prevents AIFM from using own funds as working capital, and is a significant difference from the current requirements for MiFID investment firms. This question should be raised with regulators and as far as possible improved at Level 2. In any case, we believe that this restriction should be construed as applying only to balance sheet assets held as a result of the subscription of own funds in order to meet capital requirements imposed by the Directive, as opposed to all of an AIFM's own funds.

Level 2

The Commission shall adopt measures specifying:

- the risks the additional own funds or the professional indemnity insurance must cover;
- the conditions for determining the appropriateness of additional own funds or the coverage of the professional indemnity insurance; and
- the manner of determining ongoing adjustments of additional own funds or of the coverage of the professional indemnity insurance.

Impact on Investors

Some non-EU managers may determine that these requirements fundamentally worsen their business model to the extent that they decide not to raise capital from EU investors or to offer different AIF to non-EU investors on the one hand and to EU investors on the other, with a reduced rentability for the latter.

7. This is the amount required under the Capital Adequacy Directive.

Impact on FoF

There are no specific different implications for FoF managers than for any other AIFM. A FoF manager must put aside the required amount of initial capital, such sums to continue to be put aside and kept on short-term availability, at all times. FoF managers may choose to insure 50% of their required initial capital, in which case they only need to put up the other 50%. Professional indemnity insurance is also required.

FoF managers may have less available capital to invest alongside their investors as a consequence of the initial capital requirements. The alignment of interest between investors and managers, which is a core characteristic of the private equity and venture capital model, may be dented as a consequence of this.

Delegation

Overview

The Directive imposes requirements on an AIFM when delegating any of the functions set out in Annex I of the Directive. Specific additional restrictions apply when delegating portfolio management or risk management functions. The requirements and restrictions do not apply where purely administrative or technical functions are delegated.

As only a single AIFM may be authorised to manage an AIF, a global manager with international offices will need to ensure that it has the correct delegations in place in regard to portfolio management or risk management. These delegations should be identified in the AIFM's authorisation submission.

Disclosures to investors and competent authorities

An AIFM applying for authorisation will be required to disclose its delegation arrangements (including the identity of the delegate and a description of any potential conflicts of interest) to its home Member State competent authority, and must then give its competent authority advance notice of any new delegation.

Details of any delegation of management functions, the identity of the delegate and a description of any potential conflicts of interest must be made available to fund investors before they invest. This information must be updated to reflect any material changes.

Liability

Delegation does not affect the liability of the AIFM for the matters delegated.

General requirements relating to delegation

The following requirements apply:

- any delegation must be justifiable "with objective reasons";
- the AIFM must be able to demonstrate that the delegate:
  - is capable of performing, qualified to perform and has sufficient resources to perform, the functions delegated;
  - was selected with all due care; and
  - can be effectively monitored and instructed by the AIFM;
- the delegation:
  - must not inhibit effective supervision of the AIFM or its ability to act in investors' best interests; and
  - must be capable of immediate termination when this is in the interest of investors; and
- the delegate's relevant staff must be sufficiently experienced and of good repute.

An AIFM must not delegate its functions to the extent that, in essence, it is no longer the manager of the relevant fund (i.e. it becomes a "letter-box entity"). Level 2 measures will specify when an AIFM would become a "letter-box entity".

Sub-delegation

Delegation by a delegate or sub-delegate ("sub-delegation") is generally permitted, provided that:

- the AIFM has consented in advance;
- the AIFM has given prior notice of the sub-delegation to its home Member State competent authority; and
- the requirements applicable to a delegation of the function are also met in relation to the sub-delegation.

The delegate must review the services provided by its sub-delegates on an ongoing basis. Additional restrictions apply on sub-delegation of portfolio or risk management.

Restrictions on delegating portfolio or risk management

Additional restrictions apply when an AIFM delegates portfolio management or risk management – these functions may not be delegated or sub-delegated to:

- the depositary or any delegate of the depositary;
- a non-EU undertaking, unless co-operation between that undertaking's regulator and the AIFM's home Member State competent authority is "ensured";
- any entity that is not authorised/registered and supervised for asset management, unless the AIFM's home Member State competent authority has given its prior consent; or
- any other entity whose interests may conflict with the AIFM or the fund investors unless:
  - the entity "functionally and hierarchically" separates its delegated tasks from any other potentially conflicting tasks; and
  - the potential conflicts are properly identified, managed, monitored and disclosed to fund investors.

An AIFM must review the services provided by its delegates on an ongoing basis.

Impact on Investors

There are no significant impacts for investors beyond checking and processing the requisite information has been received and that the necessary authorisations are in place. The primary responsibility for this lies with the competent authorities, which maintain a register of authorised AIFM, but investors may choose to make their own enquiries of the AIFM.

Impact on FoF

There are no specific different implications for FoF managers than for any other AIFM. The principle consideration will be to ensure that the correct delegations are in place where the FoF manager is an international manager with international branches or subsidiaries which may be undertaking either or both of the core functions of portfolio management and risk management. A FoF manager must identify any planned delegations in its submission for authorisation.

Depositary

General

The Directive requires the AIFM to ensure that a single depositary is appointed for each AIF it manages, even where the AIF was established before the Directive entered into force.

What is the depositary for?

The depositary concept is borrowed from the EU's retail fund (UCITS) legislation. The EU Parliament's glossary for the Directive summarises the purpose of the depositary, defining it as: "a legally separate organisation, where the formal documents showing who owns shares, bonds, etc. can be kept safely."

The glossary goes on to explain that a depositary typically has three core functions:

- the safekeeping of the assets of the fund;
- the day-to-day administration of the assets of the fund; and
- the control of the fund's operation (including compliance with investment policies and receipt of funds from/payment of funds to investors).

The need to have a single depositary for each AIF performing these roles will represent a significant, and potentially costly, change for private equity management in many EU jurisdictions. Some of the tasks carried out by the depositary in relation to private equity and venture capital investment will be duplicated between the AIFM and depositary because a PE/VC AIFM already performs these tasks as part of the investment and valuation process. Policymakers justified this additional (unquantified) cost as necessary to protect investors against losses arising from fraud by the AIFM, citing the losses incurred by investors in Madoff funds as an example despite the fact that in the EU Madoff funds were supposed to apply existing UCITS rules, including with regards to the depositary.

Does the Directive regulate depositaries?

Depositaries are not required to become registered under the Directive. Rather, the Directive sets out the functions which a depositary must perform and the circumstances in which a depositary will be liable for causing loss to investors, the AIF and/or the AIFM. It is the AIFM which is responsible for ensuring that a depositary is appointed in accordance with the requirements of the Directive for each fund it manages.

Is the requirement to have a depositary ever disapplied?

A depositary is not required in relation to non-EU funds that are:

- managed by a non-EU AIFM and marketed in the EU via national regimes; or
- managed by an EU AIFM but not marketed in the EU.

Where a non-EU fund is managed by an EU AIFM and marketed in the EU via national regimes, a depositary must still be appointed, but the full detailed Directive provisions on depositary liability, delegation and who can be a depositary do not apply. They will apply, however, once the passport is used.

Appointment

There must be a written contract of appointment. The Commission shall establish requirements for its content at Level 2. The Directive appears to leave open the possibility that the counterparty to the contract could be either the AIF or the AIFM. As the AIFM is responsible under the Directive for ensuring that the depositary is appointed in a manner which complies with the legislative requirements, it is likely that the AIFM will wish to be a party to the contract, irrespective of whether it formally appoints the depositary.

Who can be a depositary?

A depositary for an EU fund must be:

a) an EU credit institution;

b) a MiFID investment firm subject to the same CRD capital requirements as credit institutions; or

c) a prudentially regulated and supervised institution of a type that (at the date the AIFM Directive enters into force) is eligible to be a UCITS depositary under the UCITS IV Directive.

For non-EU AIF, the depositary may also be an entity "of the same nature" as one within (a) or (b) above, provided that it is subject to effectively enforced prudential regulation and supervision to the same effect as that under EU law. Whether or not prudential regulation and supervision in a third country meets these standards will depend on criteria to be established by the Commission at Level 2.

Additional flexibility is provided for (primarily) private equity and real estate funds whose investors have no redemption rights for five years from the date of their initial investment. The depositary to these funds may be an entity (e.g. a notary, lawyer or registrar) which:

- carries out depositary functions as part of professional or business activities;
- is subject to mandatory professional registration recognised by law, to legal or regulatory provisions or to rules of professional conduct; and
- can furnish sufficient financial and professional guarantees.

No clarity is offered as to what may constitute "sufficient financial and professional guarantees", other than a high-level statement that they must enable the depositary to meet its commitments and effectively perform its functions as depositary.

