

Four months left to AIFMD: it is time to get off the fence

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WITH JUST FOUR MONTHS UNTIL THE EUROPEAN UNION'S (EU) CONTROVERSIAL ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE (AIFMD) COMES INTO EFFECT, DR DAVID BORG-CARBOTT FROM GANADO ADVOCATES EXPLAINS THAT IT IS DECISION TIME FOR NON-EU FUND MANAGERS AND SUMS UP THE OPTIONS AVAILABLE.

Imagine you could no longer market or distribute your funds in the EU and the only way to raise money from EU resident investors is if an investor takes the initiative and actually asks to invest in your fund. Would this affect your business? Do you manage an EU-based hedge fund? If the answer to one of these questions is 'yes' then it is time to face the fact that although you are not based in the EU you are probably within the scope of the AIFMD and need to start taking certain key decisions before July 22, 2013.

Can we avoid being subject to the AIFMD?

AIFMD applies to managers (AIFMs) of alternative investment funds (AIFs), wherever they are based, that:

- manage AIFs in the EU (whether because the AIF or the AIFM has its registered office in the EU); or
- market units or shares of AIFs to EU investors.

So, even though you are not based in the EU, if you manage any EU AIFs or market (or intend marketing) any units or shares in AIFs in the EU, then the AIFMD is going to affect you. If you do manage an EU AIF and wish to avoid being subject to the AIFMD then it is time to consider whether to transfer the management to another entity, redomicile the AIF outside the EEA or close the AIF to new

money. Even if you opt to close the AIF, your options are limited: closed-ended funds are only outside the scope of AIFMD if (i) no new investments are made after July 22, 2013 or (ii) if the subscription period closed prior to July 21, 2011 and it is to be wound up by not later than July 22, 2016 in terms of its constitutional documents.

Can we continue to rely on the private placement regimes?

Initially, yes. The AIFMD permits non-EU AIFMs to continue



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to use the national private placement regimes (NPPRs) to market units or shares in their non-EU AIFs to professional investors until a potential long-stop date of 2019. Six years may seem like a lifetime for fund managers, however, there are a few strategic considerations here:

- (a) in order to continue using the NPPRs non-EU AIFMs will as from July 22, 2013 be required to comply with (in addition to any additional local conditions): (i) disclosure and transparency requirements (including regulatory reporting), (ii) appropriate cooperation agreements need to be in place between the regulators in the AIF's jurisdiction, that of the AIFM and each of the EU jurisdictions where the fund is to sold under the NPPRs, and (iii) neither the AIFM nor the AIF must be in an FATF non-cooperative jurisdiction;
- (b) non-EU AIFMs that rely on the NPPRs will be competing against AIFMs able to avail themselves of the AIFMD passport, the latter clearly having a significant marketing advantage including the ability to market AIFs in EU countries with no or particularly difficult NPPRs; and
- (c) the AIFMD does not prohibit EU Member States from abolishing their own NPPRs before the long-stop date, something that has been threatened by a number of the larger EU Member States effectively closing off those jurisdictions to AIFMs without an AIFMD passport.

If on the other hand you are managing an EU AIF, although you may still be able to use the NPPRs (subject to the conditions under (a)), the cut-off date may be as early as 2015 following which the non-EU AIFM would need to seek authorisation in the EU.

Should we re-organise our structure?

If you have an EU entity in your group involved in the management of your AIFs it may make sense to move activities to this entity so that it is clearly deemed to be the AIFM of your EU-based or EU-marketed AIFs. This

would entail an application for authorisation as an AIFM and compliance with all the AIFMD's requirements for that entity but would, in relation to its EU based AIFs, make the AIFMD marketing passport available from day one. Besides complying with the AIFMD's requirements, there are a number of additional considerations to be borne in mind: (a) AIFMs are subject to limitations on the other services that they can provide (e.g. the MiFID services of execution of orders or proprietary trading are not permitted); (b) tax considerations (since management/performance fees would flow through this entity); (c) outsourcing arrangements will need to be thoroughly examined; and (d) ensuring that you are comfortable with the AIFM's regulator.

Should we redomicile the fund manager? What about our funds?

If you have determined that the EU is a major market for your AIFs and have determined that you can live with the AIFMD's requirements in relation to all your AIFs then redomiciling the AIFM into the EU could be an option. Redomiciliation permits the seamless shift of the legal

What is the AIFMD?

The Alternative Investment Fund Managers Directive is a 2011 EU Directive regulating the marketing or the management of funds (other than UCITS) within the EU. The AIFMD and its implementing regulation, subjects fund managers within scope to an authorisation or registration requirement as well as a number of ongoing obligations including in relation to investor disclosure, regulatory reporting, appointment of a depositary and limits on remuneration. The AIFMD is to come into effect in all EU Member States on July 22, 2013. The AIFMD creates a passport for EU AIFMs authorised under the directive to market units or shares in their EU AIFs to professional investors in all EU Member States without needing to comply with any further local requirements. The directive could potentially introduce (as early as 2015) a passport for non-EU AIFMs/AIFs.

