Game-changing regulation?

The perceived impact of the AIFM Directive on private equity in Europe

March 2012
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1. Foreword

One of the core missions of the European Private Equity and Venture Capital Association (EVCA) is to help portray the facts about the venture capital and private equity industry while contributing to a better understanding of their unique business models.

At the dawn of a new regulatory era for our industry, it is my pleasure to introduce a survey conducted by Ernst & Young on the perceived impact of the Alternative Investment Fund Managers’ Directive (AIFM Directive) on private equity.

As this survey illustrates, the AIFM Directive is high on the industry’s agenda, with half of the participants already preparing for its implementation. The strategies in this initial phase range from setting up dedicated teams of professionals – bringing together a staff covering legal, compliance and operations – and, for some, starting implementation projects, to consulting with external advice. The industry is definitely on a starting block with regard to the AIFM Directive – a comforting message to the pensioners and savers who trust private equity and benefit from it.

Overall, survey participants noted that in order to become compliant and “do business differently from how it is done currently,” substantial costs will have to be engaged. Requirements regarding risk management provisions are perceived as an area that will materially affect the business, while valuation is highlighted as an area where some adjustments will be required, notably to ensure functional independence. Depositary requirements are already familiar to some, whereas this new entrant comes as an unwelcome guest for others, which are keen to explore the range of possibilities available to them under the AIFM Directive.

Interestingly enough, and confirming efforts conducted by EVCA for several years, enhanced transparency towards investors is not mentioned as problematic. Overall, the majority of participants believe that the AIFM Directive label will be valued by investors, especially institutional ones, but will not result in a bigger allocation to private equity from pension funds.

Widespread confidence in becoming compliant with the AIFM Directive within deadlines, resulting from a perception that this is “workable,” does not mean that the path will be easy; it does, however, mean that private equity players who participated in this first Ernst & Young AIFM Directive impact assessment survey believe that the time has come to move from politics to operations and value creation, in a context where, more than ever, Europe needs growth.

Dörte Höppner
Secretary-General
European Private Equity and Venture Capital Association
In the wake of the financial crisis, the European Commission (the Commission) pointed out that managers of alternative investment funds (AIFs) are responsible for the management of a significant amount of invested assets and can exercise an important influence on markets and companies in which they invest. Furthermore, the Commission believes that the activities of such AIFs may serve to spread or amplify risks through the financial system. In view of the above, the AIFM Directive has been developed to address a number of risks identified by the Commission relating to AIFs, including systemic risk, through a single set of rules that would apply across the board.

By conducting interviews with 23 private equity professionals operating in Europe, Ernst & Young has been able to gain a unique insight into the perceived impact of the AIFM Directive on this industry. The survey participants agreed to share with us – and you – their practitioners’ views on the impact of the various provisions of the AIFM Directive on their business.

The category of private equity managers who will be subject to the material provisions of the AIFM Directive is limited to managers managing an aggregate amount of assets under management (AUM) in excess of €500 million. Managers falling below this materiality threshold only have to comply with registration requirements towards their competent EU home Member State regulators and with requirements to periodically provide this authority with information on their activities (e.g., on investment strategies and exposures).

Going forward, each individual Member State will have the option to extend the AIFM Directive provisions to any manager managing funds that meet the definition of an AIF – even those falling below the de minimis thresholds – or to those managing AIFs offering participations to non-professional investors, such as high-net-worth individuals, for instance. Some Member States have already expressed that they will follow an all-encompassing and extensive approach in terms of scope, whereas others will stick to the rules as set out in the AIFM Directive.

The impact of the AIFM Directive on the private equity industry will be considerable, as various minimum requirements need to be implemented in the day-to-day running of the business. As confirmed by the participants, the main impacts for private equity professionals will result from the requirements on remuneration, risk management, the depositary role and the requirements that apply in situations where an AIF has control over large, non-listed, European-based companies.

A general concern raised by the participants relates to the “one size fits all” approach of the AIFM Directive. Several of the provisions of the AIFM Directive are more suited for other categories of investments and may be too restrictive or unsuitable for private equity. This is, for example, the case with respect to the functional and hierarchical separation between risk management and portfolio management. Other examples are the requirements on own fund, valuation and, for some, the depositary role as defined in the AIFM Directive. This outcome confirms the view that the application of a single rulebook could result in a disproportionate and negative effect on the business of managers managing specific categories of AIFs, such as private equity and real estate.

With regard to preparation, nearly half of the participants indicated that they are already preparing for the AIFM Directive. Although it is clear that existing business practices will require adaptation, most participants were primarily monitoring legal developments at the time of the survey and were not yet fully engaged in the process of effective adaptation of their businesses or internal organizations. Our experience is that things are evolving quickly in that respect and that an increasing number of our clients are starting to actively engage now.

Moreover, the vast majority of participants indicated that the AIFM Directive creates an uneven playing field between situations where large non-listed EU companies are controlled by a private equity AIF and those where the party exercising control is not a private equity AIF (but rather, e.g., a corporate or a sovereign wealth fund).

