

# Insight: Capital Markets

June 2013

## AIFMD: Update for non-EEA fund managers

From 22 July 2013, the Alternative Investment Fund Managers Directive (2011/61/EU) (the "**Directive**") and the supplementary level 2 Regulation (EU) No 231/2013 (the "**Regulation**") will come into effect. This legislation will introduce an authorisation regime and centralised rulebook for the management and marketing within the European Economic Area (the "**EEA**") of alternative investment funds ("**AIFs**") by alternative investment fund managers ("**AIFMs**"). Importantly, it will also introduce a European passporting regime for such activities.

This alert aims to describe, through a series of questions and answers, how the Directive will affect AIFMs that do not have their registered office in an EEA state ("**non-EEA AIFMs**") and which key dates should be borne in mind by such AIFMs. The expansive scope of the Directive and the heavy compliance burden that it may impose on fund managers, from as early as 22 July 2013, may surprise many non-EEA AIFMs. However, given that legislation implementing the Directive may not have been passed in all member states and/or may have been published in draft for consultation purposes only, we are unable to provide any definitive guidance or advice.

### What is the scope of the Directive?

The Directive defines an AIF as a collective investment undertaking, including its investment compartments, which (i) raises 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, and (ii) does not require authorisation as an undertaking for collective investment in transferable securities (UCITS). Essentially, the Directive classifies all funds that are not organised and authorised as UCITS as AIFs. Commercial companies and joint ventures will normally fall outside of the scope of the Directive, as will holding companies. The acid test is whether there is an undertaking that raises capital from investors with a view to investing it in accordance with a defined investment policy.

An AIFM is defined as a legal person whose regular business is managing one or more AIFs and therefore which performs portfolio management and/or risk management activities in relation to an AIF.

### Will non-EEA AIFMs be subject to the Directive and, if so, from what date?

Yes. The Directive expressly provides that non-EEA AIFMs should be subject to the same obligations, and benefit from the same rights, as EEA AIFMs such that a "*level playing field*" exists between them.



**Stuart Willey**  
 Partner and Head of the London  
 Regulatory practice  
 + 44 20 7532 1508  
 swilley@whitecase.com

**Sharon Hartline**  
 Partner, Hong Kong  
 + 852 2822 8733  
 shartline@whitecase.com

**Jane Cooper**  
 Local Partner, Hong Kong  
 + 852 2822 8740  
 jcooper@whitecase.com

**Mara Topping**  
 Partner, Washington, DC  
 + 1 202 626 3663  
 mtopping@whitecase.com

**Jan-Holger Arndt**  
 Partner, Düsseldorf  
 + 49 211 49195 342  
 jarndt@whitecase.com

Accordingly, non-EEA AIFMs will be required to comply with the Directive in the event that they seek to:

- manage one or more EEA AIFs; or
- market one or more AIFs managed by them to professional investors in the EEA, irrespective of the domicile of such AIFs. A discussion of the concept of marketing is provided at Question 6 below.

However, the Directive will be implemented on a staged basis and some of the provisions affecting non-EEA AIFMs (in particular, the passporting regime and requirement for authorisation) will not come into force until 22 July 2015, at the earliest.

Nevertheless, the obligations which may apply to non-EEA AIFMs prior to this date are extensive and may impose a heavy compliance burden on such entities. Although these obligations apply from as early as 22 July 2013, it is possible that some member states will adopt transitional arrangements in favour of existing non-EEA AIFMs. A one-year transitional period is currently included in draft UK legislation, and will apply to all non-EEA AIFMs which marketed one or more AIFs in the UK immediately before 22 July 2013. As a result of these transitional arrangements, non-EEA AIFMs may be entitled to postpone their compliance with the Directive's pre-2015 marketing obligations (discussed in Question 3 below) in the UK until 22 July 2014. However, the scope (and existence) of any transitional provisions will likely vary from one EEA state to another. Local legal advice will therefore need to be sought in each relevant Member State.

