

AIFMD Implementation Guidance from the Commission, ESMA and UK

Less than two months before July 22, 2013 (the “Implementation Date”), the date on which Directive 2011/61/EU (the “AIFMD”) on alternative investment fund managers (“AIFMs”) is due to be transposed by European Union Member States (“Member States”) into national law, many important practical questions remain open. Preliminary answers to some of these questions can be found in questions and answers (“Q&As”) published by the European Commission (the “Commission”) (the “EC Q&A”),¹ consultations and Q&As published by the UK’s HM Treasury (the “HMT”) and Financial Conduct Authority (the “FCA”),² as well as the European Securities and Markets Authority’s (“ESMA’s”) final report and guidelines on key concepts of the AIFMD published on May 24, 2013. This Memorandum provides a brief and non-exhaustive summary of the views expressed by the Commission, the HMT, the FCA and ESMA on AIFMD topics of particular interest to AIFMs, especially non-EU AIFMs. (“ESMA’s Key Concepts Guidelines”).³

This Memorandum also includes information on the position of other Member State authorities where available, but many Member States have not yet published specific guidance on these issues. The views of the UK authorities may be influential for other Member States, but some important differences are already emerging.

The practical issues discussed below include the following:

¹ The EC Q&A was published on [March 25, 2013](#).

² HMT published consultation papers on [January 11, 2013](#) (the “HMT CP 1”), and on [March 13, 2013](#) (“HMT CP 2”), including draft Alternative Investment Fund Managers Directive Regulations 2013 (the “Draft UK Regulations”). On [May 13, 2013](#), HMT published a response to consultation and updated [Draft UK Regulations](#). The FCA published consultation papers on [November 14, 2012](#) (“FCA CP 1”) and [March 19, 2013](#) (“FCA CP 2”), including Fund Managers Directive Instrument 2013 (“Draft Instrument”) (the HMT’s and the FCA’s four consultation papers are together referred as the “UK Consultations”). The FCA expects to issue a further consultation paper mainly to transpose AIFMD Articles 35 and 37 to 41 on marketing and management passports for non-EEA AIFMs and a full AIFMD policy statement confirming some of the FCA’s final policy provisions, including whether the FCA will accept AIFM authorisation and variation of existing permission before the Implementation Date (“FCA Policy Statement”). The FCA may also issue specific guidance on asset stripping rules applicable in the context of investments into EU non-listed companies.

³ [ESMA’s Key Concepts Guidelines](#)

- **Transitional Provisions:** Importantly, a consensus is emerging that the AIFMD’s one-year grace period applies to non-EU AIFMs as well as to EU AIFMs. However, Member States seem likely to take different positions on questions such as whether, to qualify, non-EU AIFMs need to have marketed AIFs in a specific Member State, or anywhere in the EU, and on the application of the grace period to AIFs launched after the Implementation Date. While welcome, this broad interpretation of the grace period raises the question of the AIFMD’s application after July 22, 2014 to non-EU AIFMs of non-EU AIFs marketed to EU investors when the relevant AIFs do not meet the grandfathering criteria in Articles 61.3 and 61.4 AIFMD.
- **Passive marketing and private placement regimes:** The UK Consultations take a narrow approach to the activities that will be considered “marketing” triggering application of private placement requirements (if the grace period does not apply) and a pragmatic approach to communications at investors’ initiative, which will in any case not be considered marketing.
- **Exemptions from the AIFMD:** The UK Consultations discuss the AIFMD’s exemptions, with interpretations supporting the conclusion that many management incentive plans, carried interest vehicles, co-investment vehicles and alternative investment vehicles should be exempt from the AIFMD.

I. TRANSITION PROVISIONS

A. One-year Grace Period

Article 61.1 AIFMD provides that AIFMs “performing activities” before the Implementation Date shall take all necessary measures to comply with the AIFMD and submit an application for authorization by July 22, 2014. Article 61.1 is ambiguous in key respects, including whether non-EU AIFMs benefit from the grace period, which activities must be conducted prior to the Implementation Date for the grace period to apply, whether it applies to AIFs launched post-Implementation Date and whether any AIFMD obligations will apply to qualifying AIFMs during the grace period.

