



AIFMD Webinar

3 February 2012

CREATING LASTING VALUE

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I. Where are we currently in the AIFMD process?

I. AIFMD - Where are we in the implementation process?

1. Key Milestones completed

- AIFMD publication in Official Journal - Entry into force July 21, 2011
- European Commission (EC) asked ESMA for Technical Advice on 99 Delegated Acts
- ESMA consulted on its draft advice (July-Sept 2011) - 100+ responses received
- November 16, 2011 ESMA submission to EC of Technical Advice

I. AIFMD - Where are we in the implementation process? (2)

2. Current Status 2012

- EC to finalize impact assessment by end January
- EC to finalize the Delegated Acts by end April; also decide on Directive/Regulation
- EU Parliament and Council then have 3 months during which they can object
- EC plans to have final implementing measures adopted by July 22, 2012. Final transposition into National Law then starts.

I. AIFMD - Where are we in the implementation process? (3)

3. Key Dates 2013

- **July 22, 2013 final deadline for transposition into National Law**
- **Before July 2013 - ESMA to issue MMoU for enforcement & supervisory co-operation**
- **July 22, 2013 - AIFMD in force; EU Passport available for EU AIFMs managing EU AIF**

I. AIFMD - Where are we in the implementation process? (4)

4. Key Dates 2014 and beyond

- **July 22, 2014 - deadline to submit filing for authorization of EU AIFMs**
- **July 22, 2015 - ESMA opinion on EU passport for non-EU AIFMs and AIFs**
- **July 22, 2018 - ESMA opinion on withdrawal of national PPRs**
- **July 22, 2019 - Following positive ESMA advice - national PPRs withdrawn**

II. AIFMD - General Overview

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- Determination of AIFM / Notification of AIF
- Scope
- Authorisation of AIFM
- Minimum Capital Rules
- Organisational Rules
- Separate Risk Management / Delegation
- Remuneration Rules
- Valuation Rules
- Depositary Rules
- Disclosure Rules towards investors, authorities and employees / shareholders of portfolio companies
- “Asset Stripping Prohibition”
- Passport Rules and Third Country Rules
- Grandfathering and Transition Rules

III. Determination of AIFM in typical PE-structures

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Who is AIFM?

