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The Alternative Investment Fund Managers Directive – How Does It Affect Non-EU Managers?

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The EU Alternative Investment Fund Managers Directive (2011/61/EU) (the “Directive” or “AIFMD”) applies to managers of alternative investment funds (each an “Alternative Investment Fund Manager” or “AIFM”). The main provisions of the Directive apply to AIFMs located in the European Union and which manage funds established in EU or non-EU jurisdictions. Important requirements under the Directive (elaborated in the European Commission’s December 19, 2012, Delegated Regulation (the “Level 2 Regulation”)) apply to managers based outside the European Union (non-EU AIFMs) in relation to funds established in non-EU jurisdictions which those managers wish to market in one or more EU jurisdictions.

This Advisory focuses on provisions which will apply to non-EU managers of non-EU funds to be marketed to EU investors with effect from July 22, 2013—the date that AIFMD provisions first become operational.¹

In order to continue marketing² to EU investors after July 22, 2013:

- Non-EU AIFMs will be required to comply with reporting and disclosure obligations under the AIFMD for each fund which is marketed into one or more EU jurisdictions. In summary, these obligations consist of pre-investment and ongoing disclosures to investors (see Tables A and B), an annual report (see Table C) and regular reports to an EU national regulator (see Table D) (Directive, Article 42(1)(a)).
- Cooperation agreements under the AIFMD must exist between the national regulator of each EU member state in which marketing takes place and the supervisory authorities of the fund’s domicile and the country where the AIFM is established (Directive, Article 42(1)(b)). (Therefore, no US investment managers of Cayman funds will be able to market those funds into the European Union until both the US and Cayman regulators have entered into appropriate cooperation agreements with EU national regulators.)
- The fund’s domicile and the country where the AIFM is established must not be on the list of non-cooperative countries and territories maintained by the Financial Action Task Force (Directive, Article 42(1)(c)).

If the above conditions are met, funds can be marketed to “professional investors” under the national private placement regimes of individual EU jurisdictions. As individual EU jurisdictions can impose additional requirements and conditions under their national private placement regimes, country-by-country analysis will remain necessary. “Professional investors” for this purpose include regulated banks, investment firms and insurance companies; large corporate and non-corporate entities and trusts; and investors electing to be treated as professional investors under the criteria set out in the EU Markets in Financial Instruments Directive (2004/39/EC)).

¹ The shape of the regulatory regime which will apply to such managers and marketing after 2015 is not yet certain and therefore will not be addressed in this advisory.

² Marketing is defined as direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of a fund it manages to or with investors domiciled or with a registered office in the European Union.

Reporting and Disclosure Obligations

Pre-Investment Disclosures to Investors

Pre-investment disclosures, as summarised below, must be provided to investors along with details of any material changes.

TABLE A

Required Material	Directive Provision
A description of the investment strategy and objectives of the fund, the types of assets in which the fund may invest and the techniques it may employ, together with all associated risks and any applicable investment restrictions; the circumstances in which the fund may use leverage, the maximum leverage that may be employed, the types and sources of leverage permitted and the associated risks including any restrictions on the use of leverage and of any collateral and asset reuse arrangements	Directive, Article 23(1)(a)
Details of the procedures by which the fund may change its investment strategy or investment policy, or both	Directive, Article 23(1)(b)
A description of the main legal implications of the contractual arrangements entered into for the purpose of investment, including jurisdiction, applicable law and the existence, or not, of any legal instruments providing for the recognition and enforcement of judgments in the territory where the fund is established	Directive, Article 23(1)(c)
The identity of the AIFM, the fund's depository, auditor and other service providers together with a description of their duties and the investors' rights	Directive, Article 23(1)(d)
A description of how the AIFM complies with the professional liability risk requirements	Directive, Article 23(1)(e)
A description of any management functions delegated by the AIFM and of any safekeeping function delegated by the depository, the identity of the delegate and any conflicts of interest that may arise from such delegation	Directive, Article 23(1)(f)
A description of the fund's valuation procedure and of the methodology for valuing assets, including that used for valuing hard-to-value assets	Directive, Article 23(1)(g)
A description of the fund's liquidity risk management, including the redemption rights both in normal and exceptional circumstances and existing redemption arrangements with investors	Directive, Article 23(1)(h)
A description (including the maximum amount) of all fees, charges and expenses which are directly or indirectly borne by investors	Directive, Article 23(1)(i)
A description of how the AIFM ensures fair treatment for investors and, whenever any investors obtain preferential treatment (or the right to obtain it), a description of that preferential treatment and the type of investors who will obtain it, as well as any legal or economic link such investors have with the fund or the AIFM	Directive, Article 23(1)(j)
The latest annual report	Directive, Article 22(1)(k)
Procedure and conditions of issue and sale of fund interests	Directive, Article 22(1)(l)
The latest net asset value of the fund or the latest market price of fund interests	Directive, Article 22(1)(m)
Where available, the historical performance of the fund	Directive, Article 22(1)(n)
The identity of the prime broker and a description of any material arrangements with the prime brokers including transfer and reuse of assets and conflicts of interest	Directive, Article 22(1)(o)
A description of how and when the information in Table B will be disclosed	Directive, Article 22(1)(p)

Ongoing Disclosures to Investors

Ongoing periodic disclosures must be made to investors.

