

# *Strategy, marketing and distribution*

## Focus on AIFMD

*A closer look at  
the impact  
AIFMD may  
have on  
managers'  
strategies,  
including how  
they market  
and distribute  
their funds*

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# Introduction

*On 19 December 2012 the European Commission finally published its adopted Level 2 Delegated Regulation (Level 2) for the Alternative Investment Fund Managers Directive (AIFMD or the Directive). Here we look at the impact AIFMD will have on fund managers' strategies, including how they market and distribute their funds.*

The text for AIFMD was adopted by the European Council and Parliament in May 2011, and came into force on 21 July 2011. EU Member States were given until 22 July 2013 to transpose AIFMD into their national law. AIFMD regulates AIFMs and, although not the target of the Directive, indirectly the alternative investment funds (AIFs) that are in scope. The scope is wide, capturing the managers (AIFMs) of nearly all collective investment vehicles that are not UCITS. Further, AIFMD captures not just EU AIFMs (whether they manage AIFs established inside or outside the EU) but also non-EU AIFMs that market AIFs in the EU.

AIFMD aims to provide greater investor protection, ensure investors receive regular and comprehensive information on the AIF they invest in and ensure regulators receive detailed information on AIFs and AIFMs to enable them to identify any potentially systemically significant trends or events that may impact market stability so they can take action. From AIFMs' perspective, the quid pro quo is a marketing benefit that will allow EU AIFM to market their AIFs across Europe, using a passport similar to that available to UCITS.

Whilst AIFMD provides the overriding regulatory framework within which AIFMs must act, the detailed requirements are set out in the Level 2 Delegated Regulation, adopted by the European Commission on 19 December 2012. Level 2 followed 18 months of debate and discussion, including provision of technical advice by the

European Securities and Markets Authority (ESMA) and includes rules on:

- The use of leverage
- Operational requirements (including the risk management function and delegation)
- The role of the depositary
- The contents and frequency of reports to regulators

This is one of seven updates which looks at the impact AIFMD will have on AIFMs' strategies, including how they market and distribute their AIFs.

Other updates in the Focus on AIFMD series:

1. Working with depositaries, prime brokers and other service providers
2. Transparency and reporting
3. Systems and controls
4. Governance structures
5. Valuations
6. Regulatory capital and leverage

Please see [www.pwc.co.uk/AIFMD](http://www.pwc.co.uk/AIFMD) for more information.

# Strategy

## (i) Key issues

When it comes to assessing the impact of AIFMD, and thereafter developing a strategy to address its effects and react most efficiently (and commercially) to its requirements, there are three principal issues managers need to address:

- Whether the AIFMs are established in the EU or outside the EU (and, having identified where the current AIFM is situated, to work out, whether, against marketing and other strategic issues, it is in the right place)
- Whether the AIFs are established in the EU or outside the EU
- Current and future marketing activities

As an initial step towards understanding how AIFMD will potentially impact an AIFM and its AIF(s), AIFMs should review their structures to map where their AIFMs, AIFs and investors are, as this will drive how the AIFMD rules apply to them and, as a result, what their choices could be when it comes to reacting to its requirements.

Likewise, how managers market has important implications for how the Directive applies to them, so this will also inform responses. We examine this more closely below.

## (ii) Who is the AIFM?

AIFMD regulates AIFMs rather than AIFs themselves. Every AIF within scope must have only one AIFM, which can be the AIF itself (an internally-managed AIF) if its legal nature permits and the governance arrangements of the AIF are structured to produce this result, e.g. some UK investment trust companies, Luxembourg SICAVs or Dublin established self-managed investment companies. If the AIFM is within the EU, it is responsible for ensuring compliance with AIFMD and in certain circumstances the EU Member State regulator can force the AIFM to resign if it fails to ensure compliance with the Directive. If the AIFM is not within the EU, the impact of the Directive on it will be less (see below) depending on where its AIFs are established and the extent to which accessing European investor capital is a priority.

The Directive defines AIFMs as any “legal persons whose regular business is managing one or more AIFs”. “Managing AIFs” is defined as “performing at least investment management functions for one or more AIFs” (the investment management functions being portfolio management and risk management). This is understood as meaning the AIFM is the entity which has responsibility for each function, and has sufficient substance to oversee both. The AIFM may delegate either function (or elements of either or both functions) to another entity, subject to stringent rules and express limitations in the case of delegation of portfolio management.