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1 All managers with an aggregated value of assets under management of in excess of €100 million are in scope of the Directive. If the AIFs managed by a manager (i) do not use leverage (at fund level) and (ii) do not grant their investors redemption rights exercisable within five years after issuance, a higher threshold of €500 million applies. Private equity does not generally use leverage at fund level; moreover, private equity funds are not short term by nature, with a fixed term of 8 to 10 years commonly used. Therefore, and in the absence of any survey participant mentioning the contrary, the higher threshold amount of €500 million has been considered.
The majority of participants expect the largest impact to be on operations, which includes risk management, independent valuation and mandatory depositary requirements. Regarding the latter, a clear shift appears between answers from those participants already used to working with depositaries for their private equity funds and those to whom this actor is a complete newcomer in the value chain. The latter fears that the new depositary requirements will not only result in a material increase in costs but could also disrupt their current business model. However, both groups share the view that the new requirements may result in a duplication of tasks that are already performed by the manager or by service providers.

The requirements with regard to delegation of management functions are not expected to be an issue, since the vast majority of participants do not delegate any management functions (e.g., portfolio management, risk management, valuation or fund administration) to third parties.

With regard to risk management, nearly half of the participants admit that they currently do not have a formalized risk management framework in place. However, they do not perceive the AIFM Directive as the right opportunity to formalize their risk management framework, and more generally question the relevance of the risk management concept as defined by the AIFM Directive for private equity.

More than half of the participants believe that the amount of work required to comply with the AIFM Directive is workable, though with the realization that implementation will result in a significant amount of initial costs as well as increased ongoing compliance costs. The small and mid-sized managers clearly assess the amount of work involved as high; due to their size, resource scarcity is more prevalent. Overall, the vast majority of participants feel confident that they will be able to comply with the AIFM Directive within the three-year timeframe, provided that further legislation is released on time.

Finally, the general conclusion of most participants is that they will need to do business differently and probably in a more costly manner – at least at the beginning – while not clearly perceiving the benefits for investors in terms of increased protection. Some regret that the existing, generally accepted business standards applied by private equity fund managers in their relationships with their investors have not been better taken into account. However, participants display an overall “embracing” attitude toward the AIFM Directive and try to concentrate on working out the best solutions. A majority of respondents even believe that investors could favor AIFM Directive-compliant funds and managers going forward, thereby attributing a value to the AIFM Directive label. However, nearly three-quarters of respondents expressed that investors’ decisions are not first and foremost regulatory-driven and that, as a result, the AIFM Directive label will not as such lead institutional investors, and pension funds in particular, to allocate bigger amounts to private equity in the near future.

We hope that this survey provides insight to assist you in adequately preparing for the AIFM Directive, whether you are a private equity fund manager, a service provider to private equity funds or an investor. We welcome any feedback or comments that you may have and invite you to get in touch using the contact details included at the back of this report.

Alain Kinsch
EMEIA Private Equity Funds Leader
Ernst & Young Luxembourg
3. The authors

The survey is the outcome of a joint initiative driven by private equity teams located in the Netherlands and Luxembourg. Zaina Ahmed-Karim, Partner, Private Equity, Amsterdam, and Axelle Ferey, Director, Private Equity, Luxembourg, supervised the project. The contributions of Qiuling Tsar, Manager, Private Equity, Amsterdam, and Olivier Coekelbergs, Partner, Private Equity, Luxembourg, have also been instrumental in successfully completing the project.

However, the real value of this survey comes from the insights that private equity professionals kindly agreed to share with us. We would therefore like to thank them warmly for their time, availability and trust.
4. Methodology

Between June 2011 and January 2012, a team of Ernst & Young professionals interviewed senior executives from private equity and venture capital players with operations in Europe, including managing partners, CEOs, CFOs, senior relationship managers, financial controllers, in-house lawyers and compliance officers. Survey participants consist of private equity fund managers based in the Baltic States, Belgium, France, Germany, Luxembourg, the Netherlands and the United Kingdom (87%), and of service providers to private equity and others (13%).

The survey captures the views shared by the 23 private equity professionals interviewed and therefore provides unique, first-hand, practical insights into the impacts of the AIFM Directive on their day-to-day business. A standardized set of 54 questions regarding the impact of the AIFM Directive on their day-to-day operations was used, with the results analysis identifying some of the key obstacles with which these private equity players expect to be confronted.

The questionnaire was developed by Ernst & Young based on a detailed analysis of the Level 1 AIFM Directive (Directive 2011/61/EU). Each participant completed the questionnaire based on their perception and situation at the time of the interview.

The amount of AUM by the participants varies between €150 million and €20 billion.

Seven participants at this time fall below the €500 million threshold. Two of them indicate that they have a realistic chance of exceeding the €500 million AUM threshold before the final transposition date of 22 July 2014. Three managers, currently out of scope based on their AUM, consider opting in on a voluntary basis, the main reason being marketing and the ability to raise funds with institutional investors valuing the AIFM Directive label. Therefore the vast majority of the survey participants are in scope of the AIFM Directive.

What is the amount of asset under management (AUM)?

- 57% >1b
- 30% <500m
- 13% >500m <750m
- 13% <500m
5. The AIFM Directive

5.1. Introduction

After almost two years of fierce political debate, the EU AIFM Directive entered into force on 21 July 2011. The AIFM Directive introduces, for the first time, a harmonized European regulatory regime for managers of AIFs, including private equity, where so far private equity managers have been largely unregulated in several European jurisdictions. The AIFM Directive provides a high-level regulatory framework covering, inter alia, all European-based private equity managers managing one or more AIFs that offer participations (e.g., units or shares) to professional investors; it will also impact the service providers of such funds. The AIFM Directive entered into force on 21 July 2011 and must be transposed into each EU Member State law no later than 22 July 2013. Subsequently, existing managers fulfilling the materiality requirements set out in the AIFM Directive need to be fully compliant and licensed no later than 22 July 2014. The two-year implementation phase will not only potentially bring additional local requirements but also further technical implementation guidelines and standards (the so-called Level 2 and Level 3 measures). All of these require close monitoring by the private equity industry to ensure that the current framework translates into appropriate measures.