1. Does the Grace Period apply to non-EU AIFMs?

Since Article 61.1 AIFMD refers to an exemption from authorization requirements only until July 22, 2014, while non-EU AIFMs will not be able to apply for an AIFMD authorization before late 2015 at the earliest, Article 61.1 could be interpreted to apply only

to EU AIFMs. However, the HMT's Draft UK Regulations provide that non-EU AIFMs that market AIFs before the Implementation Date may benefit from the one-year grace period.⁴ This would mean that existing non-EU AIFMs could carry on offering AIF interests to UK investors under the current UK financial promotion regime⁵ without having to comply with the AIFMD requirements applicable to marketing until July 22, 2014.⁶

Other Member States, including Germany⁷ and the Netherlands, have indicated that they will likely follow the UK's approach on the application of the grace period to non-EU AIFMs. As discussed in more detail below, however, the precise interpretation of the grace period may vary in significant respects. The position of each relevant Member State authority should be checked before marketing commences.

2. Which Existing Activities Trigger Grace Period?

The AIFMD does not specify which activities an AIFM needs to perform prior to the Implementation Date to benefit from the grace period. The Draft UK Regulations provide that an EU-AIFM needs to have managed an AIF and a non-EU AIFM needs to have marketed an AIF in an EEA State "immediately" before the Implementation Date.

Although the UK authorities take a restrictive view of what constitutes "marketing" (see below), the FCA has orally confirmed that non-EU AIFMs would not be required to show that they have sent final PPMs or signed investment agreements with EU investors to be able to rely on the grace period. Despite the reference to activities being performed "immediately" before the Implementation Date, moreover, marketing within a reasonable period before the Implementation Date would qualify. The maximum period of time between the latest marketing activities and the Implementation Date to benefit from the grace period remains to be clarified.

⁴ HMT also specifies that cooperation agreements between the country of the non-EU AIFM/AIF and the UK do not need to be in place to allow a non-EU AIFM to rely on the one-year grace period when marketing to UK investors.

⁵ A person is able to communicate a financial promotion relating to a "collective investment scheme" to an investor if such person is an "authorised person" (*e.g.*, authorised by the FCA or Prudential Regulation Authority or otherwise within Section 31 of the Financial Services and Markets Act 2000 ("FSMA")) or the content of the communication is approved by an authorised person, or if an exemption applies. In practice, managers usually rely on an exemption (exemptions for certain offerings not made to the public or to investment professionals, high net worth companies, unincorporated associations or qualifying sophisticated investors usually apply in practice). Authorised persons are subject to restrictions on the categories of person to whom a collective investment scheme may be promoted, set out in s. 238 FSMA and COBS 4.12 of the FCA Rules.

⁶ In Luxembourg, the draft bill currently contemplates a two-year transition period for non-EU AIFMs already marketing in Luxembourg.

⁷ Under the current German draft legislation implementing the AIFMD the grace period attaches to AIF that has been marketed in Germany before July 22, 2013 and there is no differentiation whether the AIFM of such AIF is a non-EU AIFM or an EU-AIFM.

It appears that other Member States will likely take somewhat different views on the activities required to qualify for the grace period. For example, Austria, Ireland and Germany seem likely to require a non-EU AIFM to have marketed AIF interests in their territory, rather than anywhere in the EEA, to qualify for the grace period. The Netherlands seems likely to require AIFMs to have been authorized or exempted in the Netherlands prior to the Implementation Date to benefit from the grace period.

3. Does the Grace Period Apply with respect to New AIFs?

The AIFMD does not address this question. According to HMT, the exemption attaches to the AIFM and therefore applies with respect to existing and new AIFs. Under this approach, a non-EU AIFM that qualifies for the grace period could begin marketing new AIFs in reliance on the grace period up to July 22, 2014 (though it would thereafter be required to comply with the UK private placement requirements).

Other Member States, such as Germany, seem likely to follow a more restrictive approach than the UK, for instance allowing marketing in reliance on Article 61.1 of AIFs existing on the Implementation Date to continue during the grace period but not marketing of AIFs established after July 22, 2013. The Netherlands will likely allow an AIFM to market new AIFs under grace period as long as the AIFM's activities fall within the AIFM's authorization or exemption as applicable prior to the Implementation Date.

4. Obligations Exempted During Grace Period

Article 61.1 AIFMD is ambiguous as regards the obligations from which an AIFM will be excused during the grace period. Does Article 61.1 AIFMD apply to all AIFMD obligations or only to the authorization requirement?