Question 3 addresses the obligations which may apply to non-EEA AIFMs from as early as 22 July 2013 and, in any event, prior to 22 July 2015. Question 5 summarises how these obligations are expected to change after 22 July 2015.

### How will non-EEA AIFMs be able to manage EEA AIFs and/or market AIFs in the EEA prior to 22 July 2015?

Although the Directive will eventually require non-EEA AIFMs to obtain prior authorisation in order to manage EEA AIFs or market AIFs to professional investors in the EEA, they will benefit from the following transitional regime.

#### Managing an EEA AIF

**Between 22 July 2013 and 22 July 2015**, non-EEA AIFMs will be entitled to manage EEA AIFs in the territory of a member state in accordance with its national law. They will not be required to obtain authorisation under the Directive or (subject to the provisions concerning marketing below) comply with any of its other provisions. However, they will not be entitled to benefit from the Directive's passporting regime in relation to cross-border fund management.

#### Marketing AIFs in the EEA

**Between 22 July 2013 and 22 July 2018**, a non-EEA AIFM that intends to market an AIF managed by it to professional investors in the EEA will, for so long as it exists, be able to rely upon national private placement regimes. Until 22 July 2015 it will not be able to benefit from a pan-European marketing passport but equally will not be required to obtain prior authorisation under the Directive. In order to rely upon a national private placement regime, the following minimum conditions (set out in the Directive) must be satisfied<sup>1</sup>.

- The non-EEA AIFM must:
  - disclose detailed information to investors and file certain information with the competent authorities in each country where it carries out

marketing. These disclosure obligations are described in Annex 1 below; and

- satisfy additional notification, disclosure and anti-asset stripping obligations (to the extent that an AIF it manages acquires control over an EU non-listed company).
- Appropriate cooperation agreements must also be in place between (i) the Member States in which the AIFs will be marketed (and, where applicable, the competent authorities of any EEA AIFs concerned), and (ii) the third country in which the non-EEA AIFM (and, where applicable, the non-EEA AIF) is established. Such third country must not be listed as a Non-Cooperative Country and Territory by the Financial Action Task Force.

On 30 May 2013, ESMA announced that it had approved co-operation arrangements between EEA regulators<sup>2</sup> and 34 non-EEA supervisory authorities. A list of these 34 non-EEA authorities is provided at Annex 2 below. Although ESMA negotiated these arrangements centrally, they are bilateral agreements that must be signed by individual EEA supervisory authorities and their non-EEA counterparts. As a result, each EEA supervisory authority will decide with which non-EEA authorities it will ultimately sign a co-operation agreement. ESMA is continuing to negotiate co-operation agreements with further third countries in light of the 22 July 2013 deadline.

Member states are entitled to impose stricter rules on non-EEA AIFMs which seek to rely on national private placement regimes and there can be no guarantee that they will continue to exist. Germany for example has indicated that it will abolish its private placement regime by 22 July 2013. Local advice should therefore be sought on a case-by-case basis.

<sup>1</sup> As discussed in Question 2 above, further transitional arrangements may be adopted in member states (similar to those proposed by the UK Treasury) which enable non-EEA AIFMs to postpone their compliance with these marketing obligations until, for example, 22 July 2014. Local legal advice should be sought in this regard.

<sup>2</sup> ESMA has also approved co-operation agreements between Croatia and those non-EEA regulators set out at Annex 2 below. Croatia will accede to the European Union on 1 July 2013.

## Where a non-EEA AIFM is currently in discussions with a potential investor, will it be able to continue providing information about AIFs to that investor after 22 July 2013?

Possibly. As noted in Question 2 above, it is possible (and currently expected in the UK, for example) that the Directive's implementation will be subject to a one-year transitional period, during which the marketing restrictions applicable to existing non-EEA AIFMs would not apply. However, if a non-EEA AIFM does not benefit from such transitional arrangements, it will need to consider the extent of its obligations under the Directive (and relevant national law) from 22 July 2013. In this case, where additional information is provided to an investor after 22 July 2013, it may constitute marketing (subject to the definition of marketing under the Directive, as discussed in Question 6 below) and therefore would require the non-EEA AIFM to comply with the Directive's marketing restrictions (as discussed in Question 3 above). The fact that prior discussions have taken place before the Directive's implementation will not prevent the provision of further information from falling within the scope of the Directive's marketing restrictions.