5.2. The AIFM Directive and private equity

Private equity funds will generally qualify as AIFs, namely as collective investment undertakings, including investment compartments thereof that raise 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 and which is not an undertaking for collective investment in transferable securities (UCITS) within the meaning of Directive 2009/65/EC. Other private equity structures used as pooling vehicles to invest in target companies may also qualify as AIFs.

Going forward, each qualifying AIF is required to have a single AIFM who is responsible for ensuring compliance with the requirements of the AIFM Directive. An AIFM is any legal person whose regular business is managing one or more AIFs. The AIFM may be an external manager or the AIF itself where the AIF’s governing body chooses not to appoint an external AIFM (internally managed AIF).

Managing an AIF means providing at least investment management services of portfolio management or risk management to one or more AIFs. AIFMs may additionally provide administration, marketing and other services not regulated by the AIFM Directive related to the assets of the AIF. As a result, the AIFM Directive maintains the distinction between manager and advisor, contrary to the Dodd-Frank Act in the United States. Private equity players active in Europe with external AIFMs will therefore have the opportunity to strategically decide which entity they wish to have acting as their AIFM, as well as its country of establishment.

External AIFMs may also be UCITS management companies, if they are authorized under both the UCITS and the AIFM Directives. According to the feedback we received from the market, this opportunity may be of interest to some fund administrators having already established a track record with third-party UCITS management companies.

In the diagram on page 7, the AIFM Directive covers several subjects, which we classified around six core topics. In the present survey, we decided to focus on the following aspects, due to their relevance to the private equity industry: scope, remuneration, risk management, initial capital and own funds, valuation, depositary, transparency and disclosure, and control over non-listed companies.

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Overall, the AIFM Directive adopted a “one size fits all” approach under which a single harmonized set of rules will apply to industries with significantly differing operating models. The private equity industry raised its particular concerns in that respect and underlined the potential undesired or unintended effects of such an approach. As a result, the AIFM Directive includes a few private equity-tailored provisions, such as the de minimis threshold exemptions, some grandfathering clauses for open-ended funds no longer investing at the date of transposition of the AIFM Directive (July 2013) or the possibility to use non-credit institutions depositaries under conditions. However, these provisions remain limited and, following large consultation with the industry, the European Securities and Markets Authority (ESMA) technical advice to the European Commission on possible implementing measures (ESMA/2011/379) decided to raise some of these concerns again. It remains to be seen to what extent Level 2 measures will incorporate the proportionality principle.

With respect to European venture capital funds, a specific regulatory framework and label has been proposed by the European Commission in December 2011; this regime would be available to managers of collective investment undertakings established in Europe and falling below the AIFM Directive €500 million threshold and which comply with a number of investment and organizational requirements. A Presidency compromise was released early February. However, the outcome of the debate and the exact features of the new regime are not known yet.

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1. See above, footnote 1.
6. The survey

6.1. Preparation and engagement

**Background**

Each of the 27 EU Member States has to transpose the provisions of the AIFM Directive into its national legislation within a two-year period that commenced on 21 July 2011 and ends on 22 July 2013. Subsequently, all existing managers in scope of the AIFM Directive have to become fully compliant within one year after the final transposition date, i.e., on 22 July 2014 at the latest.

The Level 1 Directive will be complemented by further guidance on several topics. For this purpose, the Commission is required to compose delegated and implementing acts that, together with the technical standards to be drafted by ESMA, constitute the so-called Level 2 and Level 3 legislation. On 16 November 2011, ESMA issued its final technical advice to the European Commission (ESMA/2011/379) after in-depth consultation, in which Ernst & Young actively took part. Level 2 legislation is expected to be released by mid-2012.

The ESMA final technical advice was not part of the interviews we performed for this survey.

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**AIFM Directive timeline 2010-18**

- **November 2010**: EU Parliament votes the Directive
- **May 2011**: Council adopts Directive
- **2011-mid 2012**: Implementing measures
- **July 2013**: Transposition into national law, AIFMs to start complying
- **July 2014**: Deadline for application for authorization by AIFMs
- **July 2015**: Passport for non-EU AIFMs and non-EU AIFs may enter into force
- **July 2018**: Private placement regimes for non-EU AIFMs and non-EU AIFs may disappear
Almost half of the participants are already preparing for the AIFM Directive

In the interviews we performed between June and January 2012, 48% of the participants indicated that they have already started preparing for the AIFM Directive. The reasons mentioned for such preparation range from applicability of US Dodd-Frank Act, application for a license from their home Member State regulator, internal reorganizations of their business, or being informed and updated by their legal advisors and auditors.

However, in most cases this means that participants are actively following the legislative developments at a European as well as a national level without making any adjustments to their business yet. Several respondents indicated that dedicated workgroups, or small teams, have already been set up in their organizations. In some cases, external advisers were consulted.

