Guide to AIFMD 2014

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In this issue...

04 Introduction
By Sunil Gopalan, Chairman & Publisher, GFM Limited

06 UBS Fund Services covers all bases under AIFMD
Interview with UBS Fund Services

08 Prime broker relationships remain key
Interview with Mike Hughes, Deutsche Bank

10 The role of the CCO in a highly scrutinised global regulatory environment
By Gary Kaminsky, ConceptONE

13 The British Virgin Islands - AIFMD one year on
By Tim Clipstone & Jill Shaw, Maples and Calder

17 The Cayman Islands - End of transitional period
By Paul Govier & Harjit Kaur, Maples and Calder

21 Gibraltar - Flexibility and speed to market
Interview with Aaron Payas, Hassans

24 Guernsey - AIFMD answers to be found here
By Fiona Le Poidevin, Guernsey Finance

28 Ireland - Status of the AIFMD implementation
By Donnacha O'Connor, Dillon Eustace

32 Luxembourg - prepares for central role as AIFMD finally takes effect
By Olivier Sciales, Chevalier & Sciales

36 Malta - regulation of AIF managers
By Dr Christopher Buttigieg and Dr Isabelle Agius, Malta Financial Services Authority

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Photographs: ©European Union
Published by: GFM Ltd, Floor One, Liberation Station, St Helier, Jersey JE2 3AS, Channel Islands
Tel: +44 (0)1534 719780 Website: www.globalfundmedia.com
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well as up.
Introduction

The publication of the Global Fund Media Guide to AIFMD 2014 is timed to coincide with the 22 July 2014 date by which AIFMs are required to submit their applications for authorisation to their relevant competent authorities in compliance with the Alternative Investment Fund Managers Directive.

The GFM Guide to AIMFD is the inaugural edition of this unique online publication being made available to the 50,000-strong audience of investment managers, institutional investors and fund service providers that read GFM’s family of investment management newswires daily.

The focus of the Guide is to help managers, promoters and their advisers navigate the AIFMD and complements the daily news, special reports and fund data delivered through our specialised investment management portals (see below for complete list).

This edition of this Guide to AIFMD draws together in one volume the key points covering the following major jurisdictions – BVI, Cayman Islands, Gibraltar, Guernsey, Ireland, Luxembourg and Malta and includes expert articles on servicing and administration issues.

GFM’s Guide to AIFMD 2014 has been produced with the support of leading law firms, service providers and jurisdiction promoters, and in this regard we would like to thank all the firms who feature in this Guide for their invaluable time and assistance in preparing a comprehensive overview of each jurisdiction, plus articles on key subjects related to the Directive.

We look forward to your feedback and participation in forthcoming editions of this Guide.

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It’s fair to say that under AIFMD UBS Fund Services has got all bases covered. Not only has the firm developed a depositary solution to support both EU-based and non-EU based funds under Article 21 and Article 36 of the directive, it also has a management company platform that can allow it to act as a third party AIFM (after 22th of July) as well as the ability to act as the Swiss legal representative to managers wishing to continue marketing their AIFs into Switzerland. It’s a comprehensive offering that few can rival.

Depositary solution – an open architecture approach

Under AIFMD two Depositary models exist: Full Depositary as known from the traditional funds world under Article 21 of the directive, which applies to EEA managers running EEA funds on one hand and Depositary lite under Article 36 of the directive, which applies to non-EEA funds. Therefore, this March, UBS Fund Services launched its Depositary Lite platform to help managers of offshore funds fulfill the requirements of AIFMD. Under this model, UBS will conduct the cash flow monitoring, safekeeping and general oversight requirements but unlike the full onshore depositary model – it will not have strict liability for the fund’s assets.

National private placement rules are changing in EU member states. Some countries like Germany are gold plating the directive, meaning that even non-EEA managers continuing with private placement may require a depositary.

“Our clients are looking at key countries and that’s why UBS Fund Services has rolled out its Depositary Lite solution,” says Monette Windsor, Head of UBS Fund Services, Cayman Islands.

David Rochford, head of regulatory product development at UBS Fund Services, adds: “Our platform can be deployed as part of a split service model working alongside other providers, or as a one-stop shop solution. It’s not a one-size fits all solution. Depending on what each manager does in the EU, how many markets and investors they have, we want to ensure we can offer a full AIFMD solution so that different parts of it will be available to managers; Depositary Lite solutions for managers who continue with private placement, and management company solutions for managers who wish to become fully compliant.”

London-based managers running non-EEA funds for example are busy scrambling to appoint their Depositary Lite provider ahead of the transposition deadline on 22 July 2014. Those clients can at any time appoint UBS to carry out the three core functions in full, or take a more à la carte approach by using their existing administrator and prime broker(s) and appoint UBS purely to perform the oversight function; this flexibility is being supported by the FCA in the UK.

The full depositary model is available to EEA managers running EEA funds who are required to comply with all facets of the directive. With this UBS provides a future proof solution. By 2018, ESMA will require all managers, including third country managers, to have AIFMD-compliant funds. Depositary Lite, whilst important, may be a short-term model.

If the private placement regime is abolished in 2018, all managers (of onshore or offshore products) will require a depositary. UBS Fund Services has developed an open architecture model to support AIFMs under the full depositary regime. This will allow the manager to continue with their existing prime brokerage relationships, provided of course the prime brokers are supported on the UBS platform.

“We can facilitate an open architecture platform for prime brokerage appointments. This gives clients the flexibility to appoint the prime brokerage counterparts they need to work with which will add significant value to their business and that of their shareholders,” says Gavin Byrnes, Head of Business Development UK, UBS Fund Services.

The open architecture approach is considered by UBS to be a more cost-effective framework to implement. UBS will work with a manager’s preferred prime broker(s) in order to implement a legal and operational framework commensurate with the framework it has in place in the UBS investment bank division.

“This framework is in line with other open architecture frameworks with respect to discharge of liability (to the prime broker under a sub-custodial agreement). Where
that is not possible we will have an indemnification model in place with the relevant prime broker."

“We therefore don’t envisage that this model is going to be as costly as some of the headlines have predicted over the last 18 months. We think the costs are going to be negligible relative to the pre-AIFMD framework that has been in place in Ireland for Irish QIAIFs,” adds Byrnes.

Provided the discharge of liability is acceptable to the AIFM, the depositary and the prime broker and the necessary disclosures are made, Byrnes sees this open architecture model as the one most likely to be adopted by the industry. With respect to strict liability, some depositaries are driving their clients towards a vertically integrated model with their own prime broker providing the necessary financing while others appreciate that an open architecture approach is required to ensure costs are minimised and managers can diversify counterparty risk.

Services such as financing, risk reporting and other prime brokerage-orientated ancillary services form the basis of this objective reasoning as without them it is difficult, if not impossible, for a hedge fund manager to operate. Separating the assets from the prime broker with depositaries will only further exacerbate the issue and contribute to increased operational cost, technology and integration difficulties as well as increased financing costs according to Byrnes.

“We are confident that an open architecture model is the most sensible approach and one that will ensure the ability of our clients to manage money while ensuring that costs are in some way mitigated for shareholders,” adds Byrnes.

**Third-party AIFM solution**

As well as providing both, offshore and onshore depositary services, UBS Fund Services has moved quickly to establish an AIFMD fund platform, which is planned to go live beginning 2015. The platform will be domiciled in Dublin and will act as the AIFM for non-EEA managers (as well as act as the external management company for EEA managers who have already launched funds) in a similar fashion to how it supports UCITS funds.

“Our AIFMD solution will be an infrastructure platform with distribution support but it absolutely won’t be an active distribution model; that’s a key differentiator. We will act as the administrator and custodian to the AIF but it will be an open architecture solution from a trading counterparty perspective,” confirms Byrnes, adding: “We will handle all the heavy lifting from a valuation, administration, collateral management, regulatory reporting and risk management perspective. The only thing that will be delegated to the manager is the portfolio management activity.”

UBS Fund Services today already operates various fund platforms in Dublin under the UCITS and QIAIF frameworks and as you would expect of a global organisation, over the years it has built out a comprehensive framework of policies and procedures to meet the complexities of all strategies supported on such platforms. Being able to offer that same level of support to non-EU managers wishing to establish EU-based AIFs makes logical sense.

“We have a platform that we are able to scale and the genesis (of the AIFMD solution) was to leverage this capacity and support clients to focus on the distribution aspect of their business; the two went hand in hand,” says Byrnes. UBS Fund Services will offer managers passive distribution support giving them access to the largest distribution network in Europe.

**Swiss legal representation**

As if that weren’t enough, UBS will also support managers wishing to distribute their AIFs into Switzerland (and vice-versa) under the AIFMD passport with the establishment of representative services. This will allow UBS Fund Services to act as the Swiss legal representative for funds marketed both to qualified and non-qualified investors. Due to the complementary nature of this service UBS has decided to offer representative services only along with other AIFMD services or to managers using UBS as a custodian, administrator prime broker or distributor.

What UBS Fund Services is keen to ensure is that accessing the Swiss funds market remains as easy as possible for its clients. Aside from helping with the fund registration process with the Swiss Financial Markets Authority FINMA if required, UBS will support managers with all the legal, compliance and tax reporting requirements.

“For AIFs distributed to qualified investors only a representative needs to respond in a timely and professional manner to any sort of inquiries – e.g. to provide the most recent legal fund documents, such as the prospectus, to investors. Furthermore, a representative is responsible that all distribution activities are in compliance with the applicable law and the relevant guidelines of the Swiss Funds and Asset Management Association (SFAMA),” explains Yves Schepperle, Head of Product Development and Representative Services, adding that “fund managers must be comfortable with their chosen representative because they may be contacted by investors and/or FINMA.

“As the name of the representative and paying agent will have to appear on any factsheet or presentation and on all legal documents used for Swiss investors, a fund manager should choose a well-known and trusted brand in Switzerland,” states Schepperle.

Whether its depositary services, management company services, or Swiss legal representation, UBS Fund Services has built a one-stop shop for managers wishing to operate in complete confidence under AIFMD.
AIFMD is here. Deutsche Bank is ready.

We provide depositary services, award-winning fund administration, globally aligned investor services, multi-currency cash management and a highly regarded sub custody network spanning more than 30 markets around the world – whether you choose to use us as your prime broker or not.

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Passion to Perform
Prime broker relationships remain key

Interview with Mike Hughes

Last year there was considerable angst and uncertainty among hedge fund managers. Central to their concerns was the impact appointing an independent depositary under AIFMD would have on their existing prime brokerage relationships. Twelve months on, however, and much progress has been made to alleviate these fears, with Mike Hughes, Global Head of Fund Services at Deutsche Bank, referring to the period as a ‘game of two halves’ (in World Cup parlance).