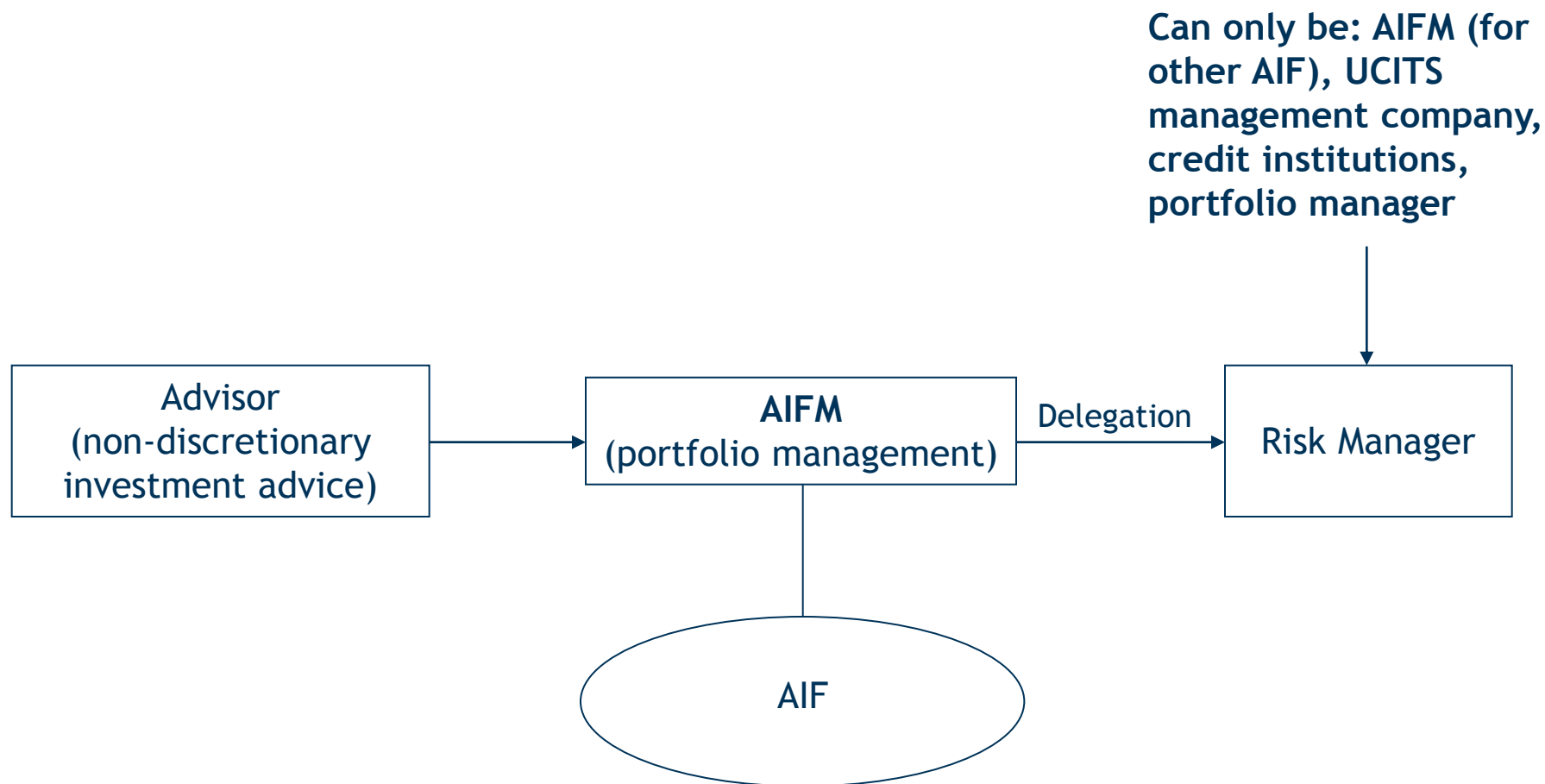
- (!): Each AIF shall have a single AIFM (Art. 5 (1) sentence 1).
- “**AIFM**” = any legal person whose regular business is managing one or more AIF (Art. 4 (1) lit. b)).
- “**Managing AIFs**” means performing at least investment management functions referred to in point 1(a) (= “portfolio management” i.e. taking investment decisions) and (b) (= “risk management”) of Annex I for one or more AIFs.
- (P): Advisory services could be seen as portfolio management function (in such case advisory agreement would have met delegation requirements).
- (P): Strict functional separation of risk management from portfolio management.

III. Determination of AIFM in typical PE-structures (2)

Separation of risk management and portfolio management functions:

- In practice separation of portfolio management and risk management to different person by delegation possible, provided that:
- There must be one AIFM which has the final responsibility for both areas;
- Delegate itself should be **AIFM, UCITS management companies, credit institution, portfolio manager**;
- Where delegation to a third country undertaking: “efficient supervision”, cooperation agreements etc.

III. Determination of AIFM in typical PE-structures (3)



IV. Scope

IV.1. Scope: AIFMD - To whom will it apply?

Authorization and Registration necessary to manage and market as from 2013

- **Applies to**
 - EU AIFM with EU or non-EU AIF
 - Non-EU AIFM with EU AIF
 - Non-EU AIFM with non-EU AIF marketed to EU investors
- **Broad scope (virtually all PE/VC funds with EU connection, whatever structure, scale or focus affected)**
 - PE/VC AIFM above MEUR 500 AuM - AIFMD authorization
 - PE/VC AIFM below MEUR 500 AuM - exempt IF subject to national registration
- **Opt-in possible**

IV.2. Scope: AIFMD - Important Definitions

- **“Marketing”** means any direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled in the Union
 - No restriction upon investors when investing in non-EU funds on their own initiative!
- **“Managing AIF”** means providing (discretionary) portfolio management and risk management services (see slide 11).
 - AIFM of an AIF must be responsible for both functions with respect to such AIF, but the assumption of only one function triggers license requirements.
- **“Small” AIFM are**
 - AIFM which manage portfolios of AIFs whose “Asset under Management” (“AuM”), including any assets acquired through use of leverage, in total do not exceed a threshold of EUR 100 million; and
 - AIFM which manage portfolios of AIFs whose AuM in total do not exceed a threshold of EUR 500 million when the portfolios of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of 5 years following the date of initial investment in each AIF.

