

INVESTMENT MANAGEMENT

# AIFMD

Reshaping for the future

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# Introduction



The AIFMD is having a significant reshaping effect on the alternative investment fund industry in Europe and beyond.

The broad scope of the Directive captures many managers of hedge funds, private equity funds, real estate funds and infrastructure funds that are marketed in the EU. Some players were either lightly regulated or unregulated in the past and the work required to adapt their operations to the new requirements is substantial. The operating model of managers that run funds across multiple jurisdictions is also impacted, and the value chain may require re-organisation due to new rules on delegation and depositaries.

The AIFMD has been transposed into national legislation in the majority of EU Member States.

In this publication we provide an overview of the AIFMD (Level 1 and Level 2) legal and regulatory framework that governs the alternative investment fund industry in the EU that has, since July 2013, reshaped the operations of managers and the alternative funds they manage.

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# Context and background to the AIFMD

At a G20 summit in November 2008 the G20 leaders concluded that a secure and stable financial system requires all significant financial market actors to be subject to appropriate regulation and supervision for investor protection as well as financial stability reasons. This conclusion led the European Commission to publish in April 2009 a proposal for a Directive for Alternative Investment Fund Managers (AIFMD), one of the major EU regulatory initiatives to extend appropriate regulation and supervision to the alternative investment fund management industry. The text was finally agreed in October 2010 by the EU legislators, came into force on 21 July 2011 and Member States needed to transpose the framework into national law by 22 July 2013.

The AIFMD essentially lays down the rules for the authorisation, ongoing operation and transparency of fund managers that manage and/or market alternative investment funds (AIF) in the European Union. The AIFMD significantly changed the regulatory framework for a wide spectrum of funds including hedge funds, private equity funds, real estate funds and infrastructure funds from its implementation deadline in July 2013. The new rules not only affect the managers of AIFs but also signal some major changes for their depositaries, administrators and external valuers. The primary focus of the Directive is to regulate the fund manager, as opposed to regulating the funds, which is the EU approach in the field of retail UCITS.

Nevertheless, fund operations will be indirectly impacted by provisions such as requirements for leverage limits, fund risk profiles and portfolio liquidity. In return for regulation, fund managers will be able to benefit from a passport to manage and market AIF throughout the EU. The Directive is only the first part of the new legal framework. On 19 December 2012 the European Commission adopted a Delegated Regulation (so-called 'Level 2 measures'), providing a very extensive set of detailed implementing measures and technical rules on a wide range of topics in the AIFMD. The Regulation is binding in its entirety and directly applicable in all Member States and does not need any national transposition.

Fund managers falling within the scope of the AIFMD need to carefully consider the implications of the Directive for their business. The AIFMD draws heavily from the UCITS Directive<sup>1</sup> and MiFID<sup>2</sup> and those managers already working within these frameworks will be familiar with many of the requirements.

Fund Managers based outside the EU that manage and/or market alternative investment funds in the EU will also be significantly impacted by the AIFMD and will need to adapt their operations and marketing activities to this new framework.

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<sup>1</sup> Directive 2009/65/EC on Undertakings for Collective Investment in Transferable Securities

<sup>2</sup> Directive 2004/39/EC on Markets in Financial Instruments

# Timeline\*

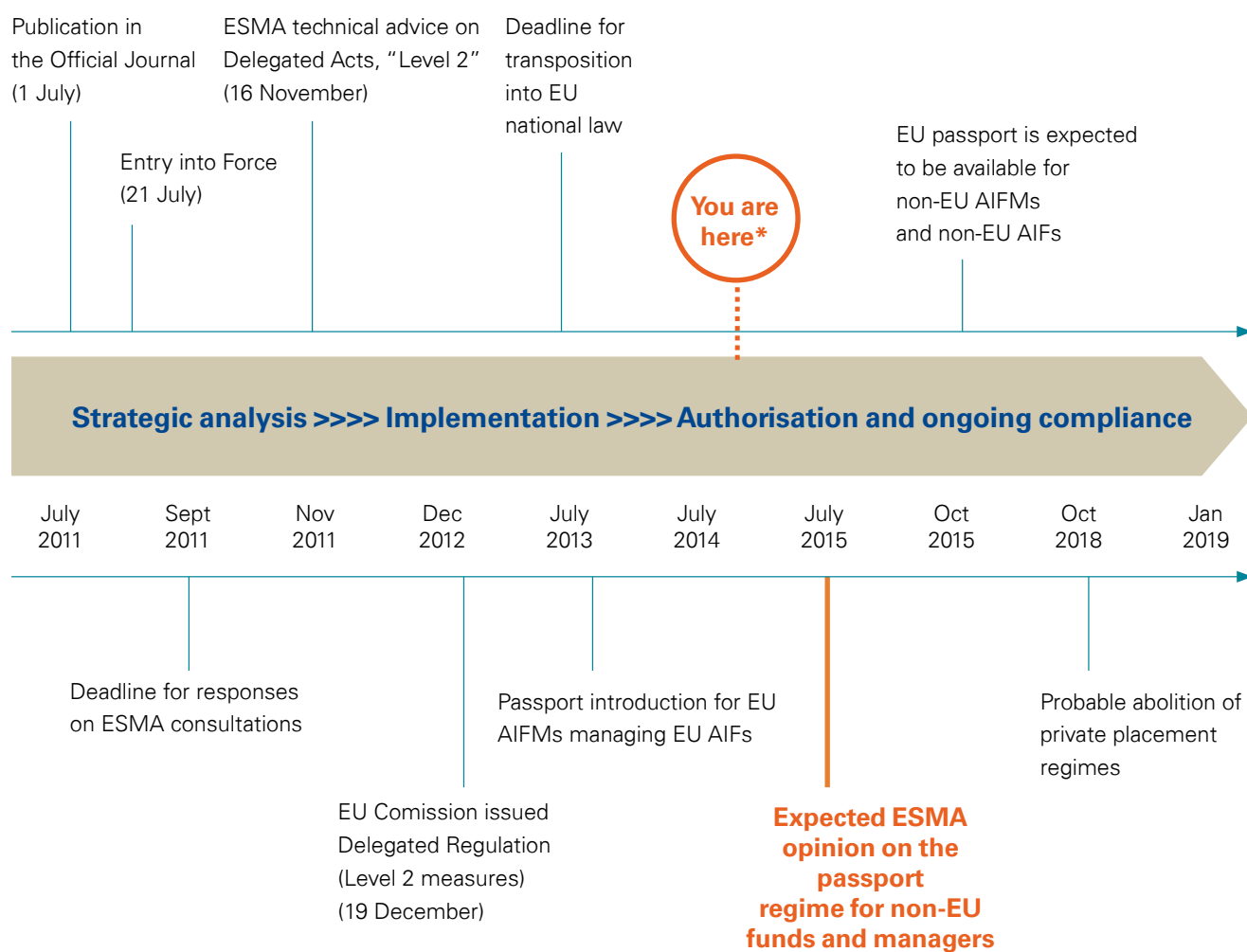


Table 1

\*As at 1 November 2014

# Impact of AIFMD

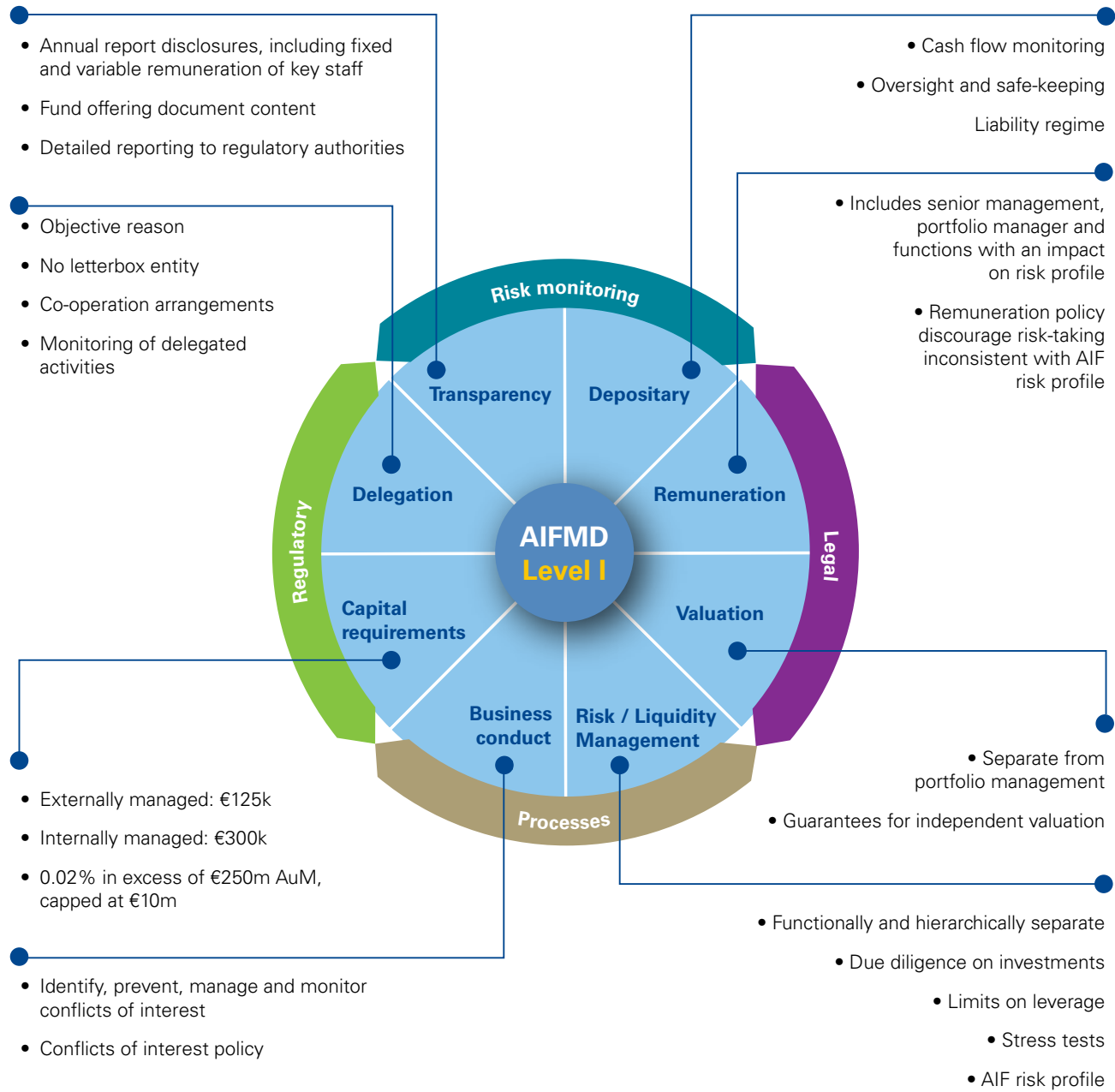


Table 2

## Impact of AIFMD detailed rules

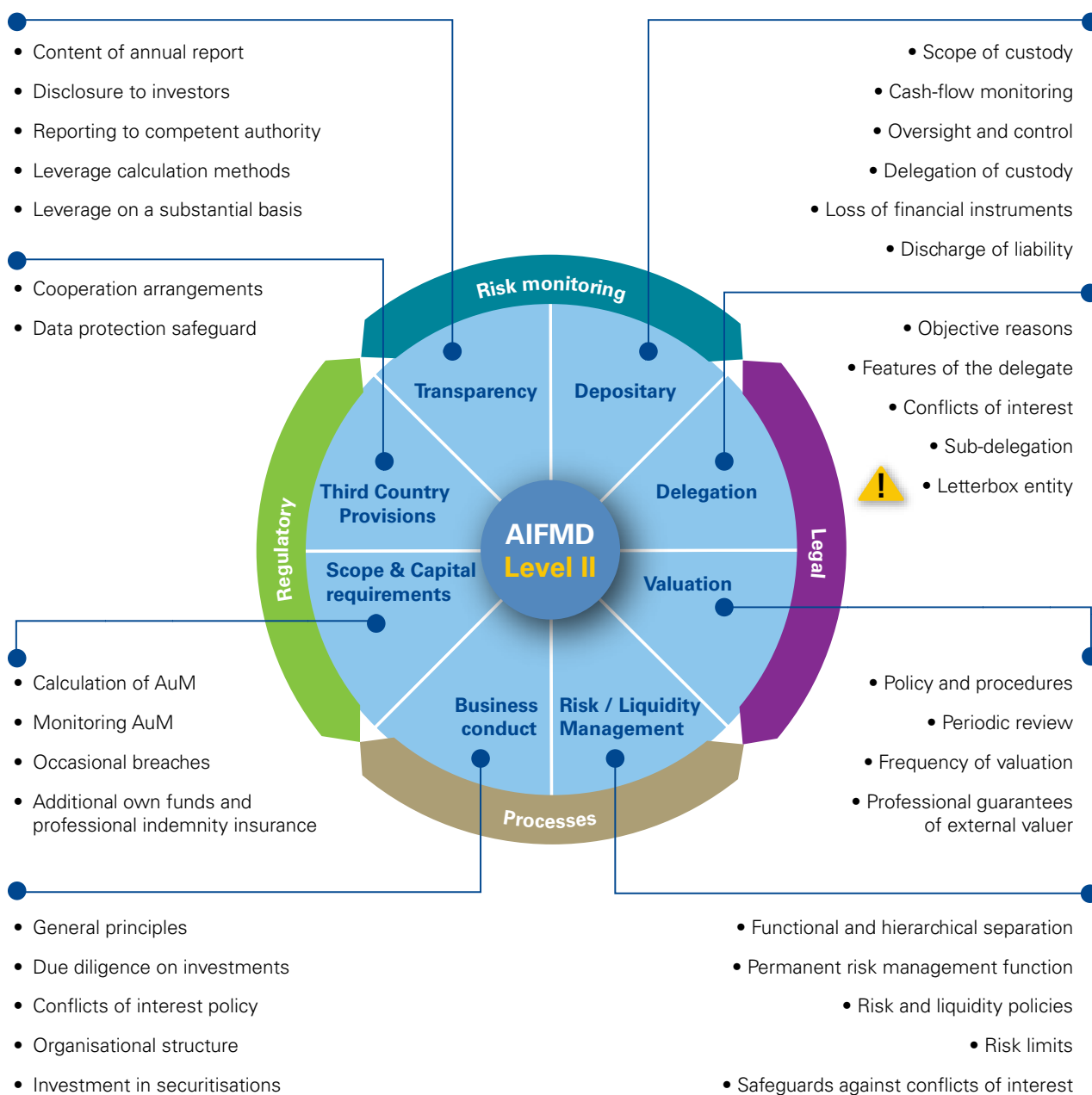


Table 3

# Managing Alternative Investment Funds in the EU

## Scope

The Directive requires any fund manager whose regular business is to manage AIFs in the European Union (EU) to be authorised by, or registered with, a competent authority in the EU. This new framework applies to fund managers that have their registered office in the EU with its provisions extending to the management of non-EU AIF by these managers. The Directive also applies to fund managers based outside EU borders which manage and/or market AIFs in the EU.

### Defining an Alternative Investment Fund

The Directive contains a broad legal definition of an AIF, and seeks to capture any non-UCITS investment fund. An AIF is defined as a collective investment undertaking which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors<sup>3</sup>. An AIF may be either an open-ended or closed-ended fund and may take any legal form<sup>4</sup>.

There are a number of key exemptions to the scope of the AIFMD. Specifically excluded from the definition of AIF are holding companies, joint ventures, securitisation special purpose entities, pension funds, employee participation or savings schemes and family offices.

The Directive foresees some 'grandfathering provisions' for fund managers of certain types of closed-ended funds. Managers of (a) closed-ended AIF that do not make any additional investments after 22 July 2013 or (b) closed-ended AIF whose subscription period for investors has closed prior to 22 July 2011 and will be wound up at the latest on 22 July 2016, will not be required to seek an AIFM license. However fund managers falling under category (b) will be required to comply with annual reporting requirements and disclosure requirements where they control portfolio companies.

### The functions of an AIFM

#### i. Core functions

The concept of 'management of AIFs' is comprised of the core activities of portfolio management and risk management, with the AIFM license covering both these activities. If permitted by its legal structure an AIF could be internally managed, and as such the AIF is authorised as the AIFM. Otherwise an external AIFM can be appointed by one or more AIFs.

#### ii. Other functions

The AIFM may also perform additional functions in the course of the management of AIFs including administration (legal and accounting services; customer inquiries; valuation, pricing, tax returns; regulatory compliance monitoring; maintenance of unit-/shareholder register; distribution of income; unit/shares issues and redemptions, contract settlements and record keeping), marketing and services specifically related to the assets of an AIF.

#### iii. Additional investment services

External AIFMs may be authorised by individual Member States to provide additional investment services permitted under MiFID including discretionary portfolio management, investment advice, safe-keeping and administration of fund units and the receipt and transmission of orders in relation to financial instruments.

MiFID 2 modifies the AIFMD to specify that an AIFM authorised to provide investment services has the right to provide these services on a cross-border basis<sup>5</sup>.



<sup>3</sup> Guidelines on key concepts of the AIFMD (Ref: ESMA/2013/611) provides guidance on the definition of an AIF

<sup>4</sup> Commission Delegated Regulation No 649/2014 with regard to regulatory technical standards determining types of alternative investment fund managers describes open ended and closed ended funds.

<sup>5</sup> ESMA Q&A Application of AIFMD - section V





#### iv. EU Passports for management and marketing of AIFs

The AIFM license will confer an EU-wide management passport to AIFM that will permit the management of AIFs based in any EU Member State, either directly or through a branch. The host country competent authorities will not be able to impose any additional requirements on the AIFM in respect of the areas covered by the Directive.

The AIFMD will also confer an EU-wide marketing passport to the AIFM to market AIFs that it manages to professional investors across the EU.

#### Small AIFMs – exemption from full AIFMD regime

The Directive foresees a registration regime for fund managers whose assets under management are below certain thresholds, less than €100 million (including any assets acquired through use of leverage) or less than €500 million in unleveraged AIFs that are without redemption rights for a period of five years.

These fund managers would fall under a lighter registration regime, rather than full AIFMD compliance, and would not benefit from the EU-wide management or marketing passport. However an opt-in procedure is included that would allow small AIFMs to apply for a full AIFM license.

#### vi. Registration regime

As part of the registration process the fund manager must provide information on its identity, the AIFs managed and their investment strategies to the competent authorities. On a regular basis the fund manager will need to report on the main instruments traded, the principal exposures and most important concentrations of AIFs managed.

The registration regime in the AIFMD is without prejudice to any stricter local rules adopted by Member States. The main intention of the regime is to allow the competent authorities to effectively monitor systemic risk.

#### Additional new EU Marketing Passport Regimes

In parallel to the AIFMD, the European authorities adopted two new Regulations creating (1) a 'European Venture Capital Fund' (EuVECA) label<sup>6</sup> and (2) a 'European Social Entrepreneurship Fund' (EuSEF) label<sup>7</sup>, that came into force on 22 July 2013. EU managers managing less than €500 million and whose funds qualify for these labels have access to a Marketing passport to market the funds to certain categories of investors (professional and sophisticated retail) across the EU. The regimes are optional, with no obligation to comply, and are less onerous than the full AIFMD regime.

#### AIFM Assets under Management (AuM) calculation

The Regulation specifies the method for calculating the total value of Assets under Management (AuM), which is a key point in defining whether an AIFM is in scope of the AIFMD.

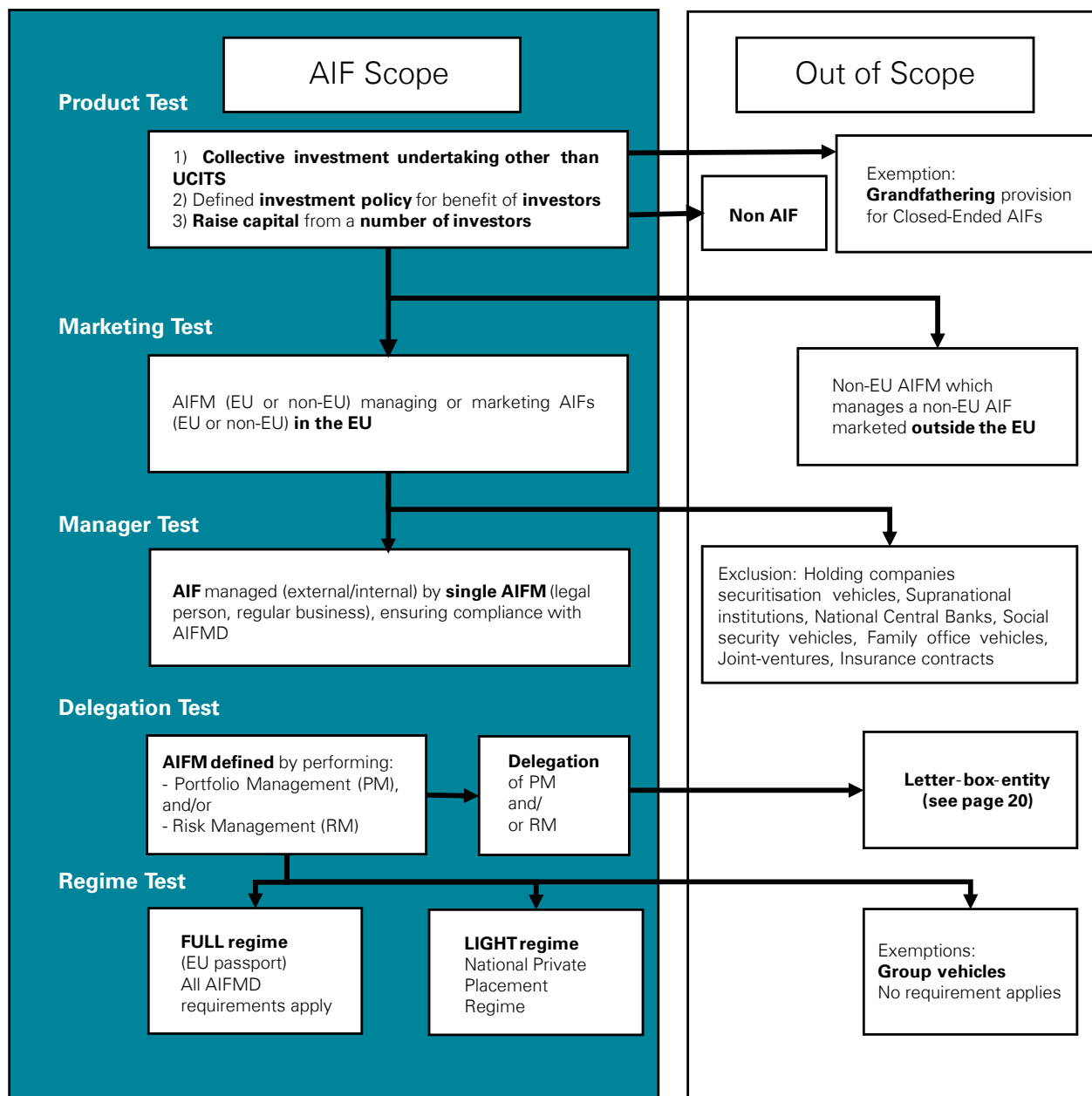
The AuM must be calculated based on the values of all assets managed by the AIFM without deducting liabilities and is not based on the NAV of the AIFs. In order to take the leverage embedded in derivatives fully into account the AIFM will have to value derivatives at the equivalent position in the underlying assets, and not at the mark-to-market value.