The EC Q&A indicates that AIFMs benefitting from the grace period are expected to comply with AIFMD requirements other than authorization on a best-efforts basis before July 22, 2014 and that no transitional period applies to reporting obligations.⁸ By contrast, the Draft UK Regulations provide that the one-year grace period applies to all AIFMD requirements, not only to authorization. UK AIFMs that benefit from the grace period would have to comply with the Handbook rules applicable to them immediately before the Implementation Date until they are AIFMD-authorized, while non-EU AIFMs would not be subject to the AIFMD at all.

⁸ ESMA's consultation paper on guidelines on reporting obligations under Article 3 and Article 24 of the AIFMD published on May 24, 2013 (the "[ESMA's Draft Guidelines on Reporting to Regulator](#)") suggests that reporting periods be aligned with the calendar year and that existing AIFMs as of the Implementation Date should report information required under Articles 3/3(d) and 24 AIFMD for the first time by January 31, 2014.

Although the UK approach offers greater legal certainty, a number of EU Member States, including Germany and the Netherlands, seem to prefer the Commission's approach, creating legal uncertainty for AIFMs established in those countries.

5. Early Termination of the Grace Period?

Although Article 61.1 refers to a grace period of one year before a qualifying AIFM has to apply for authorization under the AIFMD, the Draft UK Regulations make it clear that if a UK AIFM applies for authorization before the end of the grace period, the grace period will end for that AIFM when the AIFM's application is determined by the FCA and the AIFM needs to comply with all the AIFMD requirements from that date. Other Member States are likely to follow this approach.⁹

Thus, a group with an EU AIFM that is entitled to rely on the grace period may lose the benefit of the grace period early if it applies for authorization during the grace period. Although becoming subject to the AIFM with respect to marketing of existing AIFs may not create a significant additional burden if the AIFM will in any case become subject to the AIFMD, but an EU AIFM should consider the issue and be prepared to comply with respect to both new and existing activities if it applies for authorization before July 22, 2014.

6. Conclusions on the Grace Period

The emerging consensus that Article 61.1 can apply to both EU and non-EU AIFMs is welcome, but the specific application of the grace period will likely vary from country to country. Continuing marketing that has already commenced in an EU jurisdiction before the Implementation Date seems unlikely to raise significant questions. Questions are more likely to arise where an AIFM wants to rely on Article 61.1 to commence marketing a newly established AIF and/or in new EU jurisdictions.

Because of possible variations in different Member States' application of the grace period, it will be important to check the relevant interpretations in all Member States where marketing is to be conducted. This applies not only to non-EU AIFMs but also to EU AIFMs, since AIFMs relying on the grace period will not be able to rely on the AIFMD's marketing passport.

To ensure the greatest flexibility for new AIFs, it will be helpful to be able to show that the AIFM for any AIF marketing activities during the grace period has marketed the same or other AIFs in the EEA (and if possible in the same EU jurisdictions) in the recent

⁹ Although under the current German draft legislation implementing the AIFMD, the obligation to comply with the AIFMD on a best effort basis continues until the end of the grace period even if the AIFM becomes AIFMD authorized before the end of the grace period.

past. It may also be advisable, to the extent possible, to commence activities in respect of the relevant AIF before the Implementation Date, for example by forming the relevant legal entities or contacting EEA investors about the new AIF. Member States other than the UK seem likely to take a more restrictive approach to marketing of AIFs launched after the Implementation Date in reliance on the grace period.

B. Grandfathered AIFs

Article 61.3 AIFMD allows AIFMs of closed-ended AIFs that do not make any “additional investments” after the Implementation Date to carry on managing such AIFs without authorization. Article 61.4 AIFMD allows AIFMs of closed-ended AIFs whose subscription period closed prior to July 22, 2011 and are constituted for a period expiring no later than July 22, 2016 to continue to manage such AIFs without the need to obtain authorization or to comply with most requirements under the AIFMD.

Articles 61.3 and 61.4 raise a number of questions. Article 61.3 does not define “additional investment,” but the EC Q&A confirms that an “additional investment” implies a new contract and limited financial injections arising out of existing commitments representing a negligible percentage of the AIF’s portfolio and aimed at maintaining the value of the portfolio. Under this definition, “follow-on investments” permitted by fund documents after the end of the investment period would likely not benefit from grandfathering. Similarly, Article 61.4 is unclear as to the treatment of extensions commonly allowed by fund documents past July 22, 2016.