“In the latter half of last year there was still a lot of uncertainty. Where would the depositary fit in terms of the overall client relationship? The strongest relationship a fund manager has had, historically, has been with its prime broker and there was a view that depositaries might become a manager’s new best friend.”

“Over the last six months, however, a lot of good sense has been brought to the market. The discussion has involved practitioners (people who actually know how this model works rather than just spokespeople) coming together to develop and agree on the operating model for funds in unison with hedge fund managers, prime brokers and custodians. It has been a much more pragmatic approach.

“We’ve reached a level in the weeds that we’ve never before seen under AIFMD,” comments Hughes.

The upshot here is that managers can take reassurance that the last thing depositaries are going to do is usurp prime brokers as the key client relationship. Indeed, Deutsche Bank went on record as far back as two years ago saying that AIFMD would not upset the apple cart. The prime brokerage model remains fully intact. Of course, there are subtle contractual differences given the discharge of liability agreements that need to be put in place with depositaries, but as Hughes stresses, “the principal role of the prime broker has not changed”.

Integrated versus de-coupled model

The integrated model that Deutsche Bank has developed to support AIFMs is preferential – especially to smaller managers – because the AIF’s risk can be contained within the four walls of the bank. This offers an attractive cost benefit.

“I definitely believe that for new managers, or managers who aren’t yet bulge bracket, they are looking closely at the integrated model. We do all the regulatory reporting, trade repository reporting and all the administration and custody work under a single umbrella. It brings better economies of scale than were the manager to appoint individual counter-parties,” says Hughes.

Indeed, a white paper written by Deutsche Bank last year entitled ‘Charting a smooth course through AIFMD implementation’ stated: “We believe that AIF managers would be best served by consolidating their business with depositaries equipped to work with their existing prime brokers and that can also act as fund administrators, cash managers, transfer agents, and sub-custodians within a framework of appropriate ‘Chinese walls’ and segregation of duties.”

There was a view two years ago that such a model might not have been favourable because of conflicts of interest but that view has since dissipated according to Hughes.

“Managers are looking to bundle their risk and work with strong counterparties. The integrated model has worked very well for us and has been well received,” he confirms.

The de-coupled model is better suited to larger managers that want the flexibility to maintain existing multiple prime brokerage relationships. Deutsche Bank has developed a standardised approach and worked tirelessly over the last year to sign discharge agreements.
starting to build as local regulators deal with AIFM approvals; a clear sign that managers are willing to embrace AIFMD and do the right thing by their investors. Moving forward, Hughes believes that once a suitable number of AIFMs are up and running in Europe the biggest challenge for AIFMD will be to agree on Annex IV reporting standards.

"There is definitely a need for a level playing field. It is one of the principal unanswered issues with respect to Annex IV reporting. The interesting point about Annex IV is that the filing is largely numerical. If there are pre-defined calculable fields it will make it easier to standardise reporting across different Member States but we remain a long way away from that today. The reporting regime under Annex IV needs to mature. Once we have a reasonable number of AIFMs – say 100 AIFMs across six key Member States – reporting data, then I think we’ll see those Member States come together to review the differences (and try and reach a common reporting standard).”

Consider this: under Form PF managers must answer around 30 questions. For CPO-PQR reporting it is 22 questions. Under AIFMD, Annex IV contains 301 questions. Multiply that by 100 AIFMs and getting regulators to meaningfully interpret 3,000 data points, which will vary greatly depending on fund strategy and trading instrument, and the task ahead is onerous. After all, there is no point having all of this reporting data if it cannot be actionable.

“There needs to be an aligned view when managers start reporting under Annex IV because without one nobody benefits. The detail under Annex IV is way in advance of anything a hedge fund manager has ever seen before,” says Hughes, agreeing that the lack of a reporting standard remains the 800-pound gorilla in the room.

When asked what managers need to look for when assessing who to appoint as their depositary, Hughes concludes by saying:

“They need to look at a depositary’s ability to support them on a global basis, to have an open architecture model in place, to report in a streamlined way and to assess how effective it is at dealing with complex strategies: there are some depositaries that are starting to push back on certain fund strategies. We are not one of those.”
The role of the CCO in a highly scrutinised global regulatory environment

By Gary Kaminsky

It seems almost daily that regulators on both sides of the pond remind the industry of the importance of compliance and their high expectations of the individuals charged with managing the risks associated with operating an asset management company in the current environment.

Article 61 of Level 2 of the AIFMD mandates that AIFMs "establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the AIFM to comply with its obligation under [the Directive]", and that they designate a permanent compliance officer to oversee these. (Council Directive 2011/61/EU on Alternative Investment Fund Managers, 2011 O.J. L 174/62, art. 61).

In the UK, the FCA recently increased its enforcement focus on individuals, highlighting misconduct of senior executives in control roles and their failure to provide adequate oversight. (see Financial Conduct Authority, Final Notice to Alison Moran, 2013). This message has also been loudly broadcast in the US through the medium of frequent public speeches by senior SEC officials as well as a litany of enforcement actions accompanied by more statements containing broad pronouncements of the Staff’s view of the role of a CCO.

Are these expectations realistic for one person to fulfil? Is it prudent for anyone to voluntarily take responsibility for the compliance of an organisation that prides itself on engaging in sophisticated trading strategies run by self-proclaimed “masters of the universe?” These are questions that many CCOs may be contemplating as they consider their professional options.

The good news is that a closer look at some of the regulators’ words offers a light into the dark tunnel of acceptable compliance and a CCO’s obligations. True, the CCO is a gatekeeper of appropriate behaviour, but definitely not a guarantor, which is an important distinction.

Andrew Ceresney, the current Director of the SEC’s Division of Enforcement, recently highlighted this distinction, saying "at the end of the day, though, legal and compliance officers who perform their responsibilities diligently, in good faith, and in compliance with the law are our partners and need not fear enforcement action." (Andrew Ceresney, Keynote Address at Compliance Week 2014)

Robust regulatory enterprise risk management systems aligning front, middle and back offices with regular oversight are a CCO’s best ally (see A Mandate For Regulatory Enterprise Risk Management). Regulatory Enterprise Risk Management is the system by which a firm aligns its front, middle and back offices to better aggregate and harmonise data flows internally and among third party providers and constituents.

A CCO’s role should be to assist in the development, implementation and maintenance of the firm’s RegERM, and work with the other C-level professionals to regularly review the system to test that it is reasonably designed to prevent violations and other compliance and operational transgressions. Ceresney explained that the Staff intends to work to facilitate the CCO’s ability to perform its role by encouraging a firm’s senior management to provide them with the requisite deference and infrastructure.
Similarly, the AIFMD requires AIFMs to establish infrastructure to ensure that the governing body, the senior management, and where relevant, the supervisory function are responsible for the AIFMs complying with its obligations under the AIFMD. (Council Regulation EU No 231/2013 supplementing Directive 2011/61/EU, 2013 O.J. L 83/38, sec. 6)

Regulators consistently speak of the need for a “tone from the top” in establishing effective compliance systems. The CCO needs to be able to trust that firm personnel buy into the idea of compliance and appreciate the risk associated with actions that create regulatory arbitrage.

Andrew Bowden, the SEC’s Office of Compliance Inspections and Examinations (“OCIE”) Chief made this point in recent remarks: “[A] compliance department has the best chance of success if management is fully supportive of compliance efforts and provides the CCO with the resources needed to do an effective and thorough job.” (Andrew Bowden, Spreading Sunshine in Private Equity, excerpt from a speech to the Private Fund Compliance Forum 2014).

An investment in compliance is not a discretionary buy for an asset manager, for the cost of not devoting the appropriate resources can be prohibitive (see The Cost of Non-Compliance). Ironically, many firms seem to prefer to spend money to find ways to avoid certain regulatory burdens, i.e. marketing in the EU under AIFMD, rather than enabling their compliance professionals to navigate the path towards growing their business. Given the chance, a CCO can add significant value to the overall business of the firm.

A CCO’s role is not intended to be the guarantor of compliance, but rather an overseer of compliance systems.

In order to effectively carry out this function, the CCO needs to work closely with management and other personnel in the day-to-day business of the firm. CCOs need to gain the respect and confidence of the firm by not being seen as a barrier to conducting appropriate business, but as a check and balance of the firm’s legal and compliance framework.

Bowden explains: “Additionally, strength and effectiveness of a compliance department is boosted when compliance officers not only understand relevant laws and rules, but are integrated into a firm’s business. In OCIE, we’ve seen that compliance officers, who – for example – participate in weekly deal meetings and in meetings with investors, or who review deal memos, tend to be more effective in spotting issues early and are more respected in their organisations.”

It is essential to an effective and comprehensive compliance system that the CCO be someone who personnel will seek out for advice and counsel, rather than a person to be avoided and left in the dark. The CCO’s role should be a facilitator of lawful moneymaking – a trusted advisor who can help navigate the firm through the many regulatory hurdles that can impede its mandate of alpha creation in compliance with law.

Gary Kaminsky has over 27 years of experience in the securities industry, particularly with regard to issues relating to the legal/compliance and operational infrastructure of asset management companies. At ConceptONE Gary continues a distinguished career in the financial services sector that began as an attorney with the Enforcement Division of the Securities and Exchange Commission and includes stints as CCO of Susquehanna Investment Group and principal and co-founder of two AIFMs. He is a frequent speaker and author on matters relating to Dodd Frank, Form PF, AIFMD, Annex IV and other current regulatory issues.
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The British Virgin Islands – AIFMD one year on

By Tim Clipstone & Jill Shaw

It has been almost a year since the Alternative Investment Fund Managers Directive (“AIFMD”) was due to be implemented by the member states of the European Union (the “Member States”) on 22 July 2013 and a number of Member States have yet to enact legislation to transpose AIFMD while others, including the United Kingdom, Ireland and Luxembourg, enacted transitional provisions which gave managers of alternative investment funds one year, until 22 July 2014, to determine what steps, if any, need to be taken to ensure compliance with the provisions of AIFMD.

Who does AIFMD affect?
AIFMD seeks to regulate fund managers rather than funds themselves. An AIFM is defined as a legal person whose regular business is the managing of one or more alternative investment funds (“AIFs”). While an AIF is defined as any non-UCITS collective investment undertaking which raises 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. Careful consideration should be given to whether any of the entities managed fall within the definition of an AIF and also which entity would be considered the AIFM for those AIFs in order to determine whether the AIFM will be required to seek authorisation under AIFMD, either before 22 July 2014 or at a future date.

AIFMD does not apply to the following entities: holding companies; institutions for occupational provision; supranational institutions; national central banks; national, regional and local governments and bodies or other institutions which manage funds supporting social security and pension systems; employee participation schemes or employee savings schemes; and securitisation special purpose entities.

