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EVCA INVESTOR SEMINAR:

MAKING THE CASE FOR EUROPE
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Regulatory environment of funds/

fund managers and investors in Europe

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I. Current Status of AIFM-D / General Information

- The AIFM-Directive has come into force on 21 July 2011 and is subject to further EU legislation (so called Level II measures) and implemented into national law by July 22, 2013.
  - Directive only covers regulatory requirements with respect to the Manager (not the fund)
  - Tax consequences for AIFM or AIF are not covered

- Purpose of the AIFM-Directive:
  - the harmonization of the regulatory and supervisory framework in the EU
  - the establishment of an internal market within the EU
  - the reduction systematic risks
  - **the improvement of investor protection (including professional investors!)**

III. Scope of the AIFM-Directive

- Regulation of Managers (=**A**lternative **I**nvestment **F**und **M**anager, AIFM) of AIFs (= **A**lternative **I**nvestment **F**unds)
- No AIFM is allowed to manage AIFs unless it is authorised in accordance with the Directive
- The Directive applies to:
  - AIFMs with seat in the EU managing AIFs (with seat in or outside the EU);
  - AIFMs with seat outside the EU managing AIFs having their seat in the EU;
  - AIFMs with seat outside the EU marketing AIFs in the EU.

III. Scope of the AIFM-Directive (2)

- The AIFM-Directive applies to **AIFM** (managers) of:
- **AIFs**: i.e. collective investment undertakings
  - no matter what they are investing in (with the exception of UCITS (regulated securities funds) which are already subject to harmonised EU regulation under the UCITS-Directive)
  - and no matter whether they are open and closed-ended (i.e. with or without redemption rights)
  - and no matter whether such AIFs have “retail” and “institutional” investors
    - Therefore, PE, Mezzanine and Venture Capital funds qualify as AIF (among others)

III. Scope of the AIFM-Directive (3)

- **AIFM:** Any legal persons whose regular business is managing AIFs
- Managing is defined as:
  - Portfolio Management and Risk Management, both of which must be assumed by the AIFM.

III. Scope of the AIFM-Directive (4)

- Limited application of the Directive to AIFMs managing:
  - AIFs with assets – including assets acquired through leverage – up to a threshold of EUR 100 million; or
  - AIFs not applying leverage with assets up to a threshold of EUR 500 million and no redemption rights exercisable during a period of 5 years following the date of initial investment in each AIF.
    - ➢ Such smaller AIFMs may choose to opt-in to the full scope of the Directive to benefit from any of the rights granted under the Directive, in particular the EU passport (free distribution rights to professional investors in the EU, no national barriers);
    - ➢ Legislative initiative by the European Commission to regulate also smaller fund managers with the objective to improve of conditions for small and medium size companies in Europe to access venture capital financing;
    - ➢ Legislative Proposal on Venture Capital Regulation expected to be published as we speak (December 7, 2011).

IV. Special Rules for investor protection under AIFM-D

- Managers of alternative investment funds are subject to **authorisation and ongoing supervision**. This means that they must comply with:
  - **Capital Adequacy Requirements** (next slide)
  - General operating conditions
    - Rules on remuneration to **ensure that compensation of managers is long term profit oriented in the interest of investors**
    - Rules to ensure **avoidance and disclosure of conflicts of interests**
    - **Risk Management** procedures to be in place, including thorough due diligence requirements etc.
  - **Depositary Requirements**: for each AIF a depositary must be appointed whose functions are:
    - Verification of transfer of ownership to the benefit of the AIF
    - Oversight Functions (control of compliance with fund rules and law)
    - Cash Monitoring
  - **Transparency requirements**: Disclosure to investors and regulatory authorities.