EU AIFMs intending to rely on grandfathering rules for their closed-ended funds should check whether “follow-on investments” under their funds’ constitutional documents would qualify as “additional investments” for the purpose of the AIFMD and ensure that the terms of AIFs that are not fully invested but whose subscription periods closed prior to July 22, 2011 cannot be extended post July 22, 2016.

More generally, for non-EU AIFMs, Articles 61.3 and 61.4 raise the question how the AIFMD may apply to AIFMs that have marketed AIFs to EU investors between the Implementation Date and July 22, 2014 but do not satisfy the conditions of Articles 61.3 and 61.4. Since non-EU AIFMs will not be allowed to apply for authorization under the AIFMD under the EU third-country passport regime until late 2015 at the earliest, and even then the ability to apply for authorization will be subject to strict conditions, the better view seems to be that non-EU AIFMs managing non-EU AIFs marketed to EU investors before the expiry of the grace period will not be subject to the AIFMD even if the conditions of Articles 61.3 and 61.4 are not satisfied. However, this question is not addressed in the EC Q&A or the UK Consultations.

II. MARKETING

Many of the AIFMD's requirements relate to "marketing". In particular for non-EU AIFMs, the application of private placement requirements under the AIFMD and Member State law depends on whether the non-EU AIFM is considered to be engaged in marketing. The AIFMD definition of marketing, as a direct or indirect offering or placement of units or shares of an AIF at the initiative of the AIFM, leaves open a number of questions, including the treatment of so-called "passive marketing" and whether the AIFM's assistance to investors who wish to sell their interests (so-called "secondary sales") can ever be considered marketing.

A. Concept of Marketing in General

The EC Q&A does not discuss the concept of marketing. Because the FCA considers that offering documentation must be in final form in all material respects before an AIFM can apply for permission to market an AIF, the FCA does not consider communications involving draft documents or negotiations and discussions held prior to the communication of the final private placement/offering memorandum, constitutional documents or investment agreements to constitute "marketing" for purposes of the AIFMD.

The FSA's interpretation is helpful, especially for non-EU AIFMs, who can engage in preliminary discussions with potential investors without triggering the requirements of the UK private placement regime.¹⁰ Pending the publication of practical guidance by other Member States, however, it is unclear whether other authorities will follow the UK's approach to the definition of marketing activities that will trigger an obligation to comply with private placement regimes.

B. Passive Marketing

Although not expressly excluded under the AIFMD or discussed in the EC Q&A, HMT and the FCA consider that passive marketing falls outside the scope of the AIFMD. Regulation 47 of the Draft UK Regulations confirm that a person marketing to an EU investor is not subject to the AIFMD provisions on marketing when such marketing is at the initiative of the investor.¹¹ The FCA has informally confirmed that if the communication is initiated by the investor, subsequent communications, such as provision of a private

¹⁰ On the other hand, the FCA's approach implies that AIFMs will not be able to apply for authorization until late in the fund-formation process, which could lead to timing problems.

¹¹ A person passively marketing in the UK would still need to comply with the existing UK financial promotion regime. The UK Consultations indicate that information available on a publicly accessible website would not be considered to be sent at the initiative of an investor, but since the UK takes the view that only provision of a final PPM can be considered marketing in any case, this issue seems unlikely to arise in practice.

placement memorandum and negotiation of a limited partnership agreement, will still be treated as passive marketing from an AIFMD perspective provided there are no long gaps in communication.

The treatment of passive marketing may vary significantly from Member State to Member State, particularly since the concept is not defined in the AIFMD. Some Member State authorities may fear that passive marketing could provide a means to circumvent their private placement requirements. Where it is not possible to rely on the one-year grace period (see above) and/or where the level of investor interest may not justify compliance with national private placement requirements, it will be important to confirm with local counsel what an AIFM can do in response to investors' reverse inquiries without being deemed to be engaged in marketing.

C. Secondary Sales

The AIFMD also does not discuss the treatment of secondary sales. Can the offering or placement of shares or units in an existing AIF constitute marketing if the AIFM is involved? The EC Q&A and UK Consultations do not address the treatment of secondary transactions. These activities should arguably be treated as services provided by an AIFM to its investors, rather than as marketing. This issue does not seem to have been officially addressed by most Member States.