If these types of firm act as depositaries, they will need to comply with the same requirements as are prescribed for bank and MiFID investment firm depositaries, other than regulatory capital requirements. They will also be subject to the same level of liability. It remains to be seen whether any professional organisations will wish to offer this service under the AIFM Directive at reasonable cost.

Who cannot be a depositary?

An AIFM cannot be a depositary. However it appears that a member of the AIFM's group could be a depositary (provided they fulfil the requisite requirements).

Additional restrictions apply to prime brokers which wish to act as depositary.

Where may the depositary be established?

The Directive imposes limits on who may be a depositary based on where the depositary is established. A depositary is "established" where it has its registered office and in each jurisdiction where it has a branch.

EU funds

For EU funds, the depositary must be established in the fund's home Member State.

The fund's (or, for unregulated funds, the AIFM's) home Member State competent authorities will have discretion, until four years from implementation of the Directive, to allow a depositary to be established in another Member State if it is an EU credit institution.

Non-EU funds

The depositary of a non-EU fund must be established in the AIFM's home Member State (or Member State of reference, in the case of a third-country AIFM). Alternatively, the depositary may be established in the third country in which the AIF is established if the following conditions are met:

- co-operation and information exchange arrangements must be in place between the depositary's regulator, the AIFM's home Member State competent authority and the competent authority in each Member State where the fund is intended to be marketed;
- OECD-compliant tax information exchange agreements must be in place between the depositary's jurisdiction, the AIFM's home Member State and each Member State where the fund will be marketed;
- depositaries in the country where the depositary is established must be subject to effectively enforced prudential regulation and supervision to the same effect as that under EU law. The Commission must adopt criteria to determine this;
- the depositary's jurisdiction must not be listed by FATF as a Non-Cooperative Country and Territory; and
- the depositary must have agreed to:
  i. accept liability to the fund or fund investors on the basis provided by the Directive (see below); and
  ii. comply with the Directive requirements relating to delegation by depositaries.

These qualifying conditions apply at all times. It is of course possible that after the initial appointment, one or more of the qualifying conditions ceases to be fulfilled. This would result in the AIFM being in breach of its obligations under the Directive.

Depositary functions and duties

The depositary must:

(a) ensure that fund cash flows are properly monitored;

(b) ensure all investor subscription payments and all funds are received and booked in segregated accounts with:

- a central bank;
- an EU credit institution;
- a bank authorised in a third country; or
- another entity "of the same nature", which is subject to effectively enforced prudential regulation and supervision to the same effect as that under EU law;

(c) hold in custody the financial instruments belonging to the fund that:

- can be physically delivered (e.g. physical share certificates and bearer instruments); or
- can be registered in a financial instruments account opened in the depositary's books (in which case, the depositary's obligation is to register the instruments in a non-pooled segregated account opened the depositary's books (or the AIFM on its behalf) in the depositary's books);

(d) for all other assets of the fund, verify whether the fund (or the AIFM on its behalf) has ownership of the asset and, if so, maintain a record evidencing ownership;

(e) ensure transactions in fund units/shares are carried out in accordance with applicable national law and the fund rules;

(f) ensure fund shares/units are valued in accordance with applicable national law, the fund rules and Directive valuation requirements (see the section on Valuation below);

(g) carry out the AIFM's instructions, unless they conflict with applicable national law or the fund rules;

(h) ensure timely remittance of consideration for transactions in fund assets;

(i) ensure fund income is applied in accordance with applicable national law and the fund rules; and

(j) act independently, honestly, fairly and professionally and in the interest of the fund and fund investors.

It seems likely that these requirements will necessarily lead to the depositary being involved to some extent in both fund closings and transaction closings, which may have both cost and timetable implications. It seems that the legislator's intention was not to include PE/VC financial instruments in the custodian requirements as far as they fulfil the relevant criteria (can neither be physically delivered nor registered in an account opened in a depositary's book (i.e. are already registered in the company shares register)). This will have to be checked during the Level 2 process.

Limits on delegation

A depositary may delegate only the tasks referred to in (c) and (d) above.

Delegation of these tasks is permitted, provided that:

- the purpose of the delegation is not to avoid Directive requirements;
- the depositary can show an "objective reason" for delegating;
- the depositary exercises due skill, care and diligence in the selection, appointment, periodic review and ongoing monitoring of its delegate; and
- the depositary ensures, on an ongoing basis, that its delegate:
  - has appropriate structures and expertise;
  - if it will have sub-custody of financial instruments, is subject to:
    - effective prudential regulation (including capital requirements) and supervision; and
    - periodic external audit;
  - segregates the depositary's client assets from its own assets and those of the depositary;
  - does not re-use fund assets without informing the depositary in advance and obtaining the prior consent of the fund (or the AIFM acting on its behalf); and
  - performs the delegated functions in compliance with the standard of care required by the Directive for depositaries.

The impact of these requirements on the ability of a professional services firm depositary to delegate to another such firm is unclear. For instance, it is unclear what "effective prudential requirements" requires in these circumstances.

Where the law of a non-EU country requires that a local entity holds certain financial instruments in custody and there are no local entities that satisfy the delegation requirements, a local entity may be appointed provided that:

- the fund investors are informed prior to their investment; and
- the fund (or the AIFM on its behalf) instructs the depositary to delegate to that sub-custodian.

Sub-delegation is permitted, provided that the criteria for delegation are also met in relation to the sub-delegation.

Liability of depositary

The depositary will be liable to the AIF or its investors for certain losses. In the course of negotiation of the Directive, there was a debate over whether the depositary should have "no fault" or "strict" liability for losses or whether this should be fault based liability. The final version of the Directive imposes each type of liability on the depositary, depending on the type of loss.

Strict/"no fault" liability

Where financial instruments held in custody are lost, the depositary is obliged to return identical financial instruments or the corresponding amount to the fund (or the AIFM on its behalf) without undue delay.

However, there are two exceptions to this liability.

The first is where the depositary can prove that the loss resulted from an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. The Commission will define the scope of this "force majeure" type exclusion at Level 2; in the meantime, a Directive recital indicates that it would not cover (for example) fraud by one of the depositary's employees.

The second exception applies where financial instruments held by a sub-custodian are lost and the depositary:

- has agreed in writing with the fund (or the AIFM on its behalf) that the depositary may (in a written contract with the sub-custodian) transfer its liability for lost assets to the sub-custodian; and
- can prove that:
  - it has met all of its obligations under the Directive in relation to the delegation;
  - it has a written contract with the sub-custodian which effects the transfer of liability to the sub-custodian and makes it possible for the fund (or, on its behalf, the AIFM or the depositary) to claim against the sub-custodian in respect of the loss.

Additional criteria must be met where the sub-custodian is one in respect of whom preconditions for delegation have been disapplied.

Fault-based liability

The depositary is also liable to the fund or fund investors for "all other losses" suffered by them as a result of its negligent or intentional failure to perform its obligations.

Restrictions on the depositary

The Directive prohibits a depositary from:

- re-using fund assets without the prior consent of the fund (or the AIFM acting on its behalf);
- conducting activities in relation to the fund that may create conflicts of interest, unless:
  - it has "functionally and hierarchically" separated those activities from its depositary tasks; and
  - any potential conflicts of interest are properly identified, managed, monitored and disclosed to fund investors.

Alignment with UCITS IV

The Directive expressly acknowledges the differing investment strategies and investor bases of AIF and UCITS. It does not therefore contemplate future alignment of the roles and responsibilities of AIF and UCITS depositaries. That said, AIFMD negotiations have been influenced by Member States anticipating the debate around the UCITS review and willing to use the AIFMD as "minimal benchmark". Therefore, interaction between both texts cannot be excluded.

Disclosures to investors and competent authorities

AIFM applying for authorisation must disclose details of their funds' depositary arrangements to their home Member State competent authority, including any delegation by the depositary (see also section headed "Limits on delegation" above). This information must also be made available to fund investors before they invest, and must be updated to reflect any material changes.

The depositary must make available on request to its own competent authority and to the competent authorities of the AIF and/or AIFM information which it obtains when undertaking its duties which may be necessary for those authorities.

Investors must also be informed, pre-investment, of any agreement to transfer liability for loss of custody assets to a sub-custodian (and any changes to this must be notified to investors without delay).

Impact on Investors

It is inevitable that the requirement to appoint a depositary, even where that depositary is fulfilling principally a record keeping function, will introduce additional costs for managers and for investors. Therefore, both managers and investors will have to monitor very carefully the depositary's tasks and costs; avoid as far as possible duplication with existing checks and controls; and ensure, at Level 2 and via national transposition, the proper implementation of the PE/VC lighter regime foreseen by the Directive wherever relevant.