Thirty percent of the participants indicated that publication of the final Level 2 legislation, expected by mid-2012, will trigger their preparation.
AIFM Directive is expected to affect not just operations

At the beginning of each interview, we asked participants what part of their business they believe would be most affected by the AIFM Directive (multiple answers possible). The majority (63%) of respondents noted that the largest expected impact would be on operations, which includes risk management, independent valuation and mandatory depositary requirements. When further analyzing the results, we noted a shift among jurisdictions around the perceived depositary impact. Indeed, for jurisdictions where the depositary requirements currently do not apply to private equity, such as the Netherlands as opposed to Luxembourg or France, participants indicated that the mandatory appointment of a depositary by each AIF would require extensive operational changes that would significantly increase the operating costs of the fund.

Marketing regime and new fundraising requirements are mentioned several times under the heading “other” even if they are not detailed as such, as well as delegation provisions mentioned by a Swiss respondent.

Seventeen percent of the participants perceive governance, which includes conflicts of interest but also transparency requirements and relations with investors, as the largest impact on their business. In particular, the amount of information to be supplied to investors was emphasized.

Overall, the participants noted that substantial costs will have to be laid out (such as hiring additional staff or external advisors) to become compliant with “doing business differently from how it is done currently,” as one participant put it. These investments will consist of initial costs as well as ongoing compliance costs (transparency requirements costs, for instance). The participants who believe that the amount of work involved will remain low are the firms that are relatively large and capable of easily allocating the additional workload induced to their staff or the staff of their group of companies.

A significant number of the survey participants (22%) expect the amount of work required to comply with the AIFM Directive – if they have to comply – to be high. These are mainly the small and mid-sized firms, where resource scarcity is more prevalent. Overall, the vast majority of participants feel confident that they will be able to implement the AIFM Directive in a timely manner. Several participants stressed that if additional resources are needed, this would be temporary.
In what area do you see the main impact of the Directive for your firm at first sight?

- Operations: 63%
- Governance and relations with investors: 21%
- Other: 17%

How would you assess the amount of work required to comply with the Directive for your organization?

- Workable: 57%
- Low: 22%
- High: 22%

Where do you see the main impact in terms of costs?

- Depositary: 31%
- Risk management: 38%
- Disclosure and reporting: 24%
- Other: 7%

Do you foresee any issues with respect to having the appropriate and sufficient human and technical resources for proper management in accordance with AIFM Directive in place?

- Yes: 57%
- No: 43%
Background

The AIFM Directive requires managers to functionally and hierarchically separate the risk management function from the operating units, including the portfolio management. Managers are further required to implement adequate risk management systems in order to identify, measure, manage and monitor appropriately all risks relevant to each investment strategy to which each AIF is or can be exposed. In addition, the AIFM Directive prescribes the manager to implement an appropriate due diligence process when investing on behalf of the AIF. Finally, managers must ensure that the risk profiles of the AIFs managed by them correspond to the size, portfolio structure and investment strategies and objectives of the AIF as laid down in the AIF rules or instruments of incorporation, prospectus and offering documents as disclosed to the AIF investors.

The requirement on risk management will materially affect the business

The AIFM Directive directs managers to implement a risk management system and to create a risk management function. A majority of respondents (57%) consider that they already have a formalized and all-encompassing risk framework of which they can describe the main features (risk mapping, formalized control steps, key performance indicators (KPIs) and regular reviews). However, some participants mentioned that the approach is currently rather qualitative and that documentation will definitely need to be strengthened.

Overall, 64% of the participants do not clearly consider the AIFM Directive as an opportunity to implement a formalized risk management system or to update an existing one.

Most participants told us that they believe the existing risk management procedures adequately safeguard the interests of their investors and fulfill their additional requirements. However, they generally feel that the AIFM Directive still requires them to adhere to more stringent requirements on risk management. Therefore, adapting existing business processes will be required.

According to respondents, the possibility to create the required functional and hierarchical separation between the operating units, including portfolio management and the risk management function, depends on their size. For some of the large managers and the managers operating in a group of financial companies, the separation is already partially embedded in their organization and formalized in risk management procedures. In some cases, risk monitoring committees are in place. Sometimes these risk management systems are formalized through external certifications (ISO, SOX 404 or ISAE 3402). Risk management monitors compliance with the risk limits laid down in the fund’s constitutional documents. However, smaller respondents foresee difficulties in implementing the required separation as a result of portfolio and risk management tasks being carried out by the same people. The same people are involved throughout the whole process.

Several participants stressed the lack of clarity of the risk management function as described in the Level 1 Directive from a private equity perspective; over half of the respondents highlighted that the mere concept of risk management in the AIFM Directive was adapted to hedge funds but that its concrete meaning when transferred to private equity was far from obvious. In a comparison with banks, one participant even made the point that disconnecting risk management from operations could be dangerous and could result in investment management teams no longer feeling accountable for the risks they take.

Other risk management requirements are not considered an issue

Nearly all participants (96%) declared that they have a formalized due diligence process in place with respect of the investments of their AIFs. Most participants update processes regularly. In general, this is not a static procedure but a procedure designed for each individual investment. For the participants who do not have a formal due diligence procedure in place, or who have not included the risk profile of the fund in a formal document, the formalization thereof will not be an issue.