D. UK Private Placement Regime

The AIFMD sets out a number of minimum requirements in relation to marketing by non-EU AIFMs under national private placement regimes (Article 42 AIFMD¹²) and EU AIFMs managing non-EU AIFs (Article 36 AIFMD¹³) but permits Member States to apply additional requirements for private placements in their jurisdictions. HMT confirms that no additional requirements for non-EU AIFMs will apply in the UK above the AIFMD's minimum requirements under Article 42 AIFMD.

A non-EU AIFM planning to market to UK investors under the UK private placement regime will need to register the AIF on the "Article 42 register". Non-EU AIFMs will not need to wait for the FCA's approval before starting marketing but will need to comply with the AIFMD's minimum requirements from the date on which notification is

¹² Those requirements include: AIFM's compliance with transparency requirements and the non-listed companies rules and that the home jurisdiction of the AIF and the AIFM is a qualifying jurisdiction (*i.e.*, it (i) has in place co-operation arrangements with the competent/supervisory authorities in the relevant EU jurisdictions and (ii) is not designated as a non-cooperative country by the Financial Action Task Force on anti-money laundering and terrorist financing).

¹³ Those requirements include: compliance with all requirements under the AIFMD except the depositary requirements and the home jurisdiction of the AIF being a qualifying jurisdiction.

given. Standard notification forms will be provided in the FCA Handbook before the Implementation Date.

The Draft UK Regulations also permit AIFMs to market AIFs to retail investors if, in broad terms, (a) the AIFM can market the AIF to professional investors in accordance with the AIFMD requirements and (b) the AIFM can promote the AIF to that investor under the UK financial promotion regime.¹⁴

E. Interrelation Between AIFMD Marketing and UK Financial Promotion

HMT has not abolished the current FSMA¹⁵ financial promotion regime applicable to private placements of fund interests to UK investors. FCA CP 2 confirms that marketing has a distinct meaning under the AIFMD and that there will be an overlap between the concepts of “marketing” and “financial promotion.”¹⁶ A person who is marketing is usually also making financial promotion, but a person may be making a financial promotion without marketing: for example, an AIFM that makes a communication that is a significant step in the chain of events leading to an agreement to engage in investment activity is making financial promotion under FSMA but is not marketing under the AIFMD, since the communication only involves draft documents.

Non-EU AIFMs intending to rely on passive marketing should review their internal procedures, external dialogues with investors and level of information on their website. Non-EU AIFMs should also establish guidelines to ensure that their active assistance in finding a purchaser for outstanding LP interests does not qualify as marketing for the purpose of the AIFMD. Compliance with UK financial promotion requirements will need to be addressed prior to reaching the marketing stage (*e.g.*, before sending near final private placement memoranda) and when relying on passive marketing.

III. DEFINITION OF AIF AND EXEMPTIONS

The AIFMD applies to the managing and marketing of “AIFs,” which are defined very broadly. Under the AIFMD, an AIF: (i) is a collective investment undertaking; (ii) raises capital from a number of investors; (iii) invests that capital in accordance with a defined investment policy; (iv) invests that capital for the benefit of those investors; and (v)

¹⁴ See footnote 5 above.

¹⁵ Financial promotion is defined under the FCA Glossary as an invitation or inducement to engage in investment activity that is communicated in the course of the business. “Investment activity” includes the sale of interests in AIFs.

¹⁶ However, there should not be an overlap of permissions because if an AIFM has received consent by the FCA (or other competent authority) to market an AIF or under national private placement regimes pursuant to the AIFMD, then communications by the AIFM fall within exemptions from financial promotion to the extent they are made to professional investors. These exemptions are not available in relation to retail marketing.

is not a UCIT.¹⁷ However, the AIFMD contains a number of exemptions. ESMA's Key Concept Guidelines and the UK Consultations provide guidance on the concept of an AIF and the exemptions in the AIFMD.

A. Employee Participation and Saving Schemes

Employee participation and saving schemes are excluded from the scope of the AIFMD under Article 2.3(g). The EC Q&A states only that each scheme should be assessed on its own merits. The FCA confirms that the term "employee" is not limited to an employee within the UK labour-law meaning of the term. For AIFMD purposes, the term "employee" should include personnel who work for the business of the undertaking concerned contributing their skills and time, including partners, directors and consultants. It should also include former employees, spouses and close relatives.