Impact on FoF

Where a FoF may be investing in AIF for which a depositary must be appointed, there are likely to be additional costs that will feed up to the FoF level. These will be in addition to the cost that a FoF will incur for appointing its own depositary. It is currently unclear how a FoF might reasonably confirm that its appointed depositary provides "sufficient financial and professional guarantees". As such, that depositary's liability might be impaired.

Some of the responsibilities carried out by the depositary in relation to private equity and venture capital investment will be duplicated between the AIFM and depositary because an AIFM needs to perform these tasks as part of the investment process. One example will be record keeping, where this is a function already undertaken by a FoF manager, yet a depositary will still be required to undertake the same activity on behalf of the FoF.

Remuneration

The Directive requires AIFM to put in place remuneration policies and practices for certain senior staff, designed to promote sound and effective risk management and not to encourage risk taking which is inconsistent with the risk profiles and rules of the AIF. The private equity and venture capital industry is well placed to meet this underlying objective, given the well established use of carried interest and co-invest arrangements designed to align the interests of senior private equity manager staff and investors in the fund. The main question for most AIFM will be whether the prescriptive requirements in the Directive for aligning risk with remuneration require changes to the AIFM's compensation arrangements.

Which staff must be covered?

An AIFM's remuneration policies and practices must cover any categories of staff whose professional activities have a material impact on the risk profile of the funds it manages. Depending on their impact on risk, these might include:

- senior management;
- "risk takers" (likely to include senior investment executives who are not also senior management);
- employees whose remuneration takes them into the same bracket as senior management and risk takers; and
- "control functions" (likely to include the firm's compliance officer, for example).

"Risk takers" and "control functions" are both left undefined.

ESMA is required to issue guidelines on the application of the remuneration provisions. It is possible that these guidelines could widen the application of certain of the requirements beyond these categories of staff and the portfolio management team and, in the case of smaller managers, extend to the entire staff.

What is "remuneration" for these purposes?

The Directive does not define "remuneration", but does state that the requirements apply to:

(a) remuneration of any type paid by the AIFM;

(b) any amount paid directly by the fund, including "carried interest" (but with a definition of "carried interest" that offers some margin of manoeuvre for returns on investment - see Definitions for definition provided by the Directive); and

(c) any transfer of shares or units of the fund.

When interpreting (b) and (c), it is to be hoped that ESMA and regulators will have regard to the fact that the stated aim of this part of the Directive is to regulate amounts awarded by way of "remuneration", not to regulate any form of investment.

What are the requirements?

When establishing and applying their remuneration policies and practices AIFM must comply with a number of principles, which are listed in Annex II to the Directive. The overarching requirement is for the AIFM to have a remuneration policy that is consistent with and promote sound and effective risk management. It must include conflicts avoidance measures and must be in line with the business strategy, objectives, values and interests of the AIFM and its funds/fund investors. The policy and its implementation must be periodically reviewed.

Key additional requirements include:

- requirements for fixed remuneration (e.g. salary) and variable remuneration (e.g. bonus) to be appropriately balanced;
- restrictions on the amount of variable remuneration that can be paid without deferral;
- provisions on the payment and vesting of deferred amounts, depending on the AIFM's financial situation and the performance of the relevant individual, business unit and fund;
- provision for the contraction (or non-payment) of variable remuneration due where the AIFM or the fund performs poorly, and for claw-back of amounts already paid;
- at least 50% of variable remuneration must be paid in units or shares in the relevant fund (or similar instruments), which should also be subject to an appropriate retention policy. This 50% requirement is subject to limited adjustment (e.g. where the AIFM also manages significant amounts in separately managed accounts);
- requirements in relation to performance-related remuneration, so that (for example) the assessment of performance:
  - includes risk adjustment mechanisms;
  - takes account of non-financial as well as financial criteria;
  - is set in a multi-year framework appropriate to the life cycle of the fund; and
  - is based on a combination of individual performance and performance of the business unit, fund and the AIFM as a whole;
- restrictions on guaranteed bonuses; and
- requirements for staff in control functions to be compensated by reference to objectives linked to those functions (i.e. independently of the performance of business areas they control).

It is likely that remuneration structures will require revision in order to become compliant, particularly in relation to "variable" remuneration, which includes bonuses and carried interest (subject to definition; see above). Furthermore, it is often the case that remuneration that is linked to units or shares in a fund is limited to certain senior staff. As such, it may be impractical for a manager to meet this particular requirement, especially in those funds that are already constituted and investing. Managers are likely to have to revisit their documents of incorporation or limited partnership agreements to review current arrangements.

Applying principles developed for banks to private equity

The remuneration provisions in the Directive are based on those included within the CRD, which Member States are required to implement from 1 January 2011. The CRD provisions apply to banks and investment firms. The stated intention behind those provisions is to ensure that pay for senior staff – in particular bonuses and other "variable remuneration" – aligns the interests of those staff with the bank's interests. Many of the principles have been transposed into the Directive with little or no change, even though they are designed for banks. This means it is not easy for private equity (or other) funds or managers to apply the rules in a way which is consistent with the stated underlying aim of the provisions, namely sound and effective risk management. That said, the way carried interest is covered, i.e. excluding any return on investment made into the AIF, offers some margin of manoeuvre that has to be assessed carefully.

Proportionality

There is flexibility for AIFM to take a proportionate approach, by complying with the principles "in a way and to the extent that is appropriate to [the AIFM's] size, internal organisation and the nature, scope and complexity of [the AIFM's] activities". ESMA must produce guidelines on sound remuneration policies, and these may elucidate the principles themselves and the scope for AIFM to comply on a proportionate basis. The banking equivalent of ESMA is due to publish such guidance for firms subject to the CRD in December 2010 and ESMA may base its guidelines in part on this.

Remuneration committee

AIFM that are significant in terms of their size or the size of the funds they manage will also be required to have a remuneration committee which consists of (including its chair) non-executive members of the management body.

Disclosure requirements

AIFM applying for authorisation will be required to disclose details of their remuneration policies and practices to their home Member State competent authority.

The AIFM must also prepare an annual report in respect of each EU fund it manages and each fund it markets in the EU, and this must contain certain information in relation to remuneration (see page 19).

Valuation

Overview

For each of their funds, AIFM are required:

- to have procedures for proper and independent valuation of the AIF's assets; and
- to ensure that the net asset value ("NAV") of the AIF's assets per share or unit issued by the AIF is calculated (the "NAV calculation") and disclosed to investors.

Valuations may be performed by the AIFM or a professional external valuer. Much of the detail relating to valuations will be determined by the Commission at Level 2. There is no mandatory external valuer as initially foreseen by the Commission.

Valuation rules and procedures

The rules applicable to the valuation of the AIF's assets and the NAV calculation are those laid down in the country in which the AIF has its registered office or in the AIF rules and/or instruments of incorporation (e.g. the limited partnership agreement). The NAV calculation must be performed and disclosed in accordance with the fund rules and applicable national law. The Commission must specify additional criteria for asset valuation and NAV calculation.

Valuations must be performed impartially, with all due skill, care and diligence.

It is not clear how the "share or unit" concept is to be applied to funds which issue neither shares nor units, such as private equity funds structured as limited partnerships (probably the most common EU structure by amount of total capital invested).

Details of the valuation procedures for a fund (including pricing methodology and methods for valuing hard-to-value assets) must be made available to investors before they invest, and this information must be updated to reflect any material changes. This information must also be provided to the AIFM's home Member State competent authority when the AIFM applies for authorisation.

Valuations must be disclosed to investors in the manner required by the fund rules.

Valuation frequency

Valuations must be performed at least once a year. For closed-ended funds, valuations must also be carried out whenever there is an increase or decrease in the AIF's capital. "Capital" is not defined for these purposes. This is to be clarified with the Commission as the legislator's intention is unclear. One reasonable interpretation in the context of a venture capital or private equity fund structured as a limited partnership would be that "capital" roughly corresponds to "commitment". On this approach, capital would increase when a new commitment is made to an AIF and decrease when there is a decrease in aggregate commitments.

More frequent valuation requirements apply to open-ended funds.

Who can perform valuations?

The AIFM may perform valuations itself, or arrange for an independent external valuer to perform this function.

AIFM that carry out their own valuations must ensure independence between the valuation and portfolio management functions. The AIFM must put in place measures to mitigate conflicts of interest arising in connection with in-house valuation (e.g. arising from the AIFM's remuneration policy), and to prevent undue influence on staff.

Member States can require an AIFM which carries out its own valuations to have them and/or its valuation procedures verified by an external valuer or, where appropriate, an auditor.

Appointing an external valuer

A number of conditions must be met where an external valuer is appointed. Sub-delegation by external valuers is not permitted.