IV.2. Scope: AIFMD - Important Definitions (2)

- “Assets under Management” = Commitments, Contributions, NAV?

ESMA Final Report: “Value of the Portfolio”

- Calculation of the value once a year; after any acquisition/disposal the value shall be updated on the basis of the acquisition cost of the acquired asset or in the case of disposal the value of the sold asset from the last annual valuation
- AIFs which are covered under the grandfathering rules of Art. 61 are not included

- Assets acquired through “use of leverage”

ESMA Final Report: with regard to PE (Buy-Out) probably no consideration of financing at the level of the acquisition vehicle

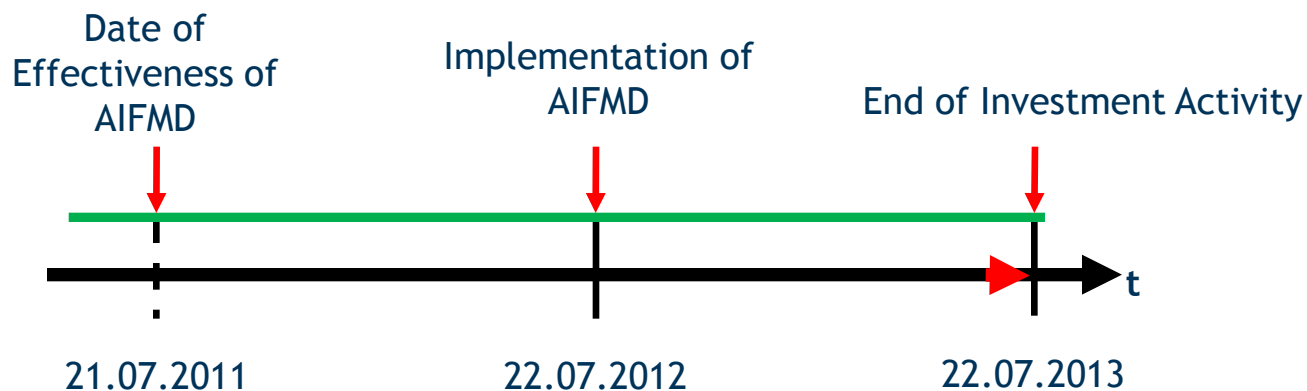
- Only consideration of financing if increase of exposure at the level of the AIF
- **BUT:** “For AIFs whose core investment policy is to acquire control of non-listed companies or issuers AIFM should not include in the calculation of exposure any leverage that exists at the level of those non-listed companies and issuers.” = as a result the meaning of this statement is unclear.
- In practice, this question is important because otherwise many lighter requirements of AIFMD will not apply (e.g.: threshold (Art. 3), transparency (Art. 25 et seqq.), liquidity management (Art. 16))

V. Grandfathering and Transitional Rules

V. Grandfathering Rule

- Only one rule is relevant for PE/VC funds

Art. 61 (3): no authorisation requirements for AIFM managing AIF whose investment activity ends prior to July 22, 2013.

