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EU Alternative Investment Fund Managers Directive: The End of the Beginning

The Alternative Investment Fund Managers Directive, which was recently approved by the European Parliament after lengthy negotiations, is expected to become effective across the EU in January 2013.

After lengthy negotiations, the European Parliament approved the Alternative Investment Fund Managers Directive ('AIFMD') on 11 November 2010. Individual EU countries have two years to pass the necessary domestic implementing legislation, so the AIFMD is expected to become effective across the EU in January 2013. However, some provisions relating to non-EU funds and non-EU fund managers will be deferred until at least 2015.

The AIFMD defines an alternative investment fund ('AIF') as any collective investment undertaking that raises capital from a number of investors with a view to investing it in accordance with a defined investment policy (but excluding UCITS funds). Thus, a listed investment fund (such as an investment trust) can be an AIF, as well as a limited partnership, trust or contractual arrangement. Each AIF can have only one fund manager (the 'AIFM'), being the entity performing the functions of portfolio management and risk management in relation to the fund.

An EU-based AIFM will be required to apply for authorisation under the AIFMD within a year after the Directive takes effect (expected to be in January 2013). However, a non EU-based AIFM who markets fund interests to EU-based investors will not be eligible to apply for authorisation until at least early 2015, and authorisation will not be required until at least 2018. As a result, the immediate impact of the AIFMD for European private equity firms will differ significantly between firms using EU-based fund structures, where the fund manager will typically be an EU-based AIFM, and those using structures where the fund is managed offshore (for example, in the Channel Islands), where the AIFM will, in many cases, be a non-EU vehicle.

The AIFMD includes an exemption for smaller firms whose aggregate assets under management ('AUM') are less than €500 million for an unleveraged AIF with no redemption rights exercisable within five years of investment, or €100 million for all other AIF. AIFM with AUM below these thresholds are not required to obtain full AIFMD authorisation but still must register with their national regulator and are subject to some regulatory reporting requirements.

Once authorised, firms must comply with the AIFMD's extensive regulatory regime, which includes:

- a substantial regulatory capital requirement;
- detailed conduct of business rules (some of which will be familiar to FSA authorised firms);
- depositary and valuation requirements;
- transparency and disclosure requirements covering investor reporting, regulatory reporting and disclosure on the acquisition of an EU portfolio company;
- rules on remuneration; and
- so-called 'anti-asset stripping' rules restricting distributions from EU portfolio companies for 24 months after acquisition.

The primary advantage of authorisation is the 'passport,' entitling firms authorised under the AIFMD to provide fund management services and to market fund interests in every EU country without separate regulatory authorisation in each jurisdiction. Firms below the AUM threshold will not be eligible for this marketing passport unless they voluntarily seek authorisation under the AIFMD, but may continue to fundraise in accordance with national private placement regimes. Non-EU AIFM will also generally be able to continue marketing under national private placement regimes, at least until 2018, but those that do will be subject to the transparency and disclosure requirements and portfolio company-related provisions of the AIFMD (including the anti-asset stripping rules) in respect of funds raised from January 2013.

The detail of the new legislation will become clear only over time, as the European Commission proposes secondary implementing measures and national governments put forward the necessary domestic legislation. However, the basic shape of things to come is now settled.

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