In addition, the following entities may be granted exemptions from the full scope of AIFMD:
• AIFMs which manage AIFs whose only investors are the AIFM or parent undertakings or subsidiaries of the AIFM or other subsidiaries of those parent undertakings, provided that none of those investors is itself an AIF.
• Sub-threshold AIFMs managing AIFs with assets under management not exceeding EUR100m (including any assets acquired through the use of leverage) or managing AIFs with assets under management of EUR600m where the AIFs are unleveraged and with no investor redemption rights for five years. These thresholds are calculated at the level of the AIFM rather than at the level of the AIF. Such AIFMs are required to be registered rather than fully authorised under AIFMD.

Managing AIFs
Managing AIFs in the context of AIFMD means performing at least portfolio management and/or risk management for one or more AIFs. It is particularly important to determine who is actually performing these functions as it is not permitted to delegate these functions to such an extent that the entity identified as the AIFM is nothing more than a “letter-box entity” which does not exercise the control and responsibility of these functions required by AIFMD. An unintended consequence of such delegation arrangements may be that the entity to which certain of the risk management or portfolio management functions have been delegated will be considered the AIFM. In order to avoid the AIFM being considered a “letter-box entity”, it would be advisable to ensure that the risk
management and/or portfolio management functions retained by the AIFM exceed the risk management and/or portfolio management activities which have been delegated. It would also be advisable to show that the AIFM retains the necessary expertise and resources to effectively supervise the delegated activities and to manage the risks associated with the delegation of such activities. It should also be ensured that the AIFM retains the power to take decisions in key areas. Delegation structures should be considered on a case by case basis.

How are British Virgin Islands entities affected?
There are three scenarios in which a British Virgin Islands (“BVI”) entity may fall within the scope of AIFMD.

A non-EU AIFM (i.e. a BVI entity) managing a non-EU AIF (i.e. a BVI fund)
A BVI AIFM which proposes to market its BVI fund(s) in one or more Member States may rely on the private placement regime(s) in the relevant Member State(s) until at least 2018 without having to seek authorisation under AIFMD. However the AIFM will have to ensure that:
- it complies with the disclosure and reporting requirements set out in AIMFD, discussed in more detail below;
- there is a cooperation agreement in place between the competent authority in the jurisdiction of the non-EU AIFM, i.e. between the BVI Financial Services Commission, and the financial regulator in the Member State(s) in which it is proposed to market the AIF; and
- the jurisdiction of the non-EU AIFM is not listed as a Non-Cooperative Country and Territory by FATF.
Additional notification and disclosure requirements in relation to the prevention of asset-stripping may also apply if an AIFM engages in the takeover of unlisted EU companies.

It is proposed that a review of the functioning of AIMFD will take place in 2018 and at that stage private placement regimes may be abolished and the only route to marketing to Member States will be to seek authorisation under AIFMD and be fully compliant with the provisions of AIFMD.

If a BVI AIFM does not propose to market its BVI AIF(s) in any Member State, it may fall outside the scope of AIFMD.

An EU AIFM managing a non-EU AIF (i.e. a BVI fund)
Once it has been determined that the AIFM is domiciled in a Member State and that the AIF is domiciled outside the EU, for example, in the BVI, then it will be necessary to consider whether or not the AIFM has to comply with AIFMD in its entirety and the AIFM should seek advice from legal counsel in the relevant Member State.

However, the marketing passport will not be available in respect of any non-EU AIFs proposed to be marketed in the EU and it will be necessary to rely on the private placement regime(s) in the Member State(s) in which it is proposed to market. It will also be necessary to ensure that the requirements set out in the first scenario have also been complied with. There is currently no requirement to appoint a single depositary in respect of a non-EU AIF, although some of the private placement regimes of Member States have been amended to require this in any event.

A non-EU AIFM (i.e. a BVI entity) managing an EU AIF
If a BVI AIFM is managing an EU AIF but not marketing that AIF within the EU then that AIFM will not currently fall within the scope of AIFMD. However if the BVI AIFM is marketing or plans to market the EU AIF in one or more Member States then it will be necessary to comply with the requirements of the private placement regime(s) in the Member State(s) in which it is proposed to market and to ensure that the requirements set out in the first scenario have also been complied with.

As with non-EU AIFMs managing non-EU AIFs, if the AIFM engages in the takeover of unlisted EU companies, additional notification and disclosure requirements relating to the prevention of asset-stripping may apply.

This will be the only direct marketing option available to non-EU AIFMs seeking to market an EU AIF until at least 2015. At that stage the European Securities and Markets Authority will review the current rules in relation to marketing and a non-EU AIFM may be permitted to apply for authorisation under AIFMD in order to avail of the marketing passport which will permit the AIFM to market its AIFs throughout the EU subject to the notification requirements set out in AIFMD.

Disclosure and reporting obligations
As set out above, non-EU AIFMs seeking to market EU AIFs or non-EU AIFs in any Member State will be required to comply with disclosure and reporting requirements contained in AIFMD.

Annual reporting
The AIFM must make available, for each AIF that it markets in any Member State, an annual report for each financial year no later than six months from the end of the AIF’s financial year.

Pre-investment (offering document) disclosure to investors
The AIFM must ensure that certain information contained in Article 23 of AIFMD is made available prior to an investor making an investment in an AIF, which includes,
but is not limited to: descriptions of the investment strategy and objectives of the AIF; the types of assets in which the AIF may invest; all associated risks; the circumstances in which the AIF may use leverage and details relating to the use of leverage; the identity of the service providers; the fees and expenses which may be borne directly or indirectly by the investors; how fair treatment of investors is ensured and whenever an investor obtains preferential treatment or the right to obtain preferential treatment; a description of that preferential treatment and the type of investors who obtain such preferential treatment (i.e. the terms of any side letters in place). Where a depositary contractually delegates its liability to a third party this also needs to be disclosed.

Regulatory reporting
The AIFM must provide reports to the regulator in any Member State(s) where its AIF(s) are marketed, which include the following information: the main instruments in which the AIF is trading; on which markets the AIF is a member or where it actively trades; the principal exposures and most important concentrations of the AIF; the percentage of the AIF’s assets which are subject to special arrangements arising from their illiquid nature; any new arrangements for managing the liquidity of the AIF; the current risk profile of the AIF and the risk management systems employed by the AIFM to manage market risk, liquidity risk, counterparty risk and other risks including operational risk; information of the main categories of assets in which the AIF invests; and the results of any stress tests required to be conducted. The frequency of this reporting may be quarterly, semi-annually or annually depending on the type of AIFs managed.

Passive marketing and reverse solicitation
Marketing is defined under AIFMD as a 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. This would suggest that where investment is made at the initiative of an investor from a Member State the investment would not be caught by the requirements of AIFMD. However, caution should be exercised in relying on this assumption as there is currently no certainty as to what constitutes “passive marketing” or “reverse solicitation” and there is no consistency between the Member States in relation to these definitions. Care should be taken when dealing with approaches from investors based in Member States where the AIF has not taken steps to comply with the relevant marketing requirements and advice from local counsel should be sought in such circumstances.

The BVI, FATF and cooperation agreements
Prior to being permitted to market AIFs in any Member State, a non-EU AIFM must ensure that:
• Its country of domicile is not listed as a Non-Cooperative Country and Territory by FATF. The BVI is not listed as a Non-Cooperative Country and Territory by FATF. In addition, the BVI is a member of the Caribbean FATF.
• Cooperation agreements have been put in place between the Member States in which the AIFM wishes to market and its country of domicile. Cooperation agreements have currently been signed by the BVI Financial Services Commission and 26 European regulators, including Luxembourg’s Commission de Surveillance du Secteur Financier, the United Kingdom’s Financial Conduct Authority, France’s Autorité des marchés financiers and Ireland’s Central Bank of Ireland.

AIFMD ready?
At a minimum, prior to 22 July 2014, BVI entities should undertake an exercise to determine whether any of the provisions of AIFMD will apply to their business.
If it is intended to rely on passive marketing and/or reverse solicitation rather than active marketing in any Member State, we would recommend that the AIFM take advice from counsel in the relevant jurisdiction as to what does and does not constitute “passive marketing” and/or “reverse solicitation” and to have procedures in place setting out how approaches from potential investors domiciled in any Member State should be dealt with. Maples and Calder can assist with any Irish law related advice through our Irish law offering.
In the case of AIFs, it may be prudent to examine whether any amendments to the offering or subscription documentation need to be made to include references to AIFMD.

Tim Clipstone is a partner in the BVI office of Maples and Calder. He advises on all aspects of BVI and Cayman Islands securities, corporate and partnership law, including the formation, sale, purchase, listing, licensing and restructuring of regulated and unregulated vehicles, joint venture arrangements and corporate governance issues. He has particular expertise in advising managers and institutional investors on all aspects of investment funds.
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The European Alternative Investment Fund Managers Directive ("AIFMD") introduces a new regime governing the management and marketing of alternative investment funds ("Funds") in the EU. The transitional period for the implementation of the AIFMD expires on 22 July 2014, and from this date Cayman Islands Funds ("Cayman Funds") may only be marketed in the member states of the EU in compliance with the requirements of the AIFMD, unless a relevant exemption applies. Different marketing regimes will apply from the end of the transitional period to 2018 and beyond.

End of transitional period to 2015
During this period only EU managers of EU Funds will be able to apply for a passport to market their EU Funds to professional investors on a cross border basis throughout the EU. However, managers of Funds established in jurisdictions outside the EU ("Third Countries") will be able to continue marketing their Funds in the EU member states subject to each member state’s national private placement regimes ("NPPRs") provided that certain minimum requirements of the AIFMD are satisfied, as follows:

- The relevant Third Country must not be listed by the Financial Action Task Force as a Non-Cooperative Country and Territory ("FATF blacklist"); and
- Appropriate co-operation arrangements must be in place between the regulators in the relevant EU member state and the relevant Third Country regulator(s). In the case of an EU manager of a Third Country Fund, the co-operation arrangements must be in place between the manager’s regulator and the Fund’s regulator, and in the case of a Third Country manager of a Third Country Fund, co-operation agreements must be in place between the manager’s regulator, the Fund’s regulator and the regulators in each EU member state in which the Fund is to be marketed.

The Cayman Islands is not on the FATF blacklist and to date the Cayman Islands Monetary Authority (CIMA) has signed Memoranda of Understanding (which satisfy the requirements for co-operations arrangements noted above) with 27 of its counterparts in EU member states.* As such, Cayman Funds satisfy the minimum requirements prescribed by the AIFMD in order for these to be marketed in the EU member states subject to each member state’s NPPRs.

