

# The AIFM Directive – The Channel Islands' Perspective

## Introduction

On 11 November 2010 the European Parliament approved the Directive on Alternative Investment Fund Managers (the "Directive"), following months of negotiation.

The Directive (No. 2011/61/EU) was published in the Official Journal of the European Union on 1 July 2011 and came into force on 21 July 2011. It will become law in EU Member States two years later, in 2013 (the "Implementation Date").

The Directive has far-reaching implications for EU managers and funds, but also for third country managers and funds, including those based in the Channel Islands. This Briefing considers the implications of the Directive from a Channel Islands' perspective.

## Scope

The Directive will affect the managers of collective investment funds, and the funds themselves. To assess the impact of the Directive in the Channel Islands one has to understand which structures are regarded by the Directive as funds, and which entities are considered to be the managers of those funds.

### The fund

A fund, for the purposes of the Directive, is defined broadly as any "collective investment undertaking" which raises capital from a number of investors, for investment in accordance with a defined investment policy, for the benefit of those investors. This includes funds investing in any asset class: hedge, private equity, venture capital, real estate, infrastructure, and both open- and closed-ended funds. As such, the starting point is that the scope of the Directive is very broad indeed.

However, the Directive does not apply to, among others (i) retail investment funds (including UCITS funds), (ii) the management of pension funds, (iii) employee schemes, (iv) securitisation SPVs, (v) family offices and similar private investment vehicles, (vi) managed accounts, (vii) holding companies and (viii) joint ventures.

There are also exemptions for (i) managers of funds with an aggregate gross asset value of no more than €100m (with leverage), (ii) managers of funds with an aggregate gross asset value of no more than €500m million (without leverage) where there is no redemption right for 5 years, and (iii) managers of closed-ended funds where no investments are made after the Implementation Date or which are closed for subscription at the Implementation Date and expire no later than 2016.

Accordingly, Channel Island structures will need to be reviewed to consider whether they fall within the Directive's definition of a fund and thus whether they may be impacted by the Directive. It is anticipated that a number of commonly-used Channel Island structures may benefit from the above restrictions in scope and thus fall outside of the scope of the Directive (for example, a number of proprietary and joint venture vehicles) or may, with appropriate restructuring, fall outside of scope. The Directive will be a material consideration as to the structuring of a number of Channel Islands vehicles so that, as desired, structures can either fall within or outside of the scope of the Directive.

## The fund manager

Fund managers are defined in the Directive, in short, as the person responsible for providing portfolio management and risk management services to a fund.

For the purposes of the Directive every fund must have a fund manager. Where a fund has an external third party manager, that entity will be the manager. Where there is no third party (the fund is 'internally managed'), the fund will itself be the fund manager.

A fund manager can include, therefore, the managing trustee or manager of a unit trust, the manager of a corporate fund, the general partner of a limited partnership and the board of a corporate fund (if there is no separate manager). It will not include advisors or administrators of funds.

However, it will not always be a simple matter to determine who the fund manager is. The precise function of participants in an arrangement and the precise nature of their appointment will influence who is the fund manager. Existing and new structures may need to be reviewed to determine the position, and if appropriate restructuring may be desirable.

## Manager authorisation

The Directive requires both EU and non-EU managers (including those in the Channel Islands) to be authorised, but at different times.

### 2013 – all EU fund managers

Immediately from the Implementation Date, all fund managers based in the EU will have to be authorised under, and to comply with the full provisions of, the Directive.

### 2015 – certain non-EU fund managers

From 2015 (two years after the Implementation Date), non-EU-based fund managers, including those in the Channel Islands, who:

- manage EU-based funds; or
- wish to market non-EU-based funds in the EU with the benefit of an EU "passport"

will also have to be authorised under and to comply with the provisions of the Directive\*.

(\*Although Channel Island managers may be able to deviate from the Directive's provisions where the relevant Channel Island has equivalent rules to those laid out by the Directive offering the same level of investor protection.)

The implications of Directive authorisation and compliance are significant, with rules on, inter alia, (i) capital requirements, (ii) remuneration, (iii) depositories, (iv) valuation, (v) delegation, (vi) risk management, (vii) liquidity management, (viii) disclosure to investors and regulators, (ix) leverage; and (x) the acquisition of stakes in EU companies.

## Marketing

As well as requiring the registration of fund managers in certain circumstances, the Directive affects the ability to market funds to EU institutional investors.

### Private placement to at least 2018

The Directive permits the continued marketing of all Channel Islands-based funds (whether with a Channel Island- or EU-based fund manager) and all EU-based funds with a Channel Island manager into the EU in exactly the same way as they are currently marketed, pursuant to the national private placement regimes of individual EU member states, up to 2018 at least.