When asked where the information that has to be disclosed to investors prior to investing in the AIF – e.g., the risk profile – is included, participants generally mentioned the private placement memorandum, the limited partnership agreement, the prospectus or the constitutional documents of the fund.
Do you currently have a formalized, all encompassing, independent risk framework?

- Yes: 43%
- No: 57%

Have you laid down the risk profile of the fund in a formal document available to investors?

- Yes: 26%
- No: 74%

Do you currently have a formalized due diligence process with respect to the investments of your AIFs in place?

- Yes: 96%
- No: 4%
6.3. Remuneration

**Background**

Managers are required to have remuneration policies in place that are consistent with, and promote, sound and effective risk management, and do not encourage risk-taking that is inconsistent with the risk profile, fund rules or instruments of incorporation of the AIFs they manage. These policies must cover those categories of staff, including senior management, risk takers and control functions, whose professional activities may have a material impact on the risk profiles of these AIFs. Managers are expected to ensure that their remuneration is based on long-term incentives. As a principle, at least 40% of the variable remuneration has to be spread out across a multiyear period (3 to 5 years). In addition, at least 50% of the variable remuneration shall consist of units or shares in the AIFs managed or consist of equivalent ownership interests, share linked instruments or equivalent non-cash instruments.

On remuneration policies, “the devil is in the details…”

A majority of the participants (61%) already have a formal remuneration policy in place; however, this does not mean that there will not be a need to fine-tune or further formalize the existing policies to meet the new requirements, for the remaining 39% in particular. Creating a policy would not really be seen as problematic.

Most managers (70%) already comply with much of the spirit of the new regime through their main financial incentive, the carried interest. Carried interest dissuades the taking of unnecessary risks and constitutes a strong long-term incentive. Moreover, the carry is directly linked to the realized performance of the fund. Although several of the respondents are in doubt whether carried interest has to be considered as remuneration, the AIFM Directive provides guidance in this respect. The AIFM Directive defines carried interest as: “a share in the profits of the AIF accrued to the AIFM as compensation for the management of the AIF and excluding any share in the profits of the AIF accrued to the AIFM as a return on any investment by the AIFM into the AIF.” Furthermore, Article 2 of Annex II to the AIFM Directive clearly states that carried interest constitutes remuneration.

However, complete adherence to the detailed remuneration requirements might be an issue. Nearly a third of the survey participants expect changes to align their remuneration and risk policy. Detailed requirements on remuneration (i.e., Level 2 legislation) may also force managers to change timing and types of payments that could materially affect existing remuneration models. Managers may experience practical problems implementing the requirements to spread out at least 40% of the variable remuneration over a multiyear period, as carried interest is only paid at the end of the fund’s lifetime and only to the extent the fund has realized a profit that exceeds the hurdle agreed upon with the investors. In addition, the requirement to pay out 50% of the variable remuneration in units or shares in the AIF is clearly perceived as practically challenging to implement by the majority of respondents (61%). The following issues were mentioned: issuing shares can result in a dilution of the participations of the limited partner(s); in closed-end funds, fundraising may only take place every 4 to 5 years; for those currently receiving a bonus, what is the incentive in having to wait for potentially several years to get their money?

All participants declared that they can easily identify staff whose professional activities have a material impact on the risk profiles of the AIF they manage. The staff commonly identified are investment managers (front office), fundraising managers and the management team and/or board (partners, directors, investment committee members).

Disclosures on remuneration, although sensitive, are not a material issue

When interviewed on the topic of the prescriptive requirements of the AIFM Directive with regard to remuneration, participants were also given the opportunity to share their views openly and not to limit themselves to the risk alignment aspect. Nearly one-third of participants spontaneously mentioned requirements in terms of remuneration disclosure as a topic on which they will need to work to achieve the right level of transparency in their communication. However, most participants feel that a good level of transparency on remuneration is already granted to investors; the perceived issue is therefore mainly one of communicating information and thus amending current communication policy as needed; indeed, as the AIFM Directive does not require managers to provide a breakdown at the level of individual officers, and the annual report that is publicly available will not contain such ancillary information on remuneration, this is not perceived as a problem.

Sixty-five percent of the participants are not concerned about the fact that differing points of recognition of carried interest across Member States may lead to discrepancies or operational challenges.
Most participants believe the playing field, with respect to carried interest, is already uneven due to different tax treatment thereof in the various Member States. The AIFM Directive will not have a material impact in this regard. Moreover, most participants indicate that it is unlikely that discrepancies will result in re-domiciliation of existing managers. However, 35% of the participants are concerned that besides the fiscal differences, differing points of recognition of carried interest may lead to even more complex remuneration structures being required.

**Do you currently have a formal remuneration policy in place?**

- Yes: 39%
- No: 61%

**Will the prescriptive requirement of the AIFM Directive for remuneration aligning with risk require changes to the AIFM's remuneration policy?**

- Yes: 70%
- No: 30%

**Are you concerned about the requirement to pay at least 50% of variable remuneration in the form of units/shares in the AIF managed by the AIFM?**

- Yes: 39%
- No: 61%

**Can you easily identify the staff (i.e., the category of staff whose professional activities have a material impact on the risk profiles of the AIF they manage) who shall be subject to the AIFM remuneration requirements?**

- Yes: 100%

**Do you foresee that you will be required to establish a remuneration committee?**

- Yes: 78%
- No: 22%

**Are you concerned about the fact that differing points of recognition of carried interest across Member States may lead to discrepancies and operational challenges?**

- Yes: 65%
- No: 35%
6.4. Initial capital, own funds and additional own funds

Background

Each external manager will be required to maintain an “initial capital” of €125,000. In addition, if the AUM by the manager exceeds a value of €250 million, the external manager is required to maintain “own funds” equal to the highest of (i) 0.02% of the amount of AUM in excess of €250 million capped at €10 million; or (ii) ¼ of the relevant annualized fixed expenditure within the meaning of Article 21 of the Capital Requirements Directive (Directive 2006/49/EC) that may therefore exceed the cap of €10 million specified in the AIFM Directive.