Managers of Cayman Funds wishing to market their Funds using the NPPRs will need to comply with certain provisions of the AIFMD. These differ depending on whether the manager is established in the EU or in a Third Country. Third Country managers wishing to market Cayman Funds using the NPPRs will only need to comply with the ‘transparency’ requirements of the AIFMD (which comprise certain reporting and disclosure obligations to investors of the Fund and the relevant EU regulators), and the ‘asset stripping’ requirements of the AIFMD (which apply where the Fund seeks to acquire control of unlisted EU companies). Crucially, Third Country managers will not have to comply with any of the other provisions of the AIFMD, including remuneration and leverage restrictions or the depositary requirement.

EU managers wishing to market Cayman Funds using the NPPRs will need to comply with all of the requirements of the AIFMD other than the requirement to appoint a depositary in accordance with Article 21 of the AIFMD. Instead, EU managers of

*EU members yet to sign such agreements with the Cayman Islands are Italy, Slovenia and Spain.
Cayman Funds will be required only to ensure that one or more entities are appointed to perform the cash management, safe-keeping/custody and oversight functions set out in Article 21(7)-21(9) of the AIFMD.

2015 to 2018

In 2015 the European Securities and Markets Authority (“ESMA”) must give an opinion as to whether the passport regime should be extended to Third Countries. If the passport regime is extended, in this period, managers of Cayman Funds will be able to choose whether to continue to market under the NPPRs (on the terms outlined above) or apply for a passport.

In order for an EU manager to obtain a passport to market a Third Country Fund in the EU, the following conditions would need to be satisfied:

a) The Third Country must not be on the FATF blacklist;
b) Appropriate co-operation arrangements must be in place between the manager’s regulator and the Fund’s regulator; and
c) Tax information exchange agreements (“TIEAs”) meeting the requirements of the OECD must be in place between the relevant Third Country and each EU member state in which the Fund will be marketed and the home member state of the manager.

Only the requirement in (c), above, is new. The Cayman Islands is on the OECD white list as a jurisdiction that is considered to have implemented the internationally agreed tax standard. To date the Cayman Islands has 35 TIEAs in place, including with the UK, France, Germany, Belgium, Czech Republic, Denmark, Finland, Iceland, Ireland, Italy, Netherlands, Norway, Poland, Portugal and Sweden. As such, it is expected that if the passport regime is extended to Third Countries, Cayman Funds should be eligible to access it.

In contrast to the position when marketing under the NPPRs, a manager applying for a passport would need to comply with all of the requirements of the AIFMD. Where the manager is itself established in a Third Country, it would have to opt in to comply with the AIFMD. Such manager would be required to apply to the regulator in the ‘member state of reference’ (which is determined in accordance with the AIFMD) for authorisation and submit to that regulator’s supervision in respect of its compliance with the AIFMD. In addition, the Third Country in which such Third Country Manager is established would also need to satisfy the conditions set out above.

2018 and beyond

If the passport regime is extended to Third Countries, then the NPPRs will be discontinued and Cayman Funds will only be able to be marketed in the EU with a passport, on the terms outlined above. If the passport regime is not extended, then the NPPRs will continue indefinitely and Cayman Funds may continue to be marketed in the EU member states under the NPPRs.

Scope of AIFMD/exemptions

There are some circumstances where the AIFMD does not apply. The following three appear to be of the most relevance to Cayman Funds.

Passive placement/Reverse solicitation

The definition of “marketing” in the AIFMD contemplates active marketing, in that it refers to an offering or placement at the initiative of the manager or on its behalf. As such, capital raising that is at the initiative of the investor falls outside of the scope of the AIFMD. This exemption is of particular relevance to Third Country managers, because it means that they may be able to raise capital from EU investors without having to comply with the AIFMD provided that they do not initiate the offering or placement. Likewise, such managers can accept additional capital from existing EU investors in their existing Funds provided there has been no further marketing to such investors. However, care will need to be taken by managers intending to rely on this exemption with respect to their Cayman Funds as the scope of the exemption is not entirely clear and different member states may have different interpretations of the scope and limits of the exemption.

Single investor funds

The definition of “alternative investment fund” in the AIFMD contemplates an investment undertaking which raises capital from a number of investors. Single investor funds are therefore outside the scope of the AIFMD. As with reverse solicitation noted above, this exemption is of particular relevance to Third Country managers as it means they may be able to raise capital from EU investors without having to comply with the AIFMD if such capital is invested only in single investor funds. This is a narrow exemption as ESMA has indicated that the exemption will only be available where there is an enforceable legal obligation preventing capital raising from more than one investor. ESMA has also indicated that the test for the exemption will be applied on a look-through basis so that it will not be available in the case of nominee arrangements, fund of funds and master/feeder structures.

Small managers

Managers with open-ended Funds having aggregate assets under management (“AUM”) of EUR100m (including assets acquired through the use of leverage), or EUR500m (not including leverage) in the case of closed-ended Funds are exempt from the AIFMD. It is important to note that
the calculation of AUM in respect of open-ended Funds includes leverage. Nevertheless, this exemption might be useful to some small start-up managers.

**Looking forward**
The Cayman Islands is the jurisdiction of choice for offshore alternative investment funds, and has taken steps over the last few years to ensure that it is well placed to navigate the new regulatory landscape in Europe following the implementation of the AIFMD. What this means in practical terms is that managers of Cayman Funds will be able to continue marketing their Funds in the EU member states under the NPPRs until at least 2018. As noted above, managers marketing under the NPPRs will not need to comply with all of the requirements of the AIFMD. This can be seen as an advantage (particularly for Third Country managers) as they will be able to avoid some of the compliance burden and associated costs. In addition to this, if the passport is extended to Third Countries (which will be in 2015, at the earliest), it is expected that Cayman Funds should be eligible to access it, although this will entail the manager complying with all of the requirements of the AIFMD.

The existence of a number of exemptions also means that it will be possible for certain managers to accept EU investors in their Cayman Funds without having to comply with the AIFMD. It is expected, therefore, that Cayman Funds will maintain their competitiveness in the European market now and in the future.

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Gibraltar has witnessed tremendous growth with many funds being domiciled in this well-regulated offshore environment.

Hassans are ranked as the sole leaders for Investment Funds by Legal 500 “Rolls-Royce investment funds practice...led by James Lasry, a leading investment funds lawyer with first-class knowledge of the local and wider market”. EMEA 2014 Edition.

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Hassans - 75 years in Gibraltar.
Gibraltar has taken a clever approach to ensuring that the Alternative Investment Managers Directive (AIFMD) is as appealing as possible to managers looking to launch AIFMD-compliant funds across Europe. It is, in short, the most cost-efficient jurisdiction, whilst its Experienced Investor Fund (EIF) offers managers one of the fastest routes to market.

Following a period of close collaboration between the Government of Gibraltar, the Financial Services Commission (FSC) and the Gibraltar Funds & Investments Association (GFIA), the directive was transposed into local law a full two weeks ahead of last June’s deadline. This in itself shows just how important the jurisdiction viewed the AIFMD.

At the heart of Gibraltar’s implementation of AIFMD is flexibility.

According to Aaron Payas, associate at Hassans, Gibraltar’s largest international law firm, who was seconded to the FSC to assist in the implementation of AIFMD in Gibraltar, there are two areas of flexibility which have been important to its clients.

“First, in respect to delegation we have taken a similar approach to the Central Bank of Ireland. The AIFM will need to issue, and submit to the FSC, a “programme of activity” that identifies which individual within the AIFM will, on a day-to-day basis, monitor and control each of the managerial functions of the AIFM.

“Provided the manager has this programme of activity and assigned an individual (or individuals) with the responsibility of the day-to-day oversight of the AIFM’s different managerial functions, then they can delegate out most of the functions of the AIFM. That is a useful flexibility that Gibraltar is allowing under AIFMD," explains Payas.

The inference here is that the more functions that are delegated out the more stringent the programme of activity will need to be to obtain approval from the FSC.

“Second, we have followed the UK’s approach to remuneration in that they have implemented a proportionality principal," says Payas. The idea is to level the playing field and not place onerous payment deferral demands on smaller managers. For leveraged funds, the AuM threshold is less than GBP1bn. Generally speaking, although other factors will need to be taken into account, crossing this threshold means the AIFM will fall under these remuneration rules. Those below the threshold will be able to disapply the payout process rules.

“Here in Gibraltar the Government, the FSC and GFIA consulted with each other resulting in the adoption of the proportionality principal and that has proved to be very important. Remuneration is one of the main concerns for fund managers under AIFMD,” comments Payas.

This level of flexibility and willingness to be adaptable in order to incorporate in an appealing fashion what may otherwise be regarded as problematic aspects of AIFMD has put Gibraltar in a favourable position. It also sends out a signal to the market that it is totally focused on the needs of fund managers in adopting the directive. This is largely what managers want to see and should bode well for Gibraltar going forward; especially when the transposition deadline arrives on 22 July 2014.

One of the most attractive features of Gibraltar is its tax regime. All funds domiciled there are tax neutral. “They are taxed only on income that is derived from Gibraltar so unless you invest within Gibraltar, which few funds do, then the funds remain tax neutral.

“The tax on a Gibraltar fund manager is...
10 per cent on profits after salaries, operating expenses, etc. This is a very attractive tax rate," states Payas.

But it’s not just the tax regime that is appealing. Gibraltar’s main fund vehicle, the EIF, is highly popular and under AIFMD it represents one of the cheapest and fastest ways for managers to market their investment strategy across Europe. There are no diversification or borrowing restrictions. The same investment strategies that are used in an offshore fund can be pursued.

“The funds will need to comply with EU anti-money laundering rules, but apart from that there’s no restriction in what the fund can invest in, how little or how much the manager wants to diversify their assets and so on,” says Payas, who adds that Gibraltar remains the only EU jurisdiction where one can launch a fund pre-authorisation.

“The manager can launch an EIF, with a legal opinion, and start marketing it as long as within 10 business days it submits all of the relevant fund documentation to the FSC. That makes it one of the most popular vehicles in Europe. Speed to market is vital for some of our clients so this is a key feature. This is one of our main selling points.”

This is certainly highly attractive, especially if the manager has interest from prospective investors and needs to get the fund to market as quickly as possible. However, the manager can only launch the EIF at the pre-authorisation stage provided they have received a legal opinion from a Gibraltar-based lawyer with at least five years’ standing stating that the Fund has been properly set up in accordance with the EIF regulations.

“Once the fund has been verified by a legal professional before launch the actual fund authorisation process with the FSC shouldn’t take any longer than 14 business days.

“For an existing AIFM that wants to set up a new fund then the best place to go is Gibraltar. As soon as the fund launches they can submit the passporting documents. Under AIFMD, the competent authority (in this case the FSC) has 20 business days to give approval to market the fund. If, after 20 days, the AIFM hasn’t heard anything it is free to passport the fund across Europe and commence marketing.”