The treatment of participation schemes for portfolio company management and "friends and family" can raise questions in many acquisition structures, especially where such vehicles are established under the laws of an EU Member State such as Luxembourg. The flexible UK approach is welcome and seems likely to be followed at least as regards including board members, consultants and other independents. Whether other Member States will be willing to extend the concept to spouses and relatives of "employees" seems less clear.¹⁸

B. Carried Interest Vehicles

Questions may also arise whether carried interest vehicles can be characterized as AIFs under the AIFMD. Many such vehicles will be exempted as employee participation or savings schemes under the broad interpretation outlined above. In addition, the ESMA Key Concepts Guidelines suggest that carried interest vehicles may not qualify as AIFs because they are not raising external capital. The FCA also confirms that if employees only invest a nominal amount of capital in a carried interest vehicle, they would not be considered as investors.

Since it is less clear that the FCA's arguments would apply where sponsors contribute their commitments through the carry vehicle, it would seem advisable to use separate vehicles for sponsors' contributions and carried interest.

¹⁷ Undertaking for Collective Investment in Transferable Securities, which are open-ended funds investing in transferable securities, raising capital from retail investors and complying with Directive 2009/65/EC.

¹⁸ In Germany, for example, BaFin has not clarified its views on this issue but is expected generally to interpret exemptions from the scope of the AIFMD narrowly.

C. Single Investor Funds

One of the elements of the definition of an AIF under the AIFMD is the raising of capital from a number of investors. ESMA's Key Concept Guidelines provide that a fund that is not prevented by its national law, its rules or instruments of incorporation, or any other binding agreement from raising capital from a number of investors could still qualify as an AIF even if the fund in fact has only a single investor. ESMA also confirms that even if the fund is prevented from raising capital from a number of investors but its sole investor consists of a vehicle with a number of persons (such as a feeder vehicle, a nominee acting as agent for more than one investor or a fund of funds), investing capital that it has raised from such persons, then the otherwise single-investor fund should itself be regarded as raising capital from a number of investors.

Thus, AIFMs should not assume that all single-investor vehicles are exempt from the AIFMD, but should look at such vehicles on a case-by-case basis.

D. Co- and Alternative Investment Vehicles

The FCA discusses the treatment of co-investment vehicles in the context of managed account structures limited to a single investor, the manager and its employees or a carried interest vehicle. In the FCA's view, such co-investment vehicles should not qualify as AIFs if they raise capital from a single external investor.

The FCA does not address the situation where a vehicle is used only by investors who have already committed capital to an AIF. A co-investment or alternative investment vehicle with more than one investor should not qualify as an AIF if the vehicle is not used to raise new capital but only to invest capital already raised.

On the other hand, a co-investment or alternative investment vehicle in which investors in the AIF or "friends and family" are permitted to increase their investment in a portfolio company above their existing commitments could qualify as an AIF. It may be advisable to create separate vehicles for any such additional investments and in any case to consider the potential application of the AIFMD before creating such structures.

E. Parallel Funds

Private equity groups often use parallel fund or alternative investment vehicles in which certain types of investors invest for tax or regulatory reasons. The FCA confirms that parallel AIFs can be considered as a single AIF when the parallel entities do not have their

own investment policies.¹⁹ Otherwise, the AIFM could be required to comply with all of the AIFMD’s requirements separately with respect to each vehicle.

F. Family Investment Vehicles

Family investment vehicles are excluded from the scope of the AIFMD under Recital (7) provided they invest the private wealth of investors without raising external capital. The EC Q&A do not address this concept, but the Commission would likely view Recital (7) as a “floating recital” suggesting that such vehicles are only excluded from the scope of the AIFMD if they do not meet the criteria of an AIF. ESMA’s Key Concept Guidelines confirm that there is no raising of external capital when members of a “pre-existing group” invest capital in a vehicle exclusively established to invest their private wealth. “Pre-existing group” includes family members when the existence of the group pre-dates the establishment of the vehicle but family members may join the group after the undertaking has been established.²⁰ The FCA takes a similar approach to ESMA on the conditions that a family investment vehicle needs to satisfy in order to be outside the scope of the AIFMD.