In addition, to cover potential professional liability risks resulting from activities the manager may carry out pursuant to the AIFM Directive, the manager shall either have “additional own funds” that are appropriate to cover potential liability risks arising from professional negligence, or hold an appropriate professional indemnity insurance against liability arising from professional negligence that is appropriate to the risks covered. Level 2 measures shall provide clarity on the relevant risks to be covered as well as the method of calculation of the cover required for such risks. Own funds (including “additional ones”) shall be invested in liquid or readily convertible assets.

Capital requirements can materially affect the business of some participants

The majority of the participants (70%) indicated that the minimum capital requirements will not have a material impact on their organization. This might be a problem for a minority of the participants. The fact that the amount of initial capital and own funds may not be less than one quarter of the relevant annualized fixed expenditure and the fact that the €10 million cap does not apply thereto – these especially may result in managers being required to maintain substantial amounts of own capital. Most participants do not believe the requirements on own capital match the risk profiles of private equity investments in general, compared to other investment categories covered by the AIFM Directive.

As far as additional own funds are concerned, they would not be a problem for 70% of the participants because they have adequate insurance cover for their potential professional liability risk, or because they are already subject to such requirements (such as in France, for instance). However, 30% of the participants perceive maintaining an amount of additional own funds invested in liquid or readily convertible assets as an issue. On the one hand, this is due to the current lack of clear guidance on how such an amount has to be calculated and how such risks have to be quantified, but it is also due to the negative impact that such requirements will have on the overall return of the fund.
Will the requirements on initial capital, own funds and additional own funds have an impact on your organization?

Additional own funds (additional to the minimum initial capital and own funds if applicable), invested in liquid or readily convertible assets, in order to cover potential professional liability under the AIFM Directive – is that an issue?

- **Yes** (70%)
- **No** (30%)
6.5. Valuation

Background

The AIFM Directive considers that reliable and objective asset valuation is crucial for the protection of investors’ interests. Accordingly, the AIFM Directive requires managers to ensure that for each AIF they manage, they have appropriate valuation procedures in place to ensure proper and functionally independent valuation of the AIF’s assets. The assets must be valued and the net asset value (NAV) per share or unit must be calculated at least once a year. For closed-end AIFs, valuations and calculations must also be carried out in case of an increase or decrease in capital. The NAV per share has to be disclosed to all investors.

The valuation function may be performed either by an external valuator, subject to mandatory professional registration, independent from the AIF and the manager, or by the manager itself, provided that the valuation task is functionally independent from the portfolio management and the remuneration policy, and other measures ensure that conflicts of interest are mitigated and that undue influence upon the internal valuators is prevented. In case of internal valuation, the competent authorities of the manager’s home Member State may require the AIFM to have its valuation procedures and/or valuations verified by an external valuator or an auditor.

External valuation is not seen as a valid alternative by the participants, mainly because external valuators do not know the underlying business of the portfolio company as internal managers do, nor do they have the same access to information or sector expertise required; therefore the potential added-value of an external valuator is not clear. Moreover, external valuation would result in a duplication of work and would involve considerable costs considering the specificities of private equity investments.

However, and interestingly enough, 8% of respondents mentioned that they use both internal and external valuation, the latter being performed at certain specific dates, for large portfolios or new funds upon investors’ request. Specialized service providers are hired for that purpose.

In terms of potential opportunity for service providers to increase support, the answers are mixed, with no clear trend emerging (52% yes, 48% no). If external support were considered, it would mainly consist of conducting portfolio reviews or procedures review rather than fully recomputing the valuation. Along the same lines, service providers would be used as third-party support during the valuation process but not as independent valuators. Their proven expertise would still be a key factor in the selection process.

The role of the depositary in overseeing valuation is perceived as potentially redundant by a vast majority of respondents (74%). This perception may be due to a lack of clarity of the Level 1 text regarding this aspect of the role of the depositary. In light of Level 2 discussions, it is, however, clear that the depositary should limit its scope to controlling whether the valuation procedure at the AIF level is in line with the requirements of Article 19 of the AIFM Directive, as well as whether it complies with national laws, regulations or constitutive documents of the fund. As one respondent put it, “overseeing and giving an opinion are two different things and should not be mixed up going forward.”

Internal valuation is the general standard in private equity

A vast majority of participants (92%) apply internal valuation and intend to maintain this practice going forward, even if meeting the requirement for functional separation between portfolio management, remuneration policy and valuation imposes challenging organizational adjustments and is not necessarily seen as relevant. Generally, the primary information and data is provided by the front office and processed by a valuation or finance department. The data provided by the front office can be compared against objective data such as financial statements or multiples of peers. Some participants have a valuation committee or an advisory board in place with members who are not part of the front office/ portfolio managers, but this is not widespread.
Will you opt for internal or external valuation?