Were an AIFM to be set up in another jurisdiction there would be a significant amount of regulatory downtime waiting for the AIF to get approved. According to Payas, this could take anywhere up to 18 weeks depending on the jurisdiction. Once approved, the AIFM would then need to wait 20 days for the fund passporting documentation to be approved.

“Our selling point is that in Gibraltar you don’t have any regulatory downtime at all. The only delay is the 20 days for passporting approval. Managers can save considerable time by setting up in Gibraltar.

“We are seeing a few AIFM applications coming in but a lot of clients are still in ‘wait and see’ mode. We expect things to pick up after 22 July when the transitional period ends,” says Payas.

The registration cost for an EIF is just GBP2,500 with an ongoing annual cost of GBP840.

As well as the flexible approach Gibraltar has taken with regards to the directive, the speed to market and cost benefits of the EIF, Gibraltar has other advantages. Apart from the 300 days of sunshine each year, it has its own airport and two more (Malaga and Jerez) within a one-hour drive with direct links to London and for those that play, there are over 60 golf courses in the region.

Factor in that the Big Four accounting firms and other key services providers are within walking distance of one another, the cooperative attitude between industry and the regulator, and there are a lot of positives for Gibraltar.
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Guernsey has been on the front foot throughout the conception, development and implementation of the Alternative Investment Fund Managers Directive (AIFMD).

Guernsey has made early decisions wherever possible in terms of how its funds industry responds to the directive, while awareness among fund managers of the requirements imposed by AIFMD has been somewhat mixed. Furthermore, and as anticipated, the way the different EU Member States have applied conditions has been inconsistent. Indeed, at the end of May, Bill Prew, Chief Executive of the independent depositary services Indos Financial, claimed that some 10 months on from the July 2013 transposition deadline for AIFMD, a third of EU member states had still not fully implemented the legislation at national level – with not long left until the one year transitional period that was allowed comes to an end on 22 July 2014.

Guernsey’s proactive response to AIFMD is evidenced as far back as 7 June 2013 when it became one of the first third country jurisdictions to introduce its own domestic AIFMD marketing rules. At that time our regulator, the Guernsey Financial Services Commission (GFSC), also published a set of frequently asked questions (FAQs) to help with AIFMD implementation as it unfolded. This was then followed by our signing of bilateral cooperation agreements with 27 securities regulators from the European Union (EU) and the wider European Economic Area (EEA)*. The cooperation agreements which became applicable from 22 July 2013 provide a set of arrangements for the on-going supervision of alternative investment funds, including hedge funds, private equity and real estate funds. At the end of 2013 Guernsey also released the set of rules which form its opt-in regulatory regime of measures equivalent to AIFMD. The AIFMD Rules, 2013, took effect from 2 January this year, ahead of when, as a third country, Guernsey would have been required to do so. The introduction of the opt-in regime means that we have another piece of the jigsaw in place to ensure that Guernsey funds can continue to be distributed to both EU and non-EU countries in the future.

It is clear that the uncertainty surrounding AIFMD has not been aided by the fact that several jurisdictions, such as the UK, have had transitory years while others have not. However, with this period coming to a close at the end of July, it is important for managers to know where they stand going forward.

Why Guernsey?
Managers and promoters have known since early 2013 that Guernsey was introducing a dual regulatory regime – thus providing them with certainty to proceed with making decisions so far as the commercial and economic climate permitted.

Guernsey is not in the EU or wider EEA (although it is in the European time zone) and therefore, is not required to implement the AIFMD. Although Europe remains one of our biggest markets, we also have a substantial and increasing amount of funds business which originates outside of Europe.

As a result, Guernsey’s regulatory regime ensures it is possible to continue to distribute Guernsey domiciled investment funds into both EU and non-EU countries via the existing rules which remain in place for those not requiring an AIFMD fund, including those using national private placement (NPP) arrangements and those marketing to non-EU investors; as well as the opt-in regime previously referenced which Guernsey brought into play ahead of schedule.
The approach means managers and funds with no connection to Europe can continue to use the existing regulatory rules which are completely free from the requirements associated with AIFMD and as such, will have significant operational and cost benefits. Where it is desirable or otherwise necessary to do so, in order to obtain authorisation under AIFMD, a manager will need to comply with various organisational, operational and transparency obligations, which will create significant additional compliance costs, some of which will likely be passed to investors in the fund.

Meanwhile, thanks to having the 27 bilateral cooperation agreements in place, Guernsey’s position as a third country means our managers and funds who want to access Europe continue to be able to use NPP regimes, which are expected to remain in place until at least 2018.

It is also expected that a full passporting regime for non-EU AIFMs will be implemented from July 2015. Guernsey intends to ensure that our managers will be ideally placed to take advantage of being able to market AIFs on a pan-European basis with a single authorisation, as passporting is currently envisaged to operate.

Optionality

The attraction of Guernsey for fund managers wishing to market into Europe is that it can provide a European platform but one which is not actually in the EU and therefore can offer optionality and all-important cost saving opportunities for platforms.

For those marketing into Europe, we have already seen that the NPP route is being favoured by many – as it means little or no change to how things were done before AIFMD.

It is expected that full-blown AIFMD compliance will only be sought if there are particular commercial reasons to do so. For example, it makes commercial sense for a fund manager marketing almost exclusively to Europe to have a fully AIFMD compliant platform. However, this does not have to be based in a mainland European domicile and indeed, it could be a Guernsey platform given that there is a fully equivalent, opt-in AIFMD route to market in place.

Managers should review whether the pan-European marketing model is relevant to their investor base. Many managers have increasingly geographically diverse investors and, therefore, it is essential to have a platform which suits all. European directives – such as AIFMD but also the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive – cater for European investors; as such, if you don’t need UCITS/ AIFMD or only need limited access to them for certain investors, then it is advisable (and possible) to structure in a way that will greatly reduce the obligations and costs that come with those regimes.

For those managers with elements of EU and non-EU business, it will be possible to break the non-EU business away into a parallel or feeder structure for which AIFMD compliance would neither be required nor necessary. The potentially onerous administration burden and costly compliance with the AIFMD will mean that parallel structures are likely to be given serious consideration. Conversely, if a manager has a platform in a mainland European domicile then it will have to comply fully with the AIFMD even if there were a large proportion of non-EU investors. European mainland platforms do not offer the ability to separate the reporting obligations away from non-EU investors, as with a Guernsey platform.

Substance

One important factor is that AIFMs should ensure that they do not fall foul of the letter box entity provisions, i.e. sufficient substance is needed to demonstrate that the management entity is established outside the EU, if that’s what it is aiming to achieve for AIFMD purposes. Therefore, investment houses must ensure they have enough substance in the domicile of their fund if they opt for it to be self-managed, for example.

Guernsey has an advantage over a number of other third countries in this respect as there is already significant substance present in fund structures. For
example, large hedge fund managers such as BlueCrest and Man Group and private equity houses such as Apax, BC Partners, Mid Europa, and Permira have Guernsey-domiciled funds as well as offices and staff based here. Indeed, BlueCrest emphasised its commitment to Guernsey when it became the first firm to register a Limited Liability Partnership (LLP) in Guernsey on the same day that the Limited Liability Partnerships (Guernsey) Law, 2013, came into force on 13 May this year.

Administration providers range from major international names such as Northern Trust, State Street and Citco to specialist independent providers. There is also a significant pool of experienced non-executive directors across a broad cross-section of industries.

There are also a number of global custodians based in Guernsey and they are being supplemented by those specialist fund administration providers who are applying to establish Guernsey-based depositaries, particularly to service private equity and real estate funds which previously were not required to have a depositary, but who can take advantage of a depositary-lite regime for non-financial assets.

Indeed, Gentoo Depositary Services Limited was the first non-financial asset depositary to be licensed under the GFSC’s AIFMD Rules, 2013. Its launch at the end of April this year along with similar plans by other local administrators allows fund managers the ability to choose a depositary that is familiar with both the domestic regulatory regime and the private equity asset class in order to manage the additional regulatory pressures of AIFMD. Whilst it is possible to appoint an EU depositary for a non-EU AIF, the ability of local administrators to offer a Guernsey-based depositary will help support the geographic residence of Guernsey funds.

Guernsey has carved out a prominent place for providing access to international stock exchanges, particularly on the London Stock Exchange (LSE) where more Guernsey companies have had successful Initial Public Offerings (IPOs) of non-UK entities than from any other jurisdiction in the world; there are currently 125 Guernsey entities listed on the LSE with a combined market capitalisation of £34 billion.

This listings capability verifies Guernsey’s strong ethos of corporate governance, as the two largely go hand-in-hand as companies are subject to and adhere to the rules applicable to the various stock exchanges on which they list.

Industry growth

Guernsey’s funds industry itself has stood up admirably to the challenges posed by AIFMD and saw a notable increase in the number of new funds being approved for domiciling or servicing in the Island during 2013. There were a total of 103 additions during the course of the year, bringing the net asset value of funds under management and administration in Guernsey to £266 billion at the end of December.

The fund launches spanned a wide range of asset classes but some of the most notable occurred in the energy sector were that of Bluefield Solar Income Fund and The Renewables Infrastructure Group, with City sources quoting the latter as the largest IPO of a clean energy firm in London, with an initial raising of £300m in July 2013.

This focus on energy has continued into 2014 with the launch of NextEnergy Solar Fund Limited. The Guernsey closed-ended collective investment fund successfully raised £86 million for its listing on the premium segment of the main market of the LSE in March, while in April the John Laing Environmental Assets Group Limited raised proceeds of £160 million for its own placing and IPO on the LSE.

Other notable Guernsey fund launches in 2014 have included the likes of European private equity giant HitecVision’s launch of HitecVision VII L.P., a Guernsey closed-ended collective investment scheme. With a focus on control buyouts and growth capital investments in the oil and gas industry, the fund attracted commitments of US$1.9 billion for its February launch. X2 has also chosen Guernsey as the base for its new natural resources venture, X2 Resources Partners LP Inc. X2 Resources has raised US$2.5 billion of committed equity capital funding and up to a further US$1.25 billion of conditional equity capital funding for its Guernsey closed-ended investment vehicle.

There have been many other successful IPOs spanning infrastructure, real estate, aircraft leasing, shipping and distressed and mezzanine debt. These fund launches can certainly be seen as something of a vote of confidence in Guernsey’s approach to AIFMD as many have come after the implementation of the directive across Europe. While these remain early days in the evolution of AIFMD, the initial indications are positive, with Guernsey’s funds industry still busy domiciling, re-domiciling and servicing more new funds in 2014.

What is important going forward is that managers realise that an EU AIFMD compliant platform is not the only answer and that in particular, Guernsey offers a dual regulatory regime for the continued distribution of funds into both European and non-European countries.