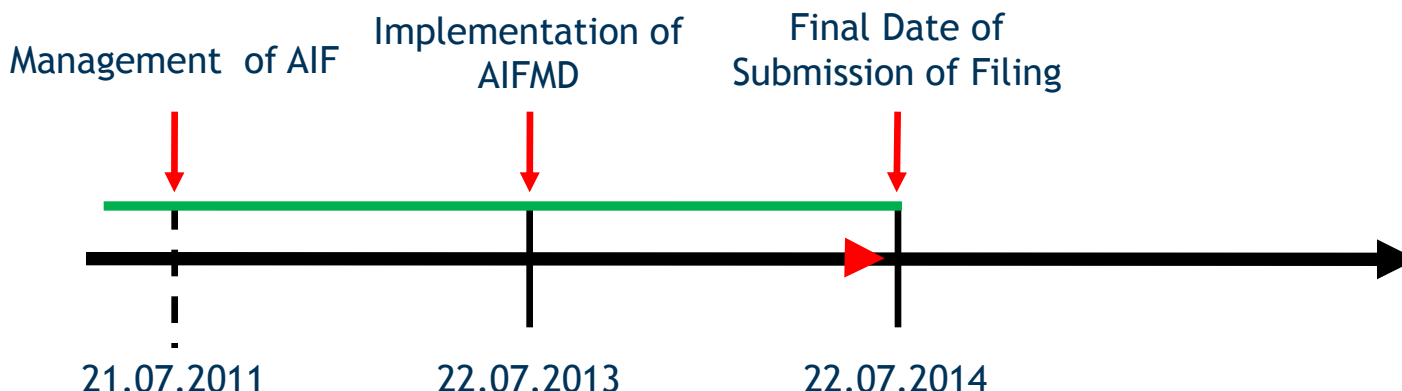


Two uncertainties in this respect:

- Follow-on investments in existing portfolio companies after July 22, 2013?
- Fund-of-Funds: Commitment = Investment?

V. Transitional Rule

- Art. 61 (1): AIFM *performing activities under this Directive* before July 22, 2013 shall take all necessary measures to comply with national law stemming from this Directive and shall submit an application for authorisation within 1 year of that date.



Q: AIF in the process of fundraising on July 22, 2013 = transitional rule applicable? (i.e. fundraising = *activity performed under this Directive*?)

- Probably to be decided in the course of the implementation at a later stage

VI. Selected Practical Issues

VI.1. Selected Practical Issues: Cost Sharing

- Additional costs arising from custodian, reporting, valuation, notification of AIF
- Probably to be borne by the AIF (i.e. the investors)
- Additional costs in connection with obtaining the AIFM-
authorisation, introduction of risk management, compliance of
AIFM, minimum capital
- Probably costs of the AIFM
- Additional costs in connection with PII?
- Could be both

VI.2. Selected Practical Issues: GP Functions

- **If GP is not AIFM:** management functions will be limited to:
 - Representing partnership, convene partners' meetings etc.
 - Appointment of service providers, i.e. external AIFM and custodian etc.
- **If GP is AIFM:**
 - In addition to the above functions: portfolio management and risk management
- **Loss of AIFM-authorisation:**
 - Removal of GP for cause in case GP = AIFM
 - In case of an external AIFM, LPA must foresee that in such case GP is required to terminate management agreement with external AIFM

VI.3. Selected Practical Issues: Impact on LPA

Amendment of existing LPAs necessary?

e.g.:

- Determination/Appointment of AIFM (GP or external ?)
- Loss of authorisation = Removal for cause
- Costs
- Reporting to authorities, investors
- Depositary
- If still in fundraising, authorisation and notification process

VI.4. Selected Practical Issues: Remuneration (Annex II)

General Rule:

Remuneration of categories of staff whose activities have an impact on the risk profiles of AIFM or AIF must comply with certain principles

- Who is covered by these rules?
- Requires the establishment of an “independent” remuneration committee, where appropriate
- Problematic with PE funds
- Carried Interest (Art. 4 (1) (d))
 - (P): definition in Art. 4 (1) (d) ambiguous; in practice currently often treated as capital gains but in certain cases levied with higher tax (like income)
 - (P): Exclusively profit-related remuneration is prohibited
- Certain portion of fees must be non-profit related
 - (P): Variable components of remuneration shall consist of at least 50% of units or shares of the fund or of share-linked instruments
- *“rules to be applied in a way and to the extent that is appropriate to their size, internal organisation, nature, scope and complexity of activities”*

VI.5. Selected Practical Issues: Depositary

- Rules regarding the depositary, description of new processes
 - cash monitoring
 - oversight function
- ESMA Final Report: ex post, but depositary must set up appropriate procedures to verify compliance of the AIF/AIFM with applicable law and AIF rules
 - In practice this may result in having the custodian to be involved at an early stage of a transaction to get his informal sign-off in order to avoid later “recall”
- Who can assume depositary function?
 - lawyer, notary, auditors, PE Administrators?
 - must be persons subject to professional conduct of business rules and registration requirements and providing financial guarantees

VI.6. Selected Practical Issues: Impact on Fundraising Process (1)

(P): PE-Funds are not an “off the shelf product” but negotiated!