Cross-holdings in other AIFs are excluded from the calculation as well as any UCITS managed by the AIFM. The AIFM will be required to monitor the AuM on an ongoing basis and should the AuM exceed thresholds for more than 3 months the AIFM must submit an application for authorisation of the AIFM to its competent authority within 30 days.

<sup>6</sup> Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds

<sup>7</sup> Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds

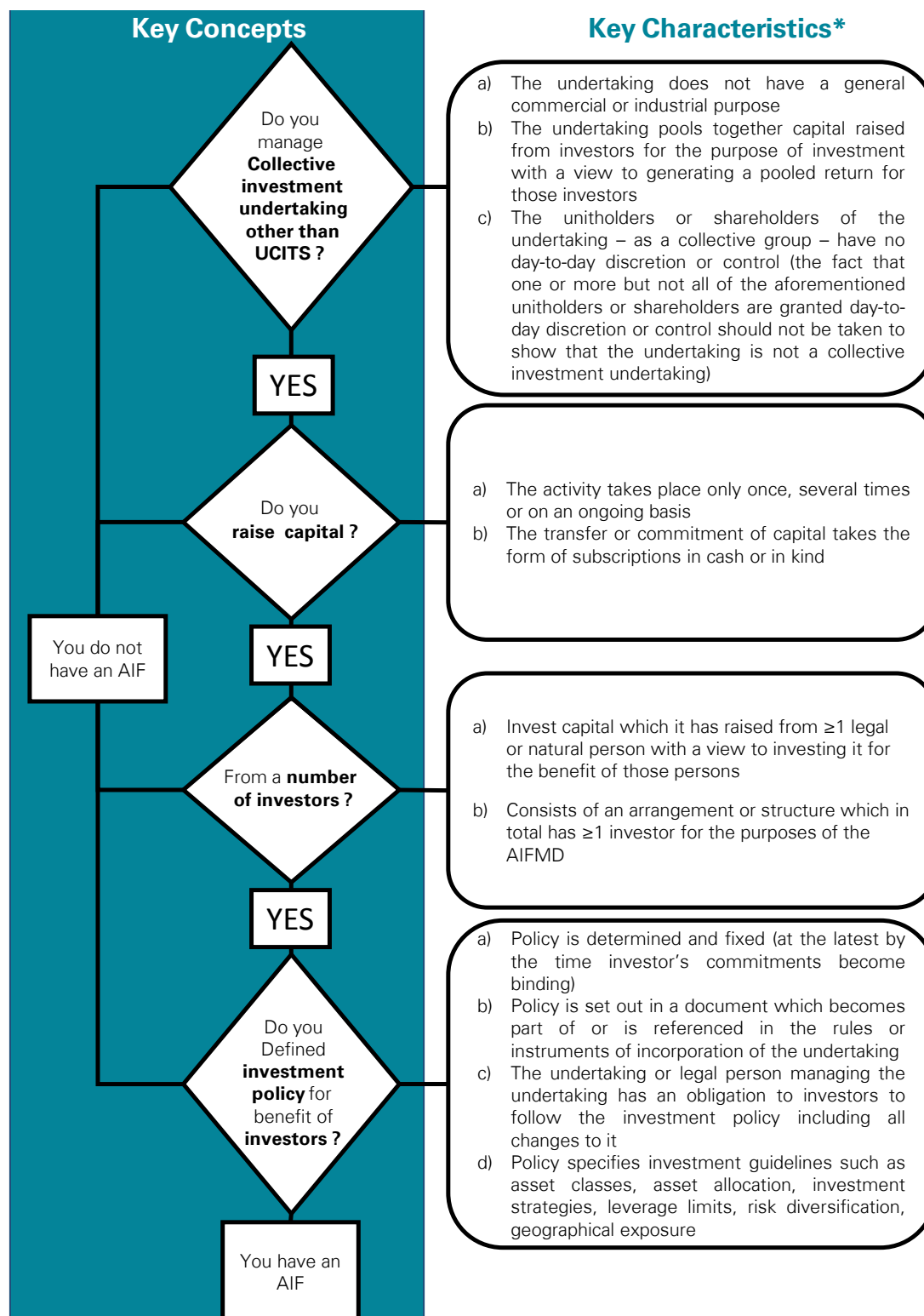
## Scope assessment Matrix



**Transposition of AIFMD in EU Member States may restrict or expand the scope further.**  
 See in Appendix for Transposition overview in EU Member States.

Table 4

## AIF decision tree



\*According to the ESMA/2013/600 "guidelines on key concepts of the AIFMD": Market participants should not consider that the absence of all or any one of the characteristics under each of the concepts above conclusively demonstrates that an undertaking does not fall under the relevant concept and thus AIFMD.

Table 5

## Authorisation process

### Requirements for EU Managers seeking authorisation

The head office and registered office of an AIFM will need to be located in the same Member State, and the fund manager will have to apply to its home competent authority for authorisation. AIFMs performing activities under the Directive before 22 July 2013 were required to submit an application for authorisation by 22 July 2014. Any new managers will need to be authorised before commencing activities.

The application file will need to contain:	
<b>1) Manager related information</b>	<ul style="list-style-type: none"> <li>- The senior management, their good repute and experience in the AIF investment strategies.</li> <li>- The shareholders with qualifying holdings.</li> <li>- A detailed business plan setting out the organisational structure and how the manager will comply with the operating conditions, including those applicable to leveraged AIF and AIF that take control of portfolio companies, transparency requirements, passport conditions and conditions for marketing to retail investors.</li> <li>- Remuneration policies and practices.</li> <li>- Delegation and sub-delegation arrangements to third parties.</li> </ul>
<b>2) AIF related Information</b>	<ul style="list-style-type: none"> <li>- Investment strategies.</li> <li>- Fund rules or incorporation documents.</li> <li>- Depositary arrangements.</li> <li>- Disclosures to investors.</li> <li>- Master fund if AIF is a feeder.</li> </ul>
<b>3) Additional information if AIFM wants to manage EU AIFs established in other Member States (Passport)</b>	<ul style="list-style-type: none"> <li>- The Member State in which it intends to manage AIFs directly or establish a branch.</li> <li>- A programme of operations stating services to be performed.</li> <li>- List of AIFs it intends to manage.</li> <li>- The organisational structure of the branch (if relevant); the names and contact details of the branch management; the branch address.</li> </ul>

Table 6

The Directive foresees specific conditions for UCITS Management Companies applying for an AIFM license, expressly mentioning that the competent authority cannot require information or documents already submitted for the UCITS license application.

The AIFM will also need to have sufficient capital as described on page 13. An applicant will be informed in writing within 3 months of submission of a complete

application file whether or not authorisation has been granted and will have to make use of the authorisation within 12 months. The competent authorities may restrict the scope of authorisation as regards the investment strategies that an AIFM is allowed to manage.

ESMA will maintain a public register of all authorised AIFMs, including a list of the AIFs managed and/or marketed in the EU for each AIFM.

### Requirements for non-EU Managers seeking authorisation to manage EU AIFs

As from 2015, non-EU Managers will have the possibility, subject to a decision from the EU authorities, to benefit from the Management and Marketing Passports. In order to benefit from these Passports the non-EU Manager will have to become authorised under the AIFMD. A non-EU fund manager must submit an application file that will include the information provided in the table on the previous page to the competent authorities in an EU 'Member State of Reference' (MSR) to become authorised to manage EU AIFs.

The fund manager is required to appoint a legal representative established in the MSR. The legal representative will act as the point of contact for the non-EU fund manager in the EU for official correspondence between the competent authorities, the investors and the non-EU fund manager. The legal representative will perform the compliance function with the non-EU fund manager for all AIFMD requirements, and should be sufficiently equipped to perform this function.

The fund manager should comply with all the provisions in the AIFMD. In cases where compliance with a provision is incompatible with provisions of another mandatory law, there is no obligation on the fund manager to comply with the relevant AIFMD provision.

The fund manager will then however be required to provide any such list of conflicting provisions in their application file, and also provide evidence that it is subject to and complies with equivalent rules with the same regulatory purpose and level of investor protection.

There will need to be appropriate co-operation arrangements ensuring efficient exchange of information between the competent authorities of the MSR, the competent authorities of the EU AIFs and the competent authorities in the non-EU country where the manager is established. This non-EU country cannot be on the FATF list of 'Non-Cooperative Countries and Territories', must have signed a tax information exchange agreement with the MSR, and its laws and regulations must not prevent effective supervision by the competent authorities.





Determination of the Member State of Reference for a non-EU Manager<sup>8</sup>

If the fund manager manages EU AIF and does not intend to market AIF in the EU using the Passport, then the ‘Member State of Reference’ is determined based on:

EU AIFs in several Member States	1) Where most of the AIFs are established, or 2) Where the greater amount of assets are managed.
----------------------------------	-----------------------------------------------------------------------------------------------------

If the fund manager manages and markets AIF in the EU via the Marketing Passport, the ‘Member State of Reference’ is as follows:

EU AIF in one Member State	1) For authorised or registered AIF either home MS or MS where AIFM intends to market. 2) For non-authorised/registered AIF the MS where AIFM intends to market.
EU AIFs in several Member States	1) If all AIFs authorised or registered in the same MS, either home MS of AIFs or MS where AIFM intends to market most AIFs. 2) If not authorised or registered in the same MS, MS where AIFM intends to market most AIFs.
Non-EU AIF in one or several Member States	One of the MS of marketing.
EU AIFs and non-EU AIFs in one or several Member States	MS where AIFM intends to market most AIFs.

Table 7

The AIFM will have to submit a written request to the competent authorities in each Member State that is a possible Member State of Reference. The competent authorities are required to make a joint decision within 1 month.

The competent authorities will consult with ESMA and seek their advice on the determination of the Member State of Reference.

<sup>8</sup> Detailed rules for determining the Member State of Reference are contained in the Commission Implementing Regulation (EU) No 448/2013 of 15 May 2013 establishing a procedure for determining the Member State of Reference of a non-EU AIFM pursuant to Directive 2011/61/EU of the European Parliament and of the Council.

General operating conditions

Capital requirements

The AIFMD sets out requirements for initial capital and own funds. AIFMs also have to cover potential liability risks by providing additional own funds or a professional indemnity insurance.

Summary of requirements
<ul style="list-style-type: none"><li>- Internally managed AIF must have initial capital of at least €300,000.</li><li>- Externally appointed AIFMs must have initial capital of at least €125,000. They must also have additional own funds equal to 0.02% of the amount by which the portfolio of AIFs exceeds €250 million, subject to an overall limit of €10 million.</li><li>- The AIFMD allows Member States to authorise AIFMs to provide up to 50% of the required additional own funds with a guarantee from a credit institution or an insurance undertaking that has a registered office either in an EU Member State or in a third country with equivalent prudential regulations.</li><li>- The own funds of the AIFM must exceed a quarter of the previous year’s fixed overheads.</li><li>- The portfolio of AIFs only includes those AIFs for which the AIFM is the appointed AIFM and excludes assets managed on a delegated basis.</li><li>- Both externally appointed AIFMs and internally managed AIFs must have either additional own funds or professional indemnity insurance to cover potential liability risks arising from professional negligence.</li><li>- Own funds must be invested in liquid assets or assets readily convertible to cash in the short term and should not include speculative positions.</li></ul>

Table 8

Additional own funds and professional indemnity insurance	
<p>Additional own funds must equal 0.01 % of the value of the portfolios of AIFs managed, valuing derivatives at market value. The AIFMs competent authority may be able to lower this to 0.008% on the basis of historical loss data for a 3 year period, or may increase this amount if it is not satisfied that the AIFM has sufficient additional own funds to cover professional liability risks.</p>	<p>Professional indemnity insurance needs to cover 0.9% of the value of the portfolios of AIFs managed for claims in aggregate per year, and 0.7% of the value of the portfolios of AIFs managed per individual claim. The Regulation requires AIFMs to establish policies and procedures for operational risk management, to be reviewed at least on an annual basis.</p>

General conduct of business principles

The AIFMD sets out the following general conduct of business principles:

Conduct of business principles

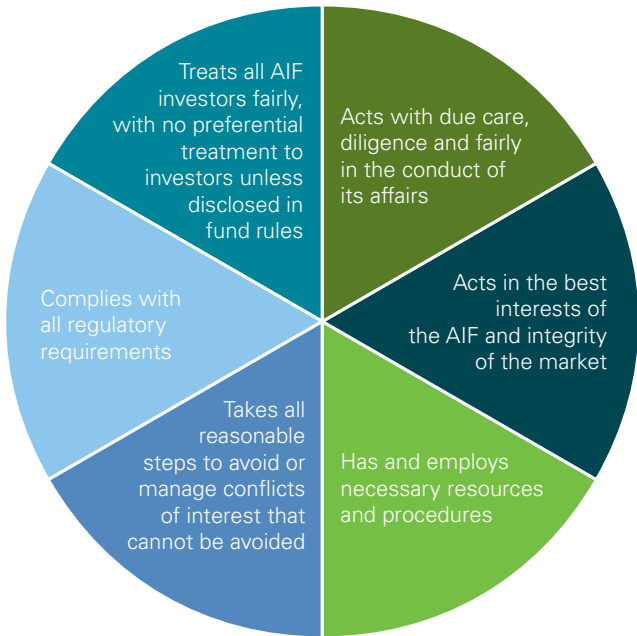


Table 9

Conflicts of interest identification and management

The Directive requires an AIFM to take all reasonable steps to identify conflicts of interest that may arise between it and various parties (between the AIFM and the AIF managed or its investors; between different AIFs managed by the AIFM or between the investors in different AIFs managed; between the AIF or its investors and other clients of the AIFM) in the course of managing an AIF.

The AIFM will have to implement procedures and organisational controls in order to identify, prevent, manage, monitor and disclose to investors of the AIF conflicts of interest that may arise in the course of managing AIFs. They will also need to segregate, within their own operating environment, tasks and responsibilities that may be regarded as incompatible or that may generate systematic conflicts of interest.

The Regulation gives indications on how to identify types of conflicts of interest and describes the requirements for a written conflicts of interest policy, as well as procedures and measures to prevent, monitor, manage and disclose conflicts of interest. The AIFM will be required to determine a **strategy for the exercise of voting rights**, to be disclosed to investors on request.





### General requirements on organisation

The AIFM is required to have adequate and appropriate human and technical resources for the proper management of AIFs proportional to the size, nature, scale and complexity of the business. This includes sound administrative and accounting procedures, controls and safeguards for electronic data processing, adequate internal controls and records in particular in relation to the AIF portfolio transactions and personal transactions by employees.

The Regulation sets out detailed requirements for general business organisation, administration procedures and internal controls that are largely inspired from the UCITS and MiFID frameworks, including requirements for a separate and independent **compliance function** and **internal audit function**.

The regulation also defines the **role and responsibilities of senior management**, requires accounting procedures for each AIF, and sets out detailed 5 year **record keeping** requirements covering portfolio transactions, AIF sub/red activity and personal transactions. AIFMs will be required to ensure business continuity and have data protection systems in place.

The Regulation allows for proportionality in terms of organisation requirements allowing AIFMs to calibrate their organisational structure to the nature, scale and complexity of their business.

### Operating Conditions for AIFMs - general principles

The Regulation imposes substantial operating requirements which are largely inspired by the UCITS regime and on which competent authorities will assess the AIFM. These include a formalised and documented **due diligence** procedure for the selection and on-going monitoring of **investments**, with additional requirements for less liquid assets.

The Regulation also imposes **due diligence** requirements on the selection and appointment of **prime brokers** and counterparties which are limited to financially sound, and properly resourced supervised entities. The prime brokers selected must be subject to approval by the AIFM's senior management.

The Regulation also contains detailed rules on **inducements, order handling, investor reporting** obligations for subscriptions/redemptions, **best execution** requirements, and **trading orders aggregation and allocation**. The AIFM board of directors will need to have sufficient skills, experience and knowledge to understand the risks of the AIFM activities, and commit sufficient time to perform their functions and receive training.

Remuneration policies and practices

The AIFMD requires remuneration policies for senior management, risk takers and control functions to comply with detailed remuneration rules.

Remuneration rules
<ul style="list-style-type: none"><li>- The policy should discourage risk-taking which is inconsistent with the risk profile or fund rules of the AIF managed.</li><li>- The assessment of performance should be set in a multi-year framework appropriate to the life-cycle of the AIF managed and the payment of any performance-based component should be spread over a period taking into account the redemption policy of the AIF managed and the investment risks.</li><li>- The fixed and variable components of remuneration should be appropriately balanced and at least 50% of any variable remuneration should consist of shares/ units in the AIF concerned.</li><li>- At least 40% of variable remuneration is deferred for a minimum of 3 to 5 years.</li><li>- AIFMs that are significant in terms of size or assets should have a remuneration committee.</li></ul>

Table 10

ESMA detailed Guidelines on sound remuneration policies<sup>9</sup>

Guidelines on sound remuneration were issued by ESMA.

Who do the remuneration rules apply to?

Remuneration principles and final guidelines apply to the external AIFM or to the governing body of an internally managed AIF that chooses not to appoint an externally managed AIFM. The guidelines are not only applicable to the AIFM but also to its identified staff. Competent authorities to whom the guidelines apply should comply by incorporating them into their supervisory practice.

As long as non-EU AIFMs market under the national regimes they are only subject to the disclosure requirements of the guidelines. With the termination of the national private placement regime and the introduction of the marketing passport the full set of remuneration provisions are applicable.

As an overall rule, AIFMs shall ensure that variable remuneration is not paid through vehicles or that methods are employed which aim at artificially evading or circumventing the provisions of the AIFMD. The AIFM shall ensure that delegated entities performing Portfolio Management or Risk Management are subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines, and that contractual arrangements are in place to ensure this.

AIFMs shall identify the 'identified staff', and be able to demonstrate this to their competent authorities. Identified staff would include executive and non-executive members of the governing body of the AIFM, senior management, control functions, staff responsible for heading the portfolio management, administration, marketing, human resources – unless they have no material impact on the AIFM's risk profile or on any AIF they manage. All persons that can exert material influence on the AIFMs or AIFs risk profile are to be included, for instance, sale persons, individual traders and trading desks.

<sup>9</sup> Guidelines on sound remuneration policies under the AIFMD were issued on 3 July 2013 Ref: ESMA/2013/232

Also included are persons whose total remuneration takes them into the same remuneration bracket as senior managers and risk takers, as they may be considered to exert material influence on the risk profile.

#### **Which remuneration is covered?**

Remuneration consists of all forms of payments or benefits paid by the AIFM, any amount paid by the AIF itself, including carried interest, and any transfer of units or shares of the AIF in exchange for professional services rendered by the AIFM identified staff. Remuneration can be divided into fixed (without consideration of performance criteria) and variable (additional payments depending on performance). Retention bonus is a variable form and can only be allowed to the extent that risk alignment provisions are properly applied. Excluded from the remuneration provisions are any pro-rata returns on any investment made by the identified staff into the AIF.

#### **The notion of Proportionality**

AIFMs shall comply with remuneration principles to the extent that it is appropriate to their size, internal organisation, nature scope, and complexity of activities. Proportionality should also exist with respect to the different categories of staff.