If an AIF has been marketed in the EEA on the basis of an approved prospectus then a non-AIFM could continue to market the fund after 22 July 2013.

## How will the obligations of non-EEA AIFMs change after 22 July 2015?

### Managing an EEA AIF

After 22 July 2015, any non-EEA AIFM managing an EEA AIF will be required to obtain authorisation and comply with the Directive's requirements concerning *inter alia* initial capital, remuneration, conflicts of interest, risk and liquidity management and depositaries.

In planning their regulatory compliance from this date, managers will in particular have to take into account restrictions on delegation of portfolio and risk management functions to third parties. The Directive stipulates that each AIF must only have a single AIFM which must not delegate its functions such that it is in fact a '*letterbox entity*'.

Given the extensive nature of these requirements, non-EEA AIFMs should consider as soon as possible how they will comply with these provisions and obtain legal advice, where relevant.

From 22 July 2015 non-EEA AIFMs will benefit from the Directive's passporting regime and therefore be able to centralise operations in one EEA country and manage AIFs in other EEA countries.

### Marketing AIFs in the EEA

Non-EEA AIFMs will have a choice after 22 July 2015. They may either:

- seek authorisation under the Directive (and benefit from the pan-European marketing passport it provides); or
- continue to rely upon those national private placement regimes that continue to exist during the period to July 2018. It is expected that all national private placement regimes in the EEA will be abolished from 2018.

## What does 'marketing' mean under the Directive?

The Directive provides that marketing means a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the EEA.

### Marketing

Although 'passive marketing' or 'reverse solicitation' should not fall within the scope of the Directive, the distinction between active and passive marketing has historically been a grey area and the Directive does not provide any specific details on what constitutes passive marketing. Draft UK guidance<sup>3</sup> has sought to interpret passive marketing restrictively by stating that only communications which are solicited by the investor should be considered to have occurred solely at the initiative of the investor: any previous communications or correspondence between the AIFM and the investor may prevent the AIFM from relying on this exemption.

In addition, the point at which active marketing will be deemed to have commenced may differ as between member states. For example:

- in relation to the UK, draft guidance suggests any communications which refer to *draft* documentation should not fall within the meaning of an offer or placement for the purposes of the Directive<sup>4</sup>; and
- on a literal reading, the Directive suggests that marketing will only be deemed to have occurred where information is made available by an AIFM (or on its behalf) in relation to units or shares in a *specific* AIF. It is therefore likely that the provision by an AIFM of information concerning the general capabilities and relative performance of different strategies (on a general basis, and without reference to specific AIFs), would not amount to marketing under the Directive.

<sup>3</sup> Annex N (Amendments to the Perimeter Guidance Manual) of FSA Consultation Paper 13/9 (dated March 2013).

<sup>4</sup> However, an investment by an investor must not be accepted on the basis of draft documentation unless the AIFM has received permission to market the AIF at that point.

### Territorial Scope

Marketing will fall within the scope of the Directive if it is directed at EEA-based investors (i.e., those which are domiciled or have their registered office in the EEA). Although not entirely clear, it seems likely that non-EEA AIFMs will be required to comply with the Directive's marketing restrictions if the marketing takes place outside of the EEA. It remains to be seen how each EEA state interprets the territorial scope of the Directive and local advice should therefore be sought, where relevant.

