

The British Virgin Islands and AIFMD: Ready for Business

By Philip Graham

The British Virgin Islands (BVI) is the world's second largest domicile of offshore investment funds and a leading international finance jurisdiction known for effective regulation and products which are flexible and relevant.

With the Phase II implementation date of the Alternative Investment Fund Managers Directive (AIFMD) fast approaching this month, interest in the AIFMD is as high as ever as investment fund managers seek to determine what, if any, effect the AIFMD will have on their structures as well as their ability to market within the European Union (EU).

Harneys offers this article as guidance on the British Virgin Islands' perspective and to assist with a careful assessment of the projected impact of the AIFMD.

What is the AIFMD?

The AIFMD came into force on 21 July 2011 to create a comprehensive and effective regulatory and supervisory framework across the European Economic Area for alternative investment fund managers (AIFMs) either based within the EU or marketing their products within the EU.

The keys drivers are investor protection and reduced risks for professional investors in alternative investment funds (AIFs) through uniformed cross-border management and marketing requirements on AIFMs.

What are AIFs?

An AIF in accordance with the AIFMD is a collective investment undertaking which raises capital from a number of investors and invests in accordance with a defined investment policy for the benefit of those investors. It does not distinguish funds based on risk spread, number of assets, minimum number of investors, open-ended or closed, listed or unlisted or of a particular legal form.

An AIF entity is either:

- (a) authorised or registered in an EU Member State under the applicable national law or has its registered/head office in an EU Member State (an "EU AIF"); or
- (b) a "non-EU AIF".

Each AIF must have one AIFM; either a legal person whose regular business is managing one or more AIFs and whose registered office is in an EU Member State (an "EU AIFM") or a non-EU alternative investment fund manager (a "non-EU AIFM"), who are also known as a "Third Country Managers".

What are AIFMs?

An AIFM is either:

- (a) an EU AIFM which manages EU AIFs or non-EU AIFs;
- (b) a non-EU AIFM which manages EU AIFs;
- (c) a non-EU AIFM which market AIFs in the EU, irrespective of whether such AIFs are EU AIFs or non-EU AIFs;
- (d) a non-EU entity which has been substantially delegated management functions for AIFs from an EU AIFM; or
- (e) an EU entity which has been substantially delegated management functions from a non-EU AIFM.

Are (d) and (e) referring to the concept of “letter-boxing”?

An analysis of where the management activities and management responsibility are being exercised must be carried out to decide which entity falls within the remit of the AIFMD and will be deemed to be the AIFM. Delegation agreements may create implications for AIFMs where management is essentially being carried out from within the EU due to letterboxing.

Where an investment manager’s performance is delegated “to the extent that it exceeds by a substantial margin the investment management functions performed by the manager itself” the listed manager may be considered a letterbox entity and not the AIFM under the AIFMD.

To avoid being deemed a letterbox entity, an AIFM should be seen as retaining the necessary expertise and resources to supervise a delegated task, have the power to make decisions in key areas and does not delegate or outsource more investment management functions than it retains.

Third Country Managers may wish to ensure that there are policies and procedures in place that guarantee diligent oversight of all decisions taken by delegates, including a clear statement within investor documents outlining the AIFM’s supervisory functions as it relates to delegates and the delegate’s boundaries or possibly a physical presence in the third country to demonstrate that they are actively managing the fund.

Are there any obvious exemptions from the AIFMD?

It should initially be noted that BVI AIFMs managing a fund before 22 July 2013 may continue marketing the AIF in the UK until 21 July 2014, without complying with the AIFMD’s transparency and reporting requirements, provided they are in compliance with the UK’s private placement regime.

There are also some other exceptions which in summary mean that the AIFMD will not apply to:

- (a) funds with assets under management (AUM) of €100 million or less;
- (b) unleveraged funds with no redemption rights exercisable during a period of five years following the date of initial investment in the fund with an AUM of €500 million or less;

- (c) securitisation special purpose companies;
- (d) single investor funds;
- (e) managed accounts, insurance contracts, joint ventures, employee participation schemes and holding companies;
- (f) funds that are marketing in the EU on a passive placement or reverse solicitation basis; and
- (g) entities that prior to the enforcement date of the AIFMD are winding down operations or not soliciting new investors.

What type of BVI entities will be affected by moving into Phase II of the AIFMD?

- (a) BVI AIFMs of EU AIFs - national law of the relevant investor's EU Member State would determine whether a BVI AIFM can market the EU AIF under the private placement regime;
- (b) BVI AIFMs of a non-EU AIF being marketed into the EU - marketing of non-EU AIFs in the EU would be subject to the private placement regime of each EU Member State, provided cooperation agreements are in place between the authority of the EU investor's Member State, the BVI Financial Services Commission (FSC) and the relevant authorities of the AIF;
- (c) EU AIFM of a BVI AIF - marketing of BVI AIFs in the EU would be subject to the private placement regime of each EU Member State, provided cooperation agreements are in place between the authority of the AIFM's Member State and the FSC;
- (d) Delegation of portfolio or risk management by an EU AIFM to a BVI entity - EU AIFMs must comply with delegation requirements of the AIFMD and a cooperation agreement between the EU AIFM's regulator and the FSC is necessary; and
- (e) Delegation of portfolio or risk management by a BVI AIFM to an EU entity - care should be taken to ensure that delegation does not create letter-boxing as the EU entity would be deemed the AIFM and subject to full compliance with the AIFMD.

