Cooley

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What is it?

The European Union's Alternative Investment Fund Managers Directive[1] (the **Directive**) came into force on 21 July 2011. The Member States of the European Union were obliged to transpose the Directive into their national laws by 22 July 2013, and they are now required to apply these laws to every relevant manager (**Manager**) of every relevant alternative investment fund (**Fund**).

For the purposes of the Directive:

- The Manager of a Fund is the legal person "whose regular business is managing one or more [Funds]".
- "Managing one or more [Funds]" means "performing at least [the portfolio management or risk management] functions for one or more [Funds]".[2]
- The Manager:
    - May also administer and market the Fund, and carry out activities related to the assets of the Fund (for example, "real estate administration …, advice to undertakings on capital structure, industrial strategy and related matters, advice and services relating to mergers and the purchase of undertakings and other services connected to the management of the [Fund] and the companies … in which it has invested");[3] and
    - May be an "internal manager" (if the Fund structure permits this, and an external manager has not been appointed) or an "external manager" (the legal person appointed by or on behalf of the Fund who is responsible for the Fund's management).[4]
- A Fund is[5] a "collective investment undertaking … which: (i) raise[s] 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) do[es] not require authorisation pursuant to Article 5 of [the undertakings for collective investment in transferable securities] Directive 2009/65/EC" - a definition that is wide enough to catch most venture capital, private equity, and hedge, funds.

We have published a related briefing, which explains what "collective investment undertaking", "raising capital", "number of investors" and "defined investment policy" mean as a matter of European law. That briefing is available here link to marketing and alternative investment briefing

When and how does it apply?

The Directive applies to the Manager of a Fund if:

- The Manager is in the European Union (**EU**); or
- The Fund is in the EU; or
- The Manager and the Fund are outside the EU, but the Fund will be marketed into the EU.

For the purposes of the Directive:

- "marketing" means "a direct or indirect offering or placement at the initiative of the [Manager] or on behalf of the [Manager] of units or shares of [a Fund] it manages to or with investors domiciled or with a registered office in the [EU]".[6]

We have published a related briefing, which gives more information about the meaning and effect of the word "marketing" as a matter of European law, and (separately) the law of the United Kingdom. That briefing is available here.

Is there a "passport", so that Managers can manage and

market Funds anywhere in the EU, if they qualify for the passport?

An EU Manager marketing an EU Fund in its home Member State

An authorised EU Manager may market interests in any EU Fund that it manages to professional investors in the home EU Member State of the Manager if:[7]

- It gives Fund-specific notice of its proposals to its home Member State regulator; and
- The regulator does not seek, within 20 working days of receipt, to prevent marketing because the Manager does not or will not comply with the Directive. (Some regulators will give express permission within the 20 working day period and, if that happens, marketing can begin immediately. Others expressly allow marketing to begin as soon as the notice has been given, unless and until the regulator withdraws the right to market.)

If the Fund changes in a material way at any time after notice has been given, the Manager must give written notice of the change to its home Member State regulator one month before the change is implemented.

For the purposes of the Directive:

- The Manager's "home Member State regulator" is "the Member State in which the [Manager] has its registered office";[8] and
- A "professional investor" is "an investor which is considered to be a professional client or [who, at his] request [is being] treated as a professional client within the meaning of Annex II to [the Markets in Financial Instruments or 'MiFID'] Directive 2004/39/EC".[9]

An EU Manager marketing an EU Fund across the EU

An authorised EU Manager may market interests in any EU Fund that it manages to professional investors in one or more of the EU Member States other than its home Member State, if:[10]

- It gives Fund-specific notice of its proposals to its home Member State regulator; and
- The home Member State regulator gives notice to the regulators in the other relevant Member States—that notice (a) can only be given if the manager complies, and intends to continue to comply, with the Directive; and (b) (if that test is met) must be given within 20 working days of receipt of the notice in 1;

Marketing can begin as soon as the notice in 2 has been given.

If the Fund changes in a material way at any time after notice has been given, the Manager must give written notice of the change to its home Member State regulator one month before the change is implemented. If the changes will not affect the Manager's compliance with the Directive, the home Member State's regulator must give notice to the regulators in the other relevant Member States.

An EU Manager managing an EU Fund established in another Member State

An authorised EU Manager may manage a EU Fund established in another Member State on a "cross-border services" basis, or by establishing a branch in that other Member State, if:[11]

- It is authorised to manage that type of Fund;
- It gives appropriate advance notice to its home Member State; and
- (If the Manager complies, and will continue to comply, with the Directive), the home Member State gives notice to the regulators in the other relevant Member States.