The early introduction of our opt-in AIFMD equivalent regime from 2 January this year is testament to our thorough and pro-active approach. Guernsey’s optionality also means clients can be serviced in the manner most appropriate to their specific circumstances.
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- Capital Markets
- Commercial Property
- Corporate Finance
- Cross Border Insurance
- Debt & Investment Funds Listing
- Distressed Asset Investing
- General Commercial
- Insolvency & Corporate Recovery
- Investment Funds
- Litigation
- Regulatory Compliance
- Restructuring
- Securitisation
- Structured Finance
- Tax
Ireland
– Status of the AIFMD implementation

By Donnacha O’Connor, Dillon Eustace

The Irish AIFMD rules


The Central Bank of Ireland’s stated general policy with respect to ESMA measures is to apply them as is. On can assume that the Central Bank’s policy will therefore be at one with the following ESMA publications and any others unless in the unlikely case that there was a conflicting applicable legislative provision or generally unless the Central Bank were to indicate the contrary: ESMA’s Final Report: Guidelines on sound remuneration policies under the AIFMD, ESMA’s Final Report: Guidelines on Key Concepts of the AIFMD, ESMA’s Final Report: Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD and ESMA’s Opinion: Practical arrangements for the late transposition of the AIFMD.

ESMA’s Final Report: ESMA’s technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive also has some relevance in interpreting the legislative requirements.

The Central Bank will also generally adopt a policy consistent with the European Commission’s pronouncements on matters relating to AIFMD in the Commission’s Q&A on the application of the AIFMD.

The Central Bank’s “AIF Rulebook” (latest version: July, 2013, available on the Central Bank’s web-site) applies to Irish regulated AIFs (Retail and Qualifying Investor), AIFMs, AIF administrators, management companies and depositaries.

The Central Bank publishes many of its policy decisions in its own Q&A on AIFMD (available on its web-site).

The Central Bank also publishes a guidance referred to as “Guidance relating to AIFs and their service providers” which is available on Central Bank web-site.

The Irish AIFMD industry
Ireland, a member of the EU, eurozone and OECD, has a funds industry that supports approximately 915 promoters across both domiciled and non-domiciled funds.

With over 439 fund promoters from over 50 countries represented, Ireland is home to 5644* regulated investment funds of which approximately 2,265* are Alternative Investment Funds (i.e. non-UCITS). It is a major international fund domicile facilitating cross-border distribution of funds to approximately 70 countries across the globe.

The industry employs in excess of 12,500 people locally providing a range of services, including fund administration, transfer agency, custody, AIFM management company services, legal, tax and audit services.
Ireland’s approach to the Directive’s national discretions and options

Member States have very little discretion as to how to implement Directive 2011/61/EU, as it is mostly what is known as a maximum harmonisation Directive.

However, Article 60 of the Directive provides for a limited number of national options or derogations: these are: Article 6 (AIFMs may be allowed to provide individual portfolio management and other ancillary services to non-AIFs), Article 9 (up to 50% of an AIFM’s own funds may be covered by a guarantee), Article 21 (certain limited liquidity AIFs may appoint depositaries subject to mandatory professional registration as opposed to regulation), Article 22 (non-EU AIFs can subject their annual financial statements to an audit meeting international accounting standards as opposed to regulation), Article 36(2) (host Member States are not obliged to allow EU AIF to market non-EU AIF to investors in their territories and may impose stricter rules on EU AIFM marketing non-EU AIF than the minimum rules set out in Article 36(1)), Article 42(2) (host Member States are not obliged to permit non-EU AIF to market AIF to investors in their territories and may impose stricter rules on non-EU AIFM marketing AIF than the minimum rules set out in Article 42(1)), Article 43 (permitting AIFM to market AIFs to retail investors) and 61(5) (transitional provision for depositaries).

The Irish implementing legislation empowered the Central Bank of Ireland to avail of each of the above options and derogations with the exception of the option referred to in Article 28(2) which Ireland has not availed of in its implementation legislation. The Central Bank has availed of each of the derogations with the exception of Article 21 and Article 22 (to date the Central Bank has not created rules for this option and derogation respectively).

Marketing AIFs to Irish Professional Investors

Ireland has transposed Articles 32, 36 and 42 of Directive 2011/61/EU. The definition of “marketing” in the Irish regulations is taken from Directive 2011/61/EU and the Irish regulations do not address reverse solicitation, nor has the Central Bank. In public pronouncements on the matter, senior officials from the Central Bank have been quite negative about the appropriateness of reverse solicitation in an Irish context as a sales strategy though it is not prohibited.

EU AIFM may market shares of EU AIFs that they manage to Irish professional investors subject to the regulator to regulator notification procedure set out in Article 32. The AIFMs in these cases must comply with the requirements set out by their national competent authorities. The Central Bank does not charge a fee for processing such notifications. While the Central Bank would expect, as is required by Annex IV point (h) of the Directive, that information about the arrangements made for the marketing of AIFs and, where relevant, information on the arrangements established to prevent shares of the AIF from being marketed to retail investors would be included in the notification, the Central Bank does not impose any specific or additional requirements in that regard.

EU or non-EU AIFM are permitted to market non-EU AIFs to Irish professional investors on a private placement basis subject to advance notification to the Central Bank of Ireland. The notification is in standard form and the forms are available on the Central Bank’s web-site. The form must include the name of the AIFM and the AIF and the identity of the jurisdiction in which the AIFM is domiciled. In the case of an Irish AIFM, the AIFM must confirm the identity of the entity(ies) performing the depositary services referenced in Articles 36(1)(a) (i.e. those services set out in Article 21(7),(8) and (9)). There is no regulatory fee associated with such notification. The Central Bank of Ireland provided for a transitional application of Article 42 in relation to such marketing up to 21 July, 2014.

The notification form contains a confirmation from the AIFM that the information in the form is accurate and complete to the best of its knowledge and belief and a number of other confirmations from the AIFM including a confirmation that the AIFM understands that it is a criminal offence to knowingly or recklessly give the Central Bank of Ireland information that is false or misleading in any way and that the AIFM will notify the Central Bank in the event that the AIF(s) is/are no longer being marketed into Ireland by the AIFM.

As is the case with Article 36, the Irish legislation requires that EU AIFMs marketing non-EU AIFs to Irish investors must also observe the following pre-conditions: a) the AIFM complies with all the requirements established in the Directive 2011/61/EU with the exception of Article 21 provided that the AIFM must ensure that one or more entities are appointed to carry out the duties referred to in Article 21(7), (8) and (9) and the AIFM must not perform those functions. The AIFM must provide its supervisory authorities with information about the identity of those entities responsible for carrying out the duties referred to in Article 21(7), (8) and (9); b) appropriate cooperation arrangements for the purpose of systemic risk oversight and in line with international standards are in place between the competent
authorities of the home Member State of the AIFM and the supervisory authorities of the third country where the non-EU AIF is established in order to ensure an efficient exchange of information that allows the competent authorities of the home Member State of the AIFM to carry out their duties in accordance with the Directive;
c) the third country where the non-EU AIF is established is not listed as a Non-Cooperative Country and Territory by FATF.
As is the case with Article 42, the Irish legislation requires that non-EU AIFMs marketing non-EU AIFs to Irish investors must also observe conditions (b) and (c) above and the following condition instead of condition (a) above:

a) The non-EU AIFM complies with Article 22, 23 and 24 in respect of each AIF marketed by it and with Articles 26 to 30 where an AIF marketed by it falls within the scope of Article 26(1).
The Irish implementing legislation gives the Central Bank the power, where the Central Bank considers it necessary for the proper and orderly regulation and supervision of alternative investment fund managers, to impose additional conditions or requirements on an AIFM that markets one or more AIFs to professional investors in Ireland.

Marketing AIFs to Irish retail investors
As regards marketing to retail investors, the Irish regulations permit AIFM to market AIFs to retail investors and empowers the Central Bank to impose stricter requirements on the AIFM or the AIF than the requirements applicable to AIFs marketed to professional investors, provided that the Central Bank may not impose stricter or additional requirements on EU AIF established in another Member State. The Central Bank’s “AIF Rulebook” dated July, 2013 provides that the AIF must be specifically approved by the Central Bank to market its shares in Ireland to retail investors and must include the following statement, in a prominent position, in each copy of its prospectus and in any marketing material distributed in Ireland for the purposes of promoting the AIF to retail investors:

- “While this AIF has been approved to market its units to the public in Ireland by the Central Bank, the scheme is not supervised or authorised in Ireland. It is incorporated/established in ________ and is supervised by ________."

Furthermore, the AIF must include the following information for Irish shareholders in its prospectus:

a) details of the facilities agent and the facilities maintained;
b) provisions of Irish tax laws, if applicable; and
c) details of the places where issue and repurchase prices can be obtained or are published.
Where the AIF is constituted as an umbrella fund, it can only market sub-funds for which it has received specific approval from the Central Bank.

The AIF, in marketing its units in Ireland to retail investors, must comply with the Irish Consumer Protection Code of the Central Bank.

Finally, the AIF must submit to the Central Bank a copy of its annual and half-yearly reports, as soon as they are available.

*Source: Central Bank of Ireland, April 2014; includes sub-funds.
Chevalier & Sciales is recommended and listed in the area of investment funds in the annual Guide to the World’s Leading Investment Fund Lawyers and in the Practical Law Company directory.
Luxembourg – prepares for central role as AIFMD finally takes effect

By Olivier Sciales, Chevalier & Sciales

As, after more than four years of preparation, the European Union’s Alternative Investment Fund Managers Directive takes full effect for existing managers, Luxembourg finds itself in the position it wanted to be in – ideally placed to become a domicile and servicing platform for alternative funds distributed across borders in the same way that it has become for traditional retail funds under the UCITS regime.

Luxembourg has long been an established jurisdiction for alternative investments, starting with funds governed by Part II (dealing with non-UCITS vehicles) of the country’s fund legislation. Already a location favoured by the private equity industry for transaction and intermediary structures, usually in the form of financial participation companies (Soparfis), it created a dedicated vehicle aimed at private equity, venture capital and real estate investment in 2004 with the launch of the risk capital investment company (SICAR).

The alternative fund sector gained significant traction in February 2007 with the launch of the Specialised Investment Fund (SIF), a light-touch regulated regime aimed at hedge funds, private equity, real estate and other types of non-traditional investments. Since then the number of SIFs authorised by the Financial Sector Supervisory Authority has grown to 1,558, with aggregate assets of EUR331.5bn (out of a total of EUR2.71trn for all Luxembourg funds).

