

EU Alternative Investment Fund Managers Directive: What Does it Mean for U.S. Private Fund Managers?

PENpoints

The newly approved Alternative Investment Fund Managers Directive will establish a new EU regulatory regime for all alternative investment fund managers, including private equity and hedge fund managers. The majority of rules are expected to come into effect in January 2013.

Yesterday, the European Parliament voted to approve the Alternative Investment Fund Managers Directive (“AIFMD”). The AIFMD establishes a new EU regulatory regime for all alternative investment fund managers, including private equity and hedge fund managers.

The AIFMD applies to:

- EU-based fund managers;
- Firms that manage EU-based fund vehicles; and
- Firms that market fund interests to EU-domiciled investors.

The new regime will be implemented in stages. The majority of rules are expected to become effective in January 2013. However, implementation of some rules relating to non-EU funds and fund managers will be deferred until 2015 or later.

The key question for many U.S. private fund managers is whether the new rules will affect their ability to market fund interests to EU-based investors. In general, it should still be possible to fundraise within the EU, but managers who do so will have to comply with a number of additional regulatory requirements beginning January 2013.

In the longer term (no earlier than 2018), it may become necessary for U.S. private fund managers to register with, and be regulated by, an EU financial services regulator in order to continue marketing to EU-based investors. However, this is not yet certain.

In some cases, U.S. private fund managers may also be subject to additional requirements when making investments in the EU.

The long-term view

The long-term EU regulatory goal is that all firms within the AIFMD’s scope (including non-EU private fund managers of EU funds or who market to EU-based investors) will be authorized (i.e., licensed) and regulated by the financial services regulator in the appropriate EU country.

Once authorized, managers will benefit from a “passport,” entitling them to provide fund management services, and to market fund interests, in every EU country without needing separate regulatory authorization in each EU jurisdiction.

For EU-based sponsors managing EU-based funds, this system will take effect as soon as the AIFMD is implemented (expected to be in January 2013). Once authorized, firms will be required to comply with the detailed AIFMD rules and regulations.

However, allowing passport rights for non-EU funds and non-EU fund managers has been politically controversial and almost derailed the negotiations in October. As a political compromise, the authorization and passporting regime for non-EU funds and fund managers will not be implemented until at least 2015. In the meantime, transitional provisions will apply from January 2013.

EU rules from January 2013

Beginning January 2013 and pending implementation of the passport in early 2015, non-EU fund managers

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will be permitted to actively market a fund within the EU only if regulatory cooperation agreements are in place between all relevant regulators (e.g., Securities and Exchange Commission for U.S. private fund managers) under which regulators agree to cooperate on monitoring and managing systemic risk. In addition, the fund jurisdiction must not have been designated by the Financial Action Task Force as a non-cooperative country or territory.

The non-EU private fund manager must then comply with the following provisions of the AIFMD:

- Transparency and disclosure: The private fund manager must prepare an annual fund report for investors in a prescribed format and disclose certain other prescribed information to investors, and will be subject to regulatory reporting requirements aimed at monitoring systemic risk.
- Portfolio Company Disclosures: The fund manager will also be required to comply with new rules to address a perceived lack of transparency in connection with the acquisition of EU companies. Where a private equity fund acquires or disposes of a substantial stake in an EU company, the private fund manager must formally notify the target company, the other shareholders and regulators. If the fund acquires a controlling stake, additional disclosures are required, including the manager's policies for managing conflicts of interest and internal and external communication. For non-listed companies, the private fund manager must also disclose, in broad terms, its intentions with regard to the future business of the company and the likely repercussions on employment. The fund manager has an obligation to ensure that company management passes on the disclosed information to employee representatives.
- "Asset-Stripping" Restrictions: In addition, to prevent alleged "asset-stripping" activities in connection with the acquisition of EU companies, the AIFMD includes provisions restricting certain shareholder distributions for a period of 24 months after acquisition of an EU company. It appears that these provisions are intended to prevent dividend recapitalizations during that period, but the drafting is not clear, so it is not yet certain how these rules will operate.

It appears likely that the above requirements will apply

only to funds marketed to EU investors under the new regime, but this is not yet wholly clear.

These new requirements apply in addition to EU individual country securities laws, which may impose more onerous rules, or even prohibit fundraising entirely, during this transitional period. It is not yet clear whether any EU country intends to make its private placement regime more restrictive, but France and Italy, for example, already have highly restrictive regimes, with fundraising in these jurisdictions likely continuing to be extremely difficult (if not impossible) until passporting rights take effect.

EU rules from early 2015

The AIFMD contains provisions that would allow non-EU private fund managers to become authorized and regulated on the same basis as EU-based firms, and consequently to benefit from pan-European passporting rights. However, these will not be implemented until at least 2015, and then only after a review and recommendation by the new European Securities and Markets Authority ("ESMA"), so implementation may be delayed, possibly indefinitely.

