

EU's AIFM Directive: *Approved*

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After 18 months of political turmoil and uncertainty, the European Parliament recently adopted the controversial Alternative Investment Fund Managers Directive. This article notes the outcome on certain key issues that proved among the most controversial. We also briefly consider the next steps in the process.

The Parliamentary Vote

At the end of October, the European Parliament announced that it had reached an agreement with the Council of the European Union on key aspects of the proposed Alternative Investment Fund Managers Directive (the "Directive"). The agreed text was voted on and passed by the Parliament at a plenary session held on November 11, 2010. Member states will have two years to implement it into national law following publication of the official text.

Resolution on Key Points

In the weeks leading up to last month's vote, there were a number of key changes to the Directive affecting alternative investment fund managers ("AIFM") and, in turn, the alternative investment funds ("AIF") they manage. The final agreement on certain key points is noted below.

Third Country Issues

The so called "third country" provisions dealing with management and marketing rights with respect to non-EU AIFM and non-EU AIF have been among the most controversial and changeable in the draft texts. Debate has centered on whether and to what extent non-EU AIF could be marketed in the EU (whether under a passport

or through private placements) and also the scope for non-EU AIFM to manage EU AIF.

The agreed text now provides for a staggered approach whereby a European passport for non-EU AIF and AIFM may be introduced approximately two years after the Directive comes into effect. Most crucially, however, individual Member States will be permitted (but not required) to retain in place their national private placement regimes for at least a period of three years following the introduction of the third country passport.

Some European jurisdictions flatly prohibit fixed-term employment arrangements except where a job is inherently temporary, such as seasonal work, a one-off project, or substituting for someone out on leave.

Private Placements: Non-EU AIFM

The private placement exemption will require an agreement to be in place between the relevant EU Member State and relevant third country regulatory authorities. The AIF's country of residence must not be listed as a non-cooperative country and territory by the Financial Action Task force on anti-money laundering and terrorist financing (FATF).

Accessing the private placement route will not require a non-EU AIFM to become authorized under the Directive. However, compliance with certain aspects of the Directive will be required (primarily reporting and disclosure requirements, as well as, in the case of certain private equity funds, the new restrictions on asset stripping).

Private Placements: EU AIFM

EU AIFMs may continue to use the private placement route for non-EU AIF they manage. As EU AIFM, they will be required to comply with the Directive in respect of such non-EU AIFMs, save for the requirement to appoint a depositary (however, one or more entities must be appointed to carry out depositary functions). Similar requirements for networks of agreements between relevant Member States and third country regulators and the absence of FATF blacklisting will also apply.

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Marketing Passport to Be Available to Non-EU AIFM As Well As EU-AIFM

Non-EU AIFM wishing to manage EU AIF or market any AIF they manage in the EU under a passport (as distinct from a private placement) will require authorization under the Directive in a “Member State of reference”, which will, in effect, require compliance with the full provisions of the Directive for the AIFM. However, this option will only be available if the recently created European Securities and Markets Authority (ESMA) gives a positive opinion and advice on the creation of the third country passport, which is proposed for two years after implementation of the Directive. This has the potential to become a new battleground for the debate over third country passports to be argued again.

A conflict of law provision is included which relaxes the requirement for Directive compliance where such compliance would be “incompatible” with the non-EU AIFM’s domestic law, provided the domestic law meets certain stringent equivalence requirements.

Depositories

The agreed text retains the requirement for AIF managed within the scope of the Directive to have a single depository. In particular, the text retains the onerous provisions for strict liability of the depository for the loss of custody assets in most circumstances. Even where the depository has delegated custody, it remains liable unless it can provide an objective reason for the delegation and puts in place an agreement under which it is possible for the AIF (or the AIFM on its behalf) to bring a claim against the delegate. There is a welcome (partial) relaxation of the rules on depositories for private equity funds.

Delegation

There must be objective reasons justifying delegation by AIFM of their functions and where the delegation relates to portfolio or risk management, the delegate must be authorized or registered for the purposes of asset management and subject to supervision. It is not necessary for the delegate to be authorized under the Directive (although this may often be the case) but where a delegation of portfolio or risk management is given to a third country undertaking, there is a requirement for cooperation agreements between the EU and third country regulators. Sub-delegation is also permitted provided, broadly speaking, that this would not circumvent the protections sought to be achieved through the delegation provisions of the Directive.

Asset Stripping

The agreed text now includes provisions requiring the AIFM to restrict distributions or reductions of capital in respect of unlisted companies acquired by AIF they manage (or to exercise voting rights to that end) for a period of two years from the acquisition.

Other Issues

The text also contains numerous other provisions which have remained more settled over recent negotiations and are beyond the scope of this article.

Next Steps

The legislative process is not yet complete. EU finance ministers need to formally approve the text on behalf of the Council. The text will then be translated into the official languages of the EU Member States and tidied up by jurists linguists, a process that is already underway but will likely take several more months to be completed, after which it will be published in the Official Journal of the European Union, which would then record the Directive as a legally binding act. This is likely to take place Q1 or Q2 of 2011. The deadline for transposition of the legislation in Member States will be two years from the publication in the Official Journal (now likely to be Q1 or Q2 of 2013).

A period of secondary rule making will follow over the course of 2011. ESMA will play a critical role in drawing up draft legislation in many areas of the Directive. Overall, ESMA has been granted over 72 different tasks and powers in 11 different areas (ranging from drawing up guidelines and recommendations, through to decision making and rule making powers). Not bad for an organization that does not yet have a functioning staff.

Work will also now commence on Level 2 and 3 measures, on which at least 20 separate consultations are expected. Overall, ESMA will become, alongside the national regulators such as the FSA (or its replacement in the UK in due course), the central actor in the AIFMD implementation process.

Conclusion

In some respects, the outcome is better than was feared in key areas such as the third country provisions and the preservation of private placements. Nonetheless, the impact will be significant and far reaching. The danger of counterproductive and unintended consequences for all sections of the industry looms large.

Although last month’s vote brings a welcome end to the first chapter in this saga, there is a great deal of analysis to be done before the full impact becomes clear. A number of points of detail will hinge on further regulations, secondary legislation and implementation measures upon which work is only now starting in earnest. The story is far from over. □