TABLE B

Required Disclosure	Directive Provision
The percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature	Directive, Article 23(1)(4)(a)

Required Disclosure	Directive Provision
Any new arrangements for managing the liquidity of the fund	Directive, Article 23(1)(4)(b)
The current risk profile of the fund and the risk management systems employed by the AIFM to manage these risks	Directive, Article 23(1)(4)(c)
Any changes to the maximum level of leverage and to any right to reuse collateral or any guarantee granted under the leverage arrangements ³	Directive, Article 23(1)(5)(a)
The total amount of leverage employed by the fund ⁴	Directive, Article 23(1)(5)(b)

Annual Reports

An annual report for each fund marketed in the European Union must be made available for each financial year no later than six months after the end of that financial year. The annual report must be provided to investors on request and must be also provided to the relevant EU national regulator (Directive, Article 22(1)).

TABLE C

Required Material	Directive Provision
Balance sheet/statement of assets and liabilities	Directive, Article 22(2)(a)
Income/expenditure account	Directive, Article 22(2)(b)
Detailed content and format requirements applicable to the balance sheet/statement of assets and income and expenditure	Article 104 of the Level 2 Regulation
Report on the main activities of the fund	Directive, Article 22(2)(c) and Level 2 Regulation, Article 105
Any material changes from the information disclosed to investors at the time of investment	Directive, Article 22(2)(d) and Level 2 Regulation, Article 106
Total amount of remuneration for the financial year, split into fixed and variable remuneration paid by the AIFM to its staff, the number of beneficiaries and, where relevant, the carried interest paid by the fund	Directive, Article 22(2)(e) and Level 2 Regulation, Article 106
Aggregate amount of remuneration broken down by senior management and members of staff of the AIFM whose actions have material impacts on the risk profile of the fund	Directive, Article 22(2)(f)

Obligations to Report to Regulators

In addition to the pre-investment and ongoing disclosure obligations in relation to investors, AIFMs must regularly report to the relevant EU regulator (the “competent authority”) concerning the principal markets and instruments in which it trades on behalf of the funds it manages. The report must include information on the main instruments in which the AIFM is trading and the markets where it actively trades, as well as the principal exposures and most important concentrations for funds (Directive, Article 24(1) and Level 2 Regulation, Article 110).

TABLE D

Required Information	Directive Provision
The percentage of fund assets which are subject to special arrangements because of their illiquid nature	Directive, Article 24(2)(a) and Level 2 Regulation, Article 110
Any new arrangements for managing the liquidity of the AIF	Directive, Article 24(2)(b) and Level 2 Regulation, Article 110
The current risk profile of the fund and the risk management systems employed by the AIFM to manage market, liquidity, counterparty, operational and other relevant risks	Directive, Article 24(2)(c) and Level 2 Regulation, Article 110
The main categories of assets in which the fund invested	Directive, Article 24(2)(d) and Level 2 Regulation, Article 110

³ In relation to a fund that uses leverage, this information must be provided “on a regular basis.”

⁴ Ibid.

Required Information	Directive Provision
The results of any stress tests required to be performed in accordance with requirements under the Directive	Directive, Article 24(2)(e) and Level 2 Regulation, Article 110
The overall amount of leverage employed by each fund it manages ⁵	Directive, Article 24(4) and Level 2 Regulation, Article 111
A breakdown of leverage arising from borrowing of cash or securities and leverage embedded in financial derivatives and the extent to which the fund's assets have been reused under leveraging arrangements ⁶	Directive, Article 24(4) and Level 2 Regulation, Article 111
The identity of the five largest sources of borrowed cash or securities for each of the funds managed by the AIFM and the amounts of leverage received from each of those entities for each AIF managed by the AIFM ⁷	Directive, Article 24(4) and Level 2 Regulation, Article 111

The AIFM must also supply to the competent authority the annual report of each fund it manages and a quarterly, detailed list of all the funds which the AIFM manages.

Under Article 24(5) of the Directive, a competent authority may require additional information on an ad hoc or periodic basis if considered “necessary for the effective monitoring of systemic risk.” The European Securities and Markets Authority (ESMA) must be informed of such additional reporting requirements. Conversely, ESMA may request competent authorities impose additional reporting requirements “in exceptional circumstances and where required in order to ensure the stability and integrity of the financial system or to promote long-term sustainable growth.”

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⁵ Information only required for an AIFM that manages a fund which employs leverage on a “substantial basis” (more than three times its net asset value).

⁶ Ibid.

⁷ Ibid.

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