So the first step for any asset manager is to map out precisely which entities within its structures perform which functions and, in performing this analysis, to distinguish between performance of “day to day” functions and “decision making” and oversight functions, if these are not carried on in the same legal entity.

Performing this analysis of mapping out the functions of entities should help managers decide who the AIFM is of each of AIFs, and where this AIFM is located. In some situations there may be more than one firm that could be appointed AIFM; here managers have a choice to decide which one they want to bear the regulatory responsibility of being AIFM (if located within the EU). Performing this analysis may also reveal if managers have AIFMs potentially located outside the EU; again here managers have a choice of deciding whether they want this AIFM domiciled outside the EU, so currently outside most of its regulatory requirements, or inside the EU, where it will be subject to all of AIFMD from the start. Managers should always consider that AIFMD is only seeking to protect investors located inside the EU; therefore it is only focused at entities located in the EU or sold to investors in the EU. If managers analyse their structures and future strategy and decide that neither of these apply then they may remove themselves from AIFMD’s requirements.



## Strategy

If an AIFM delegates risk management and/or portfolio management, this requires great care, because where the AIFM delegates the performance of these functions to an extent that exceeds by a substantial margin the functions performed by the AIFM itself, this could result in the AIFM becoming a 'letter-box entity'. This means regulators would no longer view the AIFM as the 'true' AIFM, but potentially its delegate. This could change how the AIFMD applies to a structure therefore, if, for example, the delegate as the 'real' AIFM was outside the EU, or conversely, the notional AIFM is outside the EU, but delegates so much to an EU entity that EU regulators determine that it is the EU entity which is the AIFM, thus exposing potentially the whole structure to full Directive compliance.

In structures which have entities established in different jurisdictions, whether cross-border within the EU or cross-border between an EU jurisdiction and e.g. New York or Cayman, the functional analysis will be key to identifying where the AIFM is, and, more pertinently, whether it is in the jurisdiction which most optimally reflects the organisation's strategic objectives.

### **(iii) Third country rules**

Once a manager has determined where its AIFM is (or, if it has more than one in its structure, are) located (or may be located), the next step is to see whether, as a result, the structure will be affected by the "third country rules" which

materially impact the ability of managers (both within the EU and from non-EU jurisdictions) to market their funds into the EU. The Directive principally seeks to regulate the management and marketing in the EU of EU AIFs by EU AIFMs. It is not the intention of AIFMD to close the European market to 'third country' alternative investment funds, or non-EU AIFs, and their non-EU AIFMs. However, AIFMD introduces important rules on marketing and the power to delegate functions which non-EU AIFMs and providers of non-EU AIFs may find restrictive.

As we discussed above, the AIFMD provides that AIFMs may delegate portfolio and risk management functions not only to EU-based entities but also to third country entities. The Directive however imposes the requirement of effective cooperation between the relevant EU member states (Member States) and the third country authority where the non-EU AIFs, AIFMs, delegates or depositaries are located. ESMA is currently negotiating these cooperation agreements, on behalf of each EU Member State, with non-EU regulators. The first such agreement was reached with Switzerland in December 2012. However, ESMA has much work to do here still to ensure key third countries, such as the US and Cayman Islands, are still available for firms to delegate to or so that AIFs from these countries can be marketed into the EU after July 2013.

### **(iv) Accessing the EU market under AIFMD**

Not only are there conditions around appointing third country delegates, there are also material conditions limiting the ability of non-EU AIFMs and non-EU AIFs (even those managed by EU AIFMs) to access European markets. EU AIFs with EU AIFMs get access to a passport under AIFMD, allowing them more certainty of being able to market across the EU. However, non-EU AIFs, even those with EU AIFMs, must access the EU market through individual country private placement regimes. The AIFMs of these AIFs will still need to meet some of the AIFMD requirements and have access only through private placement regimes that may change will be different from country to country.

Given that access to the EU market comes with regulatory implications under AIFMD, firms need to strategically consider whether they are (or need to be) based in the EU and whether they need to actively market in the EU to raise capital in their funds. The benefits of raising capital in the EU should be weighed against the additional complex regulatory requirements that need to be met. Making this strategic decision is a key starting point ahead of considering the impacts of AIFMD on your business.

