



A practical guide to AIFMD

About us

MUFG Investor Services provides asset servicing solutions to the global investment industry. Leveraging the financial and intellectual capital of MUFG – one of the largest banks in the world with \$2.4 trillion in assets – we provide clients access to a range of leading solutions from fund administration, custody, foreign exchange, trustee services and depository to securities lending and other banking services.

MUFG Investor Services leverages its deep market expertise and industry leading technology to partner with clients throughout the investment lifecycle. Our solutions are developed with our clients' needs firmly at the heart of the partnership.

MUFG Fund Services is the global fund administration arm of MUFG Investor Services and has been partnering with the investment industry for over 25 years. Through our partnership driven model we provide clients a comprehensive and customized fund administration solution, underpinned by our market leading technology platform. Our clients range from mutual funds, hedge funds, fund of funds, private equity and real estate funds across all investment strategies, asset types and fund structures.

\$2.4 trillion in assets

140,000 employees

40 countries

A global partner you can trust

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AIFMD IN BRIEF

European politicians and regulators changed forevermore the landscape of how hedge funds, private equity, real estate and other alternative funds, alongside their managers, were regulated in Europe when they brought in the Alternative Investment Fund Managers Directive (AIFMD). The legislation that emerged following the 2008 financial crisis was designed to harmonise various regimes across Europe, although this aspiration has not come to fruition due to the varied implementation dates among member states.

After a 12 month grandfathering period, the AIFMD first became law on 22 July 2013 and fully came into effect on 22 July 2014, five years after European politicians first proposed it. The European Commission revealed the majority of the implementing measures (Level 2) in December 2012 after several delays, with the final guidelines on remuneration policies unveiled in February 2013.

The regime introduces new risk controls, valuation, leverage, disclosure and reporting requirements. Its scope is wide-ranging, affecting the following groups:

1) EUROPEAN MANAGERS

- Any European manager that manages one or more AIF, irrespective of the AIF's domicile.
- Any European manager that markets AIFs to EU professional investors.

2) NON-EUROPEAN MANAGERS

- Any non-EU manager that manages one or more EU AIF (from 2015).
- Any non-EU manager that markets funds to EU professional investors.
- Non-EU AIFMs will have to be authorized by the regulator in their member state of reference – i.e. where European operations are effectively based and must appoint a local representative from 2015 onwards.
- Until 2015, the marketing of funds will be allowed via the private placement regime.

EXEMPTIONS

Managers who fall below a de minimus threshold of €100m, or €500m with a five year lock-up, can side-step most of the regime as they do not require authorization but must still register.

These 'small authorized AIFMs' do not have a right to market AIFs they manage to other EU member states and therefore need to consult the national law in each jurisdiction. Many sub-threshold firms have chosen to opt in to the full AIFMD, in order to better appeal to, and access, European investors.

EXCLUDED:

- Holding companies
- Securitization SPVs
- Pension Funds
- Employee Savings Scheme
- AIFMs with AUM < €100million
- AIFMs with AUM < €500million plus a 5 year lock-up period
- Smaller AIFMs will be subject to registration and annual reporting requirements only
- UCITS

MARKETING AND REVERSE SOLICITATION

Changes to marketing in the Directive are key, and among the most important elements for non-EU managers. Marketing is defined in the Directive as "a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the EU". This broad definition is expected to catch placement agents, who market on behalf of an AIFM, as well as the AIFM. Ongoing 'investor relations' activities may be viewed as marketing in certain circumstances.

Non-EU managers marketing non-EU AIFs into the continent post-AIFMD are best placed to rely on existing private placement regimes, noting, however, that some regimes are more onerous in their requirements than others.

Managers could choose to the avail of the 'reverse solicitation' exemption in which the investor approaches the AIFM, but the basis for this is four words in a 73-page Directive that read "on its own initiative". The circumstances where reverse solicitation can be successfully achieved will be relatively narrow, with ESMA expected to give further guidance in the long-term. For example, several non-EU managers sent letters to their investors prior to 22 July 2013, asking the allocators to contact the firm if they wished to be marketed to, but this activity may have violated the 'reverse solicitation' rules. European investors that contact managers outside the EU are also being asked to sign statements attesting that they were not solicited to, but these have yet to be tested by any regulatory enquiry.