The compliance obligations for firms authorized under the AIFMD are onerous, so even once authorization is a possibility, U.S. private fund managers will need to balance the compliance costs arising out of voluntary authorization against the benefits of the right to fundraise in all jurisdictions using the passport. In many cases, it may be preferable to continue fundraising under the post-January 2013 transitional rules described above (i.e., fundraising subject to country-by-country private placement regimes plus the minimum AIFMD requirements described above). However, if national private placement rules were to become unduly restrictive, full authorization, with attendant passporting rights, would maximize access to EU-based investors for U.S. private fund managers.

EU rules from mid-2018

The AIFMD also contains provisions that would ultimately terminate national private placement regimes, leaving full authorization as the only option for non-EU firms who want to continue marketing fund interests to EU-based investors. However, this cannot happen before mid-2018, and will only take place following a further review and recommendation by ESMA.

Consequently, the transitional provisions described above will be effective for at least five years from 2013, and possibly much longer.

Passive marketing

Because the AIFMD applies only to active marketing, at least for the time being, EU investors will be able to invest in non-compliant non-EU funds at their own initiative, provided there is no solicitation by the

private fund manager. It is not yet clear how viable this approach will be in practice, or how willing EU-based investors will be to invest on this basis.

Next steps

The AIFMD provides for the European Commission and ESMA to issue extensive implementing measures and guidance, so the detail of the rules will not become clear for some time.

If you have any questions about the matters addressed in this *KirklandPEN*, please contact the following Kirkland authors or your regular Kirkland contact.

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PENnotes

The Practising Law Institute's Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations & Restructurings 2010**Chicago, Illinois
November 16 - 18, 2010**

This three-day PLI program will focus on the tax issues presented by the entire spectrum of modern major corporate transactions, from single-buyer acquisitions of a division or subsidiary to multi-party joint ventures, cross-border mergers, and complex acquisitions of public companies with domestic and foreign operations, including spin-offs and other dispositions of unwanted operations. Kirkland partner Jack S. Levin, P.C., will speak on "Structuring Leveraged Buyouts," partner Jeffrey T. Sheffield, P.C., will speak on "Current Issues in Divisive Strategies—Spin-Offs and Synthetic Spin-Offs" and partner Gregory W. Gallagher will be speaking on "Tax Strategies for Financially Troubled Businesses and Other Loss Companies." For more information, or to register, please visit: www.pli.edu.

**Infrastructure Investor and PEI Media's Infrastructure Investor: Chicago Conference
Chicago, Illinois
November 18 - 19, 2010**

The Infrastructure Investor conference, sponsored by Kirkland & Ellis, will focus on U.S. infrastructure needs, developments and investment opportunities. Kirkland partner Sean Patrick Maloney will moderate a panel titled "The Next Generation of Infrastructure Transactions: Lessons learned from the Evolution of Parking Deals" and Kirkland partner Mitchell F. Hertz, P.C., will moderate a panel on "Private to Private Transactions." For more information, please visit: www.peimedia.com.

The IBA International Private Equity Transactions Symposium 2010: The Global Private Equity Market**London, England
November 30, 2010**

At this IBA conference, panelists will discuss trends and macro issues in the global private equity market, including the state of European, U.S., Asian and Brazilian markets. There will also be a general counsels' forum. Kirkland partner Kirk A. Radke is a co-chair of this conference and partner David Patrick Eich will

participate in a panel discussion on the Asian market. For more information, or to register, please visit: www.int-bar.org/conferences/conf353/.

**The Practising Law Institute's Drafting and Negotiating Corporate Agreements 2011
New York, New York
January 5, 2011**

This PLI program will focus on fundamental drafting and negotiating principles common to all corporate agreements. Panelists will discuss key terms of standard transactional agreements; when and how to use letters of intent, confidentiality and standstill agreements; the wide range of M&A agreements, both public and private, and special agreements such as equity agreements and licenses. Kirkland partner Andres C. Mena will speak on "Credit/Indenture Agreements." For more information, or to register, please visit www.pli.edu.

**American Conference Institute's 18th Annual Private Equity Summit
New York, New York
February 24 - 25, 2011**

At the American Conference Institute's 18th Annual Private Equity Summit, Kirkland partner Eva Davis will participate on a panel titled "Exit Strategies: Identifying and Capitalizing on Opportunities that Generate The Greatest Investor Returns." The panel will discuss the stability of the market, increased portfolio company sale activity and exit strategies. For more information, please contact Susan Oliver at susan.oliver@kirkland.com or (213) 680-8220.

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Private Equity Practice at Kirkland & Ellis

Kirkland & Ellis LLP's nearly 400 private equity attorneys handle leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 200 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. The Firm was named "Law Firm of the Year" in *Buyouts* magazine's "2010 Deal of the Year Yearbook," and was also honored with the 2010 "Award for Excellence" in Investment Funds by Chambers & Partners at its annual Chambers USA Awards. Kirkland was ranked in the first tier among law firms for both Private Equity Buyouts and Private Equity Funds by *The Legal 500 U.S. 2010*. Additionally, *Pitchbook* named Kirkland as one of the most active law firms representing private equity firms in its 2009 "Private Equity Breakdown."

The Lawyer magazine recognized Kirkland as one of the "The Transatlantic Elite" in 2008, 2009 and 2010, noting that the firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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