- Internal: 92%
- Both internal and external: 8%

Do you see an opportunity for service providers to increase support?

- Yes: 52%
- No: 48%

Depositary oversight of valuation role: is there a risk of duplication of tasks in PE?

- Yes: 74%
- No: 26%
6.6. Delegation of manager functions

**Background**

Managers shall notify the competent authorities of their home Member States of their intentions to delegate any of their tasks to third parties, prior to such delegation. Several conditions have to be met, among which is the requirement for “objective reasons” to delegate. The general delegation provisions also direct that the delegate must dispose of sufficient resources to perform the delegated tasks, the delegation must not prevent the effectiveness of supervision of the manager, and the manager has to be able to demonstrate that the delegate is qualified and capable of undertaking the functions in question, and that the delegate was selected with due care. With respect to the delegation of portfolio management and risk management functions, additional requirements apply. For example, the delegate has to possess the relevant license or authorization and, if it is located outside the EU, cooperation between the competent authorities of the home Member State of the AIFM and the supervisory authority of the non-EU service provider must be ensured.

With regard to the depositary, a specific delegation regime for the safekeeping duties is foreseen by the AIFM Directive. Other duties of the depositary (cash monitoring, oversight duties) may not be delegated.

**Delegation of manager’s functions is not perceived as a major issue**

The majority of participants do not delegate any management functions (e.g., portfolio management, risk management, valuation and fund administration, including capital calls and distributions to investors) and therefore are not required to review their contractual arrangements with delegates for compliance with the AIFM Directive. A slight majority of participants do not have formalized selection processes for service providers at this stage. However, jurisdictions of establishment significantly impact the answer in that respect, with some jurisdictions already imposing the regulatory requirement of a formalized selection process on regulated managers, such as in France. For the vast majority of our respondents, the ultimate selection of a service provider is driven mainly not by cost but rather by a mix between cost, quality of service (including speed of service) and sector-specific expertise. Overall, the requirements on delegation of management functions are not perceived to be problematic by the majority of participants.
Have you started to review your delegation arrangements to ensure clear distinction between responsibility, execution and advice?

- Yes: 71%
- No: 29%

Would the choice of the service provider mainly depend on cost?

- Yes: 74%
- No: 26%

Do you have a formal due diligence process in place prior to appointing a service provider?

- Yes: 52%
- No: 48%

Do you think that restrictions imposed on delegation (objective reason, Member State to be informed, regulated or supervised entity for portfolio management, issue of letter box entity) will impact your operations?

- Yes: 78%
- No: 22%
**Background**

The AIFM Directive requires that for each AIF it manages, the manager ensures that a single depositary is appointed. The manager may not act as depositary. For private equity funds, the following legal entities may act as depositary: (i) licensed EU credit institutions, (ii) licensed EU investment firms that are authorized to hold financial instruments on behalf of clients, and (iii) entities authorized to act as depositary pursuant to the UCITS IV Directive (2009/65/EC). In addition, and in the specific case of private equity, the AIFM Directive opens up an opportunity for new players to enter the depositary market — players subject to mandatory professional registration recognized by law, or to legal or regulatory provisions or rules of professional conduct, and able to provide sufficient financial and professional guarantees to effectively perform their tasks (e.g., lawyers, notaries and registrars). It will be up to individual Member States to decide whether they intend to pursue this route or not. While some Member States have already expressed that they will use this option, such as the Dutch Ministry of Finance, others remain undecided. Luxembourg and France, for instance, are still analyzing the option and its practical implications — notably in terms of ability to delegate custody of financial security-type instruments that private equity funds may hold on a short time basis, following an IPO, for instance — and the related liability.

The depositary is required to perform various tasks for the AIF. First, the depositary is entrusted with the safekeeping of the assets of the AIF, or the AIFM acting on behalf of the AIF. With respect to financial instruments that can be held in custody, safekeeping means holding such assets in custody. With respect to other assets, safekeeping means verifying the legal title of ownership, and keeping record of such titles of ownership, in order to safeguard that the AIF is indeed entitled to such assets. Generally, private equity investments do not qualify as financial instruments but as "other assets." As mentioned above, safekeeping tasks are the only tasks that the depositary may delegate.

In addition, the depositary has to perform a broad range of supervisory roles, such as ensuring the AIF’s cash flows are properly monitored, monitoring that the manager acts in accordance with applicable law and fund rules with respect to the issuance, repurchase, redemption and cancellation of units or shares of the AIF, and monitoring that valuation procedures are in place and are performed in accordance with national law and fund rules.

The depositary of an EU AIF must be established (i.e., either have its registered office or have a branch) in the AIF’s home Member State. With regard to other assets, the depositary is liable for all losses suffered as a result of the depositary's negligent or intentional failure to properly perform its obligations pursuant to the AIFM Directive.

**Depositary function already familiar to some, but implementing the detailed depositary requirements could be costly**

The requirement for managers to appoint a depositary — independent from the AIFM — for each AIF managed is definitely the most controversial topic of the survey, where a clear shift appears between those jurisdictions already familiar with the depositary concept for their private equity funds, such as France and Luxembourg, and those where none of the participants use a depositary yet, such as the Netherlands or the United Kingdom. Logically, the perceived impact varies significantly between these two groups, with the latter attributing to the new depositary the largest perceived impact of the AIFM Directive on their business going forward.