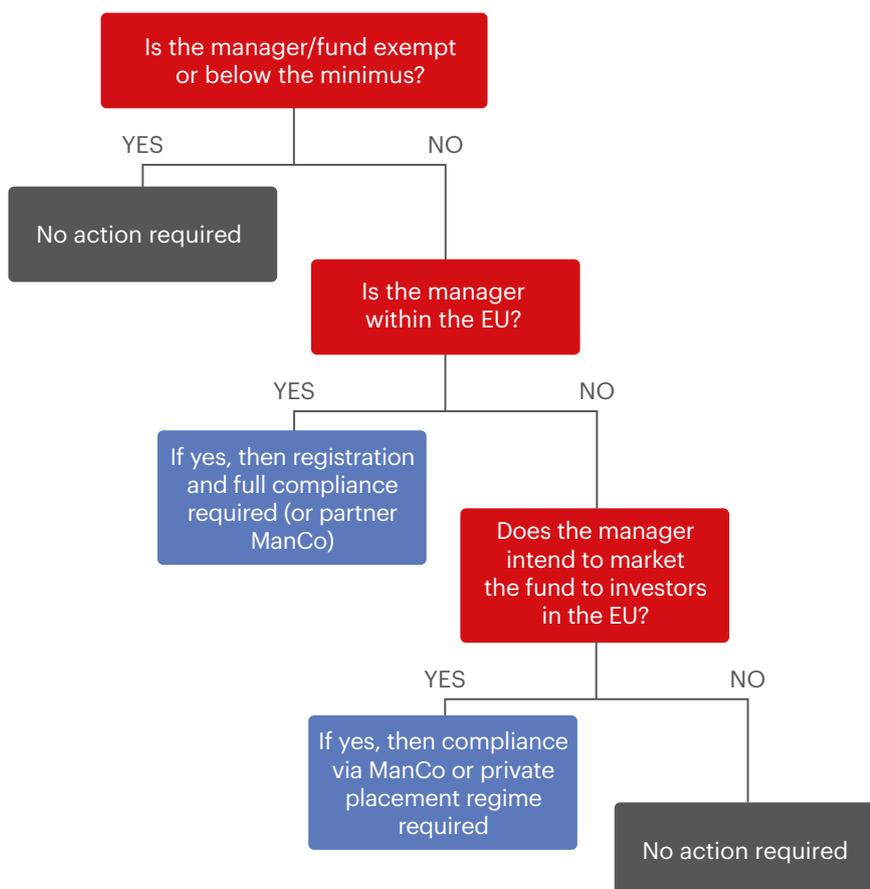
TIMELINE AND TRANSITIONAL ARRANGEMENTS

Most of the authorization deadlines have passed as EU and non-EU managers marketing into an EU member state prior to 22 July 2013 had access to a one-year transitional arrangement that expired on 22 July 2014. The timeline below details the outstanding reporting deadlines that remain, along with key dates when ESMA and the EU Commission are to consider altering the Directive.

AIFMD TIMELINE

- **29 APR 09:** EU Commission proposes new AIFMD Directive
- **11 NOV 10:** EU Parliament and Council of Ministers vote through AIFMD
- **23 FEB 11:** ESMA launches discussion paper on technical standards
- **2 OCT 12:** Netherlands first EU member state to introduce Directive
- **19 DEC 12:** EU Commission adopts implementing rules
- **22 MAR 13:** EU Commission publishes Level 2 measures in Official Journal
- **22 JUL 13:** Directive goes live although implementation lags in 21 member states
- **24 JUL 14:** Transitional periods expire
- **30 SEP 14:** Reporting begins for some entities in France
- **1 JAN 15:** Reporting starts for most regions, including Ireland, UK and Luxembourg
- **15 MAR 15:** Reporting begins in Germany
- **22 JUL 15:** ESMA to issue opinion on offering passport to non-EU AIFMs/AIFs
- **22 OCT 15:** EU Commission may permit passporting of non-EU AIFMs/AIFs
- **22 JUL 17:** European Commission to launch review
- **22 OCT 18:** ESMA must issue opinion on whether to turn off private placement
- **22 JAN 19:** ESMA may end private placement regimes

DOES THE AIFMD APPLY TO YOU?



PRIVATE PLACEMENT

Non-EU managers marketing non-EU AIFs are able to continue marketing in a post-AIFMD world to EU member states via national private placement regimes that have been updated and tightened in many cases. Managers seeking to use private placement must ensure the relevant member state has a private placement regime in place and that a cooperation agreement exists with the home country. The non-EU AIFM's home jurisdiction must not be included in FATF's list of high-risk and non-cooperative jurisdictions. Varying registration, transparency and disclosure requirements will apply, as well as a stipulation to install a depositary if marketing to Germany, Denmark, Austria or France.