- **Capital Adequacy Requirements of the AIFM**
  - Purpose: to ensure that sufficient funds are available for smooth operations of the AIF and liability reserve cushion
  - Initial capital requirements (being invested in liquid assets or assets readily convertible to cash in the short term) are required, including a fix initial capital of at least EUR 300.000 or EUR 125.000, as the case may be
  - Additionally, an amount of 0,2% of the value of the portfolios exceeding 250 million EUR must be held in cash (but in no event less than 25% of the fixed overhead costs with a cap of 10 million EUR)

IV. Special Rules for investor protection under AIFM-D (3)

- **Professional indemnity insurance („PII“) requirement**
  - In addition to the capital requirements, the AIFM must have PII in place to cover potential professional failures by the staff of the AIFM
- **Alternative to PII:**
  - Additional own funds on the value of 0.01% of the portfolios (might be reduced or risen by the competent national authorities due to ongoing recalculations) to be held in cash

V. Third Country Rules under AIFM-D (4)

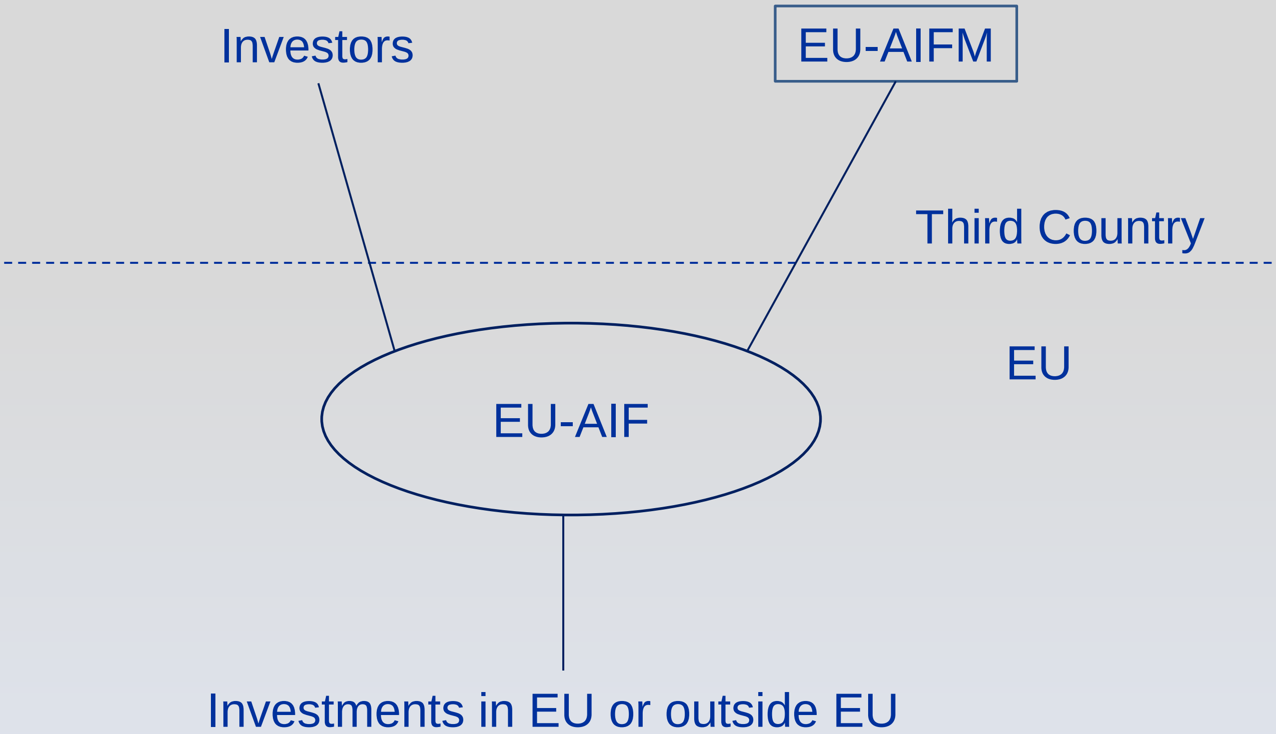
... for managing EU AIF by non-EU AIFM (slide A)

- Compliance with the Directive
- Non-EU AIFM must have a Representative in a EU Member State of reference
- Authorisation of AIFM by competent authorities of the EU Member State of reference
- Co-operation and anti money laundering arrangements between competent authorities, OECD Tax Convention among involved countries need to be in place

... for managing non-EU AIFs by EU AIFMs (slide B)

- Compliance with Directive except for rules regarding depositary and annual report
- Authorisation of AIFM
- Co-operation arrangements between competent authorities

... for managing EU AIF by non-EU AIFM (slide A)



