

# ***AIFMD Update***

## ***Impact on the Jersey asset management industry***

***22 March 2012***

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# ***AIFMD***

- Setting the scene – what was the purpose behind the AIFMD?
- Who gets caught?
- Impact of AIFMD
  - Managers
  - Service providers
- Third countries - continued access to EU institutional capital – how ?
- Structure impact analysis
- Strategic advantages of Jersey based managers/funds?

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# *AIFMD*

Setting the scene – what was the purpose behind the AIFMD?

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## ***AIFMD - Goals and outcomes***

- Single Market/Passporting: Easier access to the EU market for EU players
- Equal rights = Equal obligations for non EU AIFMs and non EU AIFs
- Investor protection through supervision, 3<sup>rd</sup> party depositaries and valuations
- Systemic Risk Detection
- Mandated minimum risk management practice
- More comprehensive information for investors and regulators
- Remuneration of managers aligned to longer term performance
- High risk players and activities monitored
- Passive marketing is not regulated

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## *The AIFMD timetable*

December 2010	European Securities and Markets Authority (ESMA) issued “call for evidence” following receipt of mandate from the EU Commission to determine “level 2” process
Spring 2011	FSA and other member state regulators form task forces to respond
July 2011	ESMA issues formal consultation paper – responses to be delivered by 13 September. Directive, level 1 becomes law
November 2011	ESMA issues formal advice to Commission – shape of Level 2 starts to become much clearer
Early 2012	EU Commission develops the implementing measures
Spring/Summer 2012	Level 2 measures adopted
Summer/Autumn 2012	National regulators issue implementing rules
22 July 2013	Directive takes effect in National Law - implementation

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Who gets caught?

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## ***So who is caught?***

- Applies to all EU based Alternative Investment Fund Managers
  - Thresholds are:
    - Total AUM of > €100m; or
    - Total AUM of >€500m if leverage is not utilised and subject to a minimum five year lock up
- This is a functional directive and seeks to regulate “actors” i.e. the investment manager and those who provide services to funds, e.g. depositories and administrators
- An authorised EU AIFM is required to maintain initial capital of at least €125k plus 0.02% of AUM exceeding €250m E.g. for a €10bn fund, capital of €2m required
- But the directive impacts non EU managers marketing to EU institutional capital

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Impact of AIFMD – managers and service providers

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## ***Impact of AIFMD – managers***

AIFMD subjects managers of alternative investment funds to compulsory regulation in the EU and will require significant modifications to the structures, strategies and operations of fund managers and funds and will also directly and materially affect those who service this industry. In particular the Directive imposes new rules affecting:

- Product structures and marketing
- Depositary oversight and liability
- Conflicts of interest and independence
- Remuneration
- Capital – significant uptick in reg cap
- Disclosure and reporting
- Valuation processes and ownership
- Compliance and risk monitoring
- Delegation and outsourcing

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## ***Impact of AIFMD – service providers***

AIFMD creates a series of new obligations for service providers to managers of alternative funds, which will require significant modifications to business models and relationships, both with clients and with networks. The Directive creates rules which:

- Will require functional and hierarchical separation of PB and custody functions
- Imposes strict liability for lost financial assets held in custody
- Imposes heavy due diligence requirements in relation to and strict liability for sub custodians
- Creates significant oversight responsibilities over manager conduct
- Imposes significant verification obligations regarding asset segregation and ownership
- Creates new obligations around cash controls and monitoring for managers.