Some member states, like the UK, Malta, Luxembourg and the Netherlands, require notification only. However, the Netherlands added an attestation stipulation in which the home jurisdiction of the non-EU AIFM must confirm via a standardised form that the manager is able to co-operate with the EU regulator.

Sweden, Finland, Belgium, Ireland and Slovakia have implemented a fairly straightforward approval process, but private placement will be limited in Austria, Denmark, France and Germany. EEA country Norway will only permit private placement if the fund is registered in Norway for marketing. In some countries, such as the Czech Republic, Hungary and Bulgaria, the registration process is not yet clear while private placements into Liechtenstein and Italy are not possible. Spain has not yet implemented the Directive.

For a full breakdown of the various markets and how they will be affected, please contact MUFG.

FULL COMPLIANCE

The AIFMD has ushered in a swathe of new rules, mostly relating to the manager rather than the fund. Under new capital requirements, the AIFM must have paid €300,000 in capital for an internally managed AIF, with a further sliding scale of adequacy as assets increase beyond €250m, while new due diligence stipulates a stricter level of care in performing initial and ongoing due diligence.

New remuneration rules apply to 'identified staff', such as senior management, risk and compliance professionals. Firms implement a remuneration policy and variable pay must be at least 50% in units of the AIF, with 40% to 60% of that deferred over a period of three to five years. The variable pay must be sustainable and justified and can be reduced via clawbacks.

Leverage must be disclosed and calculated using new 'gross' and 'commitment' methods and valuation must be conducted by the manager, albeit independently, or by an external valuer. While most hedge fund managers currently rely on administrators to value funds, under AIFMD, the external valuer will have greater responsibility, such as for any losses suffered by the manager as a result of the external valuer's negligence or intentional failure. AIFMs have found it difficult to source a firm willing to provide an external valuer service. Some studies show administrators are not willing to perform the role.

Under the AIFMD, managers must create conflict of interest policies to identify and mitigate potential issues and carry out annual audits and fulfil the Annex IV reporting obligation.

A depositary function traditionally associated with UCITS funds is a key part of the Directive.

MUFG SOLUTIONS FOR AIFMD

MUFG is building a number of solutions to assist managers with compliance, including reporting tools and depositary solutions.

1. Reporting

One of the major objectives of the AIFMD is to increase transparency around the activities of AIFMs and their AIFs in their dealings with both investors and regulators. For this reason, AIFMD sets out transparency requirements for annual reports, initial and ongoing disclosures to investors and finally for regulatory reporting, which is also referred to as Annex IV.

The regulation under Articles 22 and 23 of the Directive provide minimum requirements for the content of the annual report and list the specific initial and periodic information that must be provided by the AIFM to its investors.

Annex IV reporting, covered under Article 24, is often viewed as one of the most onerous and underestimated aspects of the Directive, and it applies to all EU and non-EU managers marketing into the EU, whether utilising the private placement regime or not. Managers under full compliance need only report to the member state regulator but those accessing private placement will be required to submit Annex IV reporting to each local authority within every jurisdiction marketed to.

Most managers will need to begin reporting from 1 January 2015, with the data 50% to 75% similar to Form PF in the US. Reports will need to be submitted annually, semi-annually or quarterly depending on Regulatory Assets under Management (RAUM). Reporting and compliance requirements are not consistent across member states, so it is important that the manager first identifies which jurisdictions they wish to market to before finalising a solution.

MUFG has an Annex IV reporting solution in partnership with a partner vendor, which pulls information from our accounting systems and the manager to format, calculate and submit the required information.

2. Depositary vs. Depositary-lite

One of the most controversial elements of the Directive, and the issue that caused the most delays at the EU Commission level, was that of the depositary. The AIFMD requires that an AIFM with an EU AIF must appoint a single depositary domiciled in Europe to provide safekeeping of financial instruments, record-keeping and verification of assets, carry out cash flow monitoring and a number of oversight duties, all with strict liability.

These depositaries must be a credit institution, investment firm or other entity that is eligible to act as a depositary under the AIFMD and which is subject to prudential regulation and ongoing supervision.