The Manager can begin to manage the relevant Fund on a cross-border services basis, and/or it can establish the proposed branch, as soon as the notice in 3 has been given.

If anything material changes at any time after the notice in 2 was given, the manager must give written notice of the change to its home Member State regulator one month before the change is implemented. If the changes will not affect the Manager's compliance with the Directive, the home Member State's regulator must give notice to the regulators in the other relevant Member States

Third-country Managers and third-country Funds

Unless and until a "third-country passport" is introduced (in or after October 2015), complex combination-specific rules will apply whenever the Manager or the Fund is domiciled outside the EU. To take two examples, if:

- An EU Manager wishes to market a non-EU Fund in the EU:[12]
  - It must:
    - Give an appropriate notice, or make an appropriate application,to the regulator(s) in every relevant Member State (each Member State has its own requirements);
    - Comply with the additional marketing requirements (if any) of every relevant Member State (for example, in the United Kingdom, the "financial promotions" regime will apply—our financial promotions briefing is here);
    - Restrict its marketing so that it only markets Funds that it manages, and it only markets these Funds to professional investors in the relevant Member State(s);
  - There must be an appropriate co-operation agreement in place between the regulator(s) in the Manager's home Member State and the supervisory authorities in the third-country where the Fund is established. (For example, the UK's Financial Conduct Authority has a co-operation agreement with each of (a) the Bermuda Monetary Authority; (b) the Board of Governors of the Federal Reserve System of the United States; (c) the British Virgin Islands Financial Services Commission; (d) the Cayman Islands Monetary Authority; (e) the Office of the Comptroller of the Currency of the United States; (f) the Securities and Exchange Commission of the United States; (g) the Swiss Financial Market Supervisory Authority; the Financial Supervision Commission of the Isle of Man; (h) the Guernsey Financial Services Commission; and (i) the Jersey Financial Services Commission); and
  - The third-country where the Fund is established must not be listed as a Non-Cooperative Country and Territory by the Financial Action Task Force.

In this section of this briefing, "relevant Member State" includes the Manager's home Member State, and every other Member State into which the Manager will market the relevant Fund.

- A non-EU Manager wishes to market an EU or non-EU Fund in or into the EU:[13]
  - It must:
    - Give an appropriate notice or make an appropriate application to the regulator(s) in every relevant Member State (each Member State has its own requirements);
    - Comply with:
      - The Directive's Annual Report, Disclosure to Investors, and Reporting Obligations to Competent Authorities requirements; and
      - The additional marketing requirements (if any) of every relevant Member State (for example, in the United Kingdom, the "financial promotions" regime will apply—our financial promotions briefing is available here);
    - Restrict its marketing so that it only markets Funds that it manages, and it only markets these Funds to professional investors in the relevant Member State(s);
  - It may also be required to comply with the Directive's "acquisition of control" and (so called, but mis-described) "asset stripping" rules;
  - (In the case of a non-EU Manager managing an EU Fund), there must be an appropriate co-operation agreement in place between:
    - The regulator(s) in the third-country where the Manager is established; and
    - Each of the Member State(s) where the Fund:
      - Is established; and/or
      - Will be marketed;
  - (In the case of a non-EU Manager managing a non-EU Fund), there must be an appropriate co-operation agreement in place between:

        - Each of the regulator(s) in each the Member State(s) where the Fund(s) will be marketed; and
        - The supervisory authorities in the third-country where the Manager is established; and
    - The third-country where the Manager and/or Fund are established must not be listed as a Non-Cooperative Country and Territory by the Financial Action Task Force.

In this section of this briefing, "relevant Member State" means every Member State into which the Manager will market the relevant Fund.

- A non-EU Manager wishes to manage an EU Fund, it must (for example):[14]
    - Obtain prior authorisation from the regulator in its "Member State of reference";
    - Comply with all relevant parts of the Directive, unless that would be incompatible with the law to which the non-EU Manager and/or (if applicable) the relevant non-EU Fund are subject; and
    - Have a legal representative established in its Member State of reference.

The Directive includes complex combination-specific rules for determining a non-EU Manager's Member State of reference. Those rules are outside the scope of this briefing.

