

Investment Management Alert

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Changes to Rules on the Private Placement of Investment Funds in Europe: Top Ten FAQs for U.S. Asset Managers in 2013

On July 22, 2013, the Alternative Investment Fund Managers Directive (“AIFMD”) is due to be implemented in every member state in the European Union. One of the most immediate areas where the AIFMD will have an impact on the activities of U.S. asset managers is through the changes that the AIFMD applies to private placement rules throughout the European Union.

In this alert, we answer some key questions that will help U.S. asset managers prepare for the changes in regulation, which are imminent.

Nothing is changing, right?

Unfortunately not. The AIFMD mandates that each European Union member state makes changes to its private placement rules, so that no alternative investment fund can be privately placed in their country, unless:

- certain mandatory disclosures are made to investors in the marketing documentation, prior to investment
- the fund in question produces an annual report that is compliant with the requirements of the AIFMD
- the manager of the relevant fund reports on a periodic basis to the regulator in each EU member state where the fund is marketed
- there are appropriate cooperation agreements in place between both the domicile where the manager of the fund is located and the domicile of the fund itself on the one hand, and the individual European Union member state in which marketing is proposed to be undertaken on the other.

These requirements mean that each EU member state ought to be making changes to their private placement rules to introduce these requirements with effect from July 22, 2013. In addition, some EU member states are also taking this as an opportunity to review their existing private placement regimes and introduce further restrictions on the marketing of alternative investment funds in their jurisdiction.

So the law will change in every EU member state on July 22, 2013?

Unfortunately, not all EU member states will implement the changes required by the AIFMD on time. A significant number of EU member states have already admitted that their implementation is behind schedule and that, therefore, changes to their private placement rules may not take effect until later in 2013. This means that any U.S. asset manager proposing to market alternative investment funds in the EU after July 22, 2013, will need to take advice on the current law in each EU member state on a jurisdiction-by-jurisdiction basis, before undertaking any marketing activity in any EU member state. It

should be noted, however, that the vast majority of EU member states where U.S. asset managers have traditionally engaged in fund raising activities have indicated their intention to implement the changes on time.

I don't need to worry about this because I can just rely on "reverse solicitation", can't I?

The AIFMD regulates "marketing" which has a specific definition in the AIFMD. The regulation of marketing is intended to be without prejudice to the rights of professional investors to "invest in alternative investment funds on [their] own initiative". It is generally accepted that this means that, where an investment in a fund is a result of "reverse solicitation", the marketing rules set out in the AIFMD will not be applicable.

However, the AIFMD itself does not define the circumstances in which an investment can be regarded as being at the initiative of the investor. It is left to each individual EU member state to make its own decision about what conduct does and does not fall within the scope of this "safe harbor". The Financial Conduct Authority in the United Kingdom is one of the few regulators to have issued any formal or informal guidance on this topic. The parameters that they are proposing in respect of this issue mean that, to all intents and purposes, it will be difficult to regard any investment in the fund as being at the initiative of the investor, where there has been some interactive communication between the investor and the manager regarding the investment in the fund.

Because of the lack of certainty around how one might qualify for this safe harbor, very few managers are intending to rely on reverse solicitation as the basis for their relationship with European investors after July 22, 2013.

I'm not going to be doing any marketing in Europe after July 22, so I don't need to do anything right now?

Generally speaking, this is correct. However, if you have an evergreen fund which remains open to further subscriptions, even if it is not being "actively" marketed, you may still need to make changes to your documentation to reflect the new rules in the EU.

The content of periodic communications with investors (eg monthly newsletters) may also need to be reviewed. Some content may be regarded as being intended to encourage investors to put more money into the fund, meaning that they might be regarded as marketing materials. Distribution of reports to recipients who are not already investors may also have consequences.

I don't need to do anything until July 2014, do I, because there is a transitional period for compliance?

The AIFMD does not contemplate any transitional period for compliance with the amended marketing rules, for either EU-managers or non-EU managers.

However, a number of EU member states have indicated that they intend to provide some form of transitional relief in respect of the impact of the changes to the marketing rules (for example, the U.K. intends to allow a transitional one year period for compliance with the new rules on marketing, subject to certain conditions, which were summarized in our recent client alert and can be found here). There is no uniformity in the approach to this issue across the EU. Unfortunately, therefore, any manager wishing to market in a particular EU member state after July 22 still needs to take advice on the rules in that jurisdiction and, to the extent that there is any transitional relief, what the conditions are that need to be satisfied in order for the manager to be eligible to take advantage of it.