Talk us through "Passive Placement/Reverse Solicitation"

Marketing as AIFMD defined is the 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 EU. Therefore, accepting subscriptions from EU investors who initiate the transactions will not constitute marketing for the purposes of the AIFMD.

But care should be taken to understand the scope of reverse solicitation within each Member State prior to reliance, as implementation may vary.

Maintenance of robust controls, compliance processes and evidence of the reverse solicitation sale would be required. This is particularly important for proof of regulatory compliance, as well as in defence of any possible private law actions for breaches of the AIFMD, for example mis-selling.

AIFMs practicing reverse solicitation may wish to review their marketing procedures for new and existing investors to ensure that promotional and other materials including website content and procedures are sufficiently robust.

Non-EU AIFMs that rely solely on reverse solicitation can remain outside the AIFMD's parameters until at least July 2015. However benefits should be weighed against limitations on marketing and the inability to target future EU revenues after this point in time.

AIFMs should also be mindful that marketing post-AIFMD will receive increased regulatory focus. Further, difficulties may arise in distinguishing between active and passive marketing and neither the AIFMD nor ESMA provide specific guidance on passive marketing.

AIFMD's phased implementation

- (a) Phase I – this ran from the date of inception through to 21 July 2013. During this period, there was no change to marketing arrangements within the EU.
- (b) Phase II – from 22 July 2013 to July 2015. Under the Passport Regime, full compliance is required with the AIFMD for EU managers of EU AIFs. For Non-EU AIFMs or EU AIFMs of non-EU AIFs, the private placement regime will apply as long as:
 - (i) cooperation agreements are in place between the relevant EU regulator and the Third Country regulator;
 - (ii) the Third Country cannot be blacklisted by the Financial Action Task Force; and
 - (iii) the AIF complies with various reduced regulatory requirements for Non-EU AIFMs marketing their Non-EU AIFs. This includes transparency requirements, the submission of an annual report to the relevant EU regulator within six months of the financial year-end, disclosure requirements to investors and periodic reporting on trading activity, risk management, leverage information and systematically relevant information.

AIFMs should familiarise themselves with the implementation of AIFMD by each relevant Member State as they have the flexibility to determine its transposition within their jurisdiction.
- (c) Phase III – from July 2015 through to 2018 – the key question here will be whether the passport regime will be extended to Third Countries. This is certainly something to monitor from this point forward. If it is extended, we would anticipate that Non-EU AIFs will only be able to be marketed within the EU on this basis.

- (d) Phase IV – from 2018 and beyond. Again, the key will be the extension of the passport regime to Third Countries.

So is the BVI ready for Phase II?

On 11 July 2013, the FSC announced that the BVI entered a Memorandum of Understanding (MOU) which encompassed twenty-five European securities regulators. The MOU covers the necessary consultation, cooperation and exchange of information requirements to satisfy Phase II of the AIFMD, enabling the continued marketing of BVI funds within most of the EU.

The BVI's participation in the AIFMD initiative is in keeping with the jurisdiction's long-standing practice of remaining in step with international best practice as it relates to transparency, anti-money laundering and regulation. The BVI is party to the IOSCO Memorandum of Understanding which includes 23 of the 27 EU member states; has entered into a number of tax information exchange agreements as well as bilateral agreements with the US; is on the OECD's white list; is not on the FATF's blacklist and scores highly comparatively in terms of its compliance with FATF anti-money laundering and anti-terrorist financing measures.

The BVI is committed to ensuring that it meets the Phases III and IV requirements, by signing cooperation agreements with all EU Member States, remaining off the FATF's blacklist, and signing TIEAs with jurisdictions where fund marketing is likely. As such, the FSC is currently pursuing further MOUs with seven additional European countries: Austria, Croatia, Germany, Italy, Slovenia and Spain, thereby ensuring that the BVI satisfies all regulatory requirements under the AIFMD and remains at the forefront of the funds industry.

BVI funds are therefore in an excellent position to continue marketing into the EU with minimum disruption, as the BVI can boast of having a regulatory regime that meets the Phase II private placement regime of the AIFMD. Further, the BVI financial industry's continuing commitment to regulation and partnering with various countries through OECD-compliant Tax Information Exchange Agreements should ensure that the industry is ready for the possible 2018 abolition of the private placement regime.

So, in conclusion?

The British Virgin Islands prides itself as being a reputable jurisdiction of choice, with a solid regulatory framework and the BVI FSC is committed to working and partnering with all stakeholders within the financial services industry to position and continuously re-position the BVI as such.

Harneys is confident that given the BVI's reputation for continuous improvements, meeting and often times exceeding international regulation, as well as maintaining its reputation as a leading alternative investment funds jurisdiction offering excellent service, the BVI FSC is doing all that they can to ensure the BVI is exceptionally positioned to navigate the AIFMD. If there are any questions or further clarity is needed please contact your usual Harneys representative.

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This article does not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action.



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