The vast majority of European managers manage non-EU funds, such as Cayman vehicles, and will be caught by the less stringent depositary-lite regime, which requires the AIF to appoint one or more providers to perform the depositary services, but without strict liability. The depositary service providers may be located in the same jurisdiction as the non-EU AIF, or the home member state of the EU manager.

Non-EU managers marketing any AIF into an EU member state via private placement are not subject to any depositary requirements, except in Germany or Denmark, where they must participate in the lite regime. Those marketing into Austria or France will need to comply with the full depositary regime if accessing the country through reverse solicitation.

Depositary offerings and documentation have consistently lagged, with many managers waiting six to eight weeks to onboard a depositary.

MUFG has a fully licensed depositary bank in Luxembourg, which can offer depositary or depositary – lite services from Luxembourg or through a Dublin branch.

3. Partner ManCo

In the case that the manager cannot or does not want to act as AIFM, a solution is needed to market their fund to investors in Europe. MUFG offers a competitive alternative to the internal AIFM route, utilising our Luxembourg Super ManCo and portfolio management operations.

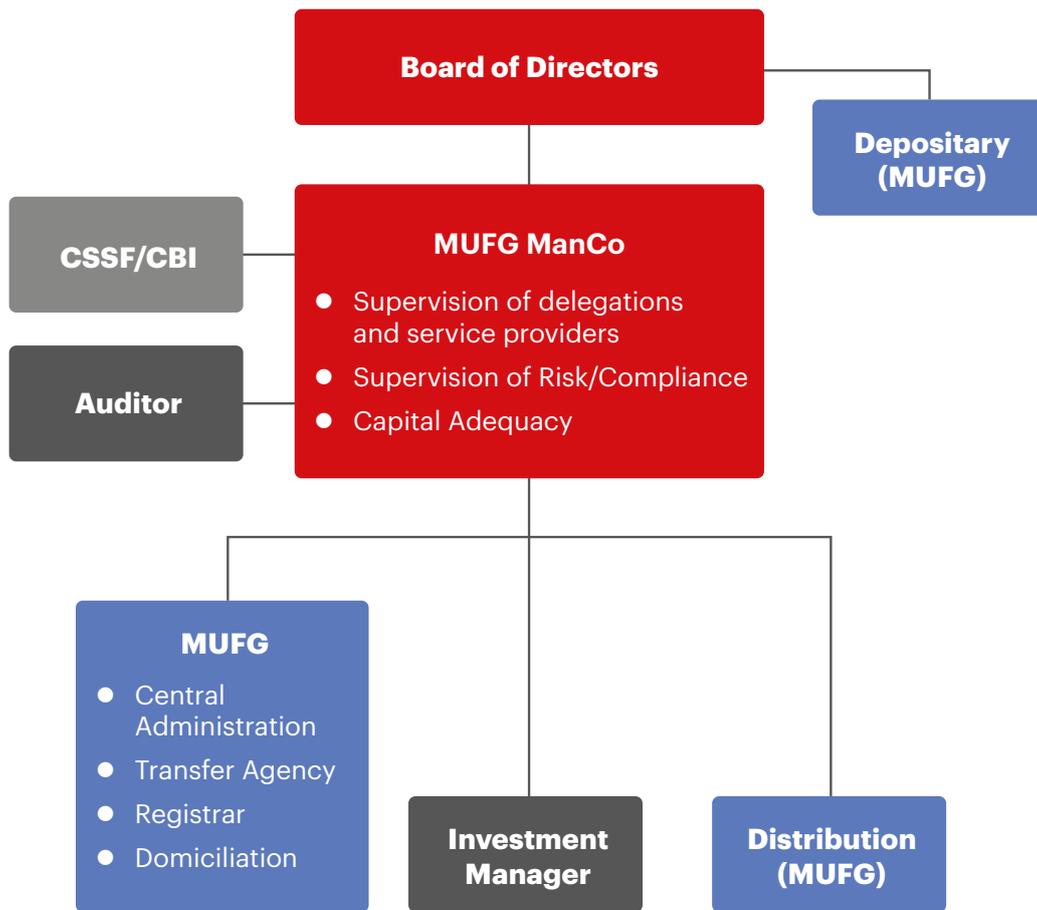
As a result of the AIFMD, managers have increased requirements that need to be met before they are authorized to market their products throughout Europe:

An AIFM under AIFMD can delegate either portfolio or risk management activities, but is prevented from delegating functions to the extent that it becomes a letter-box entity and can no longer be considered to be manager of the AIF. An AIFM must be able to justify its entire delegation structure.