I don't need to do anything about this, because my fund is closed, right?

Generally speaking, this is correct. However, if the fund is an evergreen fund, and the closure of the fund is not formal, then there are circumstances in which it would be advisable to review and update documentation in respect of the fund. Even if the fund is closed, there are also circumstances in which secondary transactions may be affected by the AIFMD-related rules, and this issue should be addressed before execution of any secondary transaction involving an EU investor.

Periodic communications with investors may also need to be reviewed (see above).

So I can just do a standard form wrapper, like we do for places such as Canada, can't I?

Unfortunately not. The disclosure requirements that the AIFMD imposes are very specific to each individual fund. The nature of disclosure is affected by a number of factors, including the investment strategy, the domicile of the fund, and various other matters that are specific to its commercial terms. This means that the disclosure requirements need to be dealt with on a fund-by-fund basis and it is not sufficient to append standard form regulatory disclosures to documentation to satisfy the disclosure requirements.

In addition, a number of EU member states are likely to require registration of the fund with the national regulator before it is eligible to be marketed there. In some cases, this registration process may include a qualitative review of disclosure documents by the relevant regulator and substantive comment on offering documents, requiring changes, before marketing can be undertaken in that jurisdiction.

What should I be doing now if I'm planning to market in the EU after July 22?

As a first step, all U.S. asset managers should be seeking to ascertain which EU member states there is likely to be viable marketing activity in after July 22. This will then allow the manager to prioritize and plan the process of obtaining advice on the requirements in respect of each relevant jurisdiction and dealing with filing and reporting obligations in those jurisdictions. Given the potential compliance costs involved, most U.S. asset managers are restricting EU marketing activities to those EU member states where there is a serious prospect of material assets being raised after July 22. Some managers are accelerating marketing campaigns, with a view to closing funds prior to July 22.

Those managers who are intending to market should also be initiating updates of their offering documents, so that the disclosure in the documents is consistent with the minimum standards required by the AIFMD. There are a number of different ways of addressing this requirement, the pros and cons of which can be discussed in detail before a decision is taken about how to structure documentation to deal with the compliance obligations.

In jurisdictions where there is the possibility of some transitional relief, there are likely to be requirements regarding the marketing activities undertaken before July 22, in order to be eligible for any transitional relief. Managers hoping to avail themselves of transitional relief should be taking steps now to obtain advice about these conditions to ensure that they are able to satisfy them.

There remains some uncertainty about the date on which reporting requirements will kick in for U.S. asset managers marketing in the EU. Most managers intending to undertake marketing in the EU after July 22 are, however, taking steps to familiarise themselves with the reporting requirements so that they can ascertain their impact on existing business processes.

There's no need to worry about compliance, is there, as no one is actually going to enforce these rules?

Although the rules are changing, there has been very little comment to suggest that marketing to institutional investors is an activity that is likely to be scrutinised more carefully by national regulators in the EU. In that sense, the risks of non-compliance from a regulatory perspective probably are not significantly affected by the implementation of the AIFMD.

However, in many EU member states, breach of the relevant regulation is likely to give an investor some sort of rescission right or claim against the manager for some form of punitive damages, if the investor suffers a loss by virtue of their investment in the fund. Given the potential costs that this exposes managers to in respect of breach of marketing rules, the expectation is that all market participants will be taking steps to ensure compliance with the requirements of the legislation.

So we update our documentation now and then we are done?

The AIFMD also regulates certain ongoing investor disclosures, which U.S. asset managers successful in raising money in the EU will need to comply with on an ongoing basis.

As the implementation process is ongoing in a number of EU member states, there are still a variety of areas where rules may be "tweaked" or additional requirements may be imposed by national regulators, as they go about the process of implementation. For that reason, monitoring of the requirement in each EU member state needs to be an ongoing process.

In addition, the AIFMD includes provisions for review of the operation of the private placement regimes and potential changes to the rules with effect from 2015.

Managers will also need to comply with the ongoing reporting requirements to regulators in these jurisdictions in which funds are being marketed. There are also obligations on which require certain information to be included in a fund's reports and accounts, and to ensure that the disclosures required by the AIFMD are kept up-to-date.

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