- The external valuer must be independent from the AIFM, the fund and any other person that is closely linked to the AIFM or the fund.
- The AIFM must notify the appointment to its home Member State regulator, which (in certain circumstances) can require a different external valuer to be appointed.
- The AIFM must also be able to demonstrate that:
  - the appointment:
    - is objectively justifiable;
    - does not inhibit effective supervision of the AIFM or its ability to act in investors' best interests; and
    - can be terminated immediately when this is in the interest of investors;
  - the external valuer:
    - is subject to mandatory professional registration/rules of professional conduct;
    - can furnish sufficient professional guarantees[8] (to be further specified by the Commission at Level 2);
    - is capable of performing, and is qualified to and has sufficient resources to perform, the valuations;
    - was selected with all due care; and
    - can be effectively monitored and instructed by the AIFM; and
  - the external valuer's relevant staff are sufficiently experienced and of good repute.

A fund's depositary may act as its external valuer, provided that:

- it "functionally and hierarchically" separates its depositary and valuation functions; and
- the potential conflicts of interest are properly identified, managed, monitored and disclosed to investors.

Liability issues

The AIFM will be responsible for valuations to the fund and its investors, whether or not an external valuer is appointed.

External valuers will be liable to the AIFM for losses suffered by it as a result of the external valuer's negligence or intentional failure to perform valuations.

Level 2

The Commission must specify:

- criteria for the procedures for asset valuation and the NAV calculation;
- the professional guarantees to be given by an external valuer; and
- criteria for open-ended fund valuation frequency.

8. No clarity is offered as to how such registration, professional conduct and/or the provision of professional guarantees is to be met. There is no current universal industry standard.

Impact on Investors

There are no particular impacts for investors except where new provisions (functional independence of valuation) could require changes compared to current policies and procedures with a possible impact on documents of incorporation or limited partnership agreements.

Impact on FoF

There are no specific different implications for FoF managers than for any other AIFM. FoF managers may elect to conduct valuation internally or to appoint an external valuer. Criteria apply for either choice. Most FoF managers will be familiar with the process of valuation.

For smaller FoF managers, there is a practical requirement for 'functional independence' from portfolio management and the remuneration policy. This is likely to be challenging for smaller FoF managers who may not currently employ sufficient people to be able to separate these activities.

6. Fundraising and Structuring

Fund structuring is likely to increase in complexity in the post-AIFMD world. EU AIFM are not able to market EU AIF under national private placement regimes, only under AIFMD, with the exception of EU AIF that fall below the size threshold exemptions.

Fundraising

Notification requirements

Before an EU AIFM (and also a non-EU AIFM benefiting from the passport – see Chapter 8) starts fundraising, it must comply with certain notification requirements and submit certain information in respect of the AIF it intends to market in the EU.

The AIFM is required to submit a notification to the competent authorities of its home Member State (or its Member State of reference in case of non-EU AIFM) in respect of each AIF that it intends to market. The notification must include, among other things, a program of operations identifying the AIF and information on where the AIF is established, the AIF rules or instruments of incorporation, the identity of the depositary of the AIF and any information on the AIF available to investors. It must also include all information required to be disclosed to investors prior to investment (see Chapter 5).

No later than 20 working days after receipt of the complete notification file, the competent authority will inform the AIFM whether it may start marketing the AIF identified in the notification.

If the AIFM intends to market the AIF in a Member State other than its home Member State (or its Member State of reference), the competent authority of the home Member State/Member State of reference of the AIFM will transmit the complete notification file to the competent authorities of each Member State in which the AIF is proposed to be marketed within 20 working days and will inform the AIFM without delay that this has taken place. The AIFM may start marketing the AIF in the host Member State(s) as of date of that notification. A regulator may refuse permission to market only if the management of the AIF will not be in accordance with the Directive, or the AIFM is generally not in compliance with its obligations under the Directive.

EU feeder AIF ("feeder AIF" broadly defined as AIF which invest 85% of their assets in another AIF, the "master AIF") may only be marketed under the above regime if they are investing into a master fund that is also an EU AIF managed by an authorised EU AIFM. Other EU feeder AIF may be marketed on the same basis as third country AIF.

Impact on existing funds being marketed at transposition date

The transparency requirements described above will have some impact on existing funds, including AIF which have already started their fundraising process on the date the Directive is transposed into national law and is therefore implemented across the EU (likely to be in early 2013).

With effect from that final transposition date and while bearing in mind that EU AIFM already operating at that date will have one year to apply for authorisation, the EU AIFM will generally be subject to full compliance with the Directive. This means, in particular, that EU AIFM managing EU AIF which are still fundraising will have to comply with the specific disclosure requirements towards investors in respect of such AIF. Please note, however, that certain grandfathering provisions are foreseen for closed-ended funds (see Chapter 3).

The extent to which the AIFM will also have to provide additional information to the "old" investors of the AIF will depend on which information the AIFM has already disclosed to these investors before they invested. Where the AIF is required to publish a prospectus certified by the competent authorities of its state of residence under the national law of that state, the AIFM will only have to disclose information which is not covered by such prospectus.

If it turns out that the transparency requirements under the Directive are exceeding those currently applicable, the disclosure requirements under the Directive will result in additional costs for the AIF which may not have been taken into account when calculating the costs of fund. However, subject to the exact terms of the fund documents, costs in connection with the transparency requirements are expenses of a type which are typically borne by the fund and, thus, by the investors.

In addition, amendments to the fund's constitutional documents (e.g. Articles or LPA) might be necessary to ensure that these costs are to be borne by the AIF and not by the AIFM or, in case of a delegation, by the delegate.

Although the Directive includes some grandfathering rules, in most cases these will not bring relief from the transparency requirements for AIFM managing existing AIF which will now start their fundraising process, since for many such funds either the fund term or the investment period will extend beyond the final transposition date.

Impact on fundraising process in future

In order to start fundraising, the AIFM will need to notify its regulator and submit the relevant documentation before any marketing activity takes place (see above). The requirement to present the competent authorities with final documentation prior to the start of the marketing process stems from a belief that private equity and venture capital funds are 'sold' when in fact they are partnership negotiations that take place over a period of time, usually many months. However, throughout the PE/VC fundraising process the terms are often negotiated and hence the documentation is being amended. Material changes in the information provided will have to be submitted to the competent authorities[9] at least one month in advance (or, immediately after the change takes place, in the event of an unplanned change). It is hoped that regulators will only require pre-notification of changes that are material from a regulatory perspective, but this rule could be interpreted to include commercial changes to fund terms, hence requiring supplemental information memorandums and final closing LPAs to be submitted to the regulator at least one month in advance.

Tailoring and clarification of this point will be a key priority in the Level 2 process.

Structuring aspects

As described above, the AIFM has to disclose to investors the fund arrangements in detail (including the identity of the AIFM, the depositary and any other service providers as well as a description of the contractual relationship entered into for the purpose of investment). Further, any delegated management function has to be disclosed. It is therefore important to distinguish precisely between the persons/entities involved.

In many current limited partnership structures, the (managing) general partner would be deemed to be the AIFM under the Directive. However, it is more likely that in future an external AIFM will be appointed for cost and administrative reasons (as is already the case in some Member States). In this case, the external manager would be the AIFM; this scenario has to be distinguished from scenarios where the general partner merely delegates certain management functions but remains the AIFM of the AIF. In case of a delegation of AIFM functions the AIFM will remain liable towards the AIF and to the investors and will have to review the services performed by the delegate on an ongoing basis.

An advisor providing non-discretionary investment advice to the fund manager would not be considered an AIFM.

9. The question remains whether the marketing programme has to stop while this review takes place.

Impact on Investors

In addition to the impacts outlined above, the staggered introduction of the AIFMD for third country funds and fund managers over a period of two years from 2013 will mean that investors need to be aware whether the AIFM is marketing under the AIFMD or under national private placement rules. Investors will also need to be aware of whether or not an AIF managed by an AIFM with whom they currently invest meets the grandfathering provisions. Investors should note that there is potential for additional costs being incurred retrospectively against any AIF which does not qualify for grandfathering. Those costs may not been taken into account when the costs of fund were originally calculated.

From their side, investors have freedom to invest at their own initiative (subject to the existing due diligence requirements). One of the outstanding clarifications to be sought during the Level 2 negotiations is the definition of "at its own initiative", as well as whether and how this is to be demonstrated.

Investors may seek to tailor their investments to their own particular specifications and internal policies, in which event they would need to consult with their AIFM to structure their investment preferences accordingly.

Impact on FoF

It is possible that FoF managers may need to consider several different investment structures into a single AIF to accommodate the particular and diverse criteria of its investors. Such a scenario would add time and cost into the planning of new FoF.

A FoF manager should take note that the (re)submission of documents needs to be made to its competent authorities. A FoF manager should also consider making allowances for the costs of this process to be included within the fund cost calculations; they may also wish to consider how they intend to charge those costs and set this out in the fund documents.