We look at these issues in more detail below.

# Marketing and distribution

AIFMD regulates active marketing to professional investors in the EU of both EU AIFs and non-EU AIFs managed by EU and non-EU AIFMs.

## In scope of the AIFMD marketing provisions

4 conditions:

- Marketing of AIF
- at the initiative of the managing AIFM
- to investors domiciled or with registered office in the EU (professional investors rather than retail investors)

## Out of scope of the AIFMD marketing provisions

- Passive marketing/reverse solicitation
- Marketing outside the EU
- Marketing to investors not domiciled or with no registered office in the EU

As noted above in the context of the operation of the third country rules, the Directive foresees two regimes in respect to marketing to run in parallel during a defined period of time; one for EU AIFs managed by EU AIFMs and one for AIFs managed by non-EU AIFMs and for non-EU AIFs managed by EU AIFMs. The operation of the timelines, though, is being complicated by the views taken by Member State regulators (particularly the UK's FSA/FCA) of the effect of transitional provisions in the Directive, which can be

construed as giving a one year grace period for compliance between July 2013 and July 2014 for managers already authorised to carry out AIF management prior to 22nd July 2013. Therefore there remains uncertainty of when EU AIFMs need to be authorised under the Directive if they want to raise new capital in AIFs after 22nd July 2013.

Therefore there remains uncertainty of when EU AIFMs need to be authorised under the Directive if they want to raise new capital in AIFs after 22 July 2013. We assume, based on the UK view, that AIFMs will be able to use existing routes to market between July 2013 and the date the AIFM becomes authorised as an AIFM, which can be no later than October 2014 (the application must be submitted by July 2014).

## (i) Different scenarios under AIFMD

Scenarios	Access to EU market	AIFMD requirements
EU AIFM EU AIF	Via EU passport from July 2013/2014	Full regime of the AIFMD
EU AIFM Non-EU AIF	Via private placement from 2013 to 2018	Full regime of the AIFMD, except certain aspects of depositary requirements (+ local registration)
	Can use EU passport from 2015 to 2018	Full regime of the AIFMD
Non-EU AIFM	Via private placement from 2013 to 2015	Transparency and controlling interest requirements (+ local registration)
EU AIF	Can use EU passport from 2015 to 2018	Full regime of the AIFMD
Non-EU AIFM	Via private placement from 2013 to 2018	Transparency and controlling interest requirements (+ local registration)
Non-EU AIF	Can use EU passport from 2015 to 2018	Full regime of the AIFMD

### EU AIFs managed by EU AIFMs

As from 2013, an EU AIFM, which is fully compliant with and authorised under the Directive, will benefit from an EU passport for each of its managed EU AIFs. This passport will allow the EU AIFM to market its EU AIFs to professional investors in any EU Member State.

### Non-EU AIFs managed by EU AIFMs

As from 2013, an EU AIFM, which is fully compliant with and authorised under the Directive, will need to ensure its non-EU AIFs are Directive compliant except for the depositary provisions. However, the managed non-EU AIFs will not have access to the EU passport until 2015. Access to EU professional investors will continue under the national private placement regimes, to the extent these are in place.

# Marketing and distribution

## *EU AIFs managed by non-EU AIFM*

As from 2013, the non-EU AIFMs will only be required to comply with limited number of provisions of the Directive including those applicable to third countries for the marketing via national private placement regimes.

As from 2015, in order to be able to continue to manage EU AIFs (whether or not marketed within the EU), the non-EU AIFM will be required to be fully compliant with the Directive including specific provisions for third country managers.

## *Non-EU AIFs managed by non-EU AIFMs*

As from 2013 and until 2018, the non-EU AIFMs will only be required to comply with limited number of provisions of the Directive including the third country rules applicable to marketing via national private placement regimes.

Three years after the introduction of the access to EU passport for Non EU AIFs, private placement regimes may be phased out from national regulations. The potential life expectancy of private placement regimes is possibly limited to five years following the entry into force of the AIFMD (i.e. July 2018).

## *(ii) The EU marketing passport*

The EU marketing passport is available for EU AIFMs from 2013. Once an EU AIFM is authorised under AIFMD (as above, by October 2014 at the absolute latest) they can only market EU AIFs under the AIFMD passport.