### Are there any exemptions and/or transitional reliefs?

Yes. There are currently three exemptions which may be of interest to non-EEA AIFMs:

- the Directive will not apply to AIFMs in so far as they manage AIFs whose only investors are the AIFM, the parent undertakings of the AIFM, the subsidiaries of the AIFM or other subsidiaries of those parent undertakings, provided that none of those investors is itself an AIF;
- AIFMs, including non-EEA AIFMs, which manage AIFs whose total assets under management fall below EUR 500m (or EUR 100m in the case of AIFs which use leverage in order to acquire assets), will be entitled to follow a simplified registration procedure with their Member State of reference ("**MSR**"). However, AIFMs which follow this simplified registration process will not benefit from passporting rights under the Directive; to obtain such rights, they must expressly opt-in to the Directive and therefore obtain full authorisation from the competent authorities of their MSR; and

- a non-EEA AIFM may be exempted from compliance with a provision of the Directive (for the purpose of obtaining authorisation after 22 July 2015) if it can demonstrate that it is incompatible with a mandatory legal requirement to which it is subject and that other requirement has the same regulatory purpose and offers the same level of investor protection as the Directive's provision.

As noted under Question 2 above, AIFMs in the UK and possibly in other EEA countries will benefit from a transitional period of one year from 22 July 2013 in order to comply with those provisions of the Directive and national law which are relevant to them. The ambit of this transitional relief may vary in each member state.

The following transitional reliefs will also apply:

- AIFMs which manage a closed-ended AIF prior to 22 July 2013, and which do not make any additional investments after that date, do not need to be authorised to continue to manage the fund; and
- AIFMs which manage a closed-ended AIF whose subscription period closed for investors prior to the entry into force of the Directive and which will be wound up not later than 22 July 2016 do not need to be authorised to continue to manage the fund.

### Will there be any divergences between member states following implementation of the Directive?

The Directive has to be transposed into the national laws of each of the 30 EEA states. Most aspects of the Directive require 'maximum harmonisation' with the result that there will be little or no discretion for member states to depart from the terms of the Directive.

However, the Directive expressly allows individual member states to impose stricter conditions than those set out in the Directive in certain circumstances. For example, member states will retain a large amount of discretion in the context of their national private placement regimes. The UK government has confirmed that it will not impose additional requirements for non-EEA AIFMs (save for the requirement to notify the Financial Conduct Authority of their intention to market an AIF in the UK). However, the draft Capital Investment Act proposed by the German government in December 2012 will significantly restrict its private placement regime and the Czech Republic is expected to offer national placement regimes for only one year following the entry into force of the transposition measures.

In addition, some further guidance at the European level is expected to be produced in order to assist member states in interpreting their obligations under the Directive. In the event that these EU-level guidelines are not sufficiently prescriptive, member state discretion may creep in to the application of the Directive and further divergences may appear. For this and other reasons, it will be necessary for non-EEA AIFMs to obtain legal advice in each relevant member state in which they are seeking to manage EEA AIFs and market AIFs.

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# Annex 1

## Basic disclosure and regulatory filing requirements

The information which non-EEA AIFMs must disclose if they seek to manage and/or market AIFs in the EEA is extensive, and will be disclosable by non-EEA AIFMs on a general basis from 2015. However, the disclosure obligations will have a limited application to non-EEA AIFMs during the transitional period. As noted in Question 3 above, they will apply to non-EEA AIFMs during the transitional period from as early as 22 July 2013<sup>5</sup> to the extent that such AIFMs market AIFs to professional investors by virtue of one or more national private placement regimes. It is advisable for non-EEA AIFMs to consider these obligations as soon as possible and to seek legal advice, where necessary.

From 22 July 2013 (subject to the adoption of additional transitional arrangements by member states), the Directive will require non-EEA AIFMs to (i) disclose detailed information to AIF investors (both prior to their investment and on an on-going basis) in relation to each of their AIFs, and (ii) submit, on an on-going basis, certain information to the competent authorities of their MSR. Further details on each of these requirements, including the contents of such disclosure, its frequency and how the obligation can be complied with in practice are set out below.

### Disclosure to investors

#### (i) Content

The *pre-investment* information that must be made available to AIF investors is particularly extensive and will cover, for example, (i) the AIFs investment strategy, (ii) the circumstances in which it may use leverage, (iii) a description of the AIF's liquidity risk management, (iv) a description of any management function delegated by the AIFM and of any safe-keeping function delegated by the depositary, (v) where available, the historical performance of the AIF, and (vi) the latest 'annual report' in respect of each AIF it markets in the EEA (the annual report is discussed in further detail below in relation to on-going disclosure requirements).

