
FS Regulatory Brief

EU's AIFMD: Impact on US Asset Managers – New regime starts July 22nd

June 2013

The EU's Alternative Investment Fund Managers Directive ("AIFMD") takes effect on July 22, 2013, and is set to immediately impact US alternative asset managers who actively market funds in the EU.

Adopted by the EU Parliament in 2010, AIFMD seeks to improve investor protection by requiring alternative asset managers to provide more disclosure to regulators and investors. It will apply to managers of alternative investment funds, including hedge funds, private equity funds, real estate funds, investment trusts and non-UCITs retail products. UCITS, which are similar to US registered mutual funds, are not subject to AIFMD as they are already subject to extensive regulation.

US alternative asset managers are affected by AIFMD only if they market to professional investors in the EU.¹ If so, they will need to notify European national regulators of their intent to market in each country by July 22, 2013, and then subsequently report to the regulators (similar to the US's Form PF) and make certain additional disclosures to regulators and investors. If the US manager is managing an *EU alternative fund*, the impact of the new regulatory obligations is heightened.²

¹ Professional investors are defined by the EU's Markets in Financial Instruments Directive ("MiFID") in a manner similar to 3(c)-1 and 3(c)-7 of the Investment Company Act in the US.

² In addition, the impact of AIFMD is largest on *EU alternative asset managers* who may be subject to full AIFMD compliance by July 2013. These EU managers will have to determine whether each of their funds is managed in the EU. For certain products, the analysis will be straightforward, but more complex structures will require greater analysis. Much of the

This **Financial Services Regulatory Brief** describes the impact AIFMD will have on these US managers and outlines the requirements in chart format in the **Appendix**. Furthermore, it details what US managers must do in order to continue to market funds in the EU, the deadlines that apply, and what actions US managers should be taking now. At a minimum, US asset managers should be reviewing their current activities in the EU and begin planning how they will market in the EU going forward, as discussed below.

Timing and overview of key requirements

EU member states must implement AIFMD by July 22, 2013. Although the law allows a one-year transition (until July 22, 2014) for managers to comply, EU regulators have clarified their expectation that managers demonstrate "best efforts" compliance during the transition period, implying they will expect that US managers comply with certain requirements starting on July 22, 2013. That said, the UK Treasury advised in mid-May that it intends to amend its regulations so that US managers marketing in the UK prior to the AIFMD effective date will be able to take advantage of the transition period before having to comply. A few other countries have followed the UK's lead by also allowing for the transition period; however, the full list of countries that will allow it remains to be seen.

EU regulators will require US managers wishing to market in the EU after July 22, 2013 to file a notification. Each regulator will have a different process and forms to accomplish this notification.

determination hinges on where portfolio management and risk management functions are being carried out.

Managers will also need to submit quarterly, half-yearly or annual reports (depending on the size/type of manager) to regulators in each jurisdiction in which they market. A consultation paper released by ESMA in late May indicates that this reporting will not be due for the first time until January 2014.

Additionally, managers must make an annual report available beginning after they market funds into a jurisdiction. For managers marketing after July 22, 2013, their next annual report will need to comply with AIFMD standards.

Finally, managers will need to provide disclosures to investors prior to any sales made after July 22, 2013

Impact of AIFMD on US managers

If you market an alternative fund to EU investors, you will have to file in each EU member state where you intend to market and comply with the country's private placement rules as early as July 22, 2013. Certain disclosure and transparency requirements will also apply to you.

If you are a US manager who is not marketing an alternative fund in the EU, AIFMD does not apply to you. Marketing alternative funds to *retail* investors is not regulated by AIFMD (although such marketing must comply each member state's requirements).

An exemption from AIFMD exists for small managers that have an aggregate assets under management (AUM) not exceeding either (i) €500m (if not leveraged and no redemption rights in first five years), or (ii) €100m (including assets acquired through leverage). However, member states may require these managers to still meet some reporting requirements. In addition, there is an exemption for those closed-end funds that will make no further investments after July 22, 2013, and an exemption for funds that will expire by July 22, 2016 (if the fund stopped taking subscriptions before July 21, 2011).

See the **Appendix** for a chart showing the various types of impact on US managers discussed in this brief.

What is "marketing"?