- Fund documentation to be submitted for authorization filing and AIF marketing notification and approval given BEFORE marketing can begin;
- At such point in time documentation is not yet final but still subject to negotiation with investors (which can only start AFTER having obtained authorisation and AIF notification).
- Rules under AIFMD need to be interpreted in a way which makes negotiations possible.

Expected Interpretation:

1. Application for AIFM-Authorisation (Art. 6 ff.)

- The following information must be submitted:
 - re AIFM:
executives, shareholders, business plan, remuneration, delegations
 - re AIF:
investment strategy,
fund documentation (drafts?),
custodian agreement etc.
- Art. 8(5): at the latest after 3 months the Authority must inform whether they grant authorisation (can be extended by further 3 months)

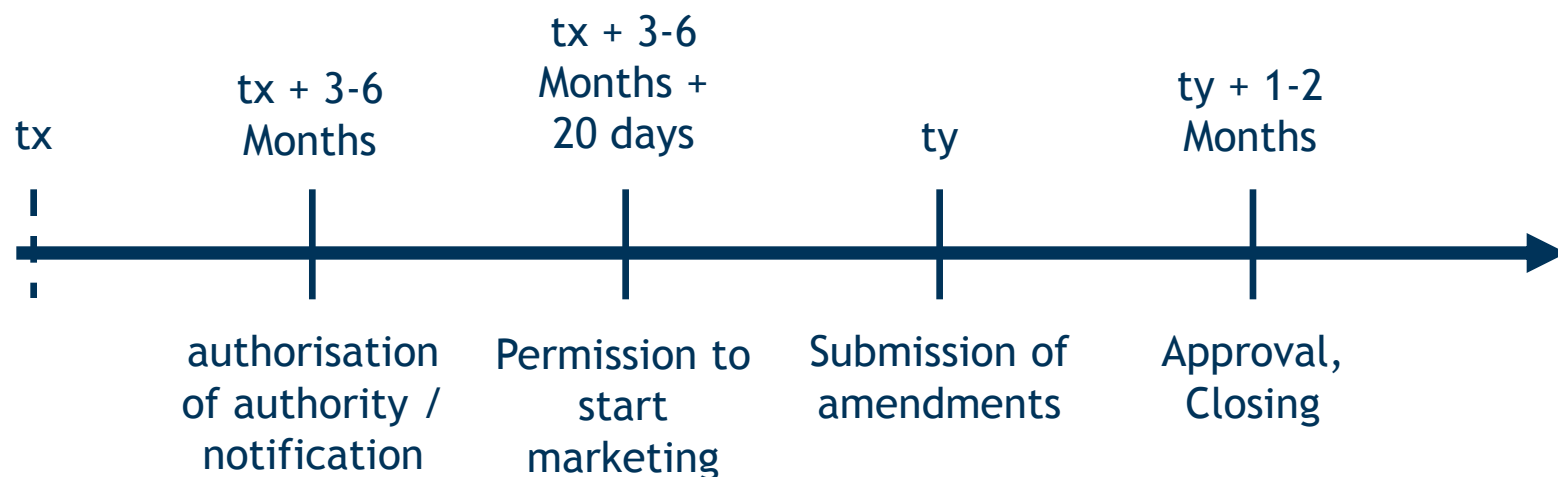
VI.6. Selected Practical Issues: Impact on Fundraising Process (3)

Expected Interpretation (2):

2. **THEREAFTER: Notification of intended marketing of AIF (Art.31 ff.)**
 - to be submitted for such notification among others:
 - target countries, “business plan” of AIF, fund documentation
 - in order to be feasible in practice this must be read to mean “drafts of fund documentation”
 - **within 20 days after receipt of complete filing, authority to say whether marketing can be started**
 - beginning of fundraising
3. **Submission of final documentation**
 - approval within one month (extension possible) (Art. 10 (2))
4. **Closing**

VI.6. Selected Practical Issues: Impact on Fundraising Process (4)

Expected timetable for fundraising:



VII. LP Perspective and Impact

VII.1. LP Perspective and Impact - Overview

- Regulator's intended aim was said to provide LPs with increased protection...
- What have LPs ended up with?
 - Increased costs borne by funds, with consequent impact on returns
 - Hard to see where protection has improved
 - Perhaps a little improvement on equal treatment of all?
- LPs need to feedback to AIFMs if opting-in will be important to them or not

VII.2. LP Perspective and Impact - Outcome

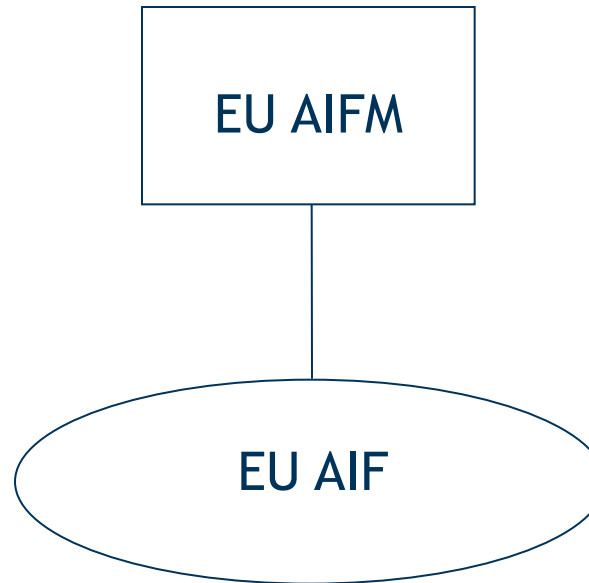
- Costs borne by AIF are real: custodian; valuation; notification to regulator
- Impact of increased time and resource the GPs will need to spend on ensuring compliance
 - more “management-focus” and less investment-focus
- Still not completely clear what practical impact of Third Country regulations will be on LPs’ ability to invest in non-EU AIFs managed by non-EU AIFMs

VII.3. LP Perspective and Impact - Specific Concerns

- Depositary
 - still a risk of the custodian “interfering” in AIFM’s investment decision-making
- PII & Own Funds
 - impact if cost of PII borne by AIF
 - if additional own funds amount is significant, impact on ability of AIFM to invest in AIF
- Marketing Rules
 - Ability to negotiate LPA
 - Ability of AIFM to invest in AIF

VIII. Case Studies

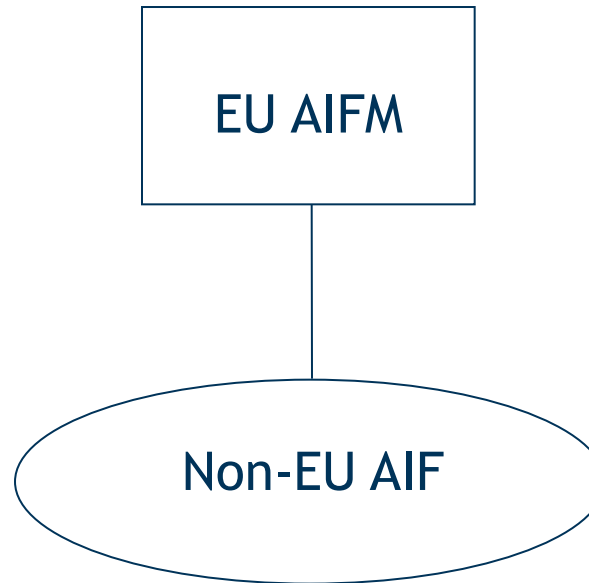
VIII.1. Case Studies: EU AIFM with EU AIF