G. Holding Companies

Holding companies are excluded from the scope of the AIFMD under Article 2.3(a) and are defined under Article 4.1(o) AIFMD. The FCA confirms that to qualify as a holding company the entity should (i) carry out a commercial business strategy through its participations by contributing to their long-term value and (ii) not generate returns for its investors by means of divestment of its participations. Another condition in the AIFMD definition of holding companies is that the company’s shares are admitted to trading on an EU regulated market. However, Recital (8) provides that managers of private equity funds or AIFMs managing AIFs whose shares are admitted to trading on a regulated market should not be excluded from the scope of the AIFMD. The FCA’s interpretation of the exclusion and Recital (8) is that the requirements that the AIF’s shares are admitted to trading on a regulated market in the EU only applies to internally managed AIFs. This view does not seem entirely in line with the European Commission’s approach as expressed in the EC Q&A, which does not seem to limit the listing requirement for holding companies to internally managed AIFs.

¹⁹ ESMA’s Key Concepts Guidelines confirm that the factors that could, singly or cumulatively, tend to indicate the existence of such a policy are: (i) the investment policy is determined and fixed at the latest at investor’s binding commitment stage; (ii) the investment policy is set out in a document which becomes part of or is referenced in the rules or instruments of incorporation of the undertaking; (iii) the undertaking or the AIFM is under a legally enforceable obligation to follow the investment policy; and (iv) the investment policy specifies investment guidelines with references the various criteria (such as types of assets, geography, leverage, holding period, risk diversifications strategy)

²⁰ The concept of family members is understood broadly and includes cohabitation and the dependants of an individual.

H. Joint Ventures

Joint ventures are excluded from the scope of the AIFMD under Recital (8). The EC Q&A confirms that Recital (8) is a “floating” recital with no legal effect. Joint ventures are therefore not excluded *per se* but only to the extent they do not have the characteristics of an AIF or fall within the scope of an express exemption.

FCA CP 2 notes that typical joint ventures do not satisfy two elements in the definition of AIF:

- (i) No investment of capital for investors. In a joint venture, the parties invest capital for themselves, not for passive investors. The main distinguishing factor is whether all or some of the parties have day-to-day control. This approach seems to be in line with ESMA’s Key Concepts Guidelines, which confirm that one of the characteristics of a collective investment undertaking is that the investors do not have day-to-day discretion or control over the management of the undertaking’s assets. FCA CP 2 confirms that this remains the case when not all partners are involved in day-to-day management but the strategic financial and operating decisions are under the control of all the parties, as is often the case in club deals.
- (ii) No raising of external capital. Where parties come together on their own initiative, there is no raising of capital within the meaning of the AIFMD. Any capital contributed to a joint venture should not be viewed as external capital because the persons raising and providing that capital are the same.

I. Securitization Vehicles

Securitisation special purpose entities (“Securitisations SPEs”) are excluded from the scope of the AIFMD under Article 2.3(g). Article 4.1(an) AIFMD defines Securitisation SPEs as entities whose sole purpose is to carry on a securitization or securitizations within the meaning of Article 1(2) of Regulation 24/2009. Under this definition, the main characteristics of a securitization are: (i) there is a transfer of assets or a pool of assets to an SPV separate from the originator; and/or (ii) there is a transfer of credit risk of an asset or pool of assets to investors in securities/debt/units/financial derivatives issued by an SPV separate from the originator; and (iii) an SPV is created for or serves the purpose of the securitization.²¹

²¹ It is worth noting that this definition differs slightly from the one provided under Article 122a of the Capital Requirements Directive (the “skin in the game” rule), which includes an express tranching requirement in addition to the transfer of risk.

The concept of “transfer” is not addressed in Regulation 24/2009, the EC Q&A or the UK Consultations. However, FCA CP 2 confirms that in case of transfer of credit risk, the transfer is achieved by either (i) the economic transfer of the assets being securitised to an SPV separate from the originator which is accomplished by transfer of ownership or through sub-participation; or (ii) the use of credit derivatives, guarantees or any similar mechanism.

This AIFMD definition would seem to be broad enough to cover most typical securitisation structures: a synthetic securitisation would not fall under limb (i) but would fall under limb (ii); a covered bond would fall under limb (i); a whole business securitisation would fall under limb (ii) and a classic true sale securitisation would fall under limb (i).

The Commission confirms in the EC Q&A that Securitisation SPEs should be interpreted narrowly and should not be used in order to circumvent the application of the AIFMD. The UK Consultations do not discuss this exemption.