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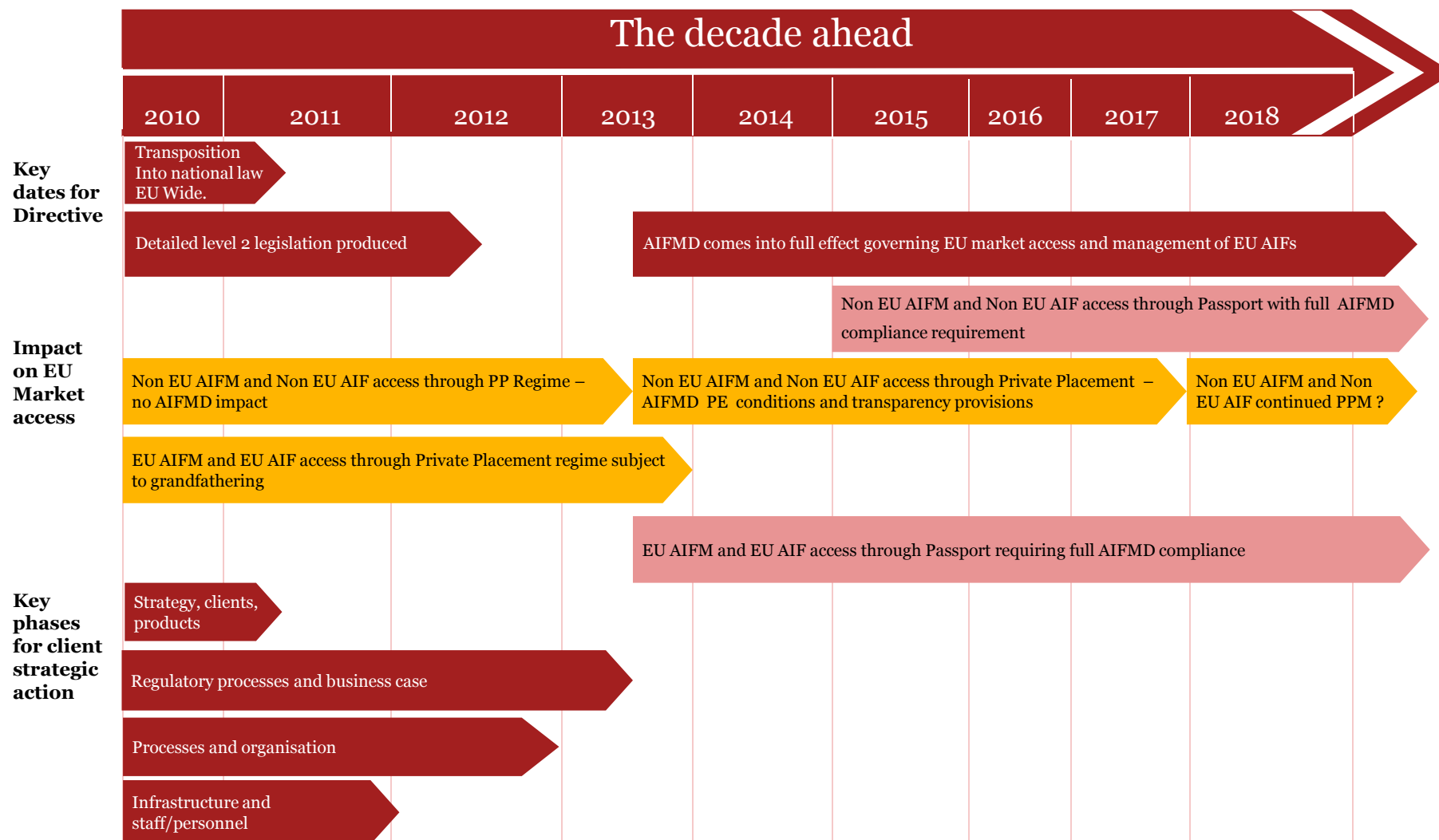
Third countries - continued access to EU  
institutional capital – how ?

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## ***Third countries: obvious impacts***

- Marketing
- Manager locations
- Fund locations
- Delegation between EU and non –EU entities and issues around function locations
- Depositaries and other service providers

# What dates impact marketing to EU investors?



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## ***Key third country provisions that must be complied with from 2013***

- A cooperation and exchange of information agreement between the home MS accessed and the third country supervisor – to facilitate monitoring of systemic risk.
- The third country has standards to prevent money laundering and terrorist financing - should not be on the non cooperative FATF list of countries, the Channel Islands lead the way in anti-money laundering procedures - more compliant with FATF recommendations than larger onshore asset management jurisdictions.
- For passporting from 2015 - The third country has signed an agreement with each member state where the AIF is marketed to exchange information on tax matters under the OECD Model Tax Convention, the Channel Islands lead this initiative with a significant network of compliant tax information sharing agreements.
- Compliance with reporting and transparency requirements, which also apply to AIFM compliant EU managers/funds.