No private placement within the EU will be allowed. Additionally, AIFMD envisages extending the EU passport to non-EU AIFMs and non-EU AIFs. This would be on a voluntary basis from 2015 and, possibly, required for all non-EU AIFMs and non-EU AIFs accessing the European market from 2018. Using the EU marketing passport means complying, in full, with AIFMD.

Marketing through the passport brings the benefit of standard rules across the EU for marketing AIFs to professional investors. Below we set out the requirements that must be met before marketing can take place through the passport.

## *Notification file*

If the AIFM intends to market units or shares of AIFs in its home Member State, the AIFM will be required to submit a notification to the competent authorities of its HMS or MSR in respect of each AIF that it intends to market. That notification will comprise the documentation and information set out in Annex III of the AIFMD.

If an AIFM intends to market an AIF in a Member State other than its home Member State, the AIFM must submit a notification to the competent authorities of its HMS or MSR in respect of each AIF that it intends to market. That notification will comprise the documentation and information set out in Annex IV of the AIFMD.

Note that for non-EU AIFMs that may eventually use the EU passport (from 2015), their 'home Member State' will be their Member State of reference. This is chosen depending on a number of criteria, such as where the non-EU AIFM has operations or where it might be marketing.

## *Cross border notification – regulator to regulator*

Notification for cross border distribution within the EU is the responsibility of the home Member State: here AIFMD seems to have borrowed the regulator-to-regulator notification concept introduced for UCITS schemes under UCITS IV. The notification is made to the home Member State who then passes the application on, within agreed timelines, to the Member State(s) where the AIFM wishes to market its AIFs. The AIFM will not be required to notify the regulator of each EU country where he intends to market; his only points of contact will be the regulator of his home Member State.

## *Timescales*

When marketing in the AIFM's home Member State, the competent authorities will, no later than 20 working days after receipt of a complete notification file, inform the AIFM whether it may start marketing the AIF. If the AIFM is not deemed to be compliant with the Directive, the competent authorities of the AIFM will prevent the marketing of the AIF within the EU.

When marketing in other Member States than the home Member State of the AIFM, the competent authorities of the AIFM will need to transmit the complete notification file to the competent authorities of the Member States where the AIFM intends to market the AIF within 20 working days.

Upon transmission of the notification file, the competent authorities of the AIFM shall, without delay, notify the AIFM about the transmission. The AIFM may start marketing the AIF in the host Member States of the AIFM as of the date of that notification.

# Marketing and distribution

## *Subsequent changes to the initial notification*

In the event of a subsequent material change to any of the information required in the initial notification file, the AIFM will provide written notice of that change to its competent authorities, at least one month before implementing a planned change, or immediately after an unplanned change has occurred.

If pursuant to a planned change, the AIFM's management of the AIF or the AIFM would no longer comply with the Directive, the AIFM will be notified without undue delay by its competent authorities that the planned change cannot be implemented.

## *(iii) Marketing to retail investors*

The AIFMD marketing provisions are aimed toward professional investors (as defined in MiFID). Generally, EU fund managers establish a UCITS scheme if they wish to raise capital from retail investors. However, Member States across the EU have established their own fund regimes for non-UCITS funds that retail investors can access. Recognising this, the Directive allows individual Member States to allow AIFs to be distributed to retail investors. Similar to the private placement regime, this means a patchwork of regulation will be in place across Europe, with different Member States putting different rules in place for AIFs that can, and cannot market to retail investors.

However, AIFMD is clear that if Member States allow AIFs to be marketed to retail investors then they cannot impose stricter requirements on incoming funds than their own funds face.

## *(iv) The private placement regime*

The AIFMD does not modify existing private placement regimes. However EU Member States must ensure the following conditions are met if non-EU AIFs are to be marketed in their country through private placement:

- Appropriate cooperation agreements exist with the competent authorities of the non-EU AIFM and non-EU AIF.
- The third country where the non-EU AIFM or the non-EU AIF are domiciled is not listed as a Non-Cooperative Country and Territory by the Financial Action Task Force.
- The EU-AIFM (when applicable) fully complies with the Directive, except with certain aspects of the depositary requirements<sup>1</sup>.
- The non-EU AIFM (when applicable) complies with the transparency requirements of the Directive<sup>2</sup>, as well as with the controlling interests requirements regarding AIFs which acquire control of non-listed companies and issuers.<sup>3</sup>

It should be noted that these conditions are the minimum conditions that need to be met – EU Member States may impose stricter ones.