According to the Association of the Luxembourg Fund Industry (ALFI), hedge fund assets administered in the grand duchy, including both local funds and those domiciled elsewhere, totalled EUR128.8bn at the end of 2012, including 347 Luxembourg hedge funds or sub-funds and 649 fund of hedge fund portfolios.

Alternative UCITS hub

Also at the end of 2012, Luxembourg was home to 273 SICARs with assets of EUR25.5bn (as well as to more than 25,000 Soparfis). In September 2013, there were 244 real estate funds and sub-funds with assets of EUR30.1bn, an increase of 26 funds and EUR4.2bn (16%) from the end of the previous year. These statistics cover only vehicles regulated by the CSSF; including unregulated real estate vehicles would increase the numbers substantially.

In addition, the grand duchy has emerged as the leading centre for the domicile, servicing and marketing of so-called alternative UCITS that typically follow hedge fund strategies while remaining within the constraints of the EU retail fund regime. As of mid-2013, around 60% of all alternative UCITS funds were established in Luxembourg, almost double the level in the next largest domicile, Ireland, according to Preqin.

This means that at the dawn of the AIFMD era, Luxembourg is already a jurisdiction with substantial alternative fund business. However, all the indications suggest that its role in the sector is poised to expand significantly in the coming months and years, in part because of the expertise on hand in deal with regulated alternative vehicles, and the fact that many of the fund houses entering the AIFMD space already have UCITS operations in the grand duchy.

An additional boost is likely to come from the initiatives taken by the authorities to enhance the jurisdiction’s attractiveness to alternative fund managers and promoters. This includes notably an enhanced and expanded limited partnership regime introduced as part of the country’s AIFMD implementation law, offering structures with the same characteristics and benefits as
those found in Anglo-Saxon common law jurisdictions such as England, Scotland and the Channel Islands, the Cayman Islands or the US state of Delaware.

As well as upgrading and modernising the existing common limited partnership (société en commandite simple), the July 12, 2013 law established the special limited partnership (société en commandite spécial, or SCSp), a structure without legal personality. The SCSp offers complete tax transparency and neutrality, contractual freedom in areas such as the allocation of voting rights and economic benefits, and flexibility regarding regulation, structuring and provision of information. Limited partners no longer have to be identified publicly, and they may become involved in internal management roles without risking loss of limited liability.

**Early adopters**

The SCSp can be either a regulated fund structure, usually a SICAR or SIF, or an unregulated vehicle such as an SPV that may lie outside the direct scope of the AIFMD, depending on the requirements of the limited partners, the fund’s investment policy and considerations relating to the jurisdictions in which investments are made. Already Luxembourg limited partnerships are being used by early adopters for SICARs, and considered for complex structures such as carried interest or management investment vehicles.

The grand duchy’s advantageous position is reflected in the level of demand for authorisation as an alternative investment fund manager in Luxembourg, which has surpassed the expectations of both the regulator and industry members. Even though some managers of alternative Luxembourg funds may have sought AIFMD authorisation in their home countries, such as the UK and France, the CSSF nevertheless reports having received no fewer than 203 applications as of the beginning of June, at least 50 more than were forecast just a couple of months earlier.

Of the applications received, 76 had been approved, although some of these are not yet on the official list of authorised AIFMs. This comprised 47 fully authorised managers as of June 6, plus a further five licensed to provide ancillary services. The approvals include at least 35 so-called Super ManCos that are authorised to manage both UCITS and AIFMD funds.

The progress being made by the regulator in dealing with this exceptional number of applications has eased the fears of industry members that bottlenecks might arise; the CSSF has taken on more employees and called on staff to work longer hours to deal with the workload. Media comment earlier this year about the relative lack of Luxembourg-authorised AIFMs has now been demonstrated to be unfounded.

The regulator has been providing guidance to the industry in Luxembourg on various aspects of AIFMD implementation through a Frequently Asked Questions document, now in its sixth updated edition since June last year, on the grand duchy’s law of July 12, 2013 implementing the directive as well as the European Commission’s Level 2 regulation on implementation of the AIFMD.

**Reporting timetable**

The FAQ document highlights key aspects of the AIFMD rules from a Luxembourg perspective and for the purposes of alternative funds and managers established in the grand duchy. They cover the scope of the law, the authorisation and registration (for managers below the assets under management thresholds) regimes, delegation requirements, entry into force of the law and transitional provisions, the scope of authorised managers’ activities, depositary rules, the application of the AIFMD passport to Luxembourg managers and funds and to foreign managers marketing in Luxembourg, reporting, valuation, transaction costs, and co-operation agreements signed by the CSSF with non-EU regulators.

The most recent update, posted on March 17, includes details of reporting requirements for Luxembourg managers. The frequency and nature of the reporting requirements depend on managers’ levels of assets under management, investment strategies and use (if any) of leverage, as set out in the directive and in the corresponding sections of the Luxembourg legislation.

AIFMs authorised after the entry into force of the directive last July 22, but before June 30 this year, must submit their first reporting statement, for the period starting July 1, by the end of October for those subject to quarterly reporting, or by the end of January 2015 for those reporting half-yearly and annually. AIFMs authorised between July 1 and 22 must submit their first reporting, for the period from October 1 to December 31, by January 31, 2015. The deadlines for funds of funds are 15 days later, to allow the gathering of data reported by underlying funds.

Managers of funds with assets below the authorisation threshold that received confirmation of registration in 2013 must report for 2014 by January 31, 2015, or February 15 for funds of funds. Those registered in 2014 must begin reporting as of the quarter following registration for a period up to the end of the calendar year (2015 for managers registered in the fourth quarter), and file their report by the end of the following January, or February 15 for funds of funds.

The latest FAQ guidance also covers the sole language for all AIFMD reporting (English) and authorised reporting channels (e-file and SOFIE). The regulator says an annual report in conformity with article 20(2) of the
2013 law must be made available for all funds whose managers were authorised before the end of the fund’s financial year, including managers authorised during 2013 for the 2013 financial year.

**Requirements for non-EU managers**

Annual reports must include a balance sheet or a statement of assets and liabilities, and an income and expenditure account for the financial year. Managers must comply with the requirements under scheme B of Luxembourg’s 2010 funds law for part II funds, in the appendix to the 2007 SIF law where applicable, and article 104 of the AIFMD Level II regulation.

The reporting requirements also apply to non-EU managers managing Luxembourg-domiciled alternative funds (irrespective of where the funds are marketed, even if exclusively outside the EU) or marketing either EU or non-EU funds in Luxembourg, during the transitional period before the marketing passport is made available to non-EU managers and funds, which will become possible (but is not guaranteed) from July 2015.

The CSSF says non-EU managers should in principle take the date of CSSF approval for marketing in Luxembourg as the start date for AIFMD reporting requirements, with the same reporting frequency and reporting periods as those applicable to Luxembourg managers, with the exception of non-Luxembourg funds that were marketed in the grand duchy by non-EU managers under Luxembourg’s private placement rules before July 22 last year.

Previous editions of the FAQs have covered issues including the definition of an alternative investment fund under the directive, which brings with it the requirement to appoint an AIFM, noting that the manager of any collective investment vehicle must make an assessment of whether the vehicles falls within scope, and the fact that the definition covers both regulated and unregulated entities. For Luxembourg purposes, they include all Part II funds, SIFs, SICARs and any other relevant vehicle not regulated under the UCITS rules.

**Feedback on AIFMD functioning**

The CSSF has clarified that credit institutions, financial sector professional entities established under Luxembourg’s 1993 financial sector legislation and investment firms cannot obtain authorisation as an AIFM, although banks and investment firms can manage alternative fund assets under a delegation arrangement with an authorised AIFM. The regulator also says its circular 12/546, which sets out the delegation rules for UCITS management companies, should be used by Luxembourg AIFMs in determining that they are not considered a letterbox company under the AIFMD implementation law.

One the July 22 deadline is past, the CSSF is expected to have more time to devote to aspects such as providing assurances on whether certain types of vehicle or structure are within AIFMD scope. However, the regulator will also have to start providing feedback fairly rapidly to the European Securities and Markets Authority on the functioning of the AIFMD, including both passporting arrangements and the continuing use of private placement distribution by non-EU managers and funds.

The information to be provided to ESMA, on four or less quarterly occasions up to the end of January 2015, will cover use of the passport, any misconduct issues, co-operation with other regulators and systemic risk. On the responses will hang ESMA’s advice to the European Commission on the planned extension of full AIFMD authorisation and passporting privileges for managers and funds outside the EU, which would eventually be followed by the complete abolition of private placement arrangements for alternative funds.

For the moment, non-EU managers may consider establishing an AIFMD management company in Luxembourg in order to target the EU market, especially given the greater restrictions placed on national private placement regimes in many countries over the past two years. The number of applications for AIFMD authorisation suggests some of them may already be doing so. But extension of the passport to non-EU managers could equally boost the role of Luxembourg as a fund servicing centre, given the growing share of business coming from outside funds and managers.

Up-to-date information about the implementation of the AIFM Directive in Luxembourg as well as related regulatory measures, guidance and consultations issued by ESMA and the European Commission is published regularly in the AIFMD blog on the firm’s web site at www.cs-avocats.lu/aifm-directive/.
Exceptional Growth for Malta’s Fund Industry

The number of funds increased from 200 in 2006 to 609 in June 2013.

This success was made possible by Malta’s highly favourable business environment. This includes the role played by the island’s Single Regulator, renowned throughout the industry for its flexibility coupled with meticulous attention to detail.

The island’s highly competitive, cost-effective business environment and the presence of all the Big Four accounting firms adds even further advantage.

An onshore EU jurisdiction allowing passporting and redomiciliation of funds, with an efficient fiscal regime, a balmy Mediterranean climate and a multilingual, ethical and professional workforce, Malta offers a winning combination of advantages specifically designed to foster further growth and maximise success.

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www.financemalta.org
Malta
– regulation of AIF managers

By Dr Christopher Buttigieg and Dr Isabelle Agius,
Malta Financial Services Authority

This paper attempts to summarise the legislative framework adopted in Malta for the implementation of the Alternative Investment Fund Managers Directive (‘AIFMD’).

Malta is considered a European domicile of choice for the establishment of investment funds and their services providers. The island’s achievement in this field came about primarily as a consequence of a highly developed regulatory framework applicable to investment funds and the Malta Financial Services Authority’s (‘MFSA’) approach to financial supervision characterised by a high degree of accessibility and robust supervision. Malta’s implementation of the AIFMD has developed and strengthened even further its regulatory and supervisory framework in the field of fund management.

The legislative framework for the regulation of investment services in Malta, including investment funds and their service providers, is the Investment Services Act, 1994 (‘the Act’). The Act, the legal notices issued by the Minister of Finance in terms of the Act, and the Investment Services Rules issued by the MFSA, set the national regulatory framework for the licensing and supervision of investment services. The Act and subsidiary legislation transpose inter alia the AIFMD. The regulatory framework is constantly under review in order to avoid the prospect of ossification and to remove rules that through the passage of time, and due to the development in financial markets, may not be adequate to attain the objectives of financial regulation.