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## ***Third countries: Non-EU Managers with non-EU funds***

### Alternatives:

- Passive marketing:
  - no AIFMD compliance issues.
- Full compliance:
  - no obvious architecture until 2015 within EU – but “opt-in” alternative to be designed?
- Private placement:
  - disclosure provisions (PE and Investor requirements) – but dependent upon MoU being put in to place.

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## ***Third countries: EU Managers with non-EU funds***

- No alternative: Full compliance from 2013 within framework of Article 34!
- Routes to market:
  - Private placement
  - Passive marketing – reduces compliance burden but still needs MoU
- Choice of Depositary – 3<sup>rd</sup> country depositary rules are onerous (practically speaking equivalence is needed: Box 76 of final ESMA advice):
- Delegation and outsourcing:
  - Delegation of functions, (including asset and risk management) offshore will be subject to material pre-conditions but the regime looks more sensible than the original proposals in the Summer CP (boxes 64 & 68)
  - Still issues over letter box entity test.....

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## ***Third countries: Non-EU Managers with EU funds***

- Article 42
- General regulatory environment
  - Unclear – certainly need an MoU between fund domicile, manager domicile and any domicile where funds are marketed....
- Routes to market
  - Private placement
  - Passive marketing – reduces compliance burden but still needs MoU
- Location of management and control?
- Delegation and outsourcing –
  - Delegation of functions, (including asset and risk management) offshore will be subject to material pre-conditions but the regime looks more sensible than the original proposals in the Summer CP (boxes 64 & 68)
  - Still issues over letter box entity test.....

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## ***Third countries: Non EU Service providers servicing EU Managers or Funds***

- Location of management and control – impact on tax structuring?
- Delegation and outsourcing:
  - delegation of functions, (including portfolio and risk management) by EU Managers offshore will be subject to material preconditions (boxes 64 and 68 of the Level 2)
- Issues remain around the “letter box entity” test.....
- Regulators will need to create the environment for the required cooperation agreements and will need to create the appropriate domestic regulatory environment to allow on-shore managers to “tick the boxes” on the various matters required under Art 20(1) (c) and (d) in relation to delegation of portfolio or risk management
- Material issues around sub delegation, depositaries and PB’s

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## ***Impact of key dates on strategic decisions regarding EU market access?***

- Fund promoters need to remember that passive marketing is not regulated by the AIFMD, promoters may therefore decide that investors will seek them out and structure processes supporting this strategy.
- 2013 is clearly a date that impacts access decisions, onshoring management/fund structures will require full compliance with all aspects of the AIFMD at that time.
- Continuing to access the EU market through the private placement regime creates a less onerous regime allowing time to observe how the AIFMD regulatory regime plays out.
- Certain jurisdictions will be better positioned to provide certainty in relation to continued access to EU institutional capital from 2013 under the private placement regime and/or from 2015 under the passport regime if that is required.

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## Structure impact analysis

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## ***Headlines from the structure impact analysis***

- Most structures remain viable, although there are question marks over a couple of less common fund structures where international rules need to be made.
- Jersey by and large has in place a regulatory structure which can be adjusted to allow for the creation of an opt-in regime, which will allow those who want to take advantage of the passport from 2015 to do so.
- For many participants, the route to EU investors through private placement will remain the most attractive option, needing least effort.
- Full blown compliance will be onerous – on-shore managers are looking at a sea change. For off-shore managers managing on-shore funds, the regime remains unclear and will depend on the response of the on-shore regulator. For on-shore managers, managing Jersey based funds, their key issue will be to have available a depositary structure which complies with the Directive's requirements – this may be the most onerous impact in the short term.

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Strategic advantages of Jersey based  
managers/funds?

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## ***Strategic advantages of Jersey based managers/funds?***

- Jersey will focus on the access conditions required under the private placement regime, providing tax neutral but transparent fund avoiding permanent establishment risk.
- The jurisdiction has a proven asset management regulatory regime that has provided adequate investor protection for over 30 years.
- The location of Jersey, close to Europe, may provide a better option for promoters looking to access EU institutional capital either on a passive or direct marketing basis.
- Jersey is exploring enhancement of the existing regime, enabling a complimentary fund product, providing the option to mirror investor protection elements of the AIFMD without suffering some of the inappropriate operational constraints.

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# *Questions*

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