AIFMD only impacts those US managers actively marketing to EU professional investors. "Marketing" is defined under AIFMD as any offering or placement "at the initiative of the manager or on behalf of the manager" to EU investors. There is no "grandfathering" provision that would allow current marketers to avoid compliance. Also, no formal guidance has of yet been provided by the European Commission as to the meaning of "active" marketing. Each member country already has different regulations governing private placements and restrictions on how funds may be marketed. As countries implement AIFMD, they may provide guidance on what constitutes active marketing.

"Passive" marketing (or "reverse solicitation"), i.e., marketing at the initiative of an EU investor, would not bring a manager under AIFMD. Though very little guidance on passive marketing has been provided to date, some member states have begun to draft guidance. For example, in the UK, regulators have stated that passive marketing is allowed without notifying the regulator and defines "passive marketing" as communication solicited by and at the initiative of the investor (not the person selling the fund). Communications that are sent to investors as part of an organized marketing campaign, or documentation that is available on a publicly accessible website, would *not* be considered passive marketing because it is not considered to be initiated by the investor. However, communications in response to an approach from a potential investor with prior knowledge of the fund and no previous involvement with the manager could be considered to be at the initiative of the investor.³

Managers who do not want their marketing activities construed as "active" should carefully evaluate all sources of potential interactions with EU investors from this perspective. Managers planning to rely on passive marketing to keep them out of the purview of AIFMD should create policies and procedures that include and address careful documentation of investor relationships, their

³ See FSA Consultation Paper 13/9, Implementation of the Alternative Investment Fund Managers Directive, Part 2, March 2013.

initiation and on-going interactions. Managers should also have discussions with clients and prospects – in advance of July 22, 2013 – to ensure that all parties have a common understanding of the line of passive versus active marketing and where it could potentially be crossed.

Action items to consider prior to July 22, 2013:

Identify each alternative investment fund and its manager;

Review each alternative fund and determine whether it is actively or passively marketed to professional investors in the EU and whether you would like to continue marketing in the same manner; and

If actively marketing, determine the relevant EU member states where you would like to focus marketing efforts.

If you are marketing in the EU

US managers marketing in the EU after July 22, 2013 will be able to continue to do so under the private placement regimes of individual EU member countries. In the future – now estimated to be late 2015 – an EU-wide “passport” is expected to be available, thus making individual member countries’ private placement regimes unnecessary. Until then, US managers will need to use the private placement regimes of each country. To do so:

- Verify that each target country within the EU has a private placement regime available;
- Understand and comply with any notification requirements in each member state marketed;
- Comply with AIFMD’s disclosure and transparency provisions (described below) and any additional local member country requirements;
- Comply with AIFMD’s private equity-specific disclosures and restrictions;
- Cooperation agreements must be in place between regulators of the member country and the alternative manager’s home country (and if the alternative fund is

located outside the EU, with that country as well);⁴ and

- The home country of the US manager and fund must not be listed as “non-cooperative” by the Financial Action Task Force (“FATF”).⁵

Items to verify prior to July 22, 2013:

Verify that each target country has a private placement regime available and, if so, understand its requirements;

Continue to monitor these countries’ private placement regimes for changes;

Check cooperation agreement status between the manager’s regulators and those in the target country, as well as between the regulators in the fund’s home country and the target country, if applicable; and

Check that relevant countries are not on the FATF list of non-cooperative countries.

Notification to each country’s regulator

As described above, to continue to market alternative funds in the EU, a US alternative fund manager will be required to notify the regulator of each EU member country in which it is actively marketing.

Each member country has different notification requirements, but many countries have not yet established them. The purpose of this notification is for regulators to monitor activities of managers through regular reporting, as further discussed below.

Note that there is no means for a manager to de-register once it has notified a country’s regulators. Therefore, it is important for a manager to decide upfront which countries it

⁴ The European Securities and Markets Authority (“ESMA”) is currently negotiating to reach a standard memorandum that each member state would then need to adopt.

⁵ A list of non-cooperative countries can be found on the FATF website (<http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions>).

would like to target; otherwise it may be subject to ongoing reporting requirements that will continue until the fund is no longer open to new investors.

Action items to consider prior to July 22, 2013:

Prepare for notification with the regulators in each EU member state where you intend to target your marketing efforts.