Non-EEA AIFMs may be entitled to treat certain disclosure requirements<sup>6</sup> as being modified in order to reflect the fact that, during the transitional period, the Directive's requirements concerning, for example, initial capital and valuation methods will not apply to them. However, guidance in this regard has not yet been provided.

In terms of *on-going disclosure*, non-EEA AIFMs will be required to make available to investors an annual report in respect of each AIF they market in the EEA. It must include *inter alia* a balance sheet or a statement of assets and liabilities, an income and expenditure account for the financial year, a report on the activities of the AIF for the financial year, information on any material changes during the financial year to the pre-investment information already disclosed to investors, and detailed information on remuneration for the financial year. Further legislation will be adopted in due course concerning the content and format of the annual report.

In addition, non-EEA AIFMs must also periodically disclose to investors *inter alia* (i) the percentage of AIF assets which are subject to special arrangements because they are illiquid, the current risk profile of the AIF and the risk management systems employed by the AIFM to manage those risks, and (ii) if they market AIFs in the EEA that employ leverage, (for each such AIF) any changes to the maximum level of leverage which the AIFM may employ on behalf of the AIF, and the total amount of leverage employed by the AIF.

#### (ii) Format

Certain provisions of the Directive seek to avoid the imposition of multiple reporting obligations on AIFMs. These are likely to be most relevant for AIFMs which manage AIFs whose units or shares are admitted to trading on an EEA regulated market. For example, where any of the AIFs that are to be marketed are:

- subject to the Transparency Directive (2004/109/EC), an AIFM can comply with the requirement to produce an annual report by including the information required under the Directive in the public annual report required by the Transparency Directive; and
- required to publish a prospectus in accordance with the Prospectus Directive (2003/71/EC), then an AIFM can comply with the requirement to disclose various information to investors (both prior to their investment and on an on-going basis) by including the information in that prospectus.

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<sup>5</sup> This is subject to any additional transitional arrangements being adopted by member states in favour of existing AIFMs, as discussed in Question 2 above.

<sup>6</sup> In particular, (i) the description of how they are complying with the requirements of the Directive concerning initial capital and own funds, (ii) a description of the methods used by the AIFs managed by them to value hard-to-value assets in accordance with the Directive's valuation requirements, and (iii) the latest net asset value of such AIFs or the latest market price of the unit or share of the AIF, in accordance with the Directive's valuation requirements.

Some of the information required to be disclosed may be supplemental to that required under the Transparency and Prospectus Directives. In this case, AIFMs are entitled to include this supplemental information in the prospectus and the public annual report of the relevant AIF. This will likely be of particular use for AIFMs when seeking to comply with their pre-investment disclosure obligations. However, it may be difficult to satisfy on-going reporting obligations through these documents.

Accordingly, AIFMs will (in relation to AIFs for which no prospectus is required) need to disclose investor information in a separate offering or other document. It is clear that, although the Directive acknowledges that the disclosure obligations might be satisfied via a number of possible means, a single offering memorandum or disclosure document is not required. Non-EEA AIFMs could consider creating a dedicated investor website or circulating an investor newsletter to relevant investors. In addition, pre-investment disclosure may (in part) be satisfied through answers to due diligence questionnaires.

### (iii) Frequency and timing

The Directive contains various on-going reporting obligations, the frequency of which will vary. Further guidance is expected to be published by ESMA in due course in this regard.

The annual report must be completed no later than six months following the end of the financial year. However, in the event that an AIFM seeks to rely on the public annual report required by the Transparency Directive, it must be made public within four (rather than six) months of the end of the financial year.

Other periodic information must generally be disclosed (i) as part of the AIFs periodic reporting to investors (and therefore, in line with the AIFs rule or instruments of incorporation), or (ii) at the same time as any related prospectus and offering document is published. At a minimum, it must be disclosed to investors at the same time as the annual report is made available to investors.