Corporate governance - Internal control framework

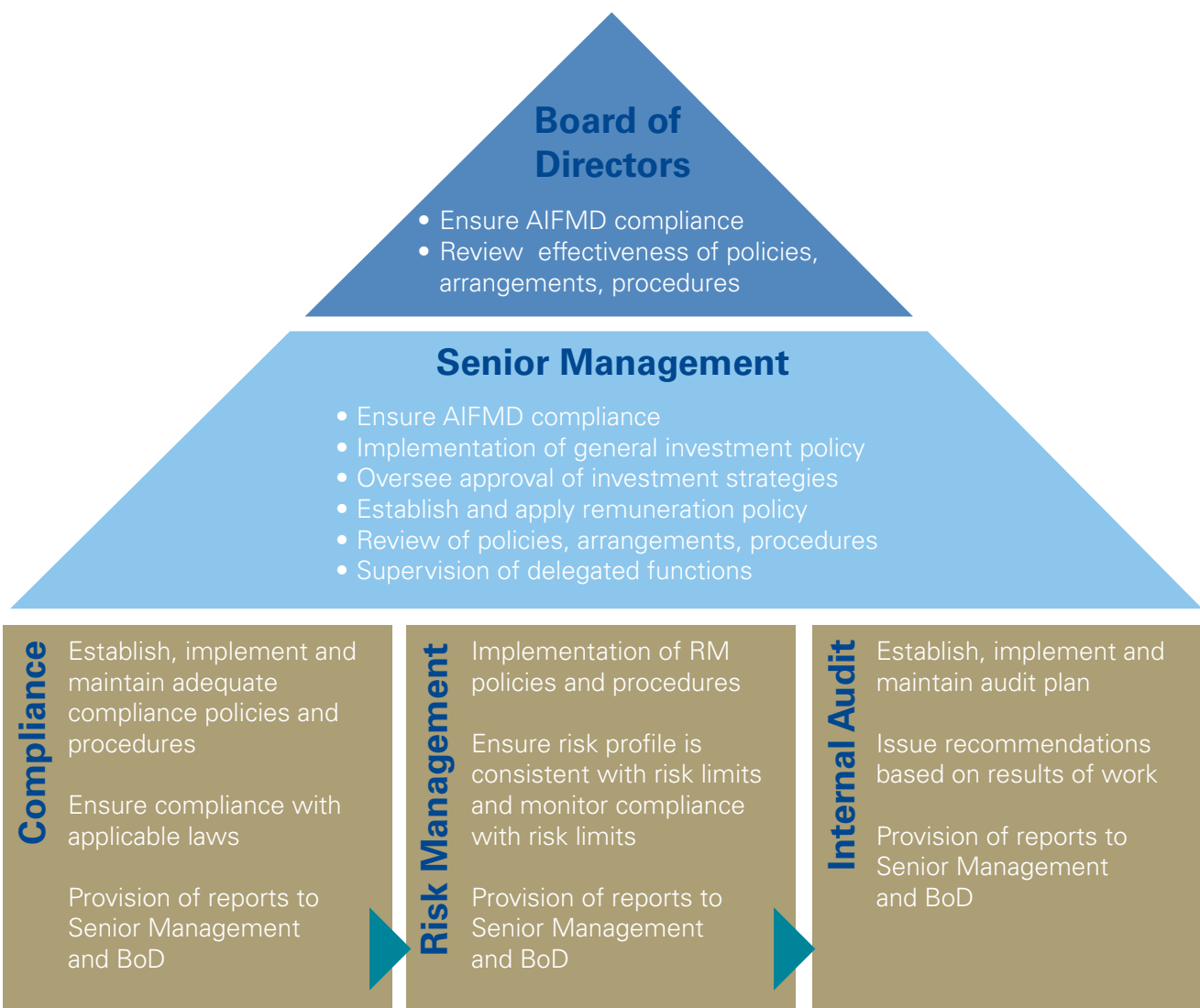


Table 11

## Delegation of AIFM functions

The Directive recognises that AIFMs may choose to delegate their functions to third parties and provides the following framework in which delegation may take place.

Delegation to third parties	
Delegation framework	<ul style="list-style-type: none"> <li>- No delegation of functions to the extent that the AIFM becomes a <b>letter-box entity</b>*.</li> <li>- Advance notification to the competent authorities before delegation arrangements become effective.</li> <li>- An <b>objective reason</b>* for the entire delegation structure.</li> <li>- The delegate needs sufficient resources to perform the task, and be of good repute and sufficiently experienced.</li> <li>- Selection of the delegate is based on a proper due diligence.</li> <li>- The delegation must not prevent the effectiveness of supervision of the AIFM, and must not prevent the AIF from being managed in the best interests of investors.</li> <li>- The AIFM must be able to monitor at any time the delegated activity.</li> <li>- Sub-delegation is possible, subject to prior consent by the AIFM and to notification to the competent authorities before sub-delegation arrangements become effective.</li> </ul>
Specific conditions for the delegation of portfolio management or risk management	<ul style="list-style-type: none"> <li>- Only to authorised/registered asset managers that are subject to supervision. If based in a third country, then cooperation between the authorities of the AIFM and the delegate must be in place. The entities to whom risk management or portfolio management may be delegated is limited to authorised UCITS Management Companies, MiFID investment firms, credit institutions, external AIFM and authorised third country asset managers where a cooperation arrangements exists between the supervisory authorities. The cooperation arrangements must satisfy a number of conditions that are set out in the Regulation.</li> <li>- No delegation or sub-delegation to the depositary or a delegate of the depositary.</li> <li>- No delegation to any other entity whose interest may conflict with those of the AIFM or the investor of the AIF, unless such entity has functionally and hierarchically separated the performance of its portfolio management or risk management tasks from other potential conflicting tasks.</li> </ul>

Table 12

\* See Table 13

Delegation of AIFM functions	
<b>Letter-box entity</b>	<p>The Regulation specifies the meaning of a '<b>letter-box entity</b>' to any one of four situations. The <b>first</b> is where the AIFM delegates the performance of investment management functions to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself. The AIFM's supervisory authority will assess the delegation model based on eight criteria including the assets managed under delegation:</p> <ul style="list-style-type: none"> <li>- the types of assets, and importance of assets managed under delegation to risk/reward profile of the AIF;</li> <li>- the importance of the assets managed under delegation for achievement of investment goals;</li> <li>- the geographical and sector spread of investments;</li> <li>- risk profile of the AIF;</li> <li>- types of investment strategies;</li> <li>- types of tasks delegated in relation to those retained;</li> <li>- configuration of delegates and their sub-delegates, geographical sphere of operation and their corporate structure including whether the delegation is conferred on an entity belonging to the same corporate group as the AIFM.</li> </ul> <p>In line with ESMA's advice a 'letter box entity' would also arise in a <b>second</b> situation where the AIFM no longer retains necessary expertise and resources to supervise the delegated tasks effectively and manage the risks associated with the delegation, and <b>thirdly</b> where the AIFM no longer has the power to take decisions in key areas. The Commission includes a <b>fourth</b> situation where the AIFM loses its contractual right to inquire, inspect, have access or give instructions to its delegates or the exercise of such rights becomes practically impossible. The Commission shall monitor the application of the letter box entity provision in the light of market developments, review the situation after two years and take, if necessary, appropriate measures to further specify this term. Furthermore, ESMA may issue guidelines to ensure a consistent assessment of the delegation structures across the EU. In their Q&amp;A on the application of the AIFMD, ESMA indicated that the assessment whether any delegation of portfolio management and/or risk management by the AIFM results in the AIFM becoming a letter-box entity should be carried out at the level of each individual AIF.</p>
<b>Objective reason</b>	<p>The Regulation provides a number of criteria to assess whether delegation is based on an '<b>objective reason</b>' including cost saving, optimisation of business functions, expertise and access to global trading capabilities. It also requires the management of any conflicts of interest in the delegation model.</p> <p>The Regulation also reiterates that the AIFM remains at all times fully responsible for the proper performance of the delegated tasks and compliance with the AIFMD and the implementing measures. The AIFM will have to ensure that the delegate carries out the delegated functions effectively and in compliance with applicable laws and also establish procedures for reviewing the services provided by each delegate on an on-going basis.</p>

Table 13

## General requirements for the management of AIFs

### Appointment of a depositary for each AIF

The AIFM is required to appoint a single depositary for each AIF managed, which should be evidenced in a written contract. The AIFM cannot act as depositary for any AIFs.

AIFMs managing non-EU AIFs that are not marketed in the EU are not subject to the depositary requirements.

Non-EU AIFMs managing non-EU AIFs marketed to professional investors in the EU via the national private placement regimes do not have to comply with the full depositary provisions. However they will need to ensure that one or more entities are appointed to perform the cash monitoring, safe-keeping and oversight duties, which cannot be performed by the AIFM.

The depositary requirements are described in detail on page 35.

### Appointment of a Prime Broker

AIFMs will be responsible for exercising due skill, care and diligence when selecting and appointing prime brokers. The terms will be set out in a written contract, and any re-use of assets shall be provided for in the contract and in line with the AIF rules.

### Risk management and Leverage requirements

The AIFM will need to ensure that risk management is functionally and hierarchically separate from operations, including portfolio management, and will be required to implement adequate risk management systems to identify, measure, manage and monitor all risks that each AIF is exposed to. This would include the use of appropriate stress-testing procedures.

The AIFM does not place limits on the investments or the strategies that an AIF may employ. However it requires the AIFM to set a maximum leverage limit for each AIF managed that should be disclosed in the AIF offering documents.

This maximum level should be set by taking into account the investment strategy, the sources of leverage, the need to limit the exposure to a single counterparty and the extent of collateral. The total amount of leverage employed by the AIF will need to be disclosed to investors on a regular basis.

The competent authorities may impose limits on the level of leverage that an AIFM is entitled to employ based on concerns regarding systemic risk and disorderly markets.

The Regulation outlines the role and responsibilities of the AIFMs **permanent risk management function** and defines the conditions to be satisfied in order to ensure the functional and hierarchical separation of risk management. These include that the persons in risk management should not be supervised by the head of operating units, including portfolio management, and that they should not perform activities within the operating units. The basis for calculating their remuneration should be independent of the performance of the operating units.

The AIFM will need to have an adequately documented **risk management policy** covering all risks faced by the AIFs and will need to set quantitative or qualitative risk limits for each AIF covering market, credit, liquidity, counterparty and operational risks. Risk measurement includes requirements for back-testing, stress testing and scenario analyses and the rules also require remedial actions for breaches of limits. The risk management systems should be subject to an annual review by the senior management.

**Liquidity management for each AIF**

The AIFMD sets out requirements for liquidity management for all open-ended AIFs and those AIFs which use leverage, to ensure that investors should be able to redeem their investments in line with the AIF redemption policy. The AIFM will need to monitor the liquidity risk within the AIF and regularly conduct stress tests under normal and exceptional liquidity circumstances.

In terms of AIF liquidity management the Regulation specifies that each AIF needs to maintain an appropriate level of liquidity taking into account investor profile, size of investments and redemption terms. The AIFM will need to monitor the liquidity risk of the AIF portfolios and set liquidity limits where appropriate to be monitored on an ongoing basis.

**Valuation of the AIF portfolio of assets**

The AIFM is required to ensure that appropriate and consistent procedures are in place for the proper and independent valuation of the assets of each AIF under management. An AIFM must ensure that the valuation function is performed either by itself or an external valuer, but in both cases the AIFM remains liable for proper valuation.

Where the AIFM performs the valuation, it will need to ensure functional independence from portfolio management and ensure that there are sufficient safeguards in place to manage any conflicts of interest, including with regard to the remuneration policy. In any case, the competent authorities of the home Member State of the AIFM may require the valuation procedures to be checked by an external valuer or an auditor.

The AIFM may appoint an external valuer, subject to demonstrating that:
<ul style="list-style-type: none"><li>- The external valuer is subject to mandatory professional registration recognised by law or to legal or regulatory provisions or rules of professional conduct.</li><li>- The external valuer can provide sufficient professional guarantees to be able to effectively perform the valuation function. The professional guarantees shall be written documents proving sufficient personnel, technical resources, procedures, knowledge and experience. Any registered valuer must include the name of the relevant authority and the relevant rules of professional conduct.</li><li>- The appointment of the external valuer complies with delegation rules.</li><li>- The external valuer does not delegate the valuation function to a third party.</li></ul>

Table 14

The depositary cannot be appointed as the external valuer, unless there is functional and hierarchical separation of functions and that potential conflicts of interest are properly managed.





### Valuation policies and procedures

The Regulation provides a detailed valuation framework, including requirements for a detailed valuation policy and procedures to be applied consistently across all AIF, and subject to periodic review. The Regulation requires competence and independence for personnel performing valuation. The valuation policy must set out a review process for assets where a material risk of inappropriate valuation exists and describes the checks and controls used in this review process, as well as escalation procedures.

Where the AIFM uses models to value assets, the model must be sufficiently documented and subject to validation by a person with sufficient expertise who has not been involved in building the model. The model must also be subject to senior management approval.

### Net Asset Value Calculation and Disclosure to Investors

The AIFMD requires that the Net Asset Value of the AIF is calculated at least once a year, but does not prescribe any calculation methodology. For open-ended funds, the calculation frequency shall be appropriate to the assets held and the issuance/redemption frequency. For closed-ended funds the calculation shall additionally be performed at an increase/decrease in capital of the AIF.

The NAV calculation frequency needs to match the frequency of investor activity and the calculation procedures and methodologies used must be subject to regular verification by the AIFM. Valuation of other assets must be on an annual basis, and financial instruments must be valued on each NAV calculation date. The AIFM will also need to ensure remedial actions in case of NAV error.

### Specific rules for investments in securitisation positions

The Directive sets out rules which will apply to AIFMs investing in securitisation positions on behalf of the AIF managed. An AIFM will only be allowed to invest in the securitisation securities issued after 1 January 2011 if the originator, sponsor or original lender retains a net economic interest in excess of 5%.

The Regulation provides a list of scenarios that qualify as 'retention of a material net economic interest of not less than 5% by the issuer'. It also contains a list of qualitative requirements that the AIFM will have to assess regarding the sponsors and originators of securitisations that will have to be respected for new securitisations issued from 1 January 2011.

There is an additional list of detailed qualitative requirements for the AIFMs regarding their investment due diligence process, risk and liquidity management, internal reporting and disclosure of securitisation positions to investors.

The Regulation provides for a grandfathering clause for existing securitisations up until 31 December 2014. After that date the new framework will apply where new underlying exposures are added or substituted.

### Specific rules regarding asset stripping of portfolio companies when the AIF has acquired control of the company

For a period of 24 months after the AIF has acquired control of a non-listed company, the AIFM must use best efforts to prevent any distributions, capital reductions, share redemptions or acquisitions of own shares by the company.

## Disclosure and reporting requirements

### Disclosure to fund investors

AIFMs are required to make available certain information to investors before they invest in an AIF. There are also some additional periodic disclosure requirements.

The Directive does not prescribe any format for delivering the information and fund managers will need to identify any gaps compared to current disclosure requirements.



Disclosure to fund investors	
<b>Pre-sale disclosure requirements</b>	<ul style="list-style-type: none"> <li>- Investment strategy and objectives, master fund and target funds, types of assets, investment techniques and associated risks, investment restrictions, types and sources of leverage, maximum leverage level, any collateral and re-use arrangements, and valuation and pricing procedure of the AIF.</li> <li>- How changes to the investment strategy/policy are made.</li> <li>- Latest NAV and historical performance.</li> <li>- Procedure for the issue of units.</li> <li>- Identity of AIFM, depositary, prime broker, auditor and service providers, delegates of the AIFM and of the depositary.</li> <li>- Any contractual discharge of liability by the depositary.</li> <li>- Valuation procedure and pricing methodology.</li> <li>- AIF liquidity risk management and redemption rights in normal and exceptional circumstances.</li> <li>- Maximum fees, charges, and expenses (direct and indirect).</li> <li>- Fair treatment of investors and any preferential treatment for an investor group.</li> </ul>
<b>Additional periodic disclosure requirements</b>	<ul style="list-style-type: none"> <li>- Liquidity arrangements - the percentage of assets subject to special arrangements which may have been put in place due to their illiquid nature.</li> <li>- Any new arrangements for managing AIF liquidity.</li> <li>- The current risk profiles of AIFs and the main features of the risk management system employed by AIFM to manage the risks.</li> <li>- Total amount of leverage employed by the AIF.</li> <li>- Any changes to the maximum level of leverage.</li> </ul>

Table 15

Annual report

The AIFMD contains annual reporting provisions and lists a minimum set of mandatory information to be provided for each EU AIF managed and non-EU AIF marketed in the EU.

Annual reporting – List of mandatory information to be provided

- A balance sheet or statement of assets and liabilities.
- An income and expenditure account for the financial year.
- A report on the activities of the financial year.
- Any material changes to the information disclosed to investors.
- The total amount of remuneration, split into fixed and variable, paid by the AIFM to its staff, and number of beneficiaries, and, if relevant, carried interest paid by the AIF.
- The aggregate amount of remuneration broken down by senior management and risk takers.

Table 16

The accounting information should be prepared in accordance with the accounting standards in the AIF Member State and audited by an approved auditor. The annual report must be made available within 6 months of the AIF financial year end.

The annual report – Additional disclosure requirements for AIFs that acquire control of portfolio companies

- Review of the development of the portfolio company’s business.
- Any important events.
- The company’s likely future development.
- Information concerning the buy-back of own shares.

Table 17

Transparency requirements

The Regulation sets out the content and format of the annual report for each AIF that will also need to comply with local accounting standards. It also defines the content of the Manager's report and provides more detail on the remuneration disclosure.

### Reporting to competent authorities

One of the core objectives of the AIFMD is to enhance the ability of regulators to identify, assess, monitor and manage systemic risk effectively. In this respect AIFMs are required to provide certain information regularly to their competent authority on each AIF managed.

#### The AIFMD sets out the following detailed reporting requirements:

- The principal markets and instruments traded.
- The main categories of assets held by each AIF, including principal exposures and concentrations.
- The percentage of assets subject to special arrangements due to illiquidity, any new liquidity arrangements and results of liquidity stress tests.
- Risk profile of the AIF, risk management systems employed and results of stress tests.
- For AIF using leverage on a substantial basis, reporting on the level of leverage in each AIF distinguishing between sources of leverage, identity of five largest sources of borrowed cash/securities and extent that assets are re-used under leveraging arrangements.
- Additional reporting may be requested by the competent authorities on an ad-hoc basis.

Table 18

#### The frequency of reporting to competent authorities is defined in terms of AuM

Single AIF over €500m	AIFM with AIFs of AuM under €1bn	AIFMs managing AIFs in excess of €1bn
Quarterly report	Semi-annual report	Quarterly report

Table 19

AIFMs are required to report annually in respect of AIF investing in non-listed companies and issuers to acquire control. However national competent authorities are permitted to impose more frequent reporting. The Annex to the Regulation contains all the relevant templates for reporting to competent authorities.

### Detailed guidance on reporting to regulatory authorities

On 15 November 2013, ESMA published the final report on guidelines<sup>10</sup> on reporting obligations to the supervisory authorities. Key provisions include:

- Transitional arrangements: ESMA indicates a principle based approach giving more flexibility to the National Competent Authorities. All existing AIFMs as of 23 July 2013 shall take into account: (i) the transitional provisions of Art 61(1) of the AIFMD, (ii) the European Commission's interpretation of Art. 61(1) in its Q&A<sup>11</sup>, and (iii) their authorisation status. AIFMs should start reporting to their national NCAs as from the first day of the following quarter after they have information to report until the end of the first reporting period.
- Reporting periods: AIFMs subject to semi-annual reporting obligations will report twice a year as of the last business day of June and December and AIFMs reporting on quarterly basis should report as of the last business day of March, June, September, and December.
- Procedure for changes in reporting frequency: The guidelines include procedures for AIFMs that become subject to new reporting obligations due to a change from registered AIFM to authorised AIFM, or a shift in reporting frequency, including the information to be reported depending on when the change occurs. ESMA published additional material (not legally binding) defining all possible scenarios and how to report those in xml code.
- Reporting of specific types of AIF:
  - Feeder AIFs of the same master AIF must be reported individually, and no aggregation of information will be permitted.

<sup>10</sup> Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD (ESMA/2013/1339)

<sup>11</sup> <http://ec.europa.eu/yqol/index.cfm?fuseaction=legislation.show&lid=9>

- Previously, EMSA requested AIFMs that manage non-EU master AIFs to report information on the master AIF if one of the feeder AIF is marketed in the EU or is an EU AIF. This is not a “must” requirement anymore, but it is part of the ESMA opinion paper, and the NCAs may ask for it.
- For umbrella funds, AIF specific information should be reported at the level of the sub-funds.

On 1 October 2013, ESMA issued its opinion (2013/1340) on the collection of information for the effective monitoring of systemic risk under Article 24(5), first sub-paragraph, of the AIFMD. It is aiming at clarifying the content of the information that AIFMs should provide to their NCAs when complying with the provisions of Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD. ESMA's opinion includes information on the number of transactions for high frequency trading, geographical focus based on the domicile of investments made (as percentage of the total AuM), on short positions (hedging expressed in %), on risk measures such as VaR, or portfolio sensitivity to a change in FX rates or commodity prices, and on non-EU master AIFs not marketed in the Union.

### Methods for calculating leverage

The Regulation adopts two mandatory methods for calculating the leverage of each AIF managed which are the ‘Gross’ and the ‘Commitment’ methods and provides detailed calculation methodologies, including conversion methods for financial derivative instruments and duration netting rules. The Commission undertakes to review these calculation methods by 21 July 2015 and may develop an additional method if the ‘Gross’ and ‘Commitment’ methods are considered inappropriate for all AIFs.

The level of leverage that will trigger additional reporting requirements to the AIFMs local competent authorities has been set at 3 x NAV (based on the Commitment calculation). The Regulation also provides a framework for competent authorities to exercise their power to impose leverage limits or other restrictions on the AIFM.

Debt raised by any financial or legal structures controlled by an AIF to finance the acquisition of assets shall be included in the calculation of the exposure where those structures are: (1) specifically set up to directly or indirectly increase the exposure at the level of the AIF and (2) the AIF controls such a structure.

### The NCA in Luxembourg provides additional information and technical details

On 13 January 2014, the CSSF issued Circular 14-581 on AIFM Reporting Obligations for the attention of all AIFMs governed by Luxembourg law and to those involved in the operation and control of such entities.

The circular contains technical details in relation to the submission of reporting files to the CSSF. Furthermore, the CSSF issues information on operational issues (e.g. reporting periods, information to report in relation to ESMA Opinion 2013/1340) related to AIFMD reporting in the AIFM FAQ, which will be updated on a regular basis.

### Additional disclosures for AIFs that acquire control of portfolio companies

The AIFM will have to notify the competent authorities of the proportion of voting rights of a non-listed company (excluding SMEs) held by an AIF when the proportion exceeds or falls below the thresholds of 10%, 20%, 30%, 50% and 75%.