7. Management of Investment in Portfolio Companies

Fund managers will need to review the contractual documentation entered into with portfolio companies as well as general company law provisions applicable in the relevant jurisdiction, to ensure that they are able to comply with the disclosure and notification requirements outlined in this Chapter. They should also be aware that the Directive may result in a certain unlevel playing field whereby other forms of owner will not be subject to the same obligations and restrictions. Finally, it will be important to consider deal structures in the light of these notification requirements and asset stripping provisions.

Notification of an interest in a company

When an AIF acquires or disposes of shares in an unlisted portfolio company (other than an SME – see below) which has its registered office in the EU, the relevant AIFM is obliged to notify its competent authority (within ten working days) if the proportion of shares held reaches, exceeds or falls below the thresholds of 10%, 20%, 30%, 50% or 75%. This applies even if there is no controlling position, and so applies to funds acquiring minority stakes.

Initial disclosures when a company is "controlled" by AIF(s)

The Directive also includes additional disclosure and notification requirements for AIFM which manage funds that acquire "control" of portfolio companies (either alone, or in combination with other AIFs on the basis of an agreement between them or their managers). The provisions only apply in relation to portfolio companies (other than SMEs) with their registered office in the EU.

Meaning of "control"

In the case of an unlisted company (the definition of which could conceivably include EU companies listed on non-EU stock markets), an AIF (or combination of AIFs) will have "control" if they have more than 50% of the voting rights of the company (subject to various anti-abuse provisions which aggregate shares held by related entities). For "issuers", which means listed companies which have their registered office in the EU and are traded on an EU regulated market[10], "control" is defined by reference to the way in which Member States define it for the purposes of the Takeover Directive[11] (which in many countries is at or around 30%, but which varies across the EU from 25% to 66%[12]).

Notification on acquisition of control of an unlisted company

When there is an acquisition of control of an unlisted company, the AIFM(s) managing the relevant AIF(s) will be obliged to notify that fact:

(i) to the company;

(ii) to those shareholders whose identities and addresses are available to the AIFM or can be made available by the company or through a register to which the AIFM has or can get access; and

(iii) to the competent authority of the home Member State of the AIFM.

This notification will also have to include details of the voting rights held (presumably only those held by the AIF(s), although that is not entirely clear), the "conditions under which control has been reached" (including the identity of the different shareholders involved, any person entitled to exercise voting rights on their behalf and, if applicable, the chain of undertakings through which voting rights are effectively held), and the date on which the AIF(s) acquired control.

10. The AIFMD refers to regulated markets under MiFID, that includes EEE (European Economic Area) regulated markets.
11. Article 5(3) of Directive 2004/25/EC.
12. See Report on the Implementation of the Directive on Takeover Bids, 2007 (21.02.2007 SEC (2007) 268).

Disclosures on an acquisition of control

As well as the notification referred to above, there are further disclosure requirements on an acquisition of control. These also apply in relation to "issuers", as well as unlisted companies.

These disclosure provisions will require the AIFM(s) to notify (to the same people as above):

- the identity of the AIFM which either individually or in agreement with other AIFM manage(s) the AIF that has/ have acquired control;
- the policy for "preventing and managing conflicts of interest, in particular between the AIFM, the AIF and the company" and including "the specific safeguards established" to ensure that any agreement between the AIFM and/or the AIF and the company is at arms length; and
- the policy for external and internal communication relating to the company, in particular as regards employees.

In relation to unlisted companies, Member States can also require this information to be disclosed to the "national competent authorities of the non-listed company". This is undefined, but would seem to refer to an authority (perhaps the trade industry or company registrar) in the Member State where the unlisted company has its registered office.

Notification of future intentions

Where control is acquired of an unlisted company (but not, in this case, an "issuer", in relation to which other European law already makes similar provision elsewhere), the AIF must disclose "its intentions with regard to the future business" of the company and the "likely repercussions on employment, including any material change in the conditions of employment". This information must be made available to the company and its shareholders, and (as below) the AIFM must use its best efforts to ensure that the board passes the information on to employee representatives (or, if there are none, to the employees themselves).

This wording is taken from the Takeover Directive and has been subject to interpretation by case law in that context, which confirms that this obligation can be fulfilled by fair but rather general information. Our intention is to continue to use that benchmark in the implementation of the AIFMD.

Notification and disclosure to employees

The AIFM will be obliged to request that the board of directors of the company pass all of the above information on to the representatives of employees (or, if there are none, the employees themselves). The fund manager must use its "best efforts" to make sure that the employee representatives (or employees) are informed.

It is important to insist on the fact that there is no obligation of any direct disclosure from the AIFM to the company's employees.

Confidential information will not have to be disclosed to employees in cases where disclosure of the information could damage the company.

Information concerning financing

Finally, there are obligations (which only seem to apply in the case of acquisition of control of an unlisted company, although the recitals[13] say they should also apply in relation to issuers) to provide competent authorities and fund investors with "information on the financing of the acquisition".

13. See Recital 35.

Again this wording is taken from the Takeover Directive which might be considered as a useful benchmark for the implementation.

Additional information about controlled companies in annual reports

When an unlisted company (other than an SME or real estate holding company, see below) is controlled by an AIF (jointly or in combination with others) the AIF has to ensure that additional information is disclosed on an annual basis. It can do this in one of two ways:

- "request and use its best efforts to make sure" that the company's own annual report includes the additional disclosures; or
- include the additional information in the fund's own annual report to investors (see Chapter 5).

In both cases, there are provisions to make sure that employee representatives (through the company's board) and fund investors receive the information disclosed.

The information which must be disclosed includes:

- a fair review of the development of the company's business representing the situation at the end of the period covered by the annual report;
- an indication of any important events that have occurred since the end of the financial year;
- an indication of the company's likely future development; and
- certain information concerning any acquisitions of its own shares by the company.

"Asset stripping" provisions

Rules to prevent "asset stripping" by private equity owners could, depending on jurisdiction, impose certain additional restrictions on distributions, capital reductions, share redemptions or purchases of own shares by "controlled" portfolio companies (listed and unlisted) during the first two years of an AIF's ownership. Although drawn from European company law, these restrictions will apply to all types of company owned by private equity funds, and therefore go further than is the case in many Member States at the moment.

The way the rules are drafted means that they impose obligations on the AIFM (rather than the company itself). The AIFM is not allowed to "facilitate, support or instruct" any of the prohibited actions, nor can it vote in favour of them, and it must use "best efforts" to prevent them.

The restrictions imposed do not prevent all payments to shareholders during the two year period, but broadly they only allow "distributable profits" to be paid out, and only then when the company's net assets would remain at or above the level of subscribed capital plus undistributable reserves. Distributions which are prohibited include "dividends and interest relating to shares", and there are additional exceptions for certain share re-purchases or capital reductions.

Existing company law rules on distributions and other payments to shareholders by private companies vary across EU Member States, and so the impact of these changes will be different in different countries. However, these prohibitions may prevent, for example, special dividends being paid following a recapitalisation of the company, and certain other forms of partial exit. They may therefore have an impact on exit strategies and deal structuring during the first two years following acquisition of the company.

Exclusion for SMEs, real estate special purpose vehicles

The notification, disclosure and asset stripping requirements set out above only apply to companies whose registered office is in the EU.

There is an exception for special purpose vehicles which purchase, hold or administer real estate, and for portfolio companies which are "SMEs". SMEs are companies which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million[14].

Further changes to company law

The recitals of the Directive acknowledge that the additional provisions imposed by Articles 26-30 create an unlevel playing field between European private equity funds and other types of owner, and invite the European Commission to consider whether to extend these provisions "on a more general level". This may result in further changes to European company law, at least so far as necessary to apply these additional requirements to all companies of a similar size, regardless of the identity of their shareholders. Member States are also asked to consider, in transposing the provisions into national law, the need to maintain a level playing field between "EU AIF and non-EU AIF when acquiring control in companies established in the European Union", which hints strongly at a wider implementation than strictly required by the operative provisions themselves.

Impact on Investors

Investors can anticipate plenty of communication regarding portfolio companies that are established or marketed in the EU, owned by an AIFM and which are not classified as an SME. There will be disclosures each time an AIFM acquires or disposes of shares at one of the stated thresholds.

Investors should note that the control threshold is triggered when the threshold is reached by AIFM "individually or jointly". As such, it seems likely that investors will receive duplicate notifications at the point when any threshold levels are breached since each AIFM has notification responsibilities under its authorisation.

Impact on FoF

A FoF does not generally invest directly in or take control positions directly in portfolio companies and so a FoF manager is likely not to be subject to these provisions. Note that an AIFM which is authorised principally as a FoF manager, but which also manages direct investment portfolios, would be subject to these provisions.

