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## The AIFM Directive and its Impact on U.S. Fund Managers Marketing in the European Union

### Private Investment Funds Group Alert

*This Alert provides only general information and should not be relied upon as legal advice. We would be pleased to discuss our experience and the issues presented in this Alert with those contemplating investments in these markets. For more information, contact your Patton Boggs LLP attorney or the authors listed below.*

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During the last several years, managers of private funds based in the United States have been forced to address significantly increased regulation on the heels of the global financial crisis. In particular, changes implemented by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the Securities and Exchange Commission (SEC) through its rulemaking authority now require many private fund managers to register as investment advisers with the SEC.

While U.S. fund managers have rightly been focused on the Dodd-Frank Act and its implications, extensive new regulatory requirements are also in the process of implementation in Europe. U.S. fund managers that intend to raise capital from investors in the European Union (EU) will be significantly impacted by the Alternative Investment Fund Managers Directive (AIFM Directive) approved by the European Parliament in November 2010 and formally adopted by the Council of the European Union (EU Council) on May 27, 2011.

This client alert is intended to provide a brief introduction to the AIFM Directive and how it will impact U.S. fund managers seeking to market U.S. funds or offshore (but non-EU) funds in the EU. Additional regulations (not discussed here) will apply to a U.S. fund manager that *manages* a fund domiciled in the EU.

#### ***What is the AIFM Directive?***

The AIFM Directive establishes an extensive regulatory regime in the EU for “alternative investment funds” (AIFs), with the purpose of establishing a harmonized regime for AIFs and their managers with respect to their marketing activities in the EU and increased transparency into their activities and operations.

As mentioned above, the AIFM Directive has been approved by the European Parliament and adopted by the EU Council. Each EU member state is now required to implement (or “transpose”) the directive into national law no later than July 22, 2013. Much like the process involved in the U.S. with the SEC’s rulemaking to implement the Dodd-Frank Act, there is a significant amount of detail related to the AIFM Directive that must still be implemented through rulemaking by various EU authorities.

#### ***What types of “alternative investment funds” are covered by the AIFM Directive?***

An “alternative investment fund” under the AIFM Directive includes most open-ended or closed-ended pooled investment vehicles commonly thought of as private funds, including private equity funds, venture capital funds, hedge funds, real estate funds, fund of funds and other closed-end funds.<sup>1</sup>

#### ***How does the AIFM Directive impact U.S. fund managers seeking to market in the EU?***

The AIFM Directive will significantly impact the ability of U.S. fund managers (and other non-EU fund managers) to market their funds and raise capital from investors based in the EU. U.S. fund managers should review the AIFM Directive and future rulemaking in detail with counsel, as the framework and transition periods are complex, and are subject to future rulemaking. The basic framework for the various transition periods is as follows:

### **Marketing in the EU prior to July 22, 2013:**

The AIFM Directive applies to U.S. fund managers that are marketing in EU countries that have “transposed” the AIFM Directive into national law. All EU member states are required to do so no later than July 22, 2013. U.S. fund managers who are currently marketing (or who have historically marketed) to investors in the EU are doing so under the national “private placement regimes” (*i.e.*, the existing national laws relating to fund marketing and securities offerings) of each individual country. U.S. fund managers may continue to do so in each EU country until the date of “transposition” for that country, without the need to comply with the marketing requirements, or any other requirements, of the AIFM Directive.

### **Marketing in the EU between 2013 and 2018:**

Any marketing activities of U.S. fund managers in an EU country after the date on which that country has implemented the AIFM Directive under national law (which for any EU member state will be no later than July 22, 2013) will need to be performed strictly in compliance with the AIFM Directive.

Sometime after September 2015, it is expected that a marketing “passport” will be implemented across the entire EU (see further discussion below). Fund managers who satisfy the related requirements and are able to obtain such a passport will be free to market their funds in any EU country.

Marketing activity by a U.S. fund manager in an EU country after July 22, 2013 (or earlier if that country’s date of transposition occurs prior to such date) may continue in compliance with the existing private placement regime of that country until the private placement regimes expire (currently expected in 2018), but only if at least the following conditions are satisfied in addition to compliance with the private placement regime of each individual country:

- The U.S. fund manager must comply with certain disclosure and transparency requirements of the AIFM Directive relating to the manager, its funds and its portfolio companies, including (i) filing an annual report for each underlying fund that is marketed in the EU; (ii) providing investors with certain disclosures prior to their investing, including information on all fees, charges and expenses directly or indirectly borne by investors, as well as the details of any preferential treatment provided to any investor; (iii) periodic reporting to the regulatory authorities in each EU country where any funds are being marketed; (iv) detailed disclosures concerning any EU company acquired by a non-EU fund managed by a U.S. fund manager; and (v) potential compliance with anti-asset stripping rules applicable to private equity investments.
- Certain “cooperation agreements” must be in place between (i) the SEC, (ii) the regulatory authorities of the jurisdiction of domicile for any fund being marketed by the U.S. fund manager in the EU (which would be the SEC for a U.S. fund, or the appropriate authority for an offshore jurisdiction in the case of an offshore fund), and (iii) the regulatory authority of each EU country in which the fund is being marketed.
- Neither the U.S. nor any other jurisdiction of domicile of any fund managed by the U.S. fund manager and marketed in the EU may be listed by the Financial Action Task Force (FATF) on anti-money laundering and terrorist financing as a “non-cooperative country and territory.”

Also, the foregoing are solely the minimum conditions which must be satisfied for U.S. fund managers to market in the EU after July 22, 2013 (or any earlier transposition date). Each EU member state has discretion under the AIFM Directive to implement stricter conditions on U.S. and other non-EU fund managers. Accordingly, U.S. fund managers will need to monitor the

national-level implementation of the AIFM Directive in each EU country in which it desires to market funds.