When an AIF either individually or jointly acquires control of a non-listed company the AIFM will need to notify the non-listed company, its shareholders and the AIFM competent authorities of the acquisition of control, and ensure that the non-listed company's board of directors informs the employee representatives. The AIFM will need to make available the identity of any other AIFMs that jointly acquired control; provide details on the policy for preventing and managing conflicts of interest between the AIFM, the AIF and the non-listed company; disclose its intentions with regard to the future business of the non-listed company; and disclose the financing of the acquisition to its competent authorities and the AIF investors.

# Marketing Alternative Investment Funds in the EU

The AIFMD defines Marketing as a direct or indirect offering or placement at the initiative of the AIFM or on its behalf of units/shares of an AIF it manages to investors domiciled in the EU, or having a registered office in the EU. Therefore any ‘reverse solicitation’ or passive marketing whereby an investor initiates the transaction is not in scope of the AIFMD. Marketing outside the EU is also not covered by the Marketing provisions.

Member States may allow AIFMs to market AIFs to retail investors in their territory, irrespective, of whether such AIFs are marketed on a domestic or cross-border basis, or whether they are EU or non-EU AIFs. Marketing to retail investors is not covered by the AIFMD and is subject to any additional national rules that the Member State wishes to impose.

## EU Marketing Passport

One of the main changes in the AIFMD is the creation of a single market for the marketing of AIF to professional investors in the EU. The new regime is based on a single authorisation in the AIFM home Member State to market the AIFs under management to professional investors, and a subsequent regulator-to-regulator notification process.

The AIFM will need to submit the information contained in table 19 to get the Marketing Passport (distinct from the information required for the application for authorisation to manage AIFs in Table 5).

The Marketing Passport is available to EU AIFMs marketing EU AIF on the 22 July 2013 at the latest (deadline for transposition of the AIFMD into national law) and will be the only way for authorised EU AIFM to market EU AIF to professional investors in the EU. The current national private placement regimes will cease to apply for these transactions.

The Marketing Passport should be available to EU AIFMs marketing non-EU AIF, and to non-EU AIFMs marketing EU or non-EU AIF in the EU from July 2015, however this is subject to positive advice and opinion from ESMA and enabling legislation to be adopted by the Commission.

The notification file to be submitted to the EU AIFM home Member State competent authorities (Member State of Reference competent authorities for non-EU Managers) should contain the following information:
<ul style="list-style-type: none"><li>- The identity of each AIF the AIFM intends to market.</li><li>- The AIF’s rules or instruments of incorporation.</li><li>- The identity of the AIF depositary.</li><li>- Information relating to any master AIF, if the AIF is established as a feeder AIF.</li><li>- AIF pre-sale disclosure documents.</li><li>- Information on the arrangements established to prevent units or shares of the AIF from being marketed to retail investors.</li><li>- Member States where the AIFM intends to market the AIF.</li></ul>

Table 20

The competent authorities will inform the AIFM within 20 working days of receiving the complete notification, and inform the competent authorities in the Member States where the AIFM intends to market the AIF. Once the AIFM receives a positive response from its home regulator it may commence marketing.

## National private placement regime

For an initial period following the transposition of AIFMD, the marketing of non-EU AIF managed by EU AIFM, and EU and non-EU AIF managed by non-EU AIFM to investors, will continue to be permitted under national private placement regimes, where these are in existence.

EU AIFMs managing non-EU AIFs marketed to professional investors in the EU via the national private placement regimes will have to comply with the AIFMD, except for the full depositary provisions. However they will need to ensure that one or more entities are appointed to perform the cash monitoring, safe-keeping and oversight duties, which cannot be performed by the AIFM.

Non-EU AIFM managing EU AIF or non-EU AIF that are marketed in the EU via the national private placement regimes will need to comply with the transparency requirements (annual report, pre-sale disclosure, regulatory reporting and the major holdings and control requirements) of the AIFMD from July 2013.

The relevant competent authorities are those where the AIFs are marketed. Appropriate co-operation arrangements for systemic risk monitoring purposes should be in place between the competent authorities of the Member States where the AIFs are marketed, and those of the non-EU AIFM and non-EU AIF. The third country of the non-EU AIFM or the non-EU AIF shall not be listed as a Non-Cooperative Country or Territory by FATF.

National private placement regimes may continue in parallel with the Passport regime from 22 July 2015 until 22 July 2018. This is an area that managers will need to monitor carefully as the NPPR are domestic regimes, with no harmonisation at EU level. In 2018 the Commission may bring the national regimes to an end, subject to ESMA's opinion on the functioning of the Passport regime and replace it with the Passport regime.

Summary – Marketing regimes and timelines		
<b>EU AIFM + EU AIF</b>	<b>From 2013</b>	Passport for marketing National private placement no longer allowed
<b>EU AIFM + Non-EU AIF</b>	<b>2013 – 2015</b>	National private placement regime only
	<b>From 2015*</b>	Passport for marketing may become available
	<b>2015 – 2018</b>	National private placement regime & Passport will co-exist
	<b>Post 2018**</b>	Private placement regimes may end and marketing may only be possible with the Passport regime
<b>Non-EU AIFM + EU AIF, or Non-EU AIF</b>	<b>2013 – 2015</b>	National private placement regime only
	<b>From 2015*</b>	Passport for marketing may become available
	<b>2015 – 2018</b>	National private placement & Passport will co-exist
	<b>Post 2018**</b>	Private placement regimes may end and marketing may only be possible with the Passport regime

Table 21

\* ESMA to provide advice and opinion to the EU Parliament, Council, and Commission of their assessment to introduce the marketing passport.

\*\* Subject to ESMA's prior analysis and adoption of delegated act by the Commission.

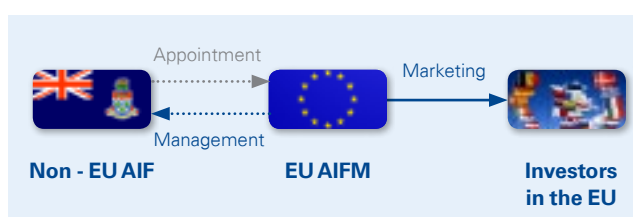


## Third country scenarios

The AIFMD sets out detailed rules for all scenarios involving non-EU AIF, non-EU AIFM or non-EU Portfolio/Risk Managers. Below are some of the most relevant cases:

- **Case 1:** EU<sup>12</sup> AIFM managing non-EU AIF marketed to professional investors in the EU
- **Case 2:** EU AIFM managing non-EU AIF that is not marketed to investors in the EU
- **Case 3:** EU AIFM managing EU AIF with delegation of PM/RM tasks to a non-EU entity and marketing to professional investors in the EU
- **Case 4:** EU AIFM managing EU AIF with delegation of PM/RM tasks to a non-EU entity and not marketing to investor in the EU
- **Case 5:** Non-EU AIFM managing EU AIF marketed to professional investors in the EU
- **Case 6:** Non-EU AIFM managing EU AIF that is not marketed to investors in the EU
- **Case 7:** Non-EU AIFM managing Non-EU AIF marketed to professional investors in the EU

### Case 1: EU AIFM managing non-EU AIF marketed to professional investors in the EU



#### Scenario A: Marketing without passport

As of July 2013<sup>13</sup>, an EU AIFM managing a non-EU AIF marketed to professional investors in the EU has to comply with the national marketing rules/private placement regime of each Member State where marketing activities take place and all provisions of the AIFMD except for the depositary requirements. However, the EU AIFM will be responsible for ensuring that an entity is in place to perform the duties of a depositary, as set out in the AIFMD (i.e. cash-flow monitoring, safekeeping, general oversight).

In addition, there must be cooperation arrangements in place between the competent authorities of the AIFM and the supervisory authorities of the non-EU AIF and the non-EU AIF must not be established in a country that is designated as non-cooperative by FATF.

#### Scenario B: Marketing with passport

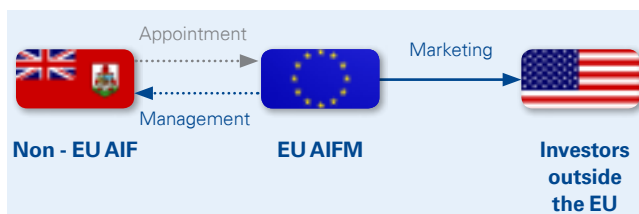
As from late 2015, an EU AIFM could have the possibility, subject to the decision from the EU authorities to extend the AIFMD passport regime (see page 29), to benefit from the EU passport for non-EU AIF it manages. For this, the AIFM will need to fully comply with the AIFMD requirements (i.e. including depositary rules). Furthermore, cooperation arrangements must be in place between the competent authorities of the home Member State of the AIFM and the supervisory authorities of the non-EU AIF, and the non-EU AIF may not be established in a country that is listed as non-cooperative by FATF. Finally, the third country where the non-EU AIF is established must have signed tax information exchange agreements with the home Member State of the AIFM and with each other Member State in which units or shares of the non-EU AIF are intended to be marketed.

<sup>12</sup> Same rules apply to EEA AIFM/AIF. Therefore, all references to "EU" shall be read as "EU/EEA".

<sup>13</sup> Note: EU/national grandfathering rules may apply.

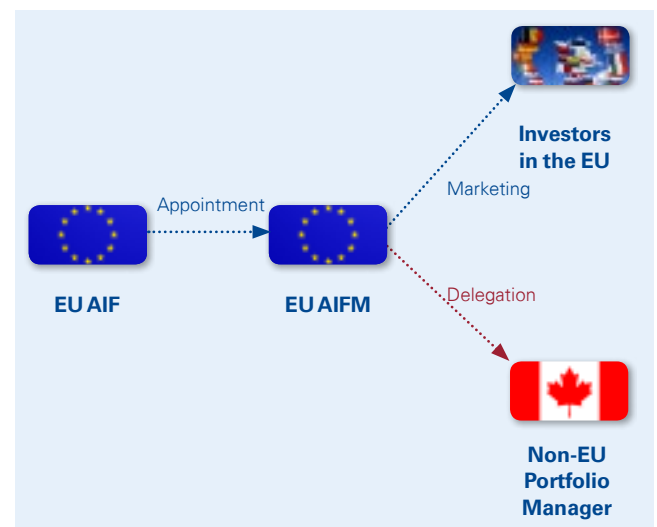


**Case 2: EU AIFM managing non-EU AIF that is not marketed to investors in the EU**



An authorised EU AIFM managing a non-EU AIF that is not marketed to investors in the EU needs to comply with all of the provisions of the AIFMD except the depositary and the annual report requirements. In addition, there must be cooperation arrangements in place between the competent authorities of the AIFM and the supervisory authorities of the non-EU AIF. The EU AIFM will also need to comply with the local marketing rules in the third countries where marketing activities take place.

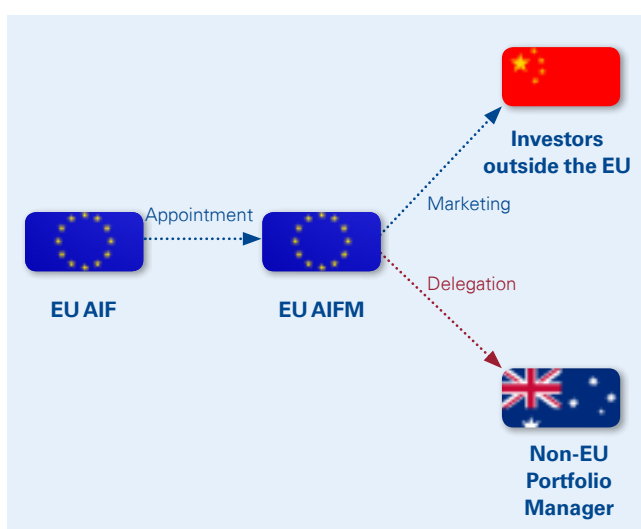
**Case 3: EU AIFM managing EU AIF with delegation of PM/RM tasks to a non-EU entity and marketing to professional investors in the EU**



An EU AIFM managing an EU AIF that is marketed to investors in the EU can delegate PM and/or RM tasks to non-EU entities. The EU AIFM will need to be fully AIFMD compliant (unless it can benefit from grandfathering) and any delegation of functions has to comply with the delegation rules of the AIFMD (see Table 11). However, the AIFM may not use delegation to an extent that it becomes a letter-box entity (see Table 12).

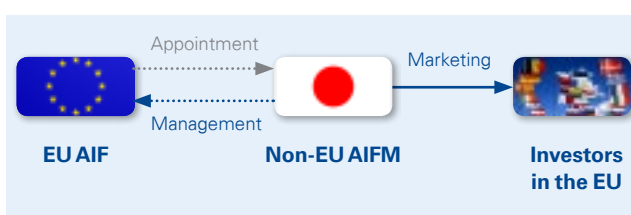


**Case 4: EU AIFM managing EU AIF with delegation of PM/RM tasks to a non-EU entity and not marketing to investor in the EU**



An EU AIFM managing an EU AIF that is not marketed to investors in the EU can delegate PM and/or RM tasks to non-EU entities following the same rules as explained under case 3. The EU AIFM will also need to comply with the local marketing rules in the third countries where marketing activities take place.

**Case 5: Non-EU AIFM managing EU AIF and marketing to professional investors in the EU**



**Scenario A: Marketing without passport**

A non-EU AIFM may (continue to) manage and market EU AIF to investors in the EU if it complies with the national marketing rules/private placement regime of each Member State where marketing activities take place. The AIFMD sets out minimum requirements for this (see below). Member States may, however, impose stricter rules or even abolish their private placement regimes. In addition, national marketing/private placement regimes may be phased out in 2018 (see Table 20).

**Minimum Requirements:**

- Compliance with the transparency requirements of the AIFMD (i.e. annual report, disclosure to investors and reporting to competent authorities)
- Compliance with major holdings and control requirements in the AIFMD (if applicable)
- Cooperation arrangements between each Member State where EU AIF will be marketed and authorities of non-EU AIFM as well as the Member State of the EU AIF
- Country of AIFM is not listed as NCCT by the FATF

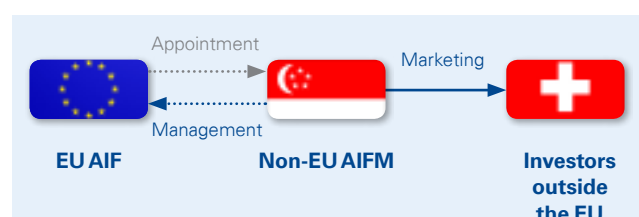
### Scenario B: Marketing with passport

Once the AIFMD passport regime has been extended, a non-EU AIFM will have the possibility to market its EU AIF to investors throughout the EU using the AIFMD marketing passport. For this, the non-EU AIFM will have to become authorised under the AIFMD in its MSR (see Table 6). As consequence, the non-EU AIFM will need to fully comply with the AIFMD.

#### Conditions:

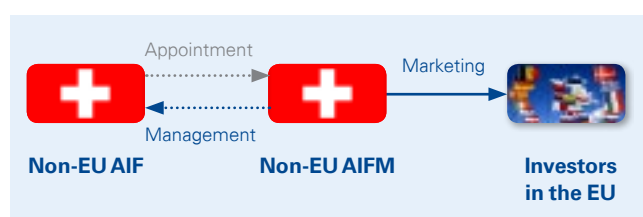
- Compliance with full Directive (exceptions possible subject to further conditions)
- AIFM must be authorised in Member State of Reference (MSR)
- AIFM must have a legal representative established in MSR as contact person for investors, ESMA and competent authorities & sufficiently equipped to perform the compliance function
- Cooperation arrangements between authorities of MSR, Member State(s) of AIF(s) and country where AIFM is established
- Country of the AIFM must have signed tax information exchange agreements with MSR
- Country of AIFM is not listed as NCCT by the FATF
- Effective supervision is not prevented by laws of the AIFM's home country or limitations on the powers of its regulators

### Case 6: Non-EU AIFM managing EU AIF and not marketing to investors in the EU



Once the AIFMD passport regime has been extended, a non-EU AIFM managing an EU AIF that is not marketed to professional investors in the EU will need to become authorised in its MSR and fully comply with the AIFMD. The same rules apply as specified under Option B of Case 5. The non-EU AIFM will also need to comply with the local marketing rules in the third countries where marketing activities take place.

### Case 7: Non-EU AIFM managing Non-EU AIF and marketing to professional investors in the EU



#### Scenario A: Marketing without passport

A non-EU AIFM can (continue to) manage and market a non-EU AIF to professional investors in the EU if it complies with the national marketing rules/private placement regime of each Member State where marketing activities take place. The AIFMD sets out minimum requirements for this (see below). Member States may, however, impose stricter rules or even abolish their private placement regimes. In addition, national marketing/private placement regimes may be phased out in 2018 (see Table 20).

#### Minimum Requirements:

- Compliance with the transparency requirements of the AIFMD (i.e. annual report, disclosure to investors and reporting to competent authorities)
- Compliance with major holdings and control requirements in the AIFMD (if applicable)
- Cooperation arrangements between each Member State where non-EU AIF will be marketed and authorities of non-EU AIFM as well as country where non-EU AIF is established
- Countries of AIFM and AIF are not listed as NCCT by the FATF

#### Scenario B: Marketing with passport

Once the passport regime has been extended, a non-EU AIFM will have the possibility to market non-EU AIF to investors throughout the EU using the AIFMD marketing passport. For this, the non-EU AIFM will have to become authorised under the AIFMD in its MSR (see Table 6). As consequence, the non-EU AIFM will need to fully comply with the AIFMD.

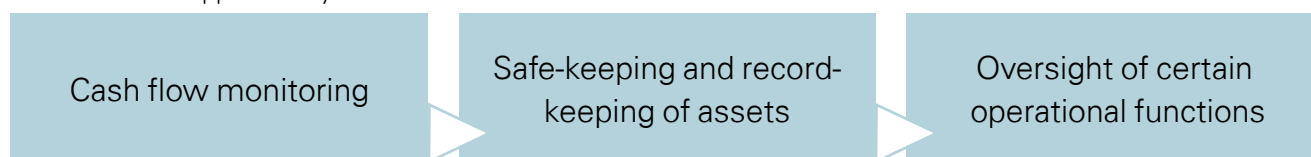
#### Conditions:

- Compliance with full Directive (exceptions possible subject to further conditions)
- AIFM must be authorised in Member State of Reference (MSR)
- AIFM must have a legal representative established in MSR as contact person for investors, ESMA and competent authorities & sufficiently equipped to perform the compliance function
- Cooperation arrangements between authorities of MSR, country where AIF is established and country where AIFM is established
- Country of AIF must have signed tax information exchange agreements with country of AIFM and each MS where units and shares are intended to be marketed
- Country of AIFM is not listed as NCCT by the FATF
- Effective supervision is not prevented by laws of the AIFM's home country or limitations on the powers of its regulators

# The Depositary Requirements

## Core duties of the depositary

According to the AIFMD the depositary has three primary functions when appointed by an AIF:



The depositary is expected to act honestly, fairly, professionally and independently and in the interest of the AIF and its investors.

The assets of the AIF may be re-used by the depositary subject to receiving prior consent from the AIF or the AIFM.

### Cash flow monitoring

The depositary is responsible for properly monitoring the AIFs cash flows and for ensuring that payments from investors and all AIF cash are booked in cash accounts opened in the name of the AIF, or the AIFM or the depositary on behalf of the AIF. If the cash account is opened in the name of the depositary, none of the depositary's own cash may be booked in the account. In terms of **cash-monitoring** duties the depositary will become the hub for cash-flows with the Regulation requiring the depositary to perform daily reconciliations of all AIF cash flows on an ex-post basis. There is the flexibility to perform less frequent reconciliation as and when cash flows occur. The depositary will also be required to identify significant cash-flows that are inconsistent with the AIF normal activity.

### Safe-keeping and record-keeping

The AIFMD makes a distinct difference between 'financial instruments that can be held in custody' and 'other assets' and the ensuing duties for each category. The Regulation defines that those transferable securities, money market instruments and fund units that can be registered or held in an account directly or indirectly in the name of the depositary are to be considered as **instruments held in custody**. The same applies to all financial instruments of the AIF/AIFM which are able to be physically delivered to the depositary. Only an outright transfer of ownership would put the financial instruments outside the scope of custody. Assets subject to collateral arrangements with no title transfer cannot be excluded from the scope of custody.

The depositary shall ensure that the assets are held in segregated accounts to clearly identify all assets belonging to the AIF at all times.

For all **other assets** the depositary is required to verify ownership and maintain an up-to-date record of the AIF's assets. The assessment of ownership shall be based on information and documents provided by the AIF and on reliable external evidence. Examples of other assets are derivatives, cash deposits and investments in privately held companies.

In terms of **safe-keeping** duties and **ownership verification** the Regulation requires the depositary to apply a 'look-through basis' to assets held by financial or legal structures controlled directly or indirectly by the AIF/AIFM, but exempts Fund of Funds and Master-Feeder structures provided that they have a depositary.

Eligible entities for an EU AIF

Oversight functions

The depositary is required to perform certain oversight functions to ensure that the AIF acts in accordance with applicable national law, AIF rules or instruments of incorporation. The oversight procedures should take into consideration the nature, scale and complexity of the AIF's strategy and AIFM's organisation. The depositary is expected to perform ex-post controls and verifications of processes and procedures under the responsibility of the AIFM, the AIF or an appointed third party.