Overall, 74% of the participants currently do not use a depositary for their alternative investment funds.

This percentage spans from 40% for those survey participants interviewed from Luxembourg, to 100% for Dutch managers, where none of the participants uses a depositary yet, other than for the safekeeping of incidental investments in financial instruments.

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4 Recital 34: “For Alternative Investment Funds that have no redemption rights exercisable during the period of 5 years from the date of the initial investment and that, in accordance with their core investment policy, generally do not invest in assets that must be held in custody in accordance with this Directive or generally invest in issuers or non-listed companies in order potentially to acquire control over such companies in accordance with this Directive, such as private equity, Member States should be able to allow a notary, a lawyer, a registrar or another entity to be appointed to carry out depositary functions.”
Overall (see above), 38% of survey respondents foresee that the depositary requirements will constitute the main impact of the AIFM Directive in terms of costs. This figure splits into 62% for participants located in the Netherlands compared with just 20% for those respondents interviewed in Luxembourg. Consequently, respondents established in the Netherlands and not currently using a depositary for their private equity funds clearly consider the depositary provisions under the AIFM Directive as costly as well as time consuming, and as a result potentially disruptive to their business. Even if more nuanced, some of the participants interviewed in Luxembourg also consider the depositary rules as costly and time consuming changes that will impact their company and, moreover, do not minimize the effort required to fully align their current model with the AIFM Directive's extensive depositary requirements. A further 20% even mention the depositary as the main impact of the AIFM Directive in terms of costs. The final Level 2 measures and their transposition at the national level will be important in that respect.

The views of survey participants on the depositary can be qualified as “mixed feelings,” with 30% of participants expressing negative feedback, qualifying the depositary as “the fifth wheel of the car” or questioning its expertise with regard to private equity. However, among those already using the services of a depositary for their private equity fund, 20% are satisfied with their services. Still, the majority of respondents fear that the extensive requirements under the AIFM Directive will substantially raise costs. This will have an impact on the AIF’s performance. An overwhelming 86% of the participants believe that the depositary role as defined by the AIFM Directive will result in a duplication of tasks already performed by the manager, the auditor or by other service providers, such as, for instance, the AML checks, or ownership verification already de facto conducted by the manager and its legal counsels during the due diligence process. Some respondents stress the importance of drafting strong operating memoranda between the manager, the depositary and the fund administrator to avoid redundancies. Interestingly enough, the difference here is not that huge between the two groups of respondents mentioned above. In terms of operations, overall, 39% of the participants believe that the restrictions imposed on the delegation of tasks by the depositary may be disruptive to their business model. For those already familiar with the depositary concept and interviewed in Luxembourg, this view is represented by just 20% of respondents.

Thus, the depositary role as laid down in the AIFM Directive is perceived in contrasting ways. Overall, it seems that those already using a depositary, or who are familiar with its concept, such as respondents based in France or in Luxembourg, are less fearful on a number of issues than those currently not using a depositary for their private equity funds. This applies in particular to costs and to the potential impact of restrictions applying to delegation of oversight tasks by the depositary. In jurisdictions such as France and Luxembourg, for instance, a track record exists, as well as well-established players operating cross-border. As a result, and contrary to participants located in other jurisdictions, the latter did not express concerns about their ability to find suitable parties capable of performing the depositary tasks. However, some concerns were expressed regarding the ability for depositaries to abide by the requirements under the AIFM Directive in some exotic jurisdictions where they do not have a network of sub-custodians, or where performing certain required tasks such as ownership-checking might prove particularly challenging with regard to local practices. Also, and interestingly enough, both groups of respondents fear the potential duplication of tasks between the depositary tasks as foreseen by the AIFM Directive and the tasks that other service providers or the manager already perform.
Quasi-depositaries: a welcomed opportunity managers intend to explore

As mentioned earlier, an option to open up the depositary market to “quasi-depositaries” exists in the AIFM Directive, while Member States seem to have different approaches to this option. In that context, we found it interesting to ask the survey participants to further elaborate and give us their feedback as practitioners.

Overall, 70% of survey participants would consider using the services of non-banks depositaries. However, only 52% of the respondents believe that other eligible “supervised” entities, such as attorneys-at-law, notaries, trust offices or auditors, will be willing, or equipped, to perform the depositary role for private equity – a role whose pillars are verifying legal titles of ownership of assets and verifying the correctness of cash flows. Therefore, a significant proportion of participants doubt that adequate capabilities will be available and point out that the depositary business requires a specific set of skills and expertise that is not limited to legal or finance and accounting. Others also regret that, depending on final Level 2 measures, only large entities may be able to perform the extensive scope of the depositary’s tasks and bear the attached risks.

Going forward, there is a general expectation that depositaries will be able to clearly establish the value they add in the overall process and adequately communicate on it if they are not to be considered as simply “rubber stamping” others’ decisions.
Do you think that the depositary tasks covered by the AIFM Directive will lead to duplication with what certain service providers already do?

In terms of eligible entities, do you think the possibility of using services of a lawyer or a notary for private equity under conditions is one that you will consider?

Do you think that these market players will be willing/equipped to perform this role?

Do you see restrictions imposed on delegation of tasks other than safekeeping of financial instruments by the depositary as potentially disruptive for your business model?
6.8. Transparency

**Background**

Transparency toward regulators and investors, and public accountability for the actