



# Update on AIFM Directive

Impact Analysis for Jersey and Guernsey Investment Funds

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# Impact Analysis for Jersey and Guernsey Investment Funds

After a protracted period of negotiation, the AIFM Directive was finally approved by the European Parliament on 11 November 2010.

The Directive, which was brought into force on 21 July 2011, regulates the activities of managers of alternative investment funds (“**AIF Managers**”) as follows:

- (a) if the AIF Manager is based in the EU, on its worldwide activities; and
- (b) if the AIF Manager is based in a third country outside the EU (a “**Third Country**”), only to the extent that it has activities within the EU.

The position of Third Country AIF Managers was initially contentious but has now been resolved by creating a dual system of allowing the existing private placement rules to continue until at least 2019, while also phasing in an option for Third Country AIF Managers to qualify under an EU passporting regime.

EU Member States have until 22 July 2013 to adopt the laws, regulations and administrative provisions necessary to comply with the AIFM Directive.

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## Private Placement Rules

Third Country AIF Managers will be able to continue to market Third Country funds to professional investors in EU Member States by using the existing private placement rules until at least 2019, subject to the following conditions:

### 1 Regulatory Co-operation

A supervisory co-operation agreement must be in place between the regulator of the EU Member State in which the fund is to be marketed and the Third Country

regulator of the AIF Manager. Jersey is a founding signatory to the IOSCO multilateral memorandum of understanding and already has bilateral regulatory agreements with the UK and with ten other EU Member States. Guernsey is also an IOSCO signatory and has bilateral regulatory agreements with the UK and seven other EU Member States.

### 2 Financial Action Task Force (“**FATF**”)

The Third Country where the AIF Manager and the fund is established must not be on the FATF blacklist. The Channel Islands have extremely high anti-money laundering standards and Jersey is rated by the IMF as being at the top of global standards and significantly ahead of a number of EU Member States. The IMF is expected to release its report on Guernsey shortly. Neither Jersey nor Guernsey is on the FATF blacklist.

### 3 Transparency and Reporting

The Third Country fund must comply with certain transparency and reporting requirements set out in the Directive. In summary, the fund’s annual report must disclose, as relevant, its principal counterparty exposures, liquidity arrangements, risk management arrangements, any controlling interests and certain other matters prescribed under the Directive.

Private placement has been the standard distribution model for the marketing of alternative investment funds both within and outside the EU for a number of years. Jersey or Guernsey general partners of limited partnerships established in the Channel Islands will be able to continue to rely on private placements for marketing of alternative funds in the EU, until at least 2019 when the Directive will be subject to review. Jersey and Guernsey incorporated managers of corporate funds set up in the Channel Islands will also have the advantage of continued stability in private placement distribution. However, once the Directive comes into effect, EU AIF Managers will no longer be permitted to use the private placement rules for marketing EU alternative investment funds, even on a domestic EU distribution basis. Instead, such EU AIF Managers with EU Funds will be required to comply with the more onerous

requirements of the proposed passporting regime. This may lead arrangers to prefer to use a Third Country AIF Manager and/or alternative investment fund formed in the Channel Islands.

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## Passporting

Third Country funds which are based in jurisdictions whose regulatory regimes qualify as equivalent in effect to EU standards will be able to apply for a passport for the fund to be marketed throughout the EU. Passporting for Third Country funds is expected to become available within two years of the Directive being implemented and will be subject to compliance with the Directive and to the following conditions:

### 1 Regulatory Co-operation

In addition to the requirement for supervisory co-operation agreements to be in place (similar to those provided above in relation to the private placement rules), the Third Country AIF Manager must also appoint a representative in the EU Member State with which it has the most substantive connection.

### 2 FATF

The Third Country must not be on the FATF blacklist (as provided above in relation to the private placement rules).

### 3 Tax Information

A tax information exchange agreement (“TIEA”) must be in place between the Third Country where the fund is based and each EU Member State where the fund is to be marketed. Jersey currently has TIEAs with the UK and with nine other EU Member States. Guernsey has TIEAs with the UK and twelve other EU Member States.

On the basis of current regulatory policy in the Channel Islands, Jersey and Guernsey should comfortably satisfy the equivalence requirements as their regulatory standards conform to international best practice and in many respects are more developed than those of a number of EU Member States.

A possible structuring option, therefore, would be to use a Jersey or Guernsey AIF Manager to distribute either EU or a Channel Island alternative investment fund throughout the EU by

using an AIFM Passport.

There is a concern, however, that the costs of complying with the full requirements of the Directive (in terms of capital adequacy, leverage restrictions, appointment of external valuation agents, depository and other requirements), may impact adversely on a fund’s total expense ratio. The benefits of passporting are likely to accrue principally to retail funds which are marketed on a pan-European basis. Alternative investment funds, which have traditionally been marketed on a selective distribution basis to professional and institutional investors, may find that the benefits of passporting prove to be illusory.

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## Passive Marketing

The Directive does not apply to passive marketing or to reverse solicitation. This means, in effect, that EU investors may contact Third Country AIF Managers and invest in Third Country funds, even if the Third Country AIF Manager does not satisfy any of the provisions of the Directive.

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## Marketing outside the European Union

EU AIF Managers and EU alternative investment funds will become subject to significant additional requirements under the Directive, including enhanced disclosure requirements, leverage limitations, concentration restrictions, reporting requirements and caps on remuneration for managers. As a result, it is expected that a number of arrangers will wish to establish Third Country alternative investment funds and/or feeder funds and associated Third Country AIF managers for the purposes of marketing funds to investors based in the United States or Asia.

	Bilateral Regulatory Agreements	TIEAs
<b>Jersey</b>	Belgium, Cyprus, France, Germany, Gibraltar, Ireland, Italy, Malta, Netherlands, Poland, United Kingdom  Australia, Bahrain, Bermuda, British Virgin Islands, Canada, Cayman Islands, China, Guernsey, Hong Kong, Isle of Man, Mauritius, Oman, Qatar, South Africa, United Arab Emirates, USA	Czech Republic, Denmark, Finland, France, Germany, Ireland, Netherlands, Portugal, Sweden, United Kingdom  Argentina, Australia, Canada, China, Faroes, Greenland, Iceland, India, Indonesia, Mexico, New Zealand, Norway, South Africa, Turkey, USA
<b>Guernsey</b>	Belgium, Cyprus, France, Germany, Gibraltar, Italy, Malta, Netherlands, United Kingdom  Australia, Hong Kong, Iceland, Isle of Man, Jersey, Mauritius, South Africa, United Arab Emirates, USA	Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Netherlands, Portugal, Romania, Slovenia, Sweden, United Kingdom  Argentina, Australia, Bahamas, Canada, Cayman Islands, China, Faroes, Greenland, Iceland, Indonesia, Mexico, New Zealand, Norway, San Marino, South Africa, USA

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This client briefing has been prepared for clients and professional associates of the firm on the basis of the form of the AIFM Directive approved by the European Parliament on 11 November 2010. The information and expressions of opinion which it contains are not intended to be a comprehensive study or to provide legal advice and should not be treated as a substitute for specific advice concerning individual situations.

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