Oversight functions
<ul style="list-style-type: none"><li>- Duties regarding subscriptions and redemptions. Ensure that adequate reconciliation procedures are in place, that comply with national law and AIF rules.</li><li>- Duties regarding the valuation of shares/units. Verify that appropriate valuation procedures exist, implemented and periodically reviewed.</li><li>- Duties regarding carrying out the AIFM instructions unless they conflict with the rules. This includes monitoring compliance with AIF investment restrictions and leverage limits.</li><li>- Duties regarding the timely settlement of transactions.</li><li>- Duties related to the AIF's income distribution. This includes checking the completeness and accuracy of dividend payments and carried interest.</li></ul>

Table 22

The AIFM will be required to ensure that a single depositary is appointed for each EU AIF it manages and if the AIFM markets non-EU AIF in the EU, then the non-EU AIF is not required to have a single depositary, but the AIFM is required to ensure one or more entities are appointed to carry out certain depositary functions the depositary must have its registered office or a branch in the AIF Member State. The AIFM cannot act as depositary.

In general, there are three categories of entities that may be appointed as depositary:

1. an EU credit institution,
2. a MiFID investment firm satisfying the same minimum capital requirements as credit institutions,
3. another category of institution that is subject to regulation and ongoing supervision and which, on 21 July 2011, falls within the categories of institution determined by Member States to be eligible to be a UCITS depositary.

A prime broker may be appointed as a depositary if it has functionally and hierarchically separated its tasks as prime broker from its depositary functions, and potential conflicts of interest are properly identified, managed, and disclosed to the investor of the AIF.

Member States may permit other entities to act as depositary to AIFs that have no redemption rights during five years of the initial investment, or AIFs that generally do not invest in financial instruments that must be held in custody, or invest in issuers or non-listed companies to potentially acquire control. In this case the entity must be able to provide sufficient financial and professional guarantees to perform the functions of depositary.

Eligible entities for a non-EU AIF

The depositary must be established in either:

- 1. the home Member State of the AIFM,
- 2. the Member State of Reference if a non-EU AIFM manages the AIF or
- 3. the third country where the AIF is established.

Conditions to appoint a depositary in any third country
<ul style="list-style-type: none"><li>- The depositary must be subject to prudential regulation, including capital requirements and supervision having the same effect as EU law. The Commission will adopt implementing acts stating which countries satisfy these requirements.</li><li>- Co-operation and exchange of information arrangements between the competent authorities of the depositary, the AIFM Member State and the Member States where the AIF are intended to be marketed.</li><li>- The third country is not listed as a Non-Cooperative Country and Territory by FATF.</li><li>- The depositary expressly agrees to the AIFMD delegation provisions and the liability regime.</li></ul>

**Contractual particulars between Depositary/ AIFM/ AIF/Third party**

The Regulation sets out the contractual particulars of a written contract by which the Depositary is appointed. Instead of a single agreement for each AIF, a framework agreement for similar AIFs can be used. It shall include amongst others:

- Description of service to be provided, and the procedures adopted for each asset type the AIF may invest in.
- Description of how the safe-keeping and oversight function is to be performed.
- Period of validity, amendment and termination of contract, and its procedure.
- Means, procedures for information transmittance between Depositary, AIFM, AIF, third party.
- Statement that depositary's liability shall not be affected by any delegation of its custody functions unless it has been discharged itself from it.

Table 23



Delegation of safe-keeping duties

There are restrictions on the duties that can be delegated by the depositary and only the safe-keeping duties may be delegated to a third party, subject to a list of conditions. There must be an objective reason for the delegation which cannot take place to avoid the requirements of the AIFMD. The depositary will have to exercise due skill, care, and diligence in the selection and appointment of any third party including a periodic review and ongoing monitoring of the delegate.

The depositary will need to ensure that the third party:
<ul style="list-style-type: none"><li>- Has the structure and expertise that are adequate and proportionate to the nature and complexity of the assets of the AIF.</li><li>- Is subject to effective prudential regulation, including capital requirements, and supervision includes external periodic audits to ensure the possession of financial instruments.</li><li>- Properly segregates the assets, and</li><li>- Does not make use of the assets without prior consent of the AIF/AIFM and prior notification to the depositary.</li></ul>

Table 24

The delegate may in turn sub-delegate their functions, subject to compliance with the same conditions.

Where the law of a third country requires certain financial instruments to be held in custody by a local entity and no local entity fulfills the delegation requirements, the depositary may delegate to a local entity provided that the investors of the AIF are duly informed of these legal constraints and the AIF/AIFM has instructed the depositary to delegate the custody of such financial instrument to such entity.





## The depositary bank liability regime

The Directive foresees two scenarios for which the depositary is liable, namely, the loss of financial instruments held in custody, and other losses suffered as a result of the depositary's negligent or intentional failure to properly fulfill its obligations.

The '**loss of a financial instrument held in custody**' is deemed to take place in three situations:

- 1) where the ownership right no longer exists or never existed;
- 2) where the financial instrument exists but the AIF has definitively lost its ownership right; and
- 3) where the AIF has the ownership right, but cannot dispose of it on a permanent basis.

The depositary shall be liable to the AIF or to the investors of the AIF for the loss by the depositary or a third party to whom the custody of financial instruments was delegated.

In case of loss of a financial instrument held in custody, the strict liability requires the depositary to return a financial instrument of identical type or the corresponding amount of cash to the AIF without undue delay.

The depositary will be exempted from liability if it can prove that the loss of a financial instrument has arisen as a result of an external event, which fell beyond reasonable control, and was unavoidable despite all reasonable efforts to the contrary. An external event beyond reasonable control that would delineate liability is limited to natural events, acts of government, war, riots or major upheavals.

A contractual liability exclusion is only possible if the depositary can prove that:

- the requirements for delegation of custody tasks were met;
- a written contract between depositary and third party exists which expressly transfers the liability and allows to make claims against that third party and
- a written contract between the depositary and the AIF/AIFM provides the objective reason to expressly contract such a discharge.

The Regulation also specifies the '**objective reason**' which is necessary for the contractual discharge of liability by the depositary. The depositary needs to demonstrate that it had no other option, but to delegate its custody duties to a third party. In particular, this shall be the case, if: a) the law of the third country requires that certain financial instruments are held in custody by a local entity and local entities exist that satisfy the delegation criteria of the AIFMD, or b) the AIFM insists on maintaining an investment in a particular jurisdiction despite warnings by the depositary as to the increased risk this presents.

The depositary is also liable for any other loss as a result of the depositary's negligent or intentional failure to properly fulfill its obligations. There is no possibility to discharge this liability. The strict liability regime covers cases of fraud, accounting errors, operational failure and failure to segregate assets held in custody by the depositary or by a third party to whom custody has been delegated.

# Transposition in Luxembourg

## The law of 12 July 2013 on alternative investment fund managers

On 10 July 2013, the Luxembourg Parliament voted the Bill of law n°6471 transposing the AIFMD into Luxembourg domestic law. The AIFM Act (Law of 12 July 2013 on alternative investment fund managers) entered into force on 15 July 2013, the day it was published in the Mémorial (official gazette), and in advance of official EU deadline for transposition of 22 July 2013.

### General overview

Chapters 1 to 11 of the Law closely follow the wording of the AIFMD and set out the legal framework that will apply to the AIFM including authorisation, capital requirements and operating conditions, governance and risk management, delegation rules, remuneration, reporting, depositary regime and marketing conditions. Luxembourg has opted to allow AIFMs to request authorisation to provide ancillary services including individual discretionary portfolio management, under its AIFM license.

Chapter 12 of the Law introduces amendments to the regulated fund laws, part II of law of 2010 on Undertakings for Collective Investment, the Specialised Investment Fund (SIF) law of 13 February 2007 and the Investment Companies in Risk Capital (SICAR) law of 15 June 2004, to ensure their consistency with the AIFMD regime, in particular in relation to the new depositary regime, annual report requirements, valuation rules and disclosure to investors. This chapter also contains amendments to various other Luxembourg laws with the aim of modernising the general investment management legal, regulatory and taxation frameworks. These include amendments to the 1915 Company law to revamp and modernise the Luxembourg limited partnership regimes, as well as the creation of a new category of PSF, the 'Professional Custodian of Assets other than Financial Instruments' under the 1993 Banking law that can act as depositary for specific types of AIFs.

Chapter 13 of the Act covers the amending, repealing and final provisions.

### Which Luxembourg entities are considered AIFs?

The concept of AIF is broad and regulated funds set up under the fund laws as well as unregulated structures may qualify as AIFs. Retail non-UCITS funds that are set up under Part II of the law of 17 December 2010 will automatically qualify as AIFs. In contrast SIFs, SICARs and unregulated investment structures will have to be appraised on a case by case basis to determine whether or not they qualify as an AIF.

### Which Luxembourg entities can apply for an AIFM license?

Each AIF will need to be managed by an AIFM, which can either be an external AIFM or should the AIF so elect, shall be an internally managed AIFM.

The AIFM is defined as any entity whose regular business is managing one or more AIFs. The AIFM will need to perform portfolio management and risk management for the AIFs managed, and may additionally perform administration, marketing and activities related to the assets of the AIFs. Luxembourg has opted to allow the AIFM to extend its authorisation to perform individual discretionary portfolio management, to provide investment advice, to provide safe-keeping and administration services in relation to shares/units in UCIs and to provide services in relation to the reception and transmission of orders in relation to financial instruments under the AIFM license.

Depending on the assets under management the manager will either be subject to the full AIFM authorisation regime or a lighter registration regime. Sub-threshold managers that would fall under the registration regime have the possibility to opt-in to the full AIFM regime on request. Existing Luxembourg managers had a 12-month transition period up until 22 July 2014 to file an application for AIFM authorisation and the application questionnaires and other relevant documents are available on the CSSF website.

## Revamping of limited partnership regimes

A new manager of AIFs that has not exercised the activity of managing AIFs before 22 July 2013 will not be able to benefit from any transitional rules and will have to obtain the full AIFM license before it can start to manage AIFs. Chapter 15 UCITS Management Companies are permitted to extend their license and obtain an AIFM authorisation, however Luxembourg banks and PSFs are not permitted to combine their licenses with an AIFM license.

The law repealed the PSF 'Manager of non-coordinated UCIs' under article 28-8 of the 1993 Act.

### Which entities can act as depositary for AIFs?

In addition to banks the new law allows investment firms to act as depositary for AIFs, as well as a newly created PSF 'Professional Custodian of Assets other than Financial Instruments'. The latter is restricted to specific types of AIFs that do not offer redemption rights during a five year period after the initial investments are made, and according to the investment policy generally will not invest in 'custody' assets or will generally invest in issuers or non-listed companies to acquire control. The possibility to appoint this new category of PSF has also been extended to part II UCIs, SICARs and SIFs that are not subject to the AIFM regime.

In addition to transposing the AIFMD, the lawmakers also used the opportunity to modernise the range of limited partnership structures to increase the attractiveness of Luxembourg for structuring investments.

Significant improvements were made to the common limited partnership regime, SCS - société en commandite simple, as well as the introduction of a new form of limited partnership, the special limited partnership, SCSp - **société en commandite special**, which is not vested with legal personality. The SCSp benefits from the same flexible company law regime as the SCS, and Investment Companies in Risk Capital (SICAR) and Specialised Investment Funds (SIF) will be able to adopt the form of a SCS/SCSp.

An SCS/SCSp is created by way of a partnership agreement between one or more General Partners (GPs) and one or more Limited Partners (LPs). As a result, an SCS/SCSp may be set up with only two partners. Most notably, the partnership agreement may be concluded under the form of a private deed, thus not requiring the intervention of a notary. In line with Luxembourg corporate law principles, the SCS/SCSp is immediately effective as of the date of the partnership agreement, without being delayed in any way by registration or publication requirements. Excerpts of the partnership agreement are subject to publication and the SCS/SCSp must be registered at the Luxembourg trade and companies' registry.

The Law fully protects the anonymity of the LPs and their respective contributions which are not subject to publication. Confidentiality is therefore fully guaranteed.

Partnership interests may be represented in the form of securities (shares) or not, according to the provisions of the partnership agreement.

Contractual freedom is the key term of the Law in respect of the corporate structuring of the SCS/SCSp. Such contractual freedom applies at every level, (i) Admission of new partners, as well as issuance of new partnership interests; (ii) Transfer of partnership interests; (iii) Repayments of partnership interests (capital return) allowing the possibility to set up a variable capital and/or an open-ended structure; (iv) Allocation of profit or losses (the traditional civil law prohibition on granting all profits or losses to one or several partners or depriving one or several partners from profits or losses is not applicable); (v) Forms of contribution (in cash, contribution in kind or in industry (services, know-how)); (vi) Voting rights: the traditional mandatory one share-one vote corporate law principle is set aside; (vii) Quorum and majority rules in respect of collective decisions; (viii) Conditions and procedure for dissolution.

The main difference between the SCS and the SCSp is that the latter does not have a legal personality. In this respect the Law sets forth that the domicile of the SCSp is located at the place of its central administration, which will be deemed to coincide with its Luxembourg registered office. Registrations relating to assets which are contributed to the SCSp are made in the name of the SCSp and not in the name of the GP or an LP. The rights on the assets of the SCSp are exclusively reserved to creditors whose claims have arisen in connection with the SCSp lifespan. Conversely, the SCSp's assets are not available to the personal creditors of the SCSp partners. Those creditors may only have recourse against the personal assets of their debtor, including its partnership interest held in the SCSp.

One of the main advantages of a Luxembourg Limited Partnership is the possibility for full tax transparency and tax neutrality for the SCS and the SCSp.

If the GP(s) taking the form of Luxembourg company(ies) hold(s) less than 5% of interest in the SCS/SCSp, the income of the SCS/SCSp will no longer be deemed to be a business income. Consequently the deemed business income theory will not apply. Moreover, if the activity of the SCS and SCSp is limited to private wealth management (which generally corresponds to the activity of private equity and real estate funds), the income of the SCS and SCSp should not be classified as business income. Consequently, no permanent establishment should be recognised, especially for Municipal Business Tax purposes.

# Tax consequences of the AIFMD

## Strategic considerations

The AIFMD created a level playing field for alternative fund managers across the EU, including a Passport that will permit managing and/or marketing AIF on a cross-border basis. However the tax treatment of AIFMs and AIFs is not in the scope of the common AIFMD framework and remains the prerogative of national Tax Authorities.

A key aim of many AIF is to achieve tax neutrality, and avoid double taxation through the application of tax treaties, while the AIFM may have as objective to receive management and advisory fees in a country with moderate income taxation and if possible in a VAT neutral manner.

Therefore, when developing an AIFMD-compliant operating model a key area for strategic decision-making is the domicile or residency of the AIF and of the AIFM.



## Substance and tax residency of the AIFM/AIF

Depending on circumstances, there may be inconsistencies in the criteria for determining substance from a regulatory perspective compared to the tax perspective. Hence, an important challenge for AIFMs is to design an efficient operating and management structure for their AIFs that will also satisfy the substance requirements for tax residency.

From a tax point of view, an AIF should generally be tax resident where it is effectively managed. In recent years tax residency has been increasingly challenged by Tax Authorities on the basis of substance. The Tax Authorities may deny the application of tax treaties by trying to demonstrate that a foreign entity is effectively managed in their jurisdiction, and therefore taxable in their jurisdiction. Alternatively the Tax Authorities may not challenge the tax residency of an entity, but may consider that an entity has a taxable presence in the form of a permanent establishment in their jurisdiction, and thus attract a taxation right on a significant part of the profits.

The location of the AIFM is likely to influence the tax residency of the AIF which is determined based on the statutory seat or central administration, the place of effective management and ultimately on the specific facts and circumstances, including where key decisions are made, the board composition, the level and type of activities, office and employees.

The EU Passport for AIFMs may give rise to more complex taxation issues in cross-border situations when an AIFM located in a given jurisdiction manages AIFs in various jurisdictions, with this complexity increasing when AIFM functions are delegated. The question arises as to whether the residence of AIFs is defined by their country of establishment or the place of establishment of the AIFM. The jurisdictional separation of the AIFM and the AIF may lead to double taxation or double tax exemptions at AIF level. Such separation may also lead to withholding taxes on distributions from the AIF to its investors in its country of establishment and/or in the jurisdiction of the AIF. Finally, this separation may alter the ability of the AIF to access double taxation treaties.

The specific tax provisions that accompany the AIFMD transposition into national law are decisive in relation to this tax risk. In this respect Luxembourg is an exception when it comes to attracting the tax residency of an AIF under the principle of effective management. Similar to the approach taken when transposing UCITS IV into national law, the Luxembourg AIFM Act ensures Luxembourg tax neutrality when a foreign AIF is managed by a Luxembourg AIFM. In this case, a foreign AIF would not become taxable in Luxembourg. A Luxembourg AIF managed by a foreign AIFM may however be taxable abroad based on the approach taken by the foreign tax authorities while potentially remaining subject to tax in Luxembourg.

In order to enable economies of scale, reduction of costs and concentration of key resources and expertise in one place, AIFMs may prefer to concentrate substance in one jurisdiction. This may however trigger adverse tax consequences compared to set-ups where the AIFM is located in the jurisdiction of the AIF. AIFM active in multiple jurisdictions should therefore need to carefully consider the tax implications in each jurisdiction when planning for a streamlining of their operating model. One solution could be an increased delegation of activities abroad, within the framework permitted by the AIFMD.

Value added tax (VAT)

The implementation among Member States of the European VAT Directives and interpretation of the case law from the Court of Justice of the European Union has created a number of differences in how investment funds are considered and in the treatment of the services they receive:

<b>Scope of the qualification of an investment fund as taxable person</b>
Although the principles have been defined by the Court of Justice of the European Union, their application at Member State level often creates distortions, also when it comes to determining the fund's input VAT recovery right.
<b>Differences in the interpretation of fund management services</b>
This will lead to varying scope of the exemption applicable to these services.

Table 25

These differences have substantially impacted fund location decisions over the last years and will most likely constitute a further concern for AIFs.

In many circumstances, funds which are subject to the supervision of a regulatory body (such as UCITS) are not able to reclaim VAT, but do benefit from a VAT exemption for management services.

Depending on how the AIFMD has been implemented in each Member State, it should be verified the extent to which the input VAT recovery right of alternative funds and the VAT exemption for management services should be affected, i.e. whether alternative funds are covered by the exemption or not.

If the fund is considered as a taxable person for VAT purposes, the services received by a fund are generally deemed to be located where the fund is established and the VAT applicable (VAT rate or exemption) should therefore be that of its country of establishment. However, exceptions to this localisation rule may apply, in particular for real estate funds where property related services are provided.

Hence, it is relevant to carefully choose the location of a fund considering that the interpretation of VAT exemptions and VAT rates vary significantly across the EU, from currently 15 percent in Luxembourg to 27 percent in Hungary at the standard rate; a wide range of reduced rates also exist.

The AIFM Act includes changes to Article 44, 1, d) of the Luxembourg VAT law covering the investment funds management services exemption.

Art. 206 of the AIFM Act is the consequence of a recent Luxembourg case-law according to which subcontracted investment management services received by a Luxembourg investment manager for the benefit of a SICAV established in an European Union Member State other than Luxembourg should not benefit from the VAT exemption of Article 44, 1, d) of the Luxembourg VAT law ("VATL").

Indeed, in the old wording the exemption applied only to the management of investment funds subject to the supervision of the Luxembourg supervisory authority (the CSSF or the CAA) and not to another European Union supervisory authority.



This lead to situations where a management company could incur input VAT on subcontracted investment fund management services without any recovery possibility considering that the management services it renders to an European Union regulated fund would be VAT exempt if located in Luxembourg.

To remedy this situation, the AIFM Act recasts Article 44, 1, d) VATL to include within the scope of the VAT exemption the management of investment funds located in other EU Member States and subject to supervisory bodies similar to the CSSF or the CAA.

The enactment of this AIFM Act should reach its aim to avoid a situation where a management company would have incurred non-recoverable input VAT on subcontracted investment funds management services.

It should be noticed that the AIFM Act also includes within the scope of the VAT exemption the management of AIF, whatever their place of establishment.

The impact of this provision should be threefold. First, the supply of management services, including risk management, to a Luxembourg AIF should be VAT exempt. Second, subcontracted AIF management services received by a Luxembourg manager should also benefit from the exemption provided formal conditions are met. And third, in return for this exemption, the input VAT recovery right of a Luxembourg AIF manager would have to be carefully monitored, even if the AIF managed is established outside the European Union. The interpretation of those provisions, if enacted as such, could be further detailed in a Grand Ducal Decree or in a Circular from the Luxembourg VAT authorities.

## Luxembourg’s carried interest regime

The AIFM Act also introduces a carried interest regime.

<b>The provisions cover the taxation of gains realised on the disposal of units, shares or other securities issued by an alternative investment fund in the framework of a carried interest as well as the mere carried interest.</b>
<ul style="list-style-type: none"><li>- Capital gains realised upon sale of units, shares or securities covered by the present law are tax free if held for more than 6 months, except if the individual holds or held a substantial participation.</li><li>- Carried interest not represented by units, shares or other securities are taxed as extraordinary income at a quarter of the global tax rate (around 12%).</li></ul>

Table 26

The provision applies to employees of alternative investment fund managers or alternative investment fund management companies.

The tax provisions qualify the income of carried interest as other income (not as income of salaried activity) and limit the tax regime to individuals that became tax resident in Luxembourg during the year or the 5 subsequent years as from the entering into force of the law. The provisions only apply for income earned within 10 years following the year the individual took its functions in Luxembourg.

They do, however, not apply to individuals that have been tax residents or taxed on professional income in Luxembourg anytime during the 5 last years before the year the law has been enacted. Neither do the provisions apply to carried interest where prepayments have been made.