AIFMD provides conditions for the private placement regime to be abolished within Europe after 2018. If this happens, all AIFs accessing the EU market will need to be managed by an AIFM that fully complies with AIFMD – no matter where the AIFM is located.

Further, although AIFMD makes no changes to private placement regimes, we already see countries taking steps to change or abolish their private placement regime now, so all AIFs that access their market in future will have to do so under the AIFMD passport. Such countries taking this step include Germany and France.

Alternatively, other EU countries, like the UK, Ireland and Luxembourg have stated they will make no changes to their private placement regimes so that non-EU AIFs can continue to access their markets uninhibited. However, even where AIFs can still use private placement regimes, they will still need to meet some AIFMD requirements.

For managers with non-EU AIFs that want to access the EU market after July 2013, there needs to be attention paid to how the private placement regimes may change across Europe. Leaving these rules up to individual countries also means that a patchwork regime will continue to exist after 2013, meaning managers need to check the requirements in each Member State before marketing there to ensure they are able to raise new capital in that country or whether they need to meet additional requirements first.

1. One or more entities should be appointed to carry out the cash flow monitoring, assets safekeeping and transactions oversight duties – the so-called 'depositary lite' regime.
2. Annual report, disclosure to investors, reporting to competent authorities
3. Notification of major holdings and control of non-listed companies, disclosure in case of acquisition control, specific provisions regarding the annual report of AIFs exercising control of non-listed companies, asset stripping rules.



## Conclusion

One of the primary objectives – and clearly one of the benefits of AIFMD – is the creation of a single EU market for EU AIFs, which would allow EU AIFMs to passport their alternative fund products throughout the EU.

The treatment of non-EU AIFMs was one of the most controversial issues in the drafting of the AIFMD. The final text is intended to create a level playing field between EU and non-EU AIFMs. However, the regime permitting a non-EU AIFM to register under the AIFMD and enjoy the same EU market access as EU AIFM will not be available until 2015.

A number of key non-EU territories are preparing for the AIFMD. Countries such as the Cayman Islands or the Channel Islands, key domiciles for funds distributed in the EU, have a strong incentive to become “AIFMD compliant”. They will ensure the necessary cooperation agreements and ultimately the appropriate tax agreements are in place to allow AIFMs to continue to market such funds in Europe.

The confluence of these ‘third country’ dynamics, the rules generally around third country entities, the ability to alter who is identified potentially as the AIFM in any given structure and the marketing rules mean managers have some important strategic options to think about. Ultimately, the strategic choices for managers may come down to the following options:

- Appointment or creation of entities outside the EU to act as AIFMs
- Ceasing fundraising for existing AIFs
- Re-location of other functions to non-EU jurisdictions.

Of course, choices will also be driven by investors’ attitudes, for example, their appetite for the EU passport and for a regulated framework, the AIFM’s distribution strategy and the evolution of national private placement regimes.

## *How we can help you*

The AIFMD is a complex piece of legislation. It contains many technical requirements, some of which may require significant modifications to your current organisation.

PwC has a multi-disciplinary and multi-industry team of professionals in business strategy, operation and structuring, regulatory compliance, tax, and assurance services, all specialists in the authorisation space, and are ready to assist you identify and assess the many impacts of the Directive on your organisation and develop an integrated response to the AIFMD.

As part of the wider PwC network in Europe, you will have access to industry experts across relevant territories, who regularly work together when required, to provide a seamless line of service on a pan-European basis.

We will use our collaborative methodology to establish a framework for your AIFMD solution, tailored to your business requirements, by helping you with:

- completing impact assessments and gap analysis;
- assisting you in assessing and identifying potential opportunities;
- defining your target business model;
- setting objectives and planning;
- designing and constructing solutions;
- implementing agreed actions; and
- ensuring effective operation, validation and ongoing review.

By working with you through the AIFMD analysis, we can assist you in managing its potential cost and resource requirements, to best exploit the opportunities presented by this new regulatory environment.

## Contacts

If you would like to discuss any of the areas covered in this paper as well as the implications for your business, please speak to your local PwC contact or one of our AIFMD specialists listed below:

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