In such an instance, the FoF manager would be responsible for making the required disclosures. The FoF manager would also be responsible for ensuring that the Board of Directors of a portfolio company communicates any required disclosures to its employees or employee representatives. Furthermore, the FoF is responsible for ensuring that the Board of Directors discloses all the information that is required to be disclosed in a portfolio company's Annual Report.

FoF managers who manage a direct investment portfolio should note that there is no concept of periodic breach within the AIFMD. An authorised AIFM must be compliant at all times or risk having its authorisation withdrawn.

14. SME is defined in Article 2(1) of the annex of Commission Recommendation 2003/361/EC. It is not yet clear whether the interpretation provisions of the Recommendation will also apply. If so, they could be problematic in the way they aggregate across "linked" and "partner" enterprises (e.g. in a similar way as when merger control filings are made by PE/VC funds).

8. Third Country Funds and Fund Managers

The rules are complicated. There are a number of different points or dates at which a non-EU AIFM may need or wish to consider applying for authorisation under the AIFMD.

A simple way to look at these points is to divide the AIFMD into four periods:

- The period up to transposition in 2013: national private placement rules for both EU and non-EU AIFM/AIF
- The period between 2013 and 2015: passports for EU AIFM with EU AIF will be available from 2013, and EU AIFM may no longer market EU AIF to professional investors in the EU via national private placement regimes from that point.

  Passports will not be available to non-EU AIFM and AIF until two years later, in 2015. In the interim, non-EU AIFM may manage EU AIF if permitted by national regimes in the EU. Non-EU AIFM may use national private placement regimes for marketing to EU investors, subject to new conditions. EU AIFM marketing non-EU AIF interests to EU investors will have to comply with almost all obligations under the AIFMD, but will not benefit from the EU passport.
- The period between 2015 and 2018: eligible non-EU AIFM may register under the AIFMD to manage EU AIF and market AIF interests in the EU under an EU passport. Alternatively, they may continue to market AIF in the EU under national private placement regimes, again subject to the new conditions. EU AIFM marketing eligible non-EU AIF interests to EU investors will now benefit from the EU passport.
- The period after 2018: national private placement regimes will in principle be withdrawn, so non-EU AIFM will be able to market AIF interests to EU investors only if they are authorised under the AIFMD.

Note that the AIFMD applies to non-EU AIFM only if they manage EU AIF or market AIF interests to EU investors.

Dates referred to above are indicative as they are not referred to explicitly in the AIFMD and may slightly vary according to the Level 2 decision-making process, even if the Commission's clear mandate and intention is to implement the sequence as described.

Non-EU AIFM

The treatment of non-EU AIFM was one of the most controversial issues in the drafting of the AIFMD. The final text is intended to create a level playing field between EU and non-EU AIFM, but the regime permitting non-EU AIFM to register under the AIFMD and enjoy the same EU-market access as EU AIFM is only scheduled to become available as from 2015.

Two years after the deadline for transposition of the AIFMD, subject to the confirmation of the specified date by the Commission after a positive recommendation by ESMA (as discussed below), non-EU AIFM from qualifying jurisdictions will be able to apply for an EU marketing authorisation under the AIFMD. To qualify, non-EU jurisdictions must have appropriate co-operation agreements with Member State regulators, have tax co-operation agreements complying with the OECD Model Tax Convention and not be designated as a Non-Cooperative Country and Territory (an "NCCT") by the Financial Action Task Force on anti-money laundering and terrorist financing. The local law in the AIFM's jurisdiction must not prevent effective supervision.

Basic requirements

A non-EU AIFM wishing to make use of this regime (i.e. to manage an EU AIF or market any AIF in different EU Member States using the passport) must apply to the regulator in its "Member State of reference" (see Definitions), which will be treated as the home Member State regulator for the non-EU AIFM. Non-EU AIFM registering under the AIFMD will be required to comply with all of the AIFMD's requirements, unless a non-EU AIFM would be subject, in its home jurisdiction, to a requirement that conflicts with an obligation under the AIFMD. In that case, the AIFM may be exempted from compliance with the requirement if it can show that it is subject to an equivalent rule having the same regulatory purpose and offering the same level of protection to the investors of the relevant AIF. Again, ESMA is required to give advice on the appropriateness of an exemption in case of incompatibility with an equivalent rule. However, the availability of such waivers is expected to be extremely limited.

Member State of reference

The choice of the Member State of reference depends on factors including the jurisdictions of any EU AIF that are managed and/or marketed, the jurisdiction of the EU AIF with the largest amount of assets, and – in the case of non-EU AIF – the EU jurisdictions in which the AIFM intends to market AIF interests. In case several Member States of reference are possible, the non-EU AIFM has to submit a request to the regulators of all Member States that could potentially be the Member State of reference. Those regulators are required to decide which of them will be the Member State of reference within a month of submission. ESMA is required to advise on the appropriateness of the choice of Member State of reference.

If the AIFM changes its marketing strategy within two years after its initial authorisation, and this change would have affected the determination of the initial Member State of reference, the AIFM must notify the competent authorities of the initial Member State of reference of this change before implementing it, and suggest a new Member State of reference based on the new strategy. The AIFM will justify its assessment by disclosing its new marketing strategy to its initial Member State of reference. At the same time, the AIFM will provide information on the entity that would be its new legal representative after the change, including at least the identity and the location of the new legal representative.

Non-EU AIFM registering under the AIFMD will be required to have a "Legal Representative" in their Member State of reference. The legal representative will, next to the AIFM itself, be the contact person of the non-EU AIFM for the investors of the relevant AIF, for ESMA and for the competent authorities as regards the activities for which the AIFM is authorised in the EU and will at least be sufficiently equipped to perform the compliance function relating to the non-EU AIFM's management and marketing activities together with the AIFM.

Non-EU AIF Interests

Until 2018, non-EU AIFM can market interests in non-EU AIF without a passport subject to compliance with national private placement regimes and the AIFMD's disclosure requirements, but only if the AIF's home jurisdiction is a qualifying jurisdiction, i.e., that it has in place co-operation arrangements with the competent/supervisory authorities in the relevant EU jurisdictions, tax agreements that comply with the OECD Model Tax Convention and that they are not designated as NCCTs. EU AIFM can market non-EU AIF interests without a passport until 2015 if they comply with all requirements of the AIFMD (except certain depositary requirements) and the AIF's jurisdiction meets these eligibility requirements.

As from 2015, again subject to a positive recommendation by ESMA, authorised AIFM will be entitled to market interests in non-EU AIF they manage to EU professional investors, with the EU passport, if the jurisdiction meets the eligibility requirements summarized above. In the case of non-EU AIFM, the procedure for authorisation is described above.

Role of ESMA

As the above summary indicates, ESMA will have an important role in the application of the AIFMD to non-EU AIFM and AIF.

In particular, two years after the deadline for transposition of the AIFMD into Member State law, ESMA must issue an opinion on the functioning of the passport for EU AIFM managing and marketing EU AIF interests and the managing or marketing of AIF interests without a passport by EU AIFM and non-EU AIFM, as well as an advice on the application of the passport to the marketing of non-EU AIF by EU AIFM and to the managing and/or marketing of AIF by non-EU AIFM. ESMA will base its opinion and advice on, among other things, the use made of the passport for EU AIF, problems encountered, the effectiveness of the collection and sharing of information by national authorities, ESMA and ESRB, compliance with the rules on marketing and managing AIF during the transitional period and potential market disruptions and distortions.

If ESMA's opinion and advice is "positive", the Commission must adopt a delegated act within three months specifying the date when the regime for non-EU AIFM to register under the AIFMD and for non-EU AIF interests to be marketed with the passport will enter into force. ESMA is required to issue a "positive" advice if it considers that there are not significant obstacles regarding investor protection, market disruption, competition and the monitoring of systemic risk. If ESMA does not issue its advice by the deadline, the Commission will set a new time limit. The consequences of a possible negative advice by ESMA are not clear.

Similarly, three years after the entry into force of the passport regime for non-EU AIFM and AIF, ESMA will issue an opinion and advice on the functioning of the passport. It the advice is positive, the Commission will adopt another delegated act setting out the date when the national law regimes for marketing non-EU AIF interests will terminate.

Annex II sets out the different requirements under the third country provisions in tabular form.

Impact on Investors

An investor may invest in any AIFM at its own initiative. It is possible that certain EU investors may determine to amend their own investment guidelines or policies to limit investment to authorised AIFM. If this is the case, then it follows that those investors may decide to implement procedures to monitor the compliance of AIFM in which they invest. However, since all authorised AIFM will be entered on a register maintained by competent authorities and held centrally by ESMA, investors should be able to confirm the register entries in order to satisfy themselves of full compliance by AIFM in which they invest.