The existing private placement regimes are expected to remain in place until 2018, when the European Security and Markets Authority (ESMA) will report on whether the regimes should continue or be abolished. If abolished, the passporting system (described below) will be the only method for U.S. fund managers to market to investors in the EU thereafter.

### ***Passporting System for U.S. Fund Managers in 2015***

Beginning in 2013, EU-based fund managers will be able to make use of a marketing passport that will permit them to market their funds freely across the EU to professional investors, without regard for the local private placement regimes of each individual EU member state. This passport will have the same benefit for EU-based fund managers as compliance with Regulation D promulgated under the Securities Act of 1933 does for U.S.-based fund managers (as a result of compliance with Rule 506 under Regulation D, U.S.-based fund managers are not subject to the blue sky securities registration requirements of the individual states in the U.S. in which they market their funds).

Assuming that ESMA issues a positive opinion on the functioning of the passport system, beginning in 2015 it is expected that the passport system will also be available to U.S. fund managers, as an alternative to compliance with the varying private placement regimes of each EU member state in which they conduct marketing activities.

In order for a U.S. fund manager to qualify for a marketing passport under the AIFM Directive, a U.S. fund manager will be required to satisfy all of the following:

- The cooperation agreements described above, as well as certain tax information exchange agreements, must be in place between the U.S. and each EU member state in which the U.S. fund manager desires to conduct marketing activities.
- The FATF condition described above must be satisfied.
- The U.S. fund manager must receive prior “authorization” from an EU “member state of reference,” which will be determined pursuant to a complex set of rules that will, among other things, require an on-the-ground presence for the U.S. fund manager in the EU through the designation of a legal representative in the EU member state of reference who will perform the compliance functions related to the management and marketing activities performed by the U.S. fund manager regulated by the AIFM Directive.
- The U.S. fund manager must comply with the *entire* AIFM Directive – not solely the marketing regulations that have been discussed above – except to the extent that the U.S. fund manager can demonstrate that compliance would result in a violation of U.S. law.<sup>2</sup>
- The effective exercise by EU authorities of their supervisory functions under the AIFM Directive must not be impeded by U.S. laws or regulations.

As noted, the “authorization” process and reliance on the passporting system may be costly and burdensome for U.S. fund managers – prohibitively so in some cases. Until at least 2018, U.S. fund managers can continue to market in the EU under the existing private placement regimes, provided that those managers comply with the AIFM Directive requirements related to marketing, which is discussed in the preceding section of this alert. After 2018, if the private placement regimes are abolished, the passporting system – and full compliance with the AIFM Directive – will be the only means for U.S. fund managers to solicit investors based in the EU.

### ***Are there any exemptions from the AIFM Directive for “small” U.S. fund managers?***

There are exemptions available for a U.S. fund manager that has aggregate assets under management (including assets acquired through the use of leverage) that do not exceed: (i) €100 million, or (ii) €500 million provided that the underlying funds are not leveraged and that investors have no redemption rights exercisable for a period of five years following the date of their initial investment in each fund.<sup>3</sup>

### ***What if an EU-based investor contacts a U.S. fund manager, without solicitation?***

Under the AIFM Directive, “reverse solicitation” or “passive marketing” will continue to be permitted. This means that investors based in the EU are free to reach out to U.S. fund managers on their own initiative, and to consummate investments in funds managed by U.S. fund managers, without the U.S. fund manager being required to comply with the AIFM Directive. However, there must be no direct or indirect initiative on the part of a U.S. fund manager in soliciting those investors.

### ***What should you do now?***

U.S. fund managers that are currently marketing funds to EU investors, or who are about to launch new funds, will not be subject to the AIFM Directive’s restrictions if they have completed their offerings (*i.e.*, held final closings) prior to July 22, 2013 or any earlier applicable date of transposition (see discussion above). U.S. fund managers who anticipate marketing funds after July 22, 2013 will need to carefully assess the implications of soliciting investors in the EU, and carefully monitor both further rulemaking related to the AIFM Directive, as well as the national implementation of the AIFM Directive in each EU member state where they intend to market. If investors based in the EU will remain an important marketing resource for a U.S. fund manager in the long-term, then that manager should begin considering now the implications of full compliance with the AIFM Directive.

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*We will continue to monitor developments, including further rulemaking and national transposition of the AIFM Directive, in order to keep our clients and friends informed. Please do not hesitate to contact your Patton Boggs attorney or one of the lawyers/authors listed on the first page of this alert with any inquiries.*

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*This Alert provides only general information and should not be relied upon as legal advice. This Alert may also be considered attorney advertising under court and bar rules in certain jurisdictions.*

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<sup>1</sup> The AIFM Directive does not apply to UCITS, which are regulated retail funds authorized by an EU member state under the UCITS Directive.

<sup>2</sup> It is beyond the scope of this client alert to detail the extensive regulatory requirements of the full AIFM Directive, but these regulations cover topics including capital requirements, staff compensation policies, valuation, the appointment of a depositary (*i.e.* a custodian), restrictions on delegation of any of the manager’s functions, use of leverage, reporting and disclosure requirements, and additional requirements relating to asset-stripping (*i.e.*, restricting fund managers from facilitating shareholder distributions, capital reductions, share redemptions and share buybacks for a period of two years after acquisition of control of a large or listed EU-based portfolio company).

<sup>3</sup> Approximately U.S. \$127 million and \$636 million, respectively, as of January 6, 2012.