Under the partner ManCo solution, MUFG is appointed AIFM and retains responsibilities for compliance with the AIFMD. MUFG appoints the existing manager as ‘investment advisor’ or ‘trading advisor’ meaning the existing manager can continue to trade as normal under the AIFMD oversight of the MUFG ManCo. The MUFG solution is fully regulated, incorporating the capital requirements introduced by the AIFMD. The solution provides highly experienced staff, infrastructure, reporting and the supervision of delegates’ activities that have been authorized with the relevant regulators to comply with AIFMD. This allows the manager to market to European investors without having to go through the majority of the AIFMD application process and legal agreements/due diligence with delegates.

For further detail about the structure of MUFG’s ManCo, see Appendix I.

APPENDIX I – MUFG’S MANCO ORGANIZATIONAL CHART



GLOSSARY

AIF:

An alternative investment fund.

AIFM:

An alternative investment fund manager.

AIFMD:

The alternative investment fund managers directive seeks to regulate the non-UCITS fund sector, in particular hedge funds, private equity funds and real estate funds, and harmonize the requirements for firms managing alternative investments marketed to professional investors in the EU. It will have a significant impact on how managers will pay their people and operate their business.

CBI:

Central Bank of Ireland.

CSSF:

Commission de Surveillance du Secteur Financier is responsible for the financial regulation in Luxembourg.

Depository:

This is a legally separate organization where the formal documents showing who owns shares, bonds, etc. can be kept safely. A depository generally has three core functions:

- The safe-keeping of the assets of the fund (the depository holds the title of the assets when they are transferable instruments such as shares, or operates as a book-keeper complementing a broker's job when it comes to derivatives);
- The day-to-day administration of the assets of the fund (the depository receives the income generated by the assets);
- The control of the fund's operation (compliance with investment policies, notably proper creation/redemption/cancellation of the units/shares issued to the investors).

EU:

The European Union is a politico-economic union of 28 member states.

EU AIF:

- (a) An AIF which is authorized or registered in a member state under the applicable national law; or
- (b) An AIF which is not authorized or registered in a Member State, but has its registered office and/or head office in a Member State.

EU AIFM:

An AIFM which has its registered office in a Member State.

ESMA:

The European Securities and Markets Authority is an independent EU Authority that contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection.

External valuer:

In relation to an AIF, means a person who performs the valuation function. Described in article 19 of the AIFMD, and is independent from the AIF, the AIFM which manages the AIF and any other person with close links to the AIF or the AIFM.

Internally Managed AIF:

Where the legal form of the AIF permits internal management and where the AIF's governing body chooses not to appoint an external AIFM.

Leverage:

Means using techniques to increase the returns offered by an investment strategy, for example through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means.

Marketing:

Marketing is defined in the Directive as "a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the [European] Union". The definition is broad and will therefore catch activities undertaken by placement agents and other intermediaries on behalf of an AIFM as well as the AIFM itself.

Member state:

A country that is part of the EU.

Non-EU AIF:

An AIF which is not an EU AIF.

Non-EU AIFM:

An AIFM with its registered office outside the EU.

Passport:

A passport allows an individual the right to move freely from one country to another after having registered and provided various personal details to the authorities of his country. Once he has a passport, he does not need to register in other countries.

Private Placement:

Private placement (or non-public offering) is a way of raising capital through a sale (offering) of shares without an initial public offering, usually to a small number of chosen private investors. Purchasers are often institutional investors such as banks, insurance companies or pension funds. Such an offering is exempt from many of the reporting and information requirements necessary in the case of a public offering.

Professional Client:

A client who possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs.

Professional Investor:

AIFMD defines 'professional investor' as an investor which is considered to be a professional client or may, on request, be treated as a professional client within the meaning of Annex II of the MiFID directive.

Regulatory assets under management:

Are the gross assets under management, without the subtraction of borrowings, short sales or other forms of leverage.

UCITS:

Undertakings for Collective Investment in Transferable Securities (UCITS) are a particular class of investment funds that comply with the terms of an EU directive of the same name. The EU rules allow fund managers to market their UCITS EU-wide without needing to register in each of the member states they are marketing in. These funds are typically sold to retail investors.

For further information and contact details please refer to:

www.mufg-investorservices.com

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