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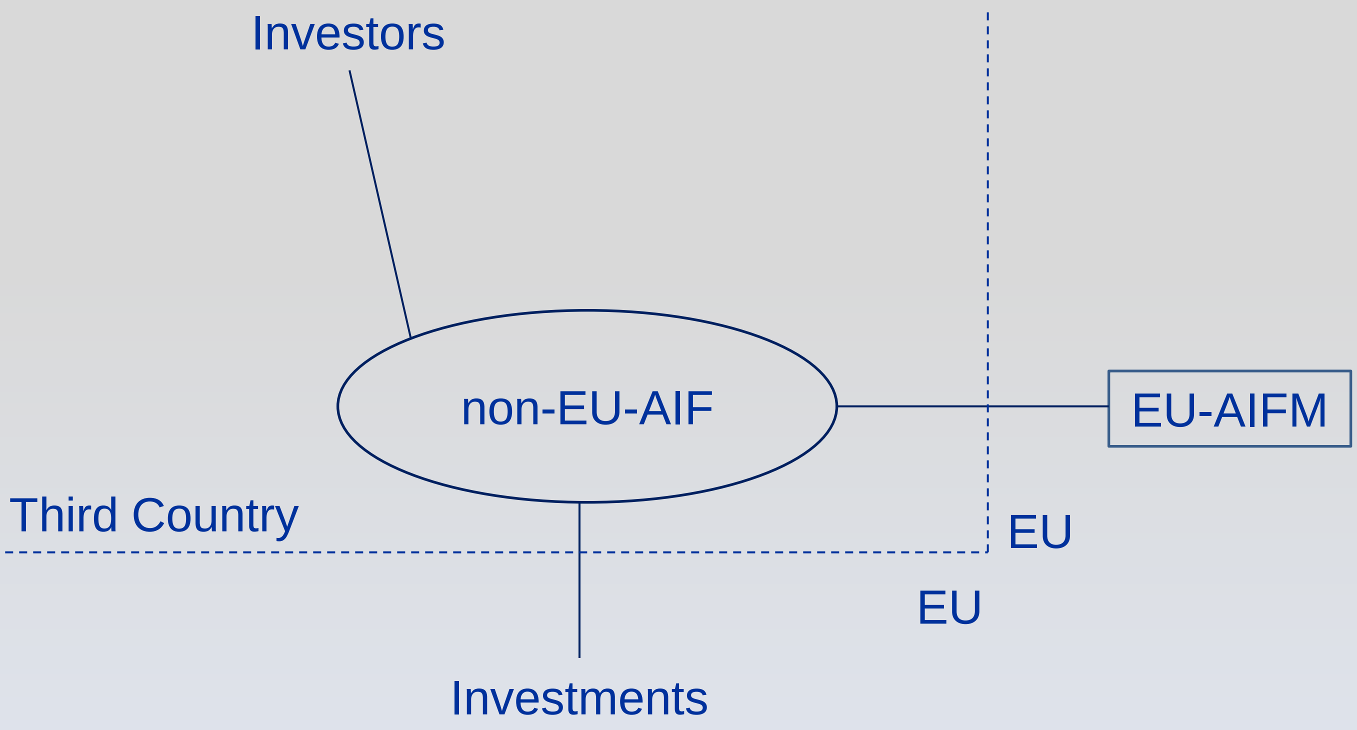
... for managing non-EU AIFs by EU AIFMs (slide B)



European Investors are also subject to EU-regulation (in particular capital adequacy requirements):

I. Basel III… (for EU Banks)

- is a new global regulatory standard on bank capital adequacy and liquidity
- aims to strengthens bank capital requirements and introduces new regulatory requirements on bank liquidity and bank leverage
- Capital adequacy requirements vary depending on the type of investment (listed or unlisted shares, debt etc.) and subject to risk managements analysis

II. Solvency II… (for EU Insurance Companies and Pension Funds)

- codifies and harmonises the EU insurance regulation
- primarily concerns the amount of capital that EU insurance companies must hold to reduce the risk of insolvency
- Capital adequacy requirements vary depending on the type of investment (listed or unlisted shares, debt etc.) and subject to risk managements analysis

➢ Impacts

- Basel III / Solvency II requires banks / insurers to hold more own funds. The additional regulation of the products (i.e. the funds and managers of such funds) is helpful if not inevitable for such investors, to make such investments.

Thank you for your attention.

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