Investors should be aware that where an AIFM is authorised to manage, but not market, an AIF, then it may not market any secondary asset or position in that AIF to investors. Such activity would only be possible at the investor's initiative.

9. What Next?

November 2010 saw the negotiations on the Directive come to an end, with its adoption by the Parliament on 11 November following earlier approval reached in trialogue in October.

The Directive is currently being translated into all of the Member State languages and will be subject to a final consistency check before its official publication.

The Directive will enter into force at EU level on the twentieth day following its publication in the Official Journal of the European Union (expected to be in early 2011).

The next phase will proceed along two main lines: Member States drafting their implementing legislation (transposition), and the Commission and ESMA working on implementing rules (Level 2).

Member States will need to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive at the latest two years after its entry into force (the deadline for transposition is therefore expected to be in early 2013).

During the Level 2 implementation phase, many of the detailed requirements of the Directive will become clearer. In all, there are expected to be 99 implementing measures, to be prepared by the European Commission together with national regulators and the new European regulator, ESMA. For more detail on the measures that will be defined further at Level 2, please see the respective Chapters above.

In early 2015, two years after the transposition deadline of the Directive, the European passport is expected to become available for non-EU AIFM and AIF, following advice from ESMA and a delegated act by the European Commission. From this point onwards, the non-EU passport and the national regimes will co-exist.

The relationships with third country undertakings will be subject to numerous restrictions and as a consequence, the AIFMD will impact not only on the legislation and regulations of the Member States but also on the ones of third countries. In particular, third countries will have to review their legal framework carefully in light of the conditions set out by the AIFMD (e.g. supervision of portfolio managers) and be ready to put in place international co-operation arrangements with the relevant Member States.

In early 2017, four years after the transposition deadline of the Directive, the European Commission will start, on the basis of public consultation and in light of discussions with competent authorities, an overall review of the application and scope of the Directive. At the same time, the Commission is specifically invited to review the relevant legislation with respect to professional investors, in order to assess the need to impose tighter requirements for the due diligence procedures to be followed by European professional investors investing on their own initiative in non-EU AIF.

Three years after the entry into force of the passport for non-EU managers, i.e. normally in 2018, the national private placement regimes available to third country AIFM and AIF will in principle be terminated, by a decision of the Commission based on ESMA's advice considering that this is appropriate following a review. In the event that the national regimes are withdrawn, full AIFMD authorisation with passporting rights will become the only option for non-EU managers who wish to operate in the EU.

10. Definitions

This chapter provides an overview of many of the terms defined in the Directive or used in this Technical Note:

'Banking Consolidation Directive' means Directive 2006/48/EC of the European Parliament and of the Council of 30 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast).

'Capital Adequacy Directive' means Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast).

'Carried interest' (as defined by the Directive) means a share in the profits of the AIF accrued to the AIFM as compensation for the management of the AIF and excluding any share in the profits of the AIF accrued to the AIFM as a return on any investment by the AIFM into the AIF.

'ESMA' means the European Securities and Markets Authority. ESMA is one of the European Supervisory Authorities (ESAs), established by the new EU financial supervisory architecture agreed upon by the European Parliament in September 2010. The proposed reforms are well on track to be formally ratified and implemented before the end of 2010, with ESAs to be operational from 1 January 2011. ESMA will be established in Paris.

'EU' means the European Union.

'EU AIF' means:

(i) any AIF which is authorised or registered in a Member State of the EU under the applicable national law; and

(ii) any AIF which is not authorised or registered in a Member State, but has its registered office and/or head office in a Member State of the EU.

'EU AIFM' means any AIFM which has its registered office in a Member State of the EU.

'FATF' means the Financial Action Task Force.

'Feeder AIF' means an AIF which:

(i) invests at least 85% of its assets in shares or units of another AIF (the master AIF); or

(ii) invests at least 85% of its assets in more than one master AIF where those master AIF have identical investment strategies; or

(iii) has otherwise an exposure of at least 85% of its assets to one or more such master AIF.

'FSA' means the UK's Financial Services Authority.

'Holding company'[15] means a company with shareholdings in one or more other companies the commercial purpose of which is to carry out a business strategy or strategies through its subsidiaries, associated companies or participations in order to contribute to their long term value and which is either:

(i) a company whose shares are admitted to trading on a European regulated market and which is operating for its own account; or

(ii) not established for the main purpose of generating returns for its investors by means of divestment of its subsidiaries or associated companies as is evidenced in the company's annual report or other official documents.

15. According to Recital 6 of the AIFMD, the purpose of the definition of "holding company" is not to exclude managers of private equity funds, nor managers of alternative investment funds whose shares are admitted to trading on a regulated market from the scope of the Directive.

'Legal representative' means any natural or legal person having its domicile, for natural persons, or its registered office, for legal persons, in the EU who, explicitly designated by a non-EU AIFM, acts on behalf of such non-EU AIFM and may be addressed by authorities, clients, bodies and counterparties to the non-EU AIFM in the EU instead of the non-EU AIFM with regard to the latter's obligations under the Directive.

'Leverage' means any method by which the AIFM increases the exposure of an AIF it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means. According to Recital 14, in particular for PE/VC funds this means that leverage that exists at the level of a portfolio company is not intended to be included when referring to such financial or legal structures.

'Marketing' means any direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled in the EU.

'Member State of reference' of a non-EU AIFM will be determined as follows:

Scenario	Member State of reference?
The non-EU AIFM intends to MANAGE only one EU AIF, or several EU AIF established in the SAME Member State, and DOES NOT INTEND TO MARKET any AIF with a passport in the EU	• the home Member State of that or those AIF - the competent authorities of this Member State will be competent for the authorisation procedure and for the supervision of the AIFM.
The AIFM intends to MANAGE several EU AIF established in DIFFERENT Member States and DOES NOT INTEND TO MARKET any AIF with a passport in the EU	• the Member State where most of the AIF are established, or • the Member State where the largest amount of assets is being managed.
The non-EU AIFM intends to MARKET only one EU AIF in only ONE Member State of the EU	• if the AIF is authorised or registered in a Member State, the home Member State of the AIF or the Member State where the AIFM intends to market the AIF; • if the AIF is not authorised or registered in a Member State, the Member State where the AIFM intends to market the AIF.
The non-EU AIFM intends to MARKET only one non-EU AIF in only ONE Member State of the EU	• the Member State of reference will be that Member State.
The AIFM intends to MARKET only one EU AIF, but in DIFFERENT Member States	• if the AIF is authorised or registered in a Member State, the home Member State of the AIF or one of the Member States where the AIFM intends to develop effective marketing; or • if the AIF is not authorised or registered in a Member State, one of the Member States where the AIFM intends to develop effective marketing.
The AIFM intends to MARKET only ONE non-EU AIF, but in DIFFERENT Member States	• The Member State of reference will be one of those Member States.

The AIFM intends to MARKET several EU AIF in the EU	• insofar as those AIF are all registered or authorised in the same Member State, the home Member State of those AIF or the Member State where the AIFM intends to develop effective marketing for most of those AIF; • insofar those AIF are not all registered or authorised in the same Member State, the Member State where the AIFM intends to develop effective marketing for most of those AIF.
The AIFM intends to market SEVERAL EU and non-EU AIF, or several non-EU AIF in the EU	• The Member State where it intends to develop effective marketing for most of those AIF.

'MiFID' means Markets in Financial Instruments Directive (2004/39/EC) of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC and its implementing measures (Directive 2006/73/EC and Regulation 1287/2006).

'NCCT' means Non-Cooperative Countries and Territories.

'OECD' means the Organisation for Economic Co-operation and Development.

'Professional investor' means any investor which is considered to be a professional client or may be treated as a professional client on request within the meaning of Annex II of MiFID. According to MiFID, a professional client is considered to possess the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs.

'Prospectus Directive' means Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

'Takeover Directive' means Directive 2004/25/EC of the European Parliament and of the Council on the regulation of takeovers

'Transparency Directive' means Directive 2004/109/EC of the European Parliament and of the Council of 20 January 2007 on financial reporting requirements, disclosure of interests in securities and communications with holders of shares and debt securities and the market.