Disclosure and transparency requirements

The disclosure (to regulators) and transparency (to investors) requirements under AIFMD generally fall into three categories:

- Disclosure to EU investors;
- Annual reports; and
- Reporting obligations to regulators in each marketed jurisdiction.

Disclosure to EU investors: Managers will be required to make certain specific disclosures to investors prior to the investor's investment in an alternative fund. Most of these required disclosures are similar to information that would typically be contained in a manager's offering documents. Anything not in these documents can be supplemented in a separate disclosure document.

Included in the required disclosures is information about the funds' investment strategy and restrictions, leverage and collateral arrangements, valuation procedures, service providers, professional liability capital requirements, delegation arrangements, liquidity, fees and expenses, performance and preferential investor treatment. In addition, periodic disclosures are required about illiquid assets subject to special arrangements (side letters) and risk management. Regular disclosures are also required relating to the amount of leverage being employed.

Action items to consider prior to July 22, 2013:

Consider the different calculation methodologies under AIFMD and seek guidance if uncertain on how to carry them out; and

Ensure that fund offering documents include all information required to be disclosed to investors under AIFMD.

Annual report: An audited annual report must be made available to investors and regulators in the marketed jurisdictions (on request) within six months of the fund's year end. AIFMD details the minimum accounting information necessary, which is consistent with most recognized GAAP disclosures.

The manager must also include any changes to the disclosure to investors described above. The annual report must also contain disclosures of the total compensation paid by the manager to its staff for the year, split into fixed and variable categories, and the amount of compensation broken down by senior management and employees whose actions have a material impact on the fund's risk profile. The compensation disclosure is required to be broken out in relation to each individual fund and may be limited to the compensation paid to employees involved in the activities of the fund being marketed in the EU.⁶

Action items to consider prior to July 22, 2013:

Review the data required to be included in the annual report to ensure your ability to prepare the report;

Consider any additional requirements under each marketed jurisdiction;

Develop policies and procedures for identifying changes to investor disclosures, and alert relevant employees that key personnel should be notified if investor disclosure information changes; and

Consider which employees' compensation will require disclosure.

⁶ Note that changes to compensation may have tax consequences.

Regulatory reporting: US managers marketing in the EU will also be required to submit periodic reports to each member state where an alternative fund is marketed. The European Securities and Markets Authority (ESMA) will release guidelines in the coming weeks with definitions on the data requirements for the reporting template, which will effectively constitute minimum requirements. Thereafter, the regulator for each country is free to expand requirements regarding both level of detail and frequency of reporting.

The new regulatory reports are similar to US Forms PF and CPO-PQR, with some differences in reporting calculations and timing. For instance, AUM and leverage disclosures are calculated differently. Also, if a fund employs leverage that exceeds three times the net asset value of the fund, then an additional form must be submitted.

With respect to timing, managers with over €1 billion AUM are required to report quarterly, and managers with between €100 million and €1 billion AUM are required to report semi-annually. However, if a single fund of the manager exceeds €500 million in assets, the manager must report quarterly. Generally, private equity funds will only be required to report on an annual basis (i.e., unleveraged funds that invest primarily in unlisted companies and issuers to acquire control).

While regulators have not yet released specific guidance on this point, we believe it is likely that these thresholds will be measured using the AUM of the funds marketed in the EU, not by the manager's total AUM. Reports must be submitted within thirty calendar days after the period end. Funds of funds are given an additional 15 days.

Action items to consider prior to July 22, 2013:

Similar to the undertakings for Form PF and CPO-PQR, evaluate the procedures and systems that will be needed to process reports within the required timeframe (the actual reporting mechanism may be different for each marketed jurisdiction);

Review required data and evaluate whether you can leverage what has been done for Form PF and CPO-PQR by mapping the requirements of Form PF to those of AIFMD;

Consider the different calculation methodologies under AIFMD and seek guidance if uncertain on how to carry them out; and

Consider any additional requirements under each marketed jurisdiction.

Additional requirements for private equity funds

AIFMD requires additional disclosures for private equity funds. Each manager of a private equity fund must notify the regulator in each marketed jurisdiction when its proportion of voting rights of a non-listed company in the EU crosses the thresholds of 10%, 20%, 30%, 50% and 75% ownership.