# Appendix












## Official texts

<b>Directive</b>
Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers
<b>Regulations</b>
Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision
Commission Implementing Regulation (EU) No 447/2013 of 15 May 2013 establishing the procedure for AIFMs which choose to opt in under Directive 2011/61/EU of the European Parliament and of the Council
Commission Implementing Regulation (EU) No 448/2013 of 15 May 2013 establishing a procedure for determining the Member State of reference of a non-EU AIFM pursuant to Directive 2011/61/EU of the European Parliament and of the Council
Commission Delegated Regulation (EU) No 649/2014 of 17 December 2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to regulatory technical standards determining types of alternative investment fund managers.
<b>European Commission Questions and Answers</b>
The European Commission published a Questions and Answers document that is available on its website <a href="http://www.ec.europa.eu/yqol/index.cfm">www.ec.europa.eu/yqol/index.cfm</a> .
<b>ESMA Guidelines</b>
Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD (ESMA/2014/869)
Guidelines on sound remuneration policies under the AIFMD (ESMA 2013/232)
Guidelines on key concepts of the AIFMD (ESMA 2013/611)
Guidelines on the model MoU concerning consultation, cooperation and the exchange of information related to the supervision of AIFMD entities (ESMA 2013/998)
<b>ESMA</b>
ESMA Opinion (ESMA/2013/1340) on the Collection of information for the effective monitoring of systemic risk under Article 24(5), first sub-paragraph, of the AIFMD
Practical arrangements for the late transposition of the AIFMD (ESMA 2103/1072)
Questions and Answers on application of the AIFMD (ESMA 2014/1194)














Table 27

# Transposition across EU Member States\*

22 July 2013 was the deadline for EU Member States to transpose the AIFMD into national law.

Member state	Draft / Consultation paper / Proposal	Implementation Date & Additional Information	
<b>Austria</b>	On 5 July 2013, the Austrian Parliament adopted the AIFM law.	The AIFM law was adopted on 5 July 2013.	
<b>Belgium</b>	The act implementing the AIFMD in Belgium has been published on 17 June 2014 in the Official Gazette, following its approval by the parliament on 3 April 2014 ("AIFM ACT")	The AIFM law has been published in the Official Gazette on 17 June 2014.	
<b>Bulgaria</b>	On 10 December 2013, the Bulgarian National Assembly adopted the Act for amendment and supplement to the Collective Investment Schemes and Other Undertakings for Collective Investments Act (the "Act"). The Act was published in the Bulgarian State Gazette on 20 December 2013.	The AIFM law was adopted on 10 December 2013.	
<b>Croatia</b>	On 25 January 2013, the Croatian Parliament adopted the AIFM Law by which the AIFM Directive has been transposed into the Croatian legal system.	Transposition effective as of 1 July 2013, the date on which Croatia entered the European Union.	
<b>Cyprus</b>	On 4 July 2013, The AIFM Law of 2013 (L. 56(I)/2013) was enacted by the Cyprus House of Representatives, transposing the AIFMD into national law. The Law came into effect following its publication in the Official Journal on 5 July 2013.	The AIFM law has been adopted on 4 July 2013, and published in the Official Journal on 5 July 2013.	
<b>Czech republic</b>	On 19 August 2013, the Act No. 204/2013 on Investment Companies and Investment Funds became effective.	The AIFM law was adopted on 19 August 2013.	
<b>Denmark</b>	On 12 July 2013, the AIFM law was published in the Official Journal.	The AIFM law was adopted on 16 May 2013, and was published in the Official Journal on 12 July 2013.	
<b>Estonia</b>	On 16 April 2014, the Estonian Parliament adopted the changes to the Investment Fund Act and transposed AIFMD. The law is in force since 19 May, 2014.	The AIFM law has been adopted on 16 April 2014.	
<b>Finland</b>	On 7 March 2014, the Finnish AIFMD Act (162/2014) was signed into law by President Sauli Niinistö. The AIFMD Act came into force on 15 March 2014.	AIFM law came into force on 15 March 2014.  On 25 March 2014, the Finnish Ministry of Finance issued its AIFMD decrees.	
<b>France</b>	On 24 July 2013, the AIFMD was transposed into French law by the Council of Ministers.	Transposed into French law on 24 July 2013.	
<b>Germany</b>	On 10 July, the AIFM law (Kapitalanlagegesetzbuch – KAGB) was published in the Official Journal Bundesgesetzblatt.	The AIFM law was adopted on 16 May 2013, and published in the Official Journal on 10 July 2013.	

\*As at: 22 July 2014

Member state	Draft / Consultation paper / Proposal	Implementation Date & Additional Information	
<b>Greece</b>	On 21 November 2013, the AIFM law 4209-2013 was published in the official gazette of the government.	The AIFM law was adopted in November 2013.	
<b>Hungary</b>	On 16 March 2014, the AIFMD has been transposed, putting in place the new Law XCI of 2014.	The AIFMD was transposed on 16 March 2014.	
<b>Ireland</b>	On 16 July 2013, the AIFM law (No. 257 of 2013) was adopted.	The AIFM law was adopted on 16 July 2013.	
<b>Italy</b>	On 9 March 2014, the Legislative Decree of March 4, 2014, n. 44 for the implementation of the AIFMD came into force. It was published in the Official Journal (Gazzetta Ufficiale) on 25 March 2014 and entered into force on 9 April 2014.	The AIFM transposition law was adopted on 4 March 2014, it was published in the Official Journal on 25 March 2014 and entered into force on 9 April 2014.	
<b>Latvia</b>	On 9 July 2013, the parliament (Saeima) voted the AIFM law during an exceptional meeting. The law entered into force on the 7 August 2013.	The AIFM law has been adopted on 9 July 2013.	
<b>Lithuania</b>	On 19 June 2014, the law for the implementation of the AIFMD and other matters has been drafted. On 11 September 2013, the transposition of the AIFMD was discussed by the Parliament's Budget and Finance Committee. No Draft/Consultation paper/Proposal has been published yet.	AIFMD transposition is delayed.	
<b>Luxembourg</b>	On 15 July 2013, the AIFM law entered into force on the day of its publication in the Official Journal (mémorial n°119 "Gestionnaires de fonds d'investissement alternatifs").	The AIFM law was adopted on 10 July 2013, and entered into force on 15 July 2013.	
<b>Malta</b>	On 27 June 2013, the Malta Financial Services Authority (MFSA) published its new Investment Services Rules and began accepting applications for licenses for managers which wish to be authorised as AIFMs.	The AIFMD law was adopted. It was published in the Official Journal on 27 June 2013.	
<b>Netherlands</b>	On 25 June 2013, the bills have been published in the Bulletin of Acts, Orders and Decrees, the official bulletin of the Dutch government	The law was adopted on 25 June 2013, and has been published in the Official Journal	
<b>Poland</b>	Currently not yet available.	AIFMD transposition will be delayed.	
<b>Portugal</b>	Currently not yet available.	AIFMD transposition is delayed.	
<b>Romania</b>	On 25 November 2013, the Ministry of Public Finance (MPF) published the draft AIFM Law, with an additional Exposition of motives. The Law transposes Directive 2011/61/EU (AIFMD) and the provisions of Article 3 of Directive 2013/14/EU. The AIFM Law will come into force three days after its publication in the Official Journal of Romania.	AIFMD transposition is delayed.	
<b>Slovakia</b>	On 19 June 2013 the Slovak Parliament (National Council of the Slovak Republic) adopted the draft amendment, which entered into force as of 22 July 2013.	AIFMD transposition effective as of 22 July 2013.	









Member state	Draft / Consultation paper / Proposal	Implementation Date & Additional Information	
<b>Slovenia</b>	On 21 November 2013, the Ministry of Finance announced that Slovenia had received a formal notice from the European Commission with regard to the transposition of the AIFMD into Slovenian legislation.	AIFMD transposition is delayed.	
<b>Spain</b>	On 12 June 2013, a prospectus of information on the Implementation of the AIFMD was published. The Comisión Nacional del Mercado de Valores (CNMV) issued a document on how AIFMs shall comply with the AIFMD and Regulation 231/2013 until the transposition into national law is complete.	AIFMD transposition is expected in Q4 2014.	
<b>Sweden</b>	On 2 July 2013, the Swedish-FSA announced their regulations filling (Rulebook) the regulatory gap in relations to the Act and AIFMD (FFFS 2013:9 – FFFS 2013:22), which will enter into force 22 July 2013. The main regulation will be FFFS 2013:10.	AIFMD has been transposed on 18 June 2013, and published in the Official Journal on 19 June 2013.	
<b>United Kingdom</b>	On 16 July 2013, the AIFM regulations (2013 No. 1773) has been published as Statutory Instruments. The AIFMD transposition entered into force on 22 July 2013.	AIFMD transposition entered into force on 22 July 2013.	
European Economic Area	Draft / Consultation paper / Proposal	Implementation Date & Additional Information	
<b>Gibraltar</b>	On 15 July 2013, the Government of Gibraltar announced the transposition of the AIFMD into national law, financial services (AIFMD) regulations 2013, financial services (AIFMD) (fees) regulations 2013.	The AIFM law was adopted on 15 July 2013.	
<b>Iceland</b>	On 30 September 2013, the Ministry of Finance and Economic Affairs appointed a committee which purpose is to prepare a proposal for the implementation of the AIFMD into Icelandic law. The committee consisted of representatives from the Ministry of Finance and Economic Affairs, the Financial Supervisory Authority, The Central Bank of Iceland, The Icelandic Financial Services Association and NASDAQ OMX Nordic (Iceland).	AIFMD transposition is delayed.	
<b>Liechtenstein</b>	On 19 July 2013, the amendments of the AIFM law from 2 July 2013 and from 24 May 2013 have been published in the Official Journal.	The AIFM law was adopted on 2 July 2013.	
<b>Norway</b>	On 20th June 2014, the Norwegian government approved the AIFMD into Norwegian law with effect from July 1st. The deadline for applying for a license as approved AIFM is postponed from 22 July 2014 until 31 December 2014.	The AIFM law was adopted on 20 June 2014 and became effective 1 July 2014.	

Table 28

An up-to-date overview of transposition across EU Member States can be accessed on our home page:  
<http://www.kpmg.com/lu/en/issuesandinsights/articlespublications/pages/aifmd-transposition-status.aspx>

### **ESMA opinion on practical arrangements for the late transposition of AIFMD**

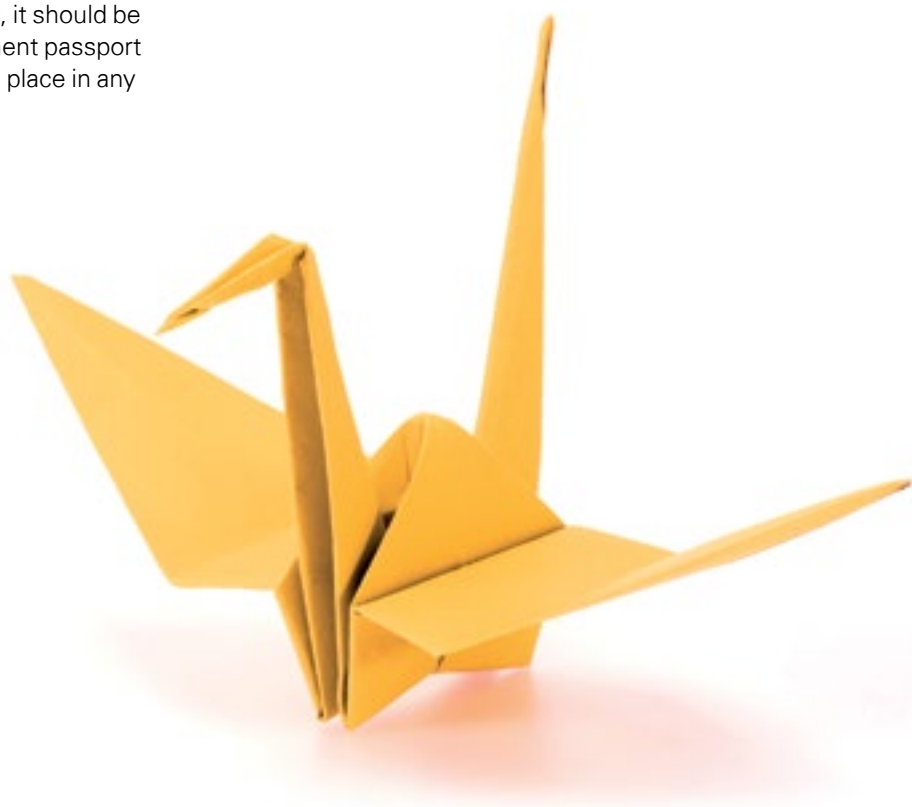
For those Member States that have not yet transposed the AIFMD into national legislation managers wishing to operate cross-border may encounter difficulties.

To address these issues, ESMA's opinion aims at proposing practical arrangements for operations under Articles 31 (Marketing of EU AIF in home MS of AIFM), 32 (Marketing EU AIF in MS other than home MS of AIFM) and 33 (Conditions of Marketing EU AIF established in other MS) of the Directive involving one Member State that has not transposed the AIFMD.

An AIFM in a Member State where the Directive has been transposed may not be able to manage an EU AIF established in another Member State that has not transposed the Directive. ESMA believes that, provided the AIFM is authorised to manage that type of AIF in accordance with Article 33 of the AIFMD, it should be able to manage EU AIF via the management passport irrespective of the provisions currently in place in any such jurisdiction.

AIFMs and competent authorities in a Member State that has transposed the Directive may have difficulties notifying the marketing of EU AIFs to relevant competent authorities if the host Member State of the AIFM has not transposed the Directive. In this instance ESMA believes that the competent authority of the host Member State of the AIFM or home Member State of the AIF may not refuse the notification on the ground that the Directive has not yet been transposed in the host Member State.

ESMA's opinion reassures early movers for authorisation to enable the use of the marketing and management passport.



# MoUs signed by the EU authorities\*

	ALBANIA	AUSTRALIA	BAHAMAS	BERMUDA	BRASIL	BVI	CANADA <sup>(2)</sup>	CANADA OSFI	CAYMAN	DUBAI	EGYPT	FYROM	GUERNSEY	HONG KONG MA	HONG KONG SFC	INDIA	ISLE OF MAN	ISRAEL	JAPAN FSA	JAPAN MAFF
AFM (The Netherlands)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
AMF (France)	✗	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Bafin (Germany)	✗	✓	✗	✓	✗	✗	✓	✓	✓	✗	✗	✗	✓	✓	✓	✓	✗	✗	✓	✓
CBol (Ireland)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
CMVM (Portugal)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓
CNMV (Spain)	✗	✓	✗	✗	✓	✗	✓	✓	✗	✓	✓	✓	✗	✗	✗	✓	✗	✓	✓	✓
FSA (Romania)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Consob (Italy)	✗	✓	✗	✗	✓	✗	✓	✓	✗	✓	✓	✗	✗	✓	✓	✓	✗	✓	✓	✓
CSSF (Luxembourg)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
CSEC (Cyprus)	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
CNB (Czech Republic)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓
Finansinspektionen (Sweden)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Finanssivalvonta (Finland)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Finanstilsynet (Denmark)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
FKTK (Latvia)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Finanzmarktaufsicht (Austria)	✗	✓	✗	✓	✗	✓	✓	✓	✓	✓	✗	✗	✓	✓	✓	✗	✓	✗	✓	✓
EFSA (Estonia)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
PFSA (Poland)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
FCA (UK)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
FSC (Bulgaria)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
FSMA (Belgium)	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓
HCMC (Greece)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Bank of Lithuania (Lithuania)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
MFSA (Malta)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
NBS (Slovak Republic)	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓
MNB (Hungary)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
AVP (Slovenia)	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗
Fjármálaeftirlitið (Iceland)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Finanstilsynet (Norway)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Finanzmarkt. (Liechtenstein)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
CFSSA (Croatia)	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗

\* As of 17 July 2014

(1) The authorities from India, Kenya, Korea and Vietnam have not yet signed the MoU. They are expected to sign the MoUs soon.

(2) Includes the Ontario Securities Commission, Autorité des Marchés Financiers du Québec, British Columbia Securities Commission and Alberta Securities Commission

	JAPAN METI	JERSEY	KENYA	KOREA (FSC & FSS)	LABUAN	MALAYSIA	MALDIVES	MAROC	MAURITIUS	MEXICO	MONTENEGRO	NEW ZEALAND	PAKISTAN	SINGAPORE	SRPSKA	SWITZERLAND	SOUTH AFRICA	TANZANIA	THAILAND	TURKEY	UAE	US CFTC	US OCC and FED	US SEC	VIETNAM
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	<	<	X	X	X	X	X	<	X	X	X	<	X	<	X	<	<	X	X	X	<	<	<	<	X
	<	<	<	X	X	X	X	X	X	X	X	X	X	<	X	<	X	X	X	X	X	<	<	<	X
	<	<	<	<	<	<	X	<	<	<	<	<	<	<	<	<	<	<	<	X	<	<	<	<	<
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	<	X	<	<	<	<	<	<	X	<	<	<	X	X	<	<	<	<	<	X	<	<	<	<	<
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	<	<	X	X	<	<	X	X	<	<	X	<	X	<	X	<	<	X	X	X	X	<	<	<	X
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	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X

It should be noted that, in addition to the supervisory cooperation arrangements, there are other conditions that need to be satisfied in the AIFMD in order for the relevant cross-border activity to be permitted in the EU. First, the non-EU country must not be listed in any of the categories of the periodic Public Statement of the FATF (last one can be found here <http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/documents/fatf-public-statement-oct-2013.html> - Please check regularly for updates). Second, as from the date of application of the passport for non-EU AIF managers, there should be an agreement between the non-EU country and the relevant EU Member State that complies fully with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters.

# List of terms and acronyms

<b>AIF</b>	Alternative Investment Fund
<b>AIFM</b>	Alternative Investment Fund Manager
<b>AIFMD</b>	Alternative Investment Fund Managers Directive
<b>ESMA</b>	European Securities and Markets Authority
<b>EU</b>	European Union
<b>FATF</b>	Financial Action Task Force
<b>MiFID</b>	Markets in Financial Instruments Directive (2009/39/EC)
<b>MoU</b>	Memorandum of Understanding
<b>MS</b>	Member State of the European Union
<b>MSR</b>	Member State of Reference for a non-EU AIFM
<b>NCCT</b>	Non-cooperative country or territory
<b>UCITS</b>	Undertakings for Collective Investment in Transferable Securities (2009/65/EC)
<b>VAT</b>	Value added tax
<b>NPPR</b>	National Private Placement Regime



# How KPMG can help you...

## Unlocking the Opportunities of the AIFM Directive

It is easy to find yourself viewing the AIFM Directive as a pure compliance exercise. However here at KPMG, we have scratched beneath the surface and found a whole range of hidden business opportunities we can unlock for our clients.

These opportunities can range from gaining investors' trust back to re-launching your business; from getting access to European markets to reaching out to new ones; creating niche businesses or positioning yourself more advantageously against a competitor; benefiting from first mover advantage and even cleaning away some organisational clutter to streamline your business.

AIFMD is a very complex directive and therefore we have multi-disciplinary specialists we call our Subject Matter Experts ("SME") with access to a global knowledge repository and network of AIFMD experts. KPMG's European Center of Excellence for Investment Management Regulation is based in our offices, providing unrivalled assistance in addressing your specific needs and areas of concern. We use innovative tools to engage with our clients and aim to provide you with a tailored service matching your business needs.

### We understand your issues

- Huge project
- Opportunities to change the business model and rationalisation of funds and managers structure
- Complex subject matter
- Short timelines
- Strategic importance, survival
- Trial and error is not an option
  - time is lacking
  - subject matter experts are scarce

### We provide solutions

- Understanding the impact of legislation
  - overall and in terms of your specific circumstance
  - domains impacted e.g. remuneration and valuation
  - wider knowledge of industry
- We have the right subject matter experts
  - reducing timelines
  - manageable workstreams
  - selected according to strategy
- We have a range of tools, methods and approaches

## What are your major points of concern?

How to ensure your strategic future?

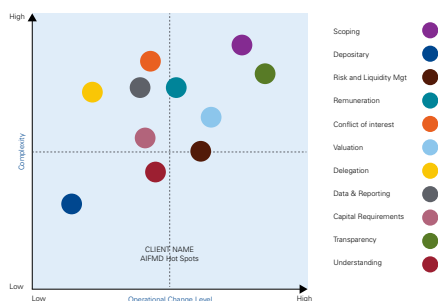
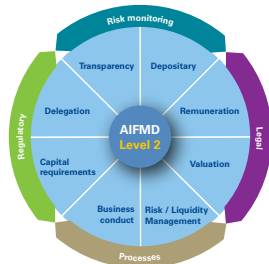
How to assess the impact?

How to organise your approach?

## How we can help you to implement the requirements of the Directive

### Understanding your Strategy

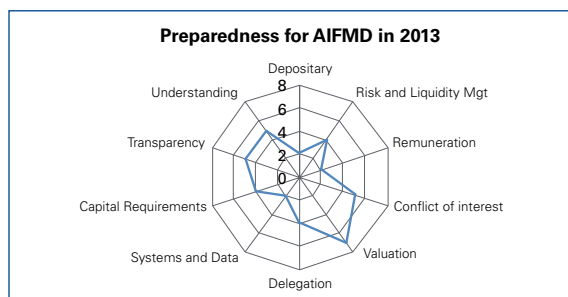
- Exploring where you are in terms of:
  - your AIFMD strategy and tactics
  - your clients' needs
  - current implementation status
  - main impacts and implications of the Directive
- Strategic review workshop and AIFMD hotspots map



### Impact Assessment

- Identification of incremental changes to existing processes and procedures
- Identification of gaps and efforts needed to address the gaps
- Substance and 'delegation waterfall' check
- Suggestions of an improvement plan & related opportunities
- Roadmap to compliance

Impact Area	Preparedness	Level of change required
Depository	2	8
Risk and Liquidity Management	4	6
Remuneration	2	8
Conflicts of interest	5	5
Valuation	7	3
Delegation	4	6
Systems and Data	2	8
Capital Requirements	4	6
Transparency	5	5
Understanding	5	5



**Involvement of our AIFMD specialists - subject matter experts**  
**Identifying business opportunities for you and your clients**



# KPMG AIFMD Reporting Services

## What are the regulatory requirements?

One of the core objectives of the AIFM Directive is to enhance the ability of regulators to identify, assess, monitor and manage systemic risk effectively. In this respect AIFMs are required to provide certain information regularly to their competent authority on each AIF managed.