How is AIF defined under AIFMD?

The AIFMD defines an Alternative Investor Fund (AIF) as any collective investment scheme (which is not a UCITS) which raises capital from a number of investors with a view to investing that capital in accordance with a defined investment policy. The definition of AIF covers all legal forms of AIF, whether open or closed-ended and applies whatever the asset class invested in. The definition does not cover: (a) managed accounts (that are not structured as collective investment schemes); (b) family offices (where no external fund raising is made); (c) insurance contracts; (d) joint ventures; and (e) funds that are explicitly restricted to one investor. There are also some key exemptions: (a) AIFs where the only investors are the AIFM itself and its group members (provided none of these is an AIF); (b) holding companies; (c) securitisation SPVs; (d) pension funds; and (e) employee saving schemes.

entity from offshore to onshore while also retaining all relevant contracts in place. Besides the considerations above, you also need to identify an EU domicile that permits redomiciliation. If on the other hand you have determined that you can live with the NPPRs you may need to redomicile your AIFM to another domicile that has the necessary cooperation agreements in place. Similar considerations apply to the AIFs: if the intention is to avail yourself of the passport from day one it might make sense to redomicile one or more AIFs into the EU once you are redomiciling your AIFM. Similarly if the intention is to avoid the application of AIFMD or settle for the NPPRs then one or more AIFs may need to be redomiciled.

Should we set up a parallel EU structure?

If you have determined that the EU is a significant market for your funds but still wish to offer non-EU investors an offshore alternative, it might make sense to set up a parallel EU based structure with an EU AIFM and EU AIF alongside your offshore AIFM and AIFs. Subject to the rules

regarding delegation, certain tasks of the EU AIFM could be outsourced to the non-EU AIFM in order to benefit from efficiencies. Setting up a parallel EU based AIFM/AIF would give access to the marketing passport within the EU as well as offer non-EU investors a regulated option.

Should we set up/convert our EU AIF into a self-managed EU AIF?

AIFMD allows AIFs to be set up as internally managed or 'self-managed' AIFs where the AIF itself retains sufficient functions (e.g. through committees) to be also considered as the AIFM. This could be an option for a fund manager with one EU AIF or looking to set up an EU passportable structure without overly committing. Self-managed structures have been around in a number of EU jurisdictions including in the major EU fund domiciles: Ireland, Luxembourg and Malta. There are a few catches though: (a) an internally managed AIF is subject to a higher minimum capital level (€300,000 instead of €125,000); (b) an internally managed AIF cannot manage other AIFs so the structure put in place cannot be re-utilised (though this can be minimised if it is set up as an umbrella fund); and (c) if outsourcing is contemplated, the internally managed AIF needs to have sufficient substance to ensure that it is not considered to be a 'letter box entity' which is not always easy to achieve with self-managed structures.

How is managing AIFs defined under AIFMD?

The AIFMD defines an Alternative Investment Fund Manager (AIFM) as a legal person whose regular business is managing one or more AIFs. Managing is in turn defined as performing either portfolio management or risk management functions for an AIF. In order to determine whether you are an AIFM you would need to assess whether you were appointed by or on behalf of an AIF or whether you are a delegate of an AIFM. If you are a delegate (e.g. a sub-manager) you could still be considered to be an AIFM if the appointer is deemed to be a 'letter box entity'.

How is marketing defined under AIFMD?

The AIFMD defines marketing as 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. The term 'marketing' was intentionally given a broad meaning and includes private placement. Reverse solicitation or passive marketing (where the investor initiates contact) is presently not covered.

What EU domicile(s) should we choose?

If you have decided to move/set-up an EU AIFM/AIF(s), the next and potentially most important decision you will face is the choice of EU domicile. Since many of the rules under AIFMD are subject to maximum harmonisation across the EU, your main considerations will relate to other factors such as cost-efficiency, tax efficiency, a business-friendly yet pleasant environment for key personnel relocating,

availability of legal vehicles for funds, an efficient and accessible regulator that is used to alternative funds, availability of qualified English speaking personnel and service providers, etc. If you have decided that it makes sense to redomicile an existing structure then your options are limited to EU countries that offer tried and tested redomiciliation legislation. In order to keep all options on the table for future developments it also makes sense to select a domicile that allows both inward as well as outward redomiciliation (if circumstances change). As the EU domicile of choice to date for alternative fund managers, Malta ticks all the above boxes and more.

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