In this section of this briefing, "legal representative":

- Means "a natural person domiciled in the [EU] or a legal person with its registered office in the [EU]; and which, expressly designated by a non-EU [Manager], acts on behalf of such non-EU [Manager] vis-a-vis the authorities, clients, bodies and counterparties of the non-EU [Manager] in the [EU] with regard to the non-EU [Manager's] obligations under [the] Directive";[15] and
- "Shall perform the compliance function relating to the management and marketing activities performed by the [Manager] under [the Directive] together with the [Manager]".[16]

Are there any exemptions?

The Directive does not apply to (for example):[17]

- Holding companies;
- Securitisation special purpose vehicles;
- Managers "in so far as they manage one or more [Funds] whose only investors are the [Manager] or the parent undertakings or the subsidiaries of the [Manager] or other subsidiaries of those parent undertakings, provided that none of those investors is itself a [Fund].

For the purposes of the Directive:

- A "holding company" is "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 a company (i) operating on its own account and whose shares are admitted to trading on a regulated market in the [EU]; or (ii) not established for the main purpose of generating returns for its investors by means of divestments of its subsidiaries or associated companies, as evidenced in its annual report…";[18] and
- "Securitisation special purpose vehicles" means "entities whose sole purpose is to carry on a securitisation or securitisations …"[19]

What about small managers, and managers managing small Funds?

Only some of the Directive applies to (so called) "sub-threshold" Managers—i.e. those that directly or indirectly manage a portfolio of Funds, where the assets under management do not exceed:

- €100 million (including any assets acquired through leverage); or
- €500 million (if the Funds are unleveraged and there are no redemption rights exercisable in the 5 years after the date of initial investment in each Fund).

For these purposes, "leverage" means "nay method by which the [Manager] increases the exposure of [a Fund] it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means".[20]

Sub-threshold Managers can opt into full regulation[21] under the Directive if they wish. Whilst Member States can apply a stricter regime, the Directive only requires[22] that such sub-threshold Managers:

- Register with the competent authorities of their home Member State and identify themselves and the Funds that they manage;
- Provide information on the Funds' investment strategies to the competent authorities at registration;
- Regularly provide information on the main instruments that they are trading, principal exposures and concentrations of the Funds to the competent authorities for systemic risk monitoring; and
- Notify the competent authorities if they fail to meet any of these requirements.

If a Manager is obliged to comply with the directive, what other obligations will it have to meet?

Under the Directive, Managers have a number of obligations which are more fully described in the Commission Delegated Regulation[23] regarding exemptions, general operating conditions, depositaries, leverage, transparency and supervision. Whilst Managers subject to full authorisation under the Directive (ie. EU Managers of EU Funds) must comply with all requirements, third country parties and sub-threshold Managers are only required to comply with some (as described above). The main requirements for fully authorised Managers are:

- Compliance with the **general principles**[24] to:
  - Act honestly and fairly, with due skill, care and diligence;
  - Act in the best interests of the Funds or the investors in the Funds, and the integrity of the market;
  - Effectively employ the resources and procedures for the proper performance of business activities;
  - Take all reasonable steps to avoid conflicts of interest (and if they cannot be avoided, identify, manage, monitor and disclose conflicts)[25];
  - Comply with all applicable regulatory requirements;
  - Treat all investors fairly; and
  - Use adequate and appropriate resources for the proper management of Funds.
- Compliance with the following **capital requirements**[26]:
- Where a Manager is an internal manager, the Manager must have an initial capital of at least €300,000;
- Where a Manager is an external manager, the Manager must have an initial capital of at least €125,000;
- Where the value of Funds managed by the Manager exceeds €250 million, the Manager must provide an additional amount of own funds equal to 0.02% of the amount by which the value of the portfolios exceeds €250 million. However, the required total of the initial capital and the additional amount shall be capped at €10 million.

Both internally managed Funds and external Managers must also have additional own funds sufficient to cover potential professional negligence liability or hold an appropriate professional indemnity insurance policy.