In addition, when a fund acquires control of a non-listed company (typically more than 50%, but this may be lower if as defined by a member country), the manager must notify the acquired company, its shareholders and regulators that it has acquired control. The manager must also ensure that the board of the acquired company informs its employees of the acquisition and discloses its intentions regarding the future development of the company and the likely repercussions on employment. Additionally, there are additional "asset stripping" restrictions that apply for 24 months following the acquisition of control of a company, that are intended to limit the manager's ability to alter the capital of the company.

Summary of key dates

July 2013

US managers marketing EU and non-EU funds may continue to market through October 2015 under the private placement regimes of each EU member state, and AIFMD requirements described in this brief.

October 2015

In October 2015, US managers will likely be able to use a new “passport” to EU countries (if available by then). Passporting would allow US managers to market throughout Europe without having to comply with different requirements in each marketed jurisdiction. If a manager chooses this option, however, it would require full authorization under AIFMD and subject the manager to many additional requirements affecting multiple business areas.

It is also likely that US managers of EU funds marketing in the EU will be required to *fully* comply with AIFMD in October 2015, as described below.

2018

In 2018, the EU will review AIFMD and may abolish individual member states’ private placements regimes altogether, leaving the AIFMD passport as the only option. The impact of this is that *all* US managers wishing to market in the EU will be required to fully comply with AIFMD.

Full compliance with AIFMD

If a US manager decides to use the passport regime in 2015, or is required to do so in 2018, it will need to become compliant with the full range of AIFMD requirements. Full compliance with AIFMD includes additional limitations and disclosure requirements, including the separation of functions, delegation of roles, use of depositaries, leverage, compensation, valuation, capital requirements, risk management and conduct requirements.⁷

In addition, the US manager will need to identify a “Member State of Reference” within the EU. This essentially subjects the manager to oversight by regulators in that country and requires the manager to comply with the member state’s AIMFD national regulations. The manager will also be required to appoint a “legal representative” in the Member State of Reference who will have responsibility for performing compliance functions under AIFMD and will be the point of contact for EU regulators and EU investors in the fund.

Action items to consider prior to October 15, 2015:

US fund managers should weigh the benefits of marketing under the passport regime (with full AIFMD compliance) versus continuing to market under the private placement regime of each jurisdiction; and

US fund managers who decide to avail themselves of the passport regime (and EU fund managers who will be required to do so in 2015) should consider all implications of full authorization under AIFMD well in advance of transitioning.

Action items to consider prior to 2018:

US fund managers still marketing under the private placement regime should consider all implications of full compliance with AIFMD well in advance of transitioning.

⁷ The full impact of AIFMD obligations are not described in detail in this brief. To learn more about AIFMD, visit <http://www.pwc.com/gx/en/asset-management/aifmd/index.jhtml>.

Appendix: AIFMD marketing implications for US managers

The impact of AIFMD’s new regulatory obligations on US alternative asset managers is heightened if the manager is managing an EU alternative fund in addition to marketing to EU investors. **If the US manager is not marketing into the EU, AIFMD will have no impact.**

Year	Marketing a <u>non</u>-EU fund to EU investors	Marketing an EU fund to EU investors
2013-2015	<ul style="list-style-type: none"> • Continue under current private placement regimes • Disclosure and transparency requirements apply • Private equity requirements apply • Supervisory cooperation arrangements must be in place • Neither the manager nor fund domicile may be FATF-designated as a “non-cooperative” country • Fund domicile must have signed OECD tax agreement 	<ul style="list-style-type: none"> • Continue under current private placement regimes • Disclosure and transparency requirements apply • Private equity requirements apply • Supervisory cooperation arrangements must be in place • Neither the manager nor fund domicile may be FATF-designated as a “non-cooperative” country
2015	<ul style="list-style-type: none"> • The European Commission may allow the passport for non-EU managers, allowing managers to market to all EU countries • If managers opt-in, full compliance with AIFMD will be required, with some relief on depositary requirements 	<ul style="list-style-type: none"> • If the passport is available for non-EU managers, managers of EU funds may be required to use it • If so, full compliance with AIFMD will be required
2018	<ul style="list-style-type: none"> • EU may abolish national private placements regimes, leaving the passport as the only option • If so, full compliance with AIFMD will be required 	<ul style="list-style-type: none"> • No additional requirements

Additional information

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