However, certain information (such as the activation of gates, side pockets or similar special arrangements or any decision to suspend redemptions) must be disclosed to investors immediately. Similarly, any changes to the maximum level of leverage must be disclosed 'without undue delay'. The frequency and timing of each individual reporting obligation will therefore need to be considered on a case-by-case basis. As noted above, guidance from ESMA should be published soon which will consider *inter alia* the frequency of reporting obligations.

### (iv) Where a non-EEA AIFM already discloses fund-related information to its investors, will the Directive's investor disclosure requirements significantly restrict future disclosure?

Although not expressly stated, the Directive's disclosure requirements appear to prescribe minimum investor information, and do not seek to prevent AIFMs from providing EEA-based investors with additional information. In fact, by seeking to caveat the detailed disclosure and transparency requirements with the words 'at least', the Directive seems to anticipate the provision by AIFMs of further information to investors.

### Reporting to Regulators

After 22 July 2013 (subject to the adoption of additional transitional arrangements by member states), a non-EEA AIFM which intends to market an AIF to professional investors in the EEA is required to submit, on a 'regular basis', certain information to the competent authorities of its MSR. In addition, the AIFM must provide (on request), a detailed list of the AIFs it manages for the end of each quarter and a copy of the annual report for each such AIF. A pro-forma reporting template is provided in Annex IV of the Regulation in order to assist AIFMs with these reporting obligations.

The reportable information is very similar to that which must be disclosed to investors (both prior to investment and on a periodic basis)<sup>7</sup>. However, it is primarily reportable in order to allow the MSR to analyse the systemic risks posed by AIFMs within its territory and to share such information with other EEA regulators.

The frequency with which AIFMs must report this information will vary according to the amount of assets under management of the AIFM and whether or not leverage is utilised by its AIFs. Some AIFMs will only be required to report this information on an annual basis, whilst others may be subject to reporting obligations on a semi-annual or quarterly basis. Moreover, the competent authorities of the MSR may deem it appropriate and necessary for the exercise of their function to require all or part of the information above to be reported on a more frequent basis.

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<sup>7</sup> Similarly to certain investor disclosure obligations, we consider that non-EEA AIFMs may be entitled to argue that certain regulatory filings concerning stress tests should be modified and/or removed for their purposes (during the transitional period) in light of the fact that they are not subject to the underlying obligations concerning stress tests set out in the Directive.

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# Annex 2

## **Non-EEA regulators with whom ESMA has approved co-operation agreements**

1. Alberta Securities Commission (Canada)
2. Australian Securities and Investments Commission
3. Autorité des Marchés Financiers du Québec (Canada)
4. Bermuda Monetary Authority
5. British Columbia Securities Commission (Canada)
6. British Virgin Islands Financial Services Commission
7. Capital Markets and Securities Authority of Tanzania
8. Capital Markets Authority of Kenya
9. Cayman Islands Monetary Authority
10. Comissão de Valores Mobiliários do Brasil
11. Conseil Déontologique des Valeurs Mobilières of Morocco
12. Dubai International Financial Centre Authority
13. Emirates Securities and Commodities Authority
14. Federal Reserve Board (US)
15. Financial Services Commission of Mauritius
16. Financial Supervision Commission of the Isle of Man
17. Financial Supervisory Authority of Albania
18. Guernsey Financial Services Commission
19. Hong Kong Monetary Authority
20. Hong Kong Securities and Futures Commission
21. Israel Securities Authority
22. Jersey Financial Services Commission
23. Labuan Financial Services Authority
24. Monetary Authority of Singapore
25. Office of the Comptroller of the Currency (US)
26. Office of the Superintendent of Financial Institutions (Canada)
27. Ontario Securities Commission (Canada)
28. Republic of Srpska Securities Commission
29. Securities and Exchange Board of India
30. Securities and Exchange Commission (US)
31. Securities and Exchange Commission of Montenegro
32. Securities and Exchange Commission of Pakistan
33. Securities and Exchange Commission Thailand
34. Swiss Financial Market Supervisory Authority (FINMA)