- Have **remuneration policies and practices** in place for senior management, risk takers, control functions, and any employees in the same remuneration bracket, or that have a material impact on the risk profiles[27]. A remuneration committee must also be established to exercise competent and independent judgement on the policies and practices, and must be chaired by an individual that has no executive functions.
- Implement adequate **risk management** systems so that it can "identify, measure, manage and monitor" the risks to each

Fund. This will require:
    - A documented due diligence process, which is updated regularly;
    - Clearly identified risks associated with each investment that can be "measured, managed and monitored" on an ongoing basis (i.e. through stress testing);
    - The risk profile of the Fund corresponds to the size, portfolio structure, investment strategies and objectives of the Fund; and
    - A maximum level of leverage which they may employ for each Fund be set by the Manager (taking into account certain factors such as the investment strategy, sources of leverage and asset-liability ratio).
- For a Fund that is not unleveraged and close-ended, the Manager needs to have an appropriate **liquidity management system** to monitor the liquidity risk of the Fund. This involves carrying out regular stress tests and ensuring that the liquidity profile is consistent for all the Funds;
- Proper and independent **valuation** of the Fund's assets (can be completed by an external valuer or the Manager itself);
- **Notification** of its home state competent authority where:
    - It cannot ensure compliance with the Directive (and this must be done immediately);
    - There are material changes to the conditions for initial authorisation;
- Ensure that a single **depository** is appointed for each Fund managed. To avoid a conflict of interest, a Manager cannot act as depositary[8];
- Prepare an **annual report** for each financial year which must be available to investors and the competent authorities. The report must include a balance sheet or statement of assets and liabilities, an income and expenditure account and other items[29];
- Make certain **disclosures to investors** prior to investing in the Fund[30]. Certain disclosures must also be made periodically[31] and some on a regular basis (if the Fund is employing leverage)[32];
- Regularly **report to the competent authorities** on certain matters, such as the risk profile of the AIF and the main categories of assets invested in[33].

Relevant External Links

DATE	PRIMARY RESOURCE
December 2014	ESMA Consultation Paper: Guidelines on asset segregation under the AIFMD
November 2014	ESMA Q&A: Application of AIFMD
August 2014	ESMA Guidelines: Reporting obligations under AIFMD
March 2014	ESMA Final Report: Technical advice to the European Commission on the information that competent authorities should provide to ESMA pursuant to Article 67(3) AIFMD

	FCA Quarterly Consultation CP14/4: Consultation on Handbook changes affecting AIFMs
January 2014	FCA Finalised Guidance: General guidance on the AIFM Remuneration Code
August 2013	ESMA Guidelines: Key concepts of the AIFMD
July 2013	HM Treasury: The AIFM Regulations
May 2013	Commission Implementing Regulation (EU) No 447/2013: Establishing the procedure for AIFMs which choose to opt in under Directive 2011/61/EU
	Commission Implementing Regulation (EU) No 448/2013: Establishing a procedure for determining the Member State of reference of a non-EU AIFM pursuant to Directive 2011/61/EU
March 2013	Commission Delegated Regulation (EU) No 231/2013: Exemptions, general operating conditions, depositaries, leverage, transparency and supervision
July 2011	Directive 2011/61/EU: The Alternative Investment Fund Managers Directive

NOTES

1. Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.
2. See article 4(1)(w) of, and Annex I to, the Directive.
3. See Annex I to the Directive.
4. See article 5 of the Directive.
5. See article 4(1)(a) of the Directive.
6. See article 4(1)(x) of the Directive.
7. See article 31 of the Directive.
8. See article 4(1)(q) of the Directive.
9. See article 4(1)(ag) of the Directive.
10. See article 32 of the Directive.
11. See article 33 of the Directive.
12. See article 36 of the Directive.
13. See article 42 of the Directive.
14. See articles 37 and 41 of the Directive.

15. See article 4(1)(u) of the Directive.
16. See article 37(3) of the Directive.
17. See articles 2(3) and 3 of the Directive.
18. See article 4(1)(o) of the Directive.
19. See article 4(1)(an) of the Directive.
20. See article 4(1)(v) of the Directive.
21. See Commission Implementing Regulation (EU) No 447/2013.
22. See article 3(3) of the Directive.
23. Commission Delegated Regulation (EU) No 231/2013: Exemptions, general operating conditions, depositaries, leverage, transparency and supervision
24. Article 12 and Article 18 of the Directive.
25. There are a number of situations where conflicts of interest may potentially arise and are listed in Article 14 of the Directive.
26. Article 9 of the Directive.
27. There are extensive provisions that the remuneration policy must comply with. Please see Annex II to the Directive for further details.
28. There are many obligations of the Depositary under the Directive which can be found in Article 21.
29. See Article 22 of the Directive
30. For example, on investment strategy and objectives, fees, charges and expenses, and the identity of the Manager (see Article 23 of the Directive).
31. For example, on risk profile of the AIF (see Article 23 of the Directive).
32. For example, any changes to the maximum level of leverage (see Article 23 of the Directive).
33. See Article 24 of the Directive.

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