Marketing finished by July 22, 2013 or not

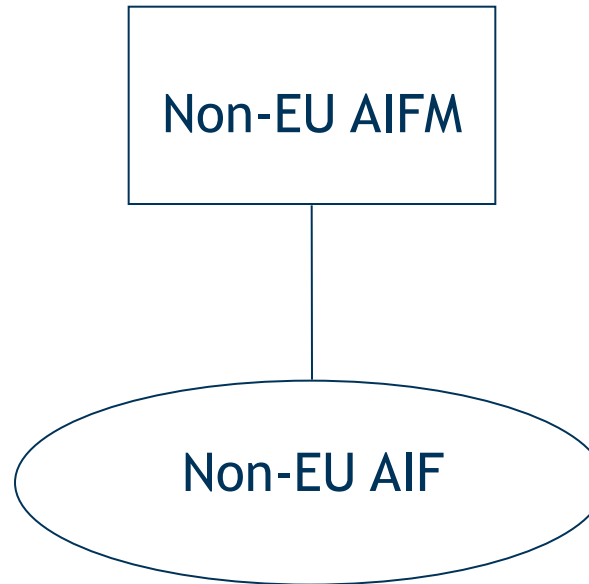
- Only grandfathered if marketing and investment finished by July 22, 2013
- Otherwise full compliance with Directive

VIII.2. Case Studies: EU AIFM with Non-EU AIF



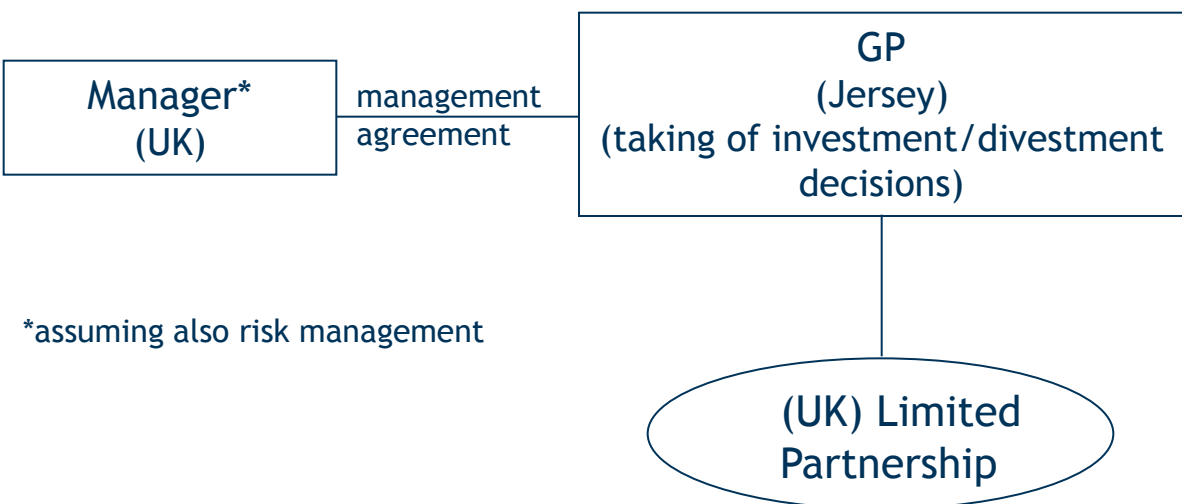
- **Marketing finished by July 22, 2013**
 - Must comply with AIFMD except for Art. 21, 22 (no depositary!) (cf. Art. 34)
- **Marketing not finished by July 22, 2013**
 - Full compliance + cooperation agreements etc.

VIII.3. Case Studies: Non-EU AIFM with Non-EU AIF



- **Marketing finished by July 22, 2013**
 - AIFMD not applicable
- **Marketing not finished by July 22, 2013**
 - Compliance with disclosure (Art. 22-24) and control requirements (Art. 26-30)

VIII.4. Case Studies: EU(?) -AIF with Non(?) -EU AIFM



*assuming also risk management

EU or third country AIF?

Art. 4(1)(k):

- a third country AIF is an AIF, which is not an EU AIF.
- EU AIF is:
 - AIF registered in a MS according to national law
 - or
 - AIF, not registered in a MS but which has its seat in a MS.

1. Which entity is AIFM?

- Unclear, but GP could be seen as AIFM and the management agreement with the Manager in the UK as “delegation” (or vice versa?)
- in such case “Manager” in UK would have to be licensed/authorised
- GP may not be an empty box!

2. Which rules apply?

- rules regarding Non-EU AIFM managing EU-AIF or Non-EU AIFM managing Non-EU AIF or EU-AIFM managing EU/Non-EU AIF?
- UNCLEAR!

Thank you for your attention.

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