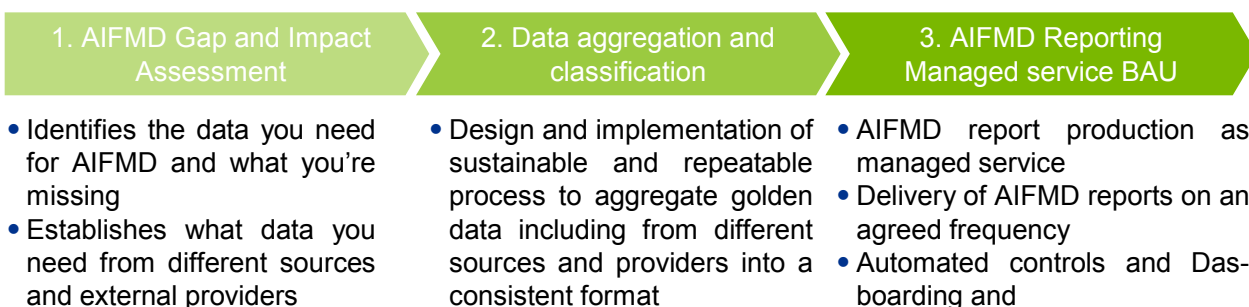
- The principal markets and instruments traded
- The main categories of assets held by each AIF, including principal exposures and concentrations
- The percentage of assets subject to special arrangements due to illiquidity, any new liquidity arrangements and results of liquidity stress tests
- Risk profile of the AIF, risk management systems employed and results of stress tests
- For AIF using leverage on a substantial basis, reporting on the level of leverage in each AIF distinguishing between sources of leverage, identity of five largest sources of borrowed cash/securities and extent that assets are re-used under leveraging arrangements.
- Additional reporting may be requested by the competent authorities on an ad-hoc basis

The AIFM Directive has defined the following five report templates to be produced:

Reporting level	Reference to AIFMD Directive	Reporting obligations	Frequency*	Reporting templates- main topics
<b>AIFM Reporting</b> (on an aggregated basis)	Art 24(1)	<ul style="list-style-type: none"> <li>• Mandatory</li> <li>• Light Regime</li> </ul>	<ul style="list-style-type: none"> <li>• Annually (at least)</li> <li>• Semi-annually</li> <li>• Quarterly</li> </ul>	<ul style="list-style-type: none"> <li>• Principle markets</li> <li>• Principal instruments</li> <li>• Values of assets under management (AuM)</li> </ul>
	Art 24 (3)	<ul style="list-style-type: none"> <li>• On request</li> </ul>	<ul style="list-style-type: none"> <li>• Quarterly</li> </ul>	<ul style="list-style-type: none"> <li>• Detailed list of all AIF's which the AIFM manages</li> </ul>
<b>AIF Reporting</b>	Art 24(1)	<ul style="list-style-type: none"> <li>• Mandatory</li> <li>• Light Regime</li> </ul>	<ul style="list-style-type: none"> <li>• Annually (at least)</li> <li>• Semi-annually</li> <li>• Quarterly</li> </ul>	<ul style="list-style-type: none"> <li>• Identification of the AIF</li> <li>• Breakdown of investment strategies</li> <li>• Principal exposures and most important concentrations (geographical, portfolio concentration, markets, investor, etc.)</li> </ul>
	Art 24(2)	<ul style="list-style-type: none"> <li>• Mandatory</li> </ul>	<ul style="list-style-type: none"> <li>• Annually (at least)</li> <li>• Semi-annually</li> <li>• Quarterly</li> </ul>	<ul style="list-style-type: none"> <li>• Instruments traded and individual exposures</li> <li>• Risk profiles</li> <li>• Results of stress tests</li> </ul>
	Art 24 (4)	<ul style="list-style-type: none"> <li>• Mandatory for AIF using leverage on a substantial basis</li> </ul>	<ul style="list-style-type: none"> <li>• On same frequency as required for mandatory reporting according Art 24(1) and (2)</li> </ul>	<ul style="list-style-type: none"> <li>• Borrowing and Exposure Risk</li> </ul>

\* Depending on the size of AuM

## How can KPMG help?

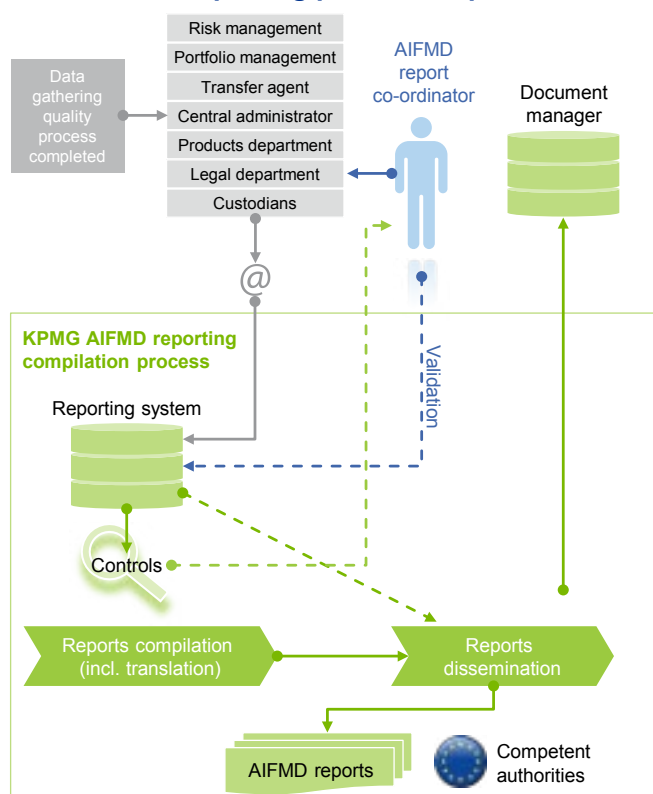


## KPMG's managed service for AIFMD reporting – Operating model:

We have developed a service covering the different aspects and challenges of AIFMD reporting which can be tailored to your requirements:

- Workflow management to gather data from different sources and providers
- Control panel for completion, plausibility and approval process
- Calculation and classification of required data and information according to AIFMD requirements
- Quick and easy access to different contributors from different locations
- Ability to cope with high volumes
- Régulateur support and updates
- KPMG internal developed reporting platform and client front-end

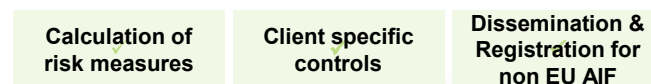
### KPMG AIFMD reporting production process:



### Key features:



### Additional added value services:



# Risk Management

"In response to the crisis, a new risk management framework [...] puts risk management at the core of the decision-making process." (J.M. González-Páramo, Executive Board Member of the European Central Bank on 14 April 2011 at Risk and Return Russia Conference)

The financial crisis has demonstrated the importance of an effective and robust risk management framework.

In order to keep the right balance between costs and benefits of such frameworks, a sound risk management framework should be tailored and properly integrated into a company's overall business model.

Risk management is also at the heart of the regulators and plays a key role in many new investment fund industry related regulations such as UCITS IV, AIFMD and EMIR.

## Regulatory Framework

Principal risk management provisions for UCITS are laid down in Commission Directive 2010/43/EU and ESMA Guidelines 10-788, transposed by Luxembourg CSSF regulation No. 10-4 and CSSF Circular 11/512. The rules require that risk management should be an integrated part of the decision process. A risk management framework should cover all significant risk exposures of an investment fund or management company and at a minimum, market risk, liquidity risk, operational risk, counterparty and concentration risk. Valuation of OTC derivatives is another topic covered by the risk management requirements.

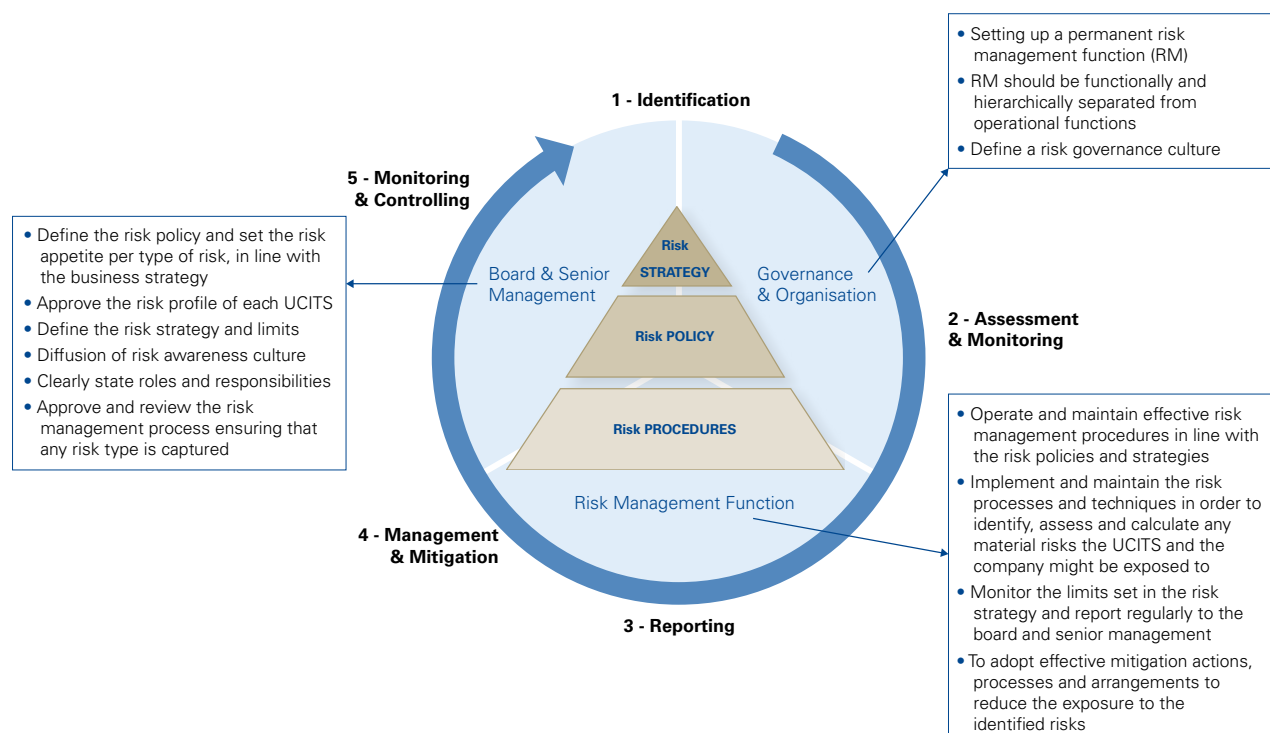
Principal risk management provisions for AIFMs are given in Directive 2011/61/EU (AIFMD) as well as in the respective Commission Delegated Regulation. They are roughly similar to the corresponding UCITS provisions. There are also additional and more AIFMD specific rules established such as certain measures for valuation, measures on methods for calculating and limiting leverage.

However, there are several other investment management related regulations which include some sort of risk management related provisions such as EMIR (European Market Infrastructure Regulation) in which regulators expect, from parties dealing with OTC derivatives contracts, a sound and efficient risk management environment.

## Risk Management Principles

Investment Funds and Management Companies are subject to financial risks and operational risks that can turn into severe losses or poor investment performance. Therefore, risk management should be regarded as an effective management tool which adds value to management decisions and which may help to gain competitive advantage

An effective and robust risk management framework should be understood as a recurring process embedded in the business organisation, comprised of the following components:



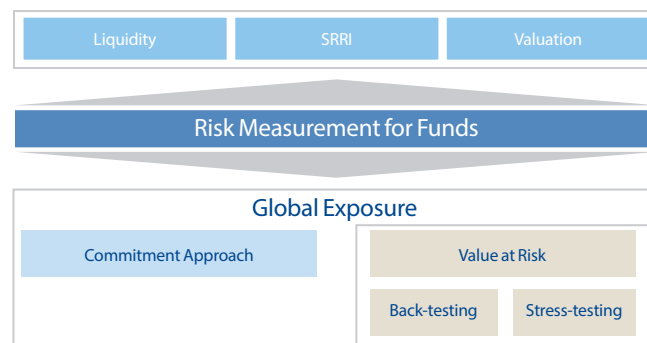
## Helping you grow

### KPMG Risk Management Services for UCITS and AIFMs

- ❑ Assisting in implementing or enhancing an effective and robust risk management framework ensuring that it complies with best practice and regulatory requirements
- ❑ Providing training on various risk management topics
- ❑ Establishing risk related processes and effective controls
- ❑ Assessing compliance with regulatory provisions
- ❑ Review of risk management frameworks, components thereof or particular risk methodologies and techniques
- ❑ Developing and/or implementation of risk measurement methodologies and models such as for market risk, liquidity risk, operational risk, reputational risk and credit/counterparty risk
- ❑ Daily computation of various risk measures (e.g. Market VaR, CVaR, liquidity risk measure, commitment, etc.) based on KPMG's internally-developed Risk Engine
- ❑ Daily valuation and/or validation of complex and sophisticated financial instruments

### Your Benefits

- ❑ Best practice solutions and compliance with regulatory provisions
- ❑ Tailor-made solutions which fit your particular needs and requirements
- ❑ Cutting-edge knowledge and methodologies from industry and academic research
- ❑ Efficient performance of risk measure calculations
- ❑ Risk management experts with deep and broad industry experience as well as financial risk engineers with a mathematical/statistical research background



## Our Valuation Services to AIFMs



The Alternative Investment Fund Directive (AIFMD) requires that appropriate and consistent procedures must be put in place by Alternative Investment Fund Managers (AIFM) for proper, consistent and independent valuation of the assets that they manage. In its technical advices, the European Securities and Markets Authority (ESMA) outlines general principles that AIFMs should follow in developing and implementing policies and procedures for a proper and independent valuation of the assets

held by Alternative Investment Funds (AIF). Valuation should be performed either by an independent, external valuer or by the AIFM if the task is functionally segregated from portfolio management.

At KPMG, we have a long experience in providing independent portfolio valuations to investors and advising on valuation policies and procedures. Here is how we can help.

### Our services

Our valuation services to AIFMs include:

- Assisting in the development and implementation of sound valuation policies and procedures in accordance with the AIFMD;
- Independent verification of AIFM valuation policies and procedures in accordance with the AIFMD;
- Providing a valuation reporting and opinion tailored to your needs and budget:
  - Negative Assurance: opinion stating that “the AIFM valuations are not unreasonable” – review of the analysis performed by the AIFM subject to a lighter scope;
  - Positive Assurance: opinion stating that “the AIFM valuations are reasonable” – review of the analysis performed by the AIFM with a stronger due diligence scope;
  - Full Scope Independent Valuation: opinion on a fair value point estimate – full due diligence process and consideration of all applicable valuation approaches to form our own opinion on value.

### Our team

Our team has deep experience in, and knowledge of the broad range of AIF investment strategies. Most of our professionals hold the CFA qualification.

KPMG Luxembourg’s Corporate Finance practice has a deep industry knowledge combined with its global reach and a proven valuation track record in:

- Private equity;
- Venture capital;
- Intellectual property;
- Infrastructure;
- Debt – senior and subordinated, high yield, mezzanine and distressed;
- Derivatives of all types;
- Real estate.



Why KPMG Corporate Finance in Luxembourg	
<b>Objective Advice</b>	We are financial advisors, not underwriters or investors. Our advice is objective and not biased towards any particular project outcome
<b>Strong Track Record</b>	We have provided independent valuation services, valuation review services, and assistance in setting up valuation methodologies to private equity, venture capital, infrastructure, renewable energy, real estate and debt funds
<b>Broad perspectives</b>	Our diverse team combines backgrounds in engineering, business, investment banking, law and consulting, and has demonstrated its efficiency in addressing the most challenging valuation issues. KPMG can help navigate complex and potentially competing stakeholder issues to strike the right balance between key policy protections and related financial implications
<b>Wide Range of Services</b>	We offer advice throughout the lifecycle of investment portfolios, from pre-deal analysis to disposal or restructuring
<b>Extensive Network</b>	Our global group includes senior resources who have advised in most industries around the world. With “on call” access to our network, our clients receive the latest market perspectives

### Scale of services

The KPMG Luxembourg’s Corporate Finance practice is part of a global network of member firms, comprising 1,200 valuation professionals, serving a wide range of industries. KPMG’s global reach combined with our unrivaled local expertise allows us to tap into professional know-how from various domains and locations to provide our clients with tailored approaches meeting specific needs in all aspects of alternative investments.

### Commitment and experience

We are committed to constantly exceeding our clients’ expectations and supporting them as they prosper by putting the best people at their disposal. What sets us apart from our competitors is our excellence and our hands-on approach allowing us to really understand clients’ needs to add value: It is not about doing different things, it’s about doing things differently.

### Global Valuation Institute

KPMG International has established the Global Valuation Institute (GVI), a global valuation think tank led by KPMG’s Corporate Finance Partners, Yves Courtois and Doug McPhee, with the objectives of sponsoring research and supporting dialogue on current valuation matters and of a thought leadership that bridges academic research with practice excellence.

## Remuneration Guidelines and Practices under the AIFMD

Under article 13 and Annex II of the AIFMD, "Member States shall require AIFMs to have remuneration policies and practices for those categories of staff, including senior management, risk takers, control functions, and any employees receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the risk profiles of the AIFMs or of the AIFs they manage, that are consistent with and promote sound and effective risk management and do not encourage risk-taking which is inconsistent with the risk profiles, rules or instruments of incorporation of the AIFs they manage".

To provide additional guidance to article 13 and Annex II, ESMA published in February 2013 its final report on the Guidelines on sound remuneration policies under the AIFMD

In this context, AIFMs today require to review and update their remuneration policies to meet the requirements imposed by the AIFMD and the ESMA Guidelines. More precisely, AIFMs need to, among other:

- Define the entities that should fall under the AIFM's remuneration policy, including delegates
- Define the list of so-called Identified Staff «Risk Takers»
- Review the way bonus pools are defined and allocated to staff members within a multi-year performance assessment model
- Define the pay out modalities, through deferrals and instruments
- Set up the adequate governance structure
- Define the adequate remuneration package model for control functions
- Organise disclosure of information

<b>Scope</b> <ul style="list-style-type: none"> <li>■ Entities in scope</li> <li>■ Delegation</li> <li>■ Components of remuneration in scope</li> <li>■ Carried interests</li> </ul>	<b>Definition of the identified staff</b> <ul style="list-style-type: none"> <li>■ Non-executives</li> <li>■ Executives</li> <li>■ Senior management</li> <li>■ Control functions</li> <li>■ "Heads of"</li> <li>■ Other risk takers</li> </ul>	<b>Performance assessment</b> <ul style="list-style-type: none"> <li>■ Multi-year performance assessment</li> <li>■ Performance of the AIFM, the business unit / AIF and the individual</li> <li>■ Financial and non-financial criteria</li> </ul>	<b>Award process</b> <ul style="list-style-type: none"> <li>■ Translation of performance assessment into variable remuneration</li> <li>■ Definition &amp; allocation of pools</li> </ul>	<b>Pay out process</b> <ul style="list-style-type: none"> <li>■ Deferrals of 40% to 60% over 3 to 5 years</li> <li>■ Payment in instruments for minimum 50%</li> <li>■ Malus &amp; clawback</li> </ul>
<b>Principle of proportionality</b> <ul style="list-style-type: none"> <li>■ "AIFMs should comply in a way that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities".</li> </ul>	<b>Governance</b> <ul style="list-style-type: none"> <li>■ Review, adoption and implementation by the supervisory function</li> <li>■ Remuneration Committee</li> <li>■ Annual independent internal review</li> </ul>	<b>Control functions</b> <ul style="list-style-type: none"> <li>■ Independence of control functions, both in activities and remuneration</li> <li>■ Limited variable component</li> </ul>	<b>Disclosure</b> <ul style="list-style-type: none"> <li>■ At the level of the AIF</li> <li>■ At the level of the AIFM</li> </ul>	<b>General prohibitions</b> <ul style="list-style-type: none"> <li>■ Guaranteed variable remuneration</li> <li>■ Golden parachute</li> <li>■ Personal hedging</li> </ul>

KPMG can provide assistance in:

- Understanding the multiple requirements imposed by the AIFMD and the ESMA guidelines in the field of remuneration
- Providing assistance in the redesign and the adaptation of the remuneration policies
- Formalising the remuneration policies

# KPMG Authorisation Support

## Background:

**AIFMs shall consider timing issues and the impact of a delayed authorisation on their ability to manage or market funds.**

An AIFM above the relevant threshold will need to apply for an authorisation from its home regulator to obtain a valid license.

- As of the submission of a complete application, the home regulator will have three months to inform the applicant in writing whether or not authorisation has been granted. Applicants shall therefore pay special attention to the specific rules and formalities of application procedure so that their application is considered as 'complete' for the purposes of the AIFMD and to avoid any unpleasant delays.
- Be aware, the regulator may prolong the three month processing period for up to three additional months (6 months in total), where they consider it necessary due to the specific circumstances of the case and after having notified the AIFM accordingly.

## A substantial amount of information has to be provided within the application:

### AIFM related information

- Information on the persons who effectively conduct the business of the AIFM;
- Identities of the shareholders who directly or indirectly hold 10 per cent or more of the capital or voting rights in the AIFM or have the ability to exercise a significant influence over management of the AIFM ("qualifying holding") and the amount of their holdings;
- A programme of activity setting out the organizational structure of the AIFM, including information on how the AIFM intends to comply with its obligation under the Directive;
- Information on the remuneration policies and practices of the AIFM;
- Information on delegation and sub-delegation.