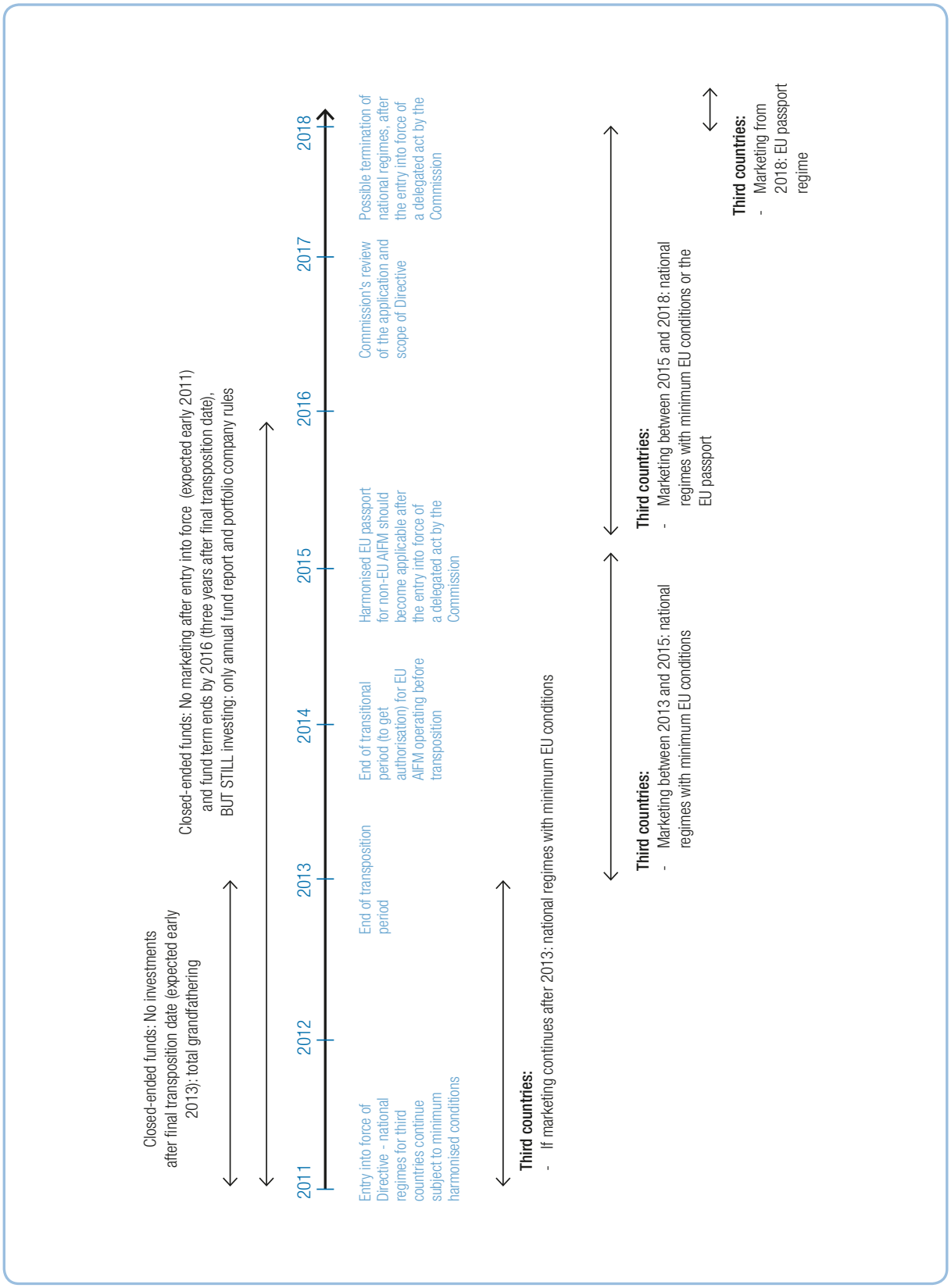
'Trialogue' refers to the process of negotiation between the Council, the European Parliament and the European Commission. Trialogues involve small teams of negotiators for each institution, with the Commission playing a mediating role. The participants in the trialogues operate on the basis of negotiating mandates given to them by their respective delegations. They explore possible avenues of compromise in an informal manner and report to their delegations. The compromise resulting from the trialogues is submitted to the delegations for approval.

'UCITS' stands for 'Undertakings for Collective Investment in Transferable Securities', investment funds that have been established in accordance with UCITS Directive. Once registered in one EU country, a UCITS fund can be freely marketed across the EU.

'UCITS Directive' means Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities.

11. ANNEX I – Timeline

ANNEX I – Timeline (Entry into Force, Transposition, Grandfathering and Third Countries)



Entity	Passport (when available, for third country AIF and AIFM 2 years after the transposition deadline of the Directive)	National private placement regimes[16] (until removed, at least 3 years after the passport for third country AIF and AIFM becomes available)
EU AIFM – EU AIF [for comparison]	Comply with full Directive	Small AIFM below the threshold are expected to be allowed to continue cross-border marketing under national regimes, subject to additional conditions set by the Directive.
EU AIFM – non-EU AIF[17]	Comply with full Directive Comply with additional conditions 1(a), 2(a) and 3(a).	Comply with the full Directive excluding aspects of Article 21 on Depositary requirements[18]. Comply with additional conditions 1(b) and 2(a).
Non-EU AIFM – EU AIF	Comply with full Directive, except to the extent that it is impossible do so, in which case comply with equivalent local rules instead. Comply with additional conditions 1(e), 2(b), 3(b) and 4.	**Until 2015** Chapter IV: Transparency requirements • Annual Report • Disclosure to Investors • Reporting obligations to competent authorities Where necessary - Chapter V: Portfolio Company requirements • Notification of acquisitions and disclosures on acquisition of control • Content of the annual report • Anti-asset stripping Comply with additional conditions 1(c) and 2(b). **From 2015** (triggered by the requirement to get authorisation for management of EU AIF) Comply with full Directive. Comply with additional conditions 1(e) and (f), 2(b), 3(b) and 4.

Entity	Passport (when available, for third country AIF and AIFM 2 years after the transposition deadline of the Directive)	National private placement regimes (until removed, at least 3 years after the passport for third country AIF and AIFM becomes available)
Non-EU AIFM – non-EU AIF	Comply with full Directive, except to the extent that it is impossible to do so, in which case comply with equivalent local rules instead. Comply with additional conditions 1(g), 2(a) and (b), 3(c) and (d), and 4.	Chapter IV : Transparency requirements • Annual Report • Disclosure to Investors • Reporting obligations to competent authorities Where necessary - Chapter V: Portfolio Company requirements • Notification of acquisitions and disclosures on acquisition of control • Content of the annual report • Anti-asset stripping Comply with additional conditions 1(d), 2(a) and (b).

16. Note that Member States may impose stricter rules on the AIFM in respect of marketing of AIF to investors on their territory.
17. If an EU AIFM wants to manage a non-EU AIF, BUT NOT market it in the EU, the AIFM will need to comply with all requirements, except for the depositary and annual report requirements, and appropriate co-operation arrangements must be in place between the competent authorities of the home Member State of the AIFM and the supervisory authorities of the 3rd country where the non-EU AIF is established.
18. Note that the AIFM must ensure that one or more entities are appointed to carry out certain depositary functions.

Additional conditions:

1. Co-operation arrangements between:
   (a) the competent authorities in the home Member State of the AIFM and the supervisory authorities in the country where the AIF is established;
   (b) the competent authorities in the AIFM's home Member State and the supervisory authorities in the country where the AIF is established*;
   (c) the competent authorities in each Member State where the AIF is marketed and the AIF's Member State and the supervisory authorities in the country where the AIFM is established*;
   (d) the competent authorities in each Member State where the AIF is marketed and the supervisory authorities in the countries where the AIFM and the AIF are established*;
   (e) from 2015, the competent authorities in the AIFM's Member State of reference and the AIF's Member State, and the supervisory authorities in the country where the AIFM is established;
   (f) from 2015, the competent authorities in the AIF's Member State and each Member State into which the AIF is marketed, and the supervisory authorities in the country where the AIFM is established*;
   (g) from 2015, the competent authorities in the AIFM's Member State of reference and the supervisory authorities in the countries where the AIFM and the AIF are established.

*The arrangements must be for the purpose of systemic risk oversight and in line with international standards.

2. The following third countries must not be listed as a non-cooperative country and territory by the Financial Action Task Force (FATF) on anti-money laundering and terrorist financing:
   (a) the country where the AIF is established;
   (b) the country where the AIFM is established.
3. From 2015, tax information sharing agreements which fully comply with standards of the OECD Model Tax Convention must be in place between:
   (a) the country where the AIF is established and the AIFM's home Member State and each other Member State in which the AIF is marketed;
   (b) the country where the AIFM is established and its Member State of reference;
   (c) the countries where the AIF and the AIFM are established and the AIFM's Member State of reference;
   (d) the country where the AIF is established and all Member States into which it is marketed.
4. From 2015, the local law in the AIFM's jurisdiction must not prevent effective supervision.

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The EVCA AIFMD Essentials is published by the European Private Equity & Venture Capital Association (EVCA).
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