However, from the Implementation Date, 3 additional conditions will be imposed in order that private placement regimes can continue to be used, namely:

- co-operation agreements for the purpose of systemic risk oversight are in place between the Channel Island and the member state where the fund is to be marketed;
- the Channel Island is not listed as a Non-Cooperative Country or Territory by the FATF; and

- (in the case of funds with a Channel Island-based fund manager) the Channel Island fund manager adheres to the same transparency requirements under the Directive as apply to EU fund managers.

The Channel Islands should easily meet all these criteria.

The Channel Islands are acknowledged as being well regulated and co-operative financial centres, in accordance with international standards. The Channel Islands are also signatories to the IOSCO multi-lateral memorandum of understanding between regulators and are party to bilateral regulatory agreements with many EU states - including all key jurisdictions - and so should easily meet any criteria based (as is anticipated) on IOSCO standards.

The Channel Islands have also received various endorsements of their anti-money laundering regimes – for example, recent IMF reviews of the islands' regulatory and supervisory legislation and practices rated the Channel Islands as being ahead of the UK and others in meeting compliance with the FATF's "40+9" Recommendations as to counter-measures against money laundering and terrorist financing. As such, the Channel Islands will not feature on the list of non-cooperative countries.

### **EU passport from 2015**

From 2015 (two years after the Implementation Date) the Directive will also allow all Channel Island-based funds (whether with a Channel Island or EU-based fund manager), and all EU-based funds with a Channel Island manager, to be marketed throughout Europe on the basis of an EU marketing "passport", provided that the following conditions are met:

- co-operation agreements are in place between the Channel Island and the "EU member state of reference" (which can mean the "home" EU country of the EU fund/EU manager or a member state where the Channel Island-based fund is to be marketed);
- the Channel Island is not listed as a Non-Cooperative Country or Territory by the FATF; and
- the Channel Island has entered into tax information exchange agreements (TIEAs) with the EU member state of reference and each EU country where the fund is to be marketed.

As noted above, the Channel Islands' regulatory regimes and network of regulatory co-operation agreements, and the high AML standards maintained in the Channel Islands, should mean the first two criteria are easily met.

In relation to tax information exchange, the Channel Islands have been commended in a recent OECD report which confirms that the islands have abided by the OECD rules on transparency and information exchange for tax purposes, and both of the Channel Islands are on the G20 "white list".

Each of the Channel Islands already has TIEAs in place with a significant number of the major EU countries – including almost all of the major markets for Channel Island funds – including TIEAs with France, Germany, Denmark, the Netherlands, Sweden and the UK (as well as major non-EU countries such as USA, Canada and South Africa). The Islands have also been working diligently to ensure that agreements are in place with all outstanding EU countries, and are already close to finalising or have received positive responses from all but the peripheral EU states (who have not yet been approached). As such, the Channel Islands have positioned themselves well for the Directive, with an appropriate functioning network of TIEAs already in place, and aim, by 2015, to have TIEAs in place with all EU nations, both large and small.

### **Opportunities**

The Directive poses both challenges and opportunities for onshore and offshore fund managers alike. For Channel Island managers, and Channel Island funds, there are opportunities to maintain, and to build, current products and services on a "business as usual" basis, but also opportunities to develop new structures and products. It is the Islands' objective to both ensure the continued functioning of existing frameworks, but also to exploit opportunities for improved market access by developing an "opt-in" Directive-compliance regulatory regime.

As noted above, there are a number of structures and products which are likely to fall outside of the scope of the Directive, and thus will continue to be attractive to managers and investors. For example, the Directive will not apply at all to Channel Island funds with a Channel Island manager where there is no "active" marketing in the EU. As such, where EU investors are not sought, a Channel Island fund with a Channel Island manager may be a very attractive option, such that the Channel Islands could become the fund domiciles of choice for promoters focussed on non- EU investors.

The Directive is also clear that it does not apply to "passive marketing" (or "reverse solicitation" as it is also known). Marketing is defined in the Directive as "any direct or indirect offering or placement *at the initiative of the fund manager...*of units in the fund to or with investors in the EU". As such, where a manager's investor base engages in

reverse solicitation, such investors can be accepted into a non-Directive fund without problems. The definition may also mean that a number of structures which would otherwise be within the scope of the Directive nonetheless fall outside.

Indeed, it may be that institutional investors based in the EU are proactive in approaching non-EU managers, or investing through Channel Island structures, if their preference is to "opt-out" of the Directive and go for a "non-Directive" solution or product (driven, perhaps, by a desire to avoid the detrimental impact on financial returns that a "Directive-compliant" fund is likely to bring). Similarly, EU managers may be motivated to move, or to move activity, outside the EU (which could include the Channel Islands) where this offers advantage.

The Channel Islands have long been and remain well-regulated and well-respected international finance centres; offering tax neutrality for funds (and low tax for fund management activity), a variety of flexible legal vehicles and a breadth and depth of funds industry expertise and services. As such, the Channel Islands should be well-positioned to continue to prosper in the new environment brought about by the Directive – offering benefits for managers and investors both inside and outside the scope of the Directive.

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