J. UK Collective Investment Schemes

Units in a collective investment scheme (“CIS”) are classified as investments in the UK, so that activities under FSMA such as dealing, arranging, managing, advising can be triggered with respect to a CIS. Establishing, operating or winding up a CIS are also regulated activities in the UK under FSMA Section 19.

The concept of CIS is broadly defined under FSMA Section 235(1) and includes certain features that are common to the concept of AIF: (i) a CIS does not have to be a legal entity and can be an arrangement that involves a contract, a partnership, a trust or even an understanding or a course of conduct; (ii) pooling of participants’ contributions; (iii) the assets must be managed as a whole by or on behalf of the operator; and (iv) participants do not have day-to-day control over the management of the assets. Various exemptions apply under the CIS Order²² such as with respect to body corporates, existing business (which typically applies to joint ventures) and employee share schemes. HMT’s approach is to keep the concept of CIS under FSMA unchanged and create a parallel concept of AIF that relates to the new regulated activity of “managing an AIF”. As a result, despite their similarities, the concepts of AIF and CIS shall be assessed separately. Exemptions that apply to a CIS do not automatically apply to an AIF and vice-versa. The FCA confirms that existing case law and the FCA’s existing guidance on the definition of CIS do not determine whether an undertaking is a “collective investment undertaking” under the AIFMD.

²² The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001.

IV. UK AUTHORIZATION PROCESS

As discussed above, the UK authorities plan to take a pragmatic approach to the one-year grace period provided in Article 61.1 AIFMD and to registration of non-EU AIFMs marketing AIF interests under the UK private placement regime. For UK AIFMs, the UK Consultations provide guidance on the authorization process.

A. Timing of Application

FCA CP 2 indicates that the FCA will confirm in its FCA Policy Statement whether applications will be accepted before the Implementation Date, although FCA CP 1 stated that applications for authorization (or variations of permission) would not be accepted until the Implementation Date. The AIFMD provides that decisions on applications will be made within three months, but the FCA CP 1 states that the FCA may prolong the process by another three months. In the meantime, a UK AIFM is permitted to carry on regulated activities subject to complying with the Handbook rules applicable to it immediately before the Implementation Date. The FCA is also considering a grandfathering process for firms currently holding the UK permissions for operating a CIS.

B. Scope of Permission

Under the AIFMD, the AIFM's core function is investment management (including portfolio and risk management). The Draft UK Regulations confirms that the AIFM is also allowed to carry out one or more additional activities listed in paragraph 2 of Annex I of the AIFMD and/or in connection with or for the purposes of the management of the AIF (together, the "Non-core Activities"). Although not expressly stated in the Draft UK Regulations, the latter should include the activities mentioned in Article 6.4 AIFMD (which covers MiFID activities).

The FCA confirms that the scope of the regulated activity of managing an AIF will cover both investment management and any Non-core Activities that the UK AIFM chooses to perform and therefore no separate permission will be required with respect to such Non-core activities. The FCA further explains that although the current regulated activity of establishing, operating or winding up a collective investment scheme will remain after the implementation of the AIFM and covers similar activities as managing an AIF, there should not be an overlap of permissions in the UK with respect to the same activities. A person establishing, operating or winding up a collective investment scheme will not need a permission when such activity relates to an AIF and that AIF is managed by an authorized AIFM. The same principle applies when a person safeguards or administers investments in relation to an AIF and has a permission to act as a depositary of an AIF in respect of that AIF.

C. Scope of Management Passport

The FCA's initial view expressed in FCA CP 1 is that a UK AIFM that carries on MiFID activities as Non-core Activities should be able to passport those services to other Member States as part of the AIFMD passport (*i.e.*, a separate MiFID passport would not be required). This approach will be welcomed by fund managers whose businesses are based in different European jurisdictions, but the efficiency of such group passporting is dependent upon other Member States' positions on this point. The FCA's approach is not in line with the Commission's view and most other Member States' official views on this remain to be published.²³

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If you have any questions with respect to the issues addressed herein, please contact [James Modrall](#) at the Brussels office of Cleary Gottlieb or any of your regular contacts listed at <http://www.cgsh.com/>.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

²³ With respect to MiFID activities performed by an EU entity in Germany, however, BaFin generally only considers whether the concerned entity is authorized under the laws of its home state. Therefore, if the UK authorizes certain MiFID activities to be covered under an AIFM's authorisation and management passport, BaFin is likely to allow passporting of such activities into Germany.

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