### AIF related information

- Information about the AIF's strategies, including the types of underlying funds if the AIF is a fund of funds and the AIFM's policy as regards the use of leverage, and the risk profiles and other characteristics of the AIF;
- Information on where the master AIF is established if the AIF is a feeder AIF;
- The fund rules or instruments of incorporation of the AIF;
- Information on the arrangements made for the appointment of the depositary for the AIF.
- Any additional information referred to in the investor disclosure requirements.



## Helping you grow

- KPMG applies a successful and structured approach from drafting the application file to assisting during the supervisory review process.
- Focus on your strategic setup while we take care of the authorisation procedure and the time-consuming formalities.
- Make sure your application meets regulatory standards.

## Why KPMG?

- Benefit from our expertise and experience with the AIFM authorisation procedure
- Market leading fund managers have been assisted by KPMG during the application process and have successfully obtained their AIFM license
- Be aware of industry's best practices and use them for your long-term advantage

# KPMG Internal Audit: A solution for the Investment Fund Industry

From a regulatory requirement to a key partner for business sustainability

## Regulatory requirements

The regulatory framework of the Luxembourg financial sector has been developed under the co-ordination works of the European Union and the Group of Ten. It complies with international standards on high-quality prudential processes.

The Commission de Surveillance du Secteur Financier (CSSF) ensures that the laws and regulations governing the various areas of the financial sector are enforced and observed.

The circulars issued by the CSSF complement the regulatory framework. Through these Circulars, the CSSF clarifies the implementation modes of different legal provisions governing supervised entities, publishes prudential rules relating to specific activities and gives recommendations regarding financial activities.

In accordance with the law of 17 December 2010 supplemented by Circular 12/546, **certain Management Companies have to establish a permanent internal audit function** and a compliance function in Luxembourg. Furthermore, indicated by the Delegated Regulation 231/2013 (Art. 62) there is likely to be a future requirement to establish an internal audit function for AIFM subject to certain criteria.

## Internal Controls & Corporate Governance

According to the Standard of the Institute of Internal Auditors, "the internal audit activity must assist the organisation in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement. The internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organisation's governance, operations, and information systems regarding the reliability and integrity of financial and operational information; effectiveness and efficiency of operations and programs; safeguarding of assets; and compliance with laws, regulations, policies, procedures, and contracts."

"The internal audit activity must assess and make appropriate recommendations for improving the **governance process** in its accomplishment of promoting appropriate ethics and values within the organisation; ensuring effective organisational performance management and accountability; communicating risk and control information to appropriate areas of the organisation; and coordinating the activities of and communicating information among the board, external and internal auditors, and management."

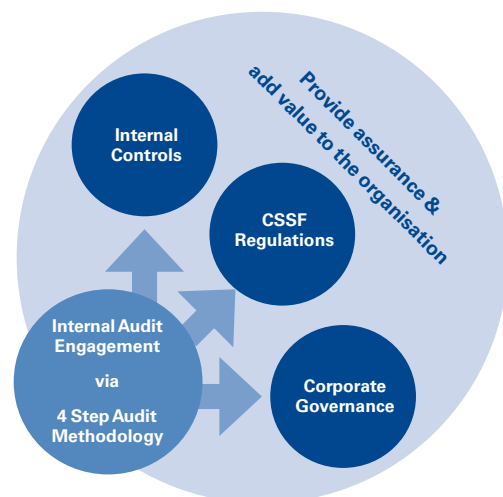
## Internal Audit & KPMG

**New demands from the board, senior organisational leaders and regulators** are requiring internal audit functions to refocus their efforts beyond regulatory compliance issues. Many leaders and regulators have recognised the need for internal audit to play an expanded role that builds on its historic focus on value preservation – a control focus - to encompass activities related to value creation – a performance focus.

**Considering both the economic climate and the ever-evolving regulations, internal audit finds itself at the heart of many companies.**

**The objective of KPMG's internal audit services** is to assist the Company in assessing and testing the design and operating effectiveness of its internal control framework (e.g. financial, operational and regulatory controls). In this KPMG engages in:

- Reviewing compliance with the CSSF regulations,
- Reviewing internal controls and corporate governance,
- Providing added value whenever possible.



## 4 Step Audit Methodology



## Helping you grow

### KPMG's expertise in Internal Audit

#### Approach and methodology

KPMG's Four-Step Audit Methodology is designed to provide a high-quality and efficient internal audit. Our ability to deliver a quality audit depends on:

- Our team's strong understanding of your business processes, internal controls, regulation requirements specific to your Company and your industry;
- Our engagement in providing continuous communication with Management, the Board of Directors and the Regulators;
- Our ability to work in cooperation with IT, Anti-Money Laundering and other relevant departments to answer your needs in many areas; and
- Our engagement in delivering at due dates and providing transparency in our fees.

#### Experienced market leader

KPMG is one of the market leaders as an internal audit service provider, and participates in or chair various industry groups, at the level of the EFAMA, ALFI, CSSF, ABBL, ILA, IRE, ALCO, and others.





# AIFMD: Business opportunity

## New entrants into the depositary market

### Are you already in touch with the industry?

Existing players such as **providers of central administration services** might be in an advantageous position.

### Points of considerations could be:

- What is your current range of services and are you willing to enlarge the scope?
- Who are your existing clients and what is your expectation on future fund structures?
- Will an increase in turnover validate the risk faced from the new service?
- How is your current business setup in terms of entity structure, control environment, staffing etc.?
- What are the key areas to leverage on?

For Depositary PSF that also provide other services to AIF **hierarchical and operational separation** and effective conflicts of interest procedures are obligatory.

In the light of the liability regime and to achieve a **maximum level of assurance** over the activities of the fund a sound control environment needs to be established.

Depositaries have to demonstrate that they perform **adequately oversight** of the core processes in the AIF lifecycle (investment, disinvestment, valuation, income distribution, financial reporting, etc.)

Besides the close **monitoring of all AIF cash flows the proof of ownership** will be amongst the biggest challenges when designing and implementing controls.

Recording	Cash Flow Monitoring	General Oversight
<ul style="list-style-type: none"> <li>• Keep a record of all assets of the AIF</li> <li>• Maintain an up to date inventory</li> <li>• Get sufficient evidence on the ownership of assets</li> </ul>	<ul style="list-style-type: none"> <li>• Identify each significant cash flow at the end of each business day</li> <li>• Identify those cash flows which are unusual in relation to the AIF's activities</li> </ul>	<ul style="list-style-type: none"> <li>• Oversight on the valuation of the shares of the fund</li> <li>• Oversight on subscriptions and redemptions</li> <li>• Oversight on the income distribution</li> </ul>

## The AIFMD defines which professionals can carry out the depositary role for Alternative Investment Funds in scope.

The Luxembourg law of 12 July 2013 on alternative investment fund managers states that:

- for **Luxembourg based AIFs**
- which have **no redemption rights** exercisable during the period of 5 years from the date of the initial investments and
- which, in accordance with their core investment policy, **generally invest in non-custody assets**

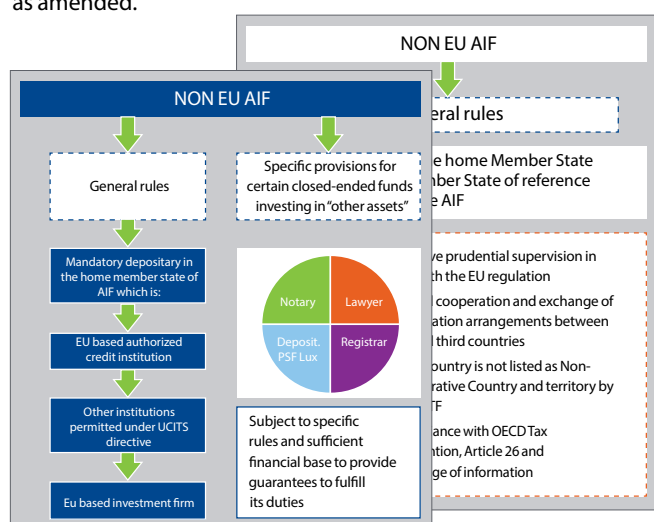
the depositary may be an **entity in accordance with article 26bis** of the law of 5 April 1993 on the financial sector, as amended.

## Making an effort...

can be rewarded with a more solid fee base as you will be able to cover a broader range of client needs. It might also give you a competitive advantage as processes are designed to be more efficient as an organization.

PSF shall define their strategy and re-design their operating model right now to benefit from this new opportunity.

## Interested in taking the next steps?



## How KPMG can help you to grow

## Feasibility study

Before starting a project a feasibility study helps you to assess the expected return on investment.

## GAP Analysis

In examining your existing structure we provide you with a summary of gaps and a roadmap in order to achieve the proposed control environment.

## Implementation support

New processes are designed to cope with requirements to enable you to go beyond. Efficiency is key when setting up new processes to remain competitive in the long run.

## Licensing process

KPMG applies a successful 4-step-approach from drafting the application file to assisting during the supervisory review process.

## Why KPMG?

Experienced industry professionals

KPMG confirmed in 2013 its place of number 1 as external auditor for banks established in Luxembourg. This enables KPMG to benefit from a large range of practical expertise. KPMG produces an IT system survey, a Salary survey for the Banking industry and the Advisory department has always been a preferred provider to banks and professionals of the financial sector for change management and the management of significant projects.

KPMG toolbox...

[illegible]

... Questionnaires...

Members of the corporate bodies and the persons in charge of the day-to-day management (members of the board of directors, members of the board of management or managers)					
Performance to apply the action plan	ENFR (Performance)	ENFR (Performance)	ENFR (Performance)		
Part 1 – Information on the overall administration and the infrastructure	ENFR 1.1.1	ENFR 1.1.1	Part 1 – Information on the overall administration and the infrastructure	ENFR 1.1.1	ENFR 1.1.1
Part 2 – Information on the overall administration and the infrastructure	ENFR 1.1.2	ENFR 1.1.2	Part 2 – Information on the overall administration and the infrastructure	ENFR 1.1.2	ENFR 1.1.2
Part 3 – Information on the overall administration and the infrastructure	ENFR 1.1.3	ENFR 1.1.3	Part 3 – Information on the overall administration and the infrastructure	ENFR 1.1.3	ENFR 1.1.3

## ... Checklists...

Internal audit						
Reference to application form	Internal Audit	Isent	Info	Internal	External	Other
Part 2 - Information on the central administration and the infrastructures	2.0.1	Report on internal audit				
Part 3 - Information on the central administration and the infrastructures	3.0.1	Report is description of the internal audit function, showing the organization of the function and capacity of the internal audit is described for the structure, that group is internal audit on the entity working with external audit external third party providers.				

# European Venture Capital Funds (EuVECA) & Social Entrepreneurship Funds (EuSEF) Regulations

## Regulations to promote innovations and social entrepreneurship

As part of the EU action plan to **improve access to finance for small and medium companies** ("SMEs") (known as Europe 2020 Strategy), the European Commission submitted two proposals for regulations in December 2011 on Managers of European Venture Capital Funds and European Social Entrepreneurship Funds.

### Efficient regulations to boost innovative start-up companies

Because of the diversity of rules in the Member States, EuVECA and EuSEF managers can face high costs in raising funds across the EU. This has led to relatively low investment into these types of funds and as such they are not helping to finance the economy as much as they potentially could. The new legislation therefore intends to simplify the laws and reduce the hurdles for fund managers. Instead of having to comply with 27 national laws, they will be subject to a **single and simplified regime** within the EU.

*98% of European venture capital fund managers manage a portfolio of funds that are **beneath €500m** and average SEF size is below €20m.*

*Source: EVCA, European Commission*

The Commission's proposal is to simplify matters by governing the marketing of funds under a "EuVECA" or "EuSEF" designation. Managers of venture capital funds or social entrepreneurship funds can apply for the use of this designation when marketing such funds in the EU provided they comply with the conditions set out in the Regulation.

### The beauty of AIFMD without its full costs

As a result of the Alternative Investment Fund Managers Directive ("AIFMD"), all managers of alternative investment funds will need to seek authorisation from their national supervisory authority if the assets under management exceed certain thresholds i.e. € 500 million and will benefit from the passport for marketing their funds. Even though managers that operate **beneath the threshold of the AIFMD** can choose to "opt-in" to the AIFMD, we believe that this is not very likely since the AIFMD sets out requirements that are often more than a manager of a small EuVECA or EuSEF can afford, both in terms of staff and technical resources.

*SMEs provided **80 % of all new jobs** in Europe in the past 5 years.*

*Social businesses represent a growing sector already employing **11 million people** in the EU.*

*Source: European Commission*

Therefore, the EuVECA and EuSEF are welcomed complementary regulations to the AIFMD for smaller funds to increase their access to capital.

The Regulation also applies **from 22 July 2013**. This means that both AIFMD and the EuVECA & EuSEF Regulations to apply from the **same date**.

### Main features at a glance

#### Fund Manager

- Legal person whose regular business is managing one or more qualifying venture capital /social entrepreneurship funds
- Established in the EU
- Below AIFMD thresholds

#### Qualifying EuVECA/ EuSEF

- Undertaking for Collective Investments ("UCI") other than UCITS
- **Intending to invest at least 70%** of its aggregate capital contribution and uncalled capital commitments in "qualifying investments" such as equity or quasi equity instruments issued by the qualifying portfolio undertaking, loans granted to a qualifying portfolio undertaking, units and shares of other EuVECA/EuSEF (EuSEF may also invest in debt instruments issued by qualifying portfolio undertaking and any other type of participation in a qualifying portfolio undertaking)
- Established within territories of a Member State ("MS") of the EU

#### Qualifying portfolio undertakings

- Established in EU or third country that is not listed by FATF and has signed tax agreements with the home MS of the fund manager and each other MS in which the fund is intended to be marketed
- **For EuVECA:** SME (i.e. not admitted to trading on a regulated market or multilateral trading facility, employing fewer than 250 persons, annual turnover not exceeding € 50m / annual balance sheet total not exceeding € 43m)
- **For EuSEF:** Undertakings complying with the definition of social businesses set out in the Regulation (i.e. primary objective is to achieve measurable positive social impacts; undertaking generally uses its profits to achieve social objectives and is managed in an accountable and transparent way)

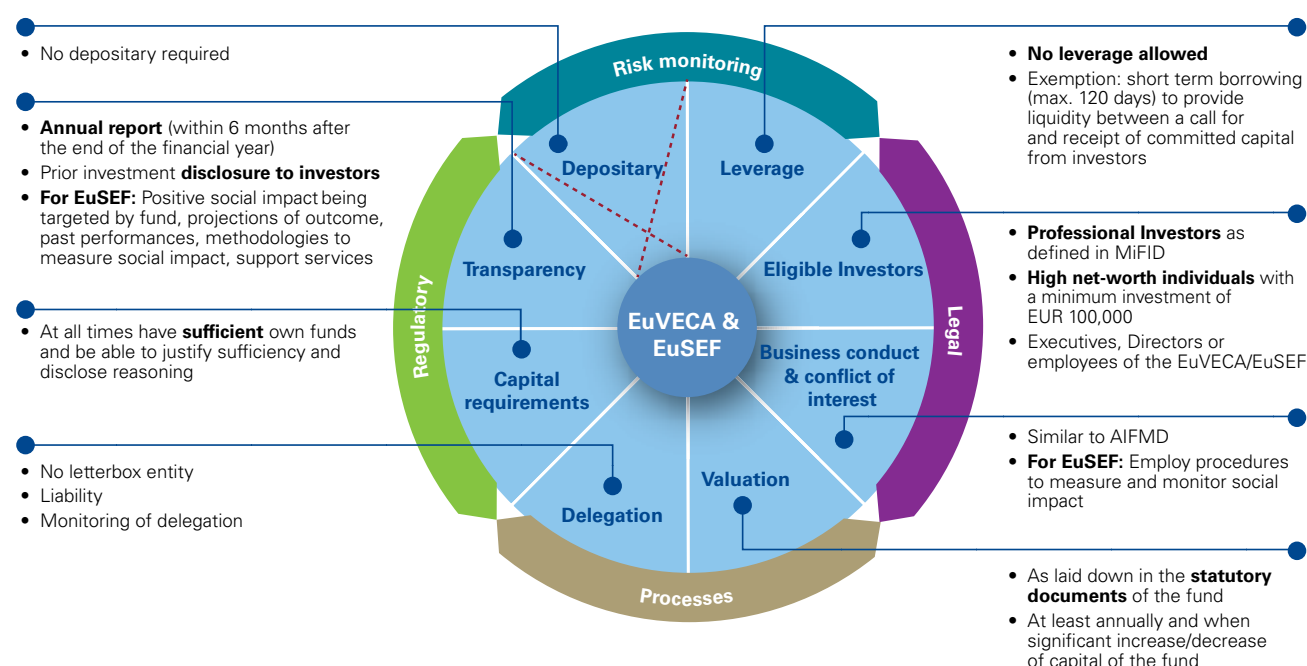


# Helping you grow

## KPMG's expertise

To help you identify and address the impact of the regulations, KPMG can help management determine the level of complexity and effort that would be needed to comply with AIFMD or the EuVECA/EuSEF regulations considering the unique model they conduct business and operations with. By helping management determine their internal capability or capacity for complying KPMG helps in the first step in determining the appropriate structure of the project – its scope and timing and the resources required. It will give you guidance on the complexity of the chosen passport and the impact of this passport on your organisation.

The main characteristics of the regulations compared to AIFMD can be therefore broken down into the four steps as illustrated below:



# Our involvement and commitment to the industry

Our professionals contribute to numerous industry organizations and working groups relevant to the Investment Fund industry, including the Association of the Luxembourg Fund Industry (ALFI), Institute of Registered Auditors, CSSF, Haut Comité de la Place Financière, Banking Association, International Investment Fund Association, EFAMA, Institut Luxembourgeois des Administrateurs, etc.

## Thought leadership is key to KPMG's contribution

KPMG's commitment to our clients, innovation and industry leadership is demonstrated in our continued investment in thought leadership. We believe that providing timely information and insightful perspectives is a vital part of serving our clients and the investment management community as a whole.

### Global thought leadership:



#### Investing in the future

We believe that the future for the investment management industry is very positive and to capture the opportunities presented, it will have to overcome unprecedented challenges. Our intent with this report is to encourage you to think about the impact of megatrends on your business. We ask you consider which trends will impact you most? Do you need to take action now? Which do you need to monitor and track going forward? How might rules of the game change and what would you do?



#### Evolving Investment Management Regulation

KPMG's look at regulation in the investment management industry. Our focus in this report is on the key areas where regulation combined with other pressures is forcing asset managers to make significant changes. The key areas are structural market change, data and reporting, risk governance, conduct, culture and remuneration.



#### The Cost of Compliance - 2013 Global Hedge Fund Survey

We believe that – for the sector to achieve growth through this era of fundamental change – fund managers will need clear insight into the challenges posed and solutions being offered in the market today.

### Some examples of KPMG Luxembourg's publications and broadcasts include:



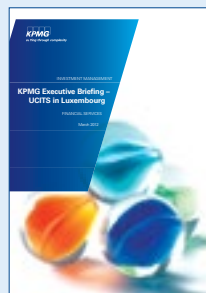
#### Fund News – monthly publication

This monthly Fund News publication is produced by our KPMG Luxembourg's Investment Fund Research Centre and provides information regarding trends, news and the latest developments in the Funds industry.



#### Luxembourg Regulated Investment Vehicles

This publication provides an overview of the regulatory requirements of Luxembourg Investment Vehicles.



#### KPMG Executive Briefing – UCITS in Luxembourg

This publication provides an overview of the regulatory requirements for UCITS in Luxembourg and also some guidance on good practices.



#### The Perfect UCITS

When we launched our Perfect UCITS survey in April 2012, we knew that the release of the European Commission UCITS V proposal was imminent (issued on 3 July 2012) and that the Commission had the groundwork well underway for a separate and more extensive review of the UCITS framework.



#### KPMG TV

[KPMG TV](#) is an online platform created by KPMG Luxembourg with the aim of sharing, through various channels, short, smart and up-to-date business insights.



#### KPMG - AIFMD blog

Our experts keep you up-to-date on current AIFMD developments through our dedicated [AIFMD blog](#)

# About KPMG in Luxembourg

KPMG in Luxembourg, with over 1,200 staff, is a leading provider of professional services including audit, tax and advisory services and a member firm of the KPMG network of legally independent professional firms with over 152,000 employees in about 156 countries.

## Services provided by KPMG to the investment management industry

We aim to provide you with a tailored service of the highest standard.

- Our **Audit services** include statutory audits, contribution in kind/merger reports, ISAE 3402 reports.
- Our **Tax services** include processing withholding tax reclaims, operational tax reporting, VAT services, tax structuring in relation with Private Equity and Real Estate investments, analysis of transfer pricing arrangements, corporate tax returns.
- Our **Management Consulting services** support asset management players in improving their operational efficiency, aligning their business and their IT strategies and running transformation projects.
- **Value for Funds** is our platform of services dedicated to Management Companies and funds including the following services:
  - Set up and engineering
    - Investment funds set up, re-domiciliation, liquidation
    - Draft and maintenance of the prospectus
    - Asset Servicers selection & migration
  - Accounting and regulatory reporting
    - Accounting and domiciliation of SPVs
    - Corporate secretarial services
    - Financial statements compilation, including IFRS
  - Tax reporting
    - European countries tax preparation (Germany, Austria, Switzerland, Italy, UK, etc.)
    - German tax certification
  - Risk management
    - Risk Management reporting (including VaR, and Commitments approaches)
    - Eligible assets and investment restrictions monitoring
    - Asset valuation review
  - Distribution
    - Cross-border registration with foreign regulators
    - KIIDs: narratives - compilation - SRRI calculation- dissemination
    - Factsheets compilation
  - Risk & compliance
    - Internal Audit insourcing
    - Compliance insourcing
    - AML & KYC compliance review

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