The AIFMD focuses on the regulation of the manager. The regulatory framework in Malta regulates both the manager and the fund. Indeed, all types of funds established in Malta are subject to specific product regulation, the primary aim of which is that of protecting investors. The regulatory framework allows the establishment of different fund structures and the application of diverse portfolio management strategies. The supervision carried out by the Authority focuses on the investor and the integrity of the financial system. The intensity of supervision varies depending on the nature of the fund, the underlying investment strategies and the relevant target investor market.

The primary purpose of this paper is to examine Malta’s implementation of the AIFMD. The resulting position is that the changes brought about by the AIFMD have strengthened the regulatory framework in Malta. Given the investor demand for robust regulation, Malta is now better placed to grow as a jurisdiction of choice for international financial services.

For narrative ease the paper has been divided into two additional sections as follows: Section 1 examines the legislative framework for the implementation of the Directive in Malta; and Section 2 covers those areas of regulation which are particular to Malta and which add value to the positioning of Malta as a jurisdiction of choice for international financial services.

1. Malta’s legislative framework
In Malta the transposition of the AIFMD required amendments to the Investment Services Act, 1994 (‘the Act’). By way of background, the Act regulates the activity of investment firms, fund managers, collective investment schemes, custodians and fund administrators. The amendments to the Act, which implement the AIFMD, provided for the licensing of an AIFM and alternative investment funds [‘AIF’]. The first schedule to the Act was also amended to include ‘collective portfolio management of assets’ as an integral part of the service of management of investments.
The Act is supplemented by the following legal notices adopted by the Minister of Finance in terms of the Act:

- Investment Services Act (Alternative Investment Fund Manager) Regulations, which enhance the MFSA’s powers qua competent authority for the purpose of the AIFMD;
- Investment Services Act (Alternative Investment Fund Manager) (Passport) Regulations, which apply to AIFM exercising passporting rights in terms of the AIFMD;
- Investment Services Act (Marketing of Alternative Investment Funds) Regulations, which regulate the cross-border marketing of AIFs; and
- Investment Services Act (Alternative Investment Fund Manager Third Country) Regulations (“Third Country Regulations”), which implement the third country provisions, including the framework applicable to the national private placement regime and the choice of the Member State of reference by third country AIFMs.

In addition to the Act and the legal notices, changes were also carried out to the MFSA’s Investment Services Rules. In terms of the Act, the MFSA, which is Malta’s single regulator and supervisor for financial services, has the power to issue Investment Services Rules stipulating requirements and conditions in relation to activities of licensed entities, the conduct of their business, their relations with customers, the public and other parties, their responsibilities to the MFSA and any other matters as the Authority may consider appropriate. The MFSA has issued (and/or amended, as the case may be) a number of Investment Services Rulebooks that generally aim at supplementing the high-level regulatory principles set in the Act and which transpose various pieces of EU regulation such as the AIFMD, the Markets in Financial Instruments Directive (‘MiFID’), the UCITS Directive and the Capital Requirements Directive.

The Investment Services Rules for Investment Services Providers ['ISP Rulebook'] which regulates the activity of investor firms, fund managers and custodians (‘depositaries’), were amended to implement the governance, compliance, capital, risk management, conduct of business and transparency requirements applicable to AIFM. In addition, as part of the AIFMD project, the Authority decided to restructure the ISP Rulebook, the on-going obligations of which applied to investment services providers in general, into four parts which apply depending on the specific type of activity undertaken by the licensed entity, these being: [i] MiFID investment firms; [ii] UCITS managers; [iii] AIFM; and [iv] depositaries.

The following diagram provides an outline of the current structure of the MFSA’s Investment Services Rulebook.
2. Malta’s Approach to AIFMD Regulation

This section examines those areas of regulation which are particular to Malta and add value to the positioning of Malta as a jurisdiction of choice for international financial services, specifically the: [i] licensing framework for de minimis fund managers; [ii] implementation of the requirements on remuneration; [iii] transitional depositary passport and depositary-lite framework; and [iv] implementation of rulebooks applicable to AIFs.

2.1 De minimis Fund Managers

The part of the Investment Services Rulebook that applies to AIFMs contains specific regulation applicable to de minimis AIFMs. Malta decided to regulate de minimis AIFMs with a stricter regime than what is prescribed in the AIFMD for this type of manager. Policy makers in Malta were of the view that a licensing regime is preferable than mere registration as it is in the best interest of investor protection and financial integrity that all fund managers are subject to a robust but proportionate regulatory framework. Moreover, it was deemed important that fund managers, irrespective of the size and complexity of their operations, should be subject to Malta’s anti-money laundering deterrence framework. Therefore, de minimis AIFMs are subject to regulation, authorisation and supervision in Malta.

To allow the MFSA to be in a position to re-assess and re-authorise as AIFM or de minimis AIFM those fund managers already licensed by the MFSA prior to the coming into effect of the AIFMD in July 2013, the ISP Rulebook contains two self-assessment questionnaires which must be completed by applicants. These self-assessment questionnaires should allow the MFSA to assess existing fund managers’ preparedness to comply with the AIFMD and are presently being submitted for the Authority’s assessment.

2.2 Implementation of the Requirements on Remuneration

The MFSA has also implemented the ESMA Guidelines on sound remuneration policies under the AIFMD [ESMA/2013/232] with the exception of paragraph 18 of the guidelines. This paragraph stipulates that the delegate of an AIFM, who has been delegated investment management activities, must be subject to regulatory remuneration requirements which are equally as effective as those applicable under the Guidelines and that appropriate contractual arrangements must be in place to ensure that there is no circumvention of the remuneration rules. ESMA has therefore extended the remuneration provisions in the Directive with the intent that entities to which AIFMs delegate investment management activities are also subject to the guidelines. The recitals of the UCITS V Directive are demanding ESMA to take a similar position with regard to delegation structures in the context of UCITS.

The adoption and implementation of requirements on remuneration is fundamental in order to address the possible detrimental effect of poorly designed remuneration arrangements on the sound management of risks. It is a mechanism which seeks to control the risk-taking behaviour by individuals. However, as a result of the uneven approach to the regulation of remuneration between Europe on the one hand and the rest of the world, the ESMA guideline that is applicable in the event of delegation may cause serious difficulties in the setting up of delegation structures where the delegate is established outside the EU.

To address the concerns that delegation structures may be applied in order to circumvent the European requirements on remuneration, while at the same time allowing delegation structures between EU and non-EU fund managers to continue existing without restrictions, instead of implementing paragraph 18 of the ESMA Guidelines, the MFSA is applying a supervisory procedure for monitoring the effective implementation of remuneration requirements by local fund managers. This monitoring process aims at keeping management companies on their toes and reminding them that they may not use the delegation provisions to circumvent their responsibilities under the AIFMD, including their responsibilities under the remuneration rules. This procedure should achieve the same outcome, however without disrupting the existing delegation structures.

2.3 Transitional depositary passport and depositary-lite

Malta exercised the optional transitional provision that allows an AIF to engage a depository in another Member State. The implementation of AIFMD was an important step for the strengthening of investor confidence in the alternative investment fund industry. In this regard, the requirement to appoint a depository to safe keep the assets of the fund and to monitor the fund manager is an important investor protection requirement. Nonetheless, the requirement that the depository should be established in the same Member State as the fund goes beyond what is necessary to achieve the investor protection objective of regulation. The restriction on the place of establishment of the depository limits the jurisdictional options for promoters of investor funds, restricts the choice of depositaries and lessens the competition within the depository industry. The restriction goes against the internal market objectives set in the Treaty of the European Union (TFEU) and the Directive.

EU harmonisation is implemented to allow the internal market to operate on the basis of single rulebook or mutual recognition. However, while as a result of AIFMD and the UCITS V Directive there is
significant harmonisation of the conduct of business of depositary services, a depositary passport has not been implemented. This illogical position is the unfortunate outcome of European processes that are largely driven by national protectionist agenda, which are prevailing over and creating barriers to the operation of the European Internal Market project. In the EU, harmonisation is not implemented for harmonisation’s sake, but for the purpose of the Internal Market. On this basis one would expect that, sooner rather than later, the jurisdictional restriction on depositaries will be challenged at the level of the European Courts.

The transitional provision on the establishment of depositaries expires in 2017. To guarantee a wider range of depositaries established in Malta, the Authority developed a specific regulatory framework for entities that provide restricted depositary services. The AIFMD contemplates the provision of services by a depositary-lite in the case of third country funds which are marketed in the EU and EU AIFs that have no redemption rights exercisable during a period of five years from the date of the initial investment and which, in accordance with their core investment policy, generally do not invest in assets that must be held in custody. Malta’s framework for depositary-lite operators allows licensed entities such as recognised fund administrators and investment firms that are subject to an initial capital requirement of EUR125,000 to apply for an authorisation to provide restricted depositary services. This is an area which is experiencing significant interest and should facilitate the process for private equity and venture capital type funds to be established in Malta.

2.4 MFSA Rulebook applicable to AIFs

During the process that led to the implementation of the AIFMD in Malta, the MFSA decided to adopt the Investment Services Rules for Alternative Investment Funds [‘AIF Rulebook’], a rule book for the establishment of AIFMD ready funds. While the MFSA opted to retain the existing regulatory framework applicable to professional investor funds, it decided to reinforce the framework for the regulation of the funds sector by establishing a rulebook which regulates self-managed funds, which in terms of the AIFMD qualify as the AIFM, and third party managed funds that are targeted for distribution as AIFs across Europe. Apart from stipulating an exhaustive list of service providers which the AIF is required to appoint, the AIF rulebook also sets requirements on the governance and transparency of the fund.

Conclusion

This paper has examined how Malta has approached the implementation of the AIFMD from a regulatory perspective. Experience in financial regulation and supervision however suggests that regulation on its own is not enough to ensure that the systemic stability objectives of financial regulation are realised. It is clear that without supervision and enforcement the industry may be inclined not to comply with regulation, which in turn may result in the failures of the past to be repeated in the future. Ultimately, the financial crisis did not only result from inter alia a failure to regulate the shadow financial system but also from a failure to carry out effective supervision. Therefore, robust supervision is equally important for the attainment of the objectives of regulation. The MFSA is fully committed towards maintaining high standards of supervision.

The authors would like to thank Professor Joseph Bannister, Chairman of the MFSA and Joseph Agius, Deputy Director Securities and Markets Unit of the MFSA, for their comments and suggestions on the paper. The views expressed in the paper are solely those of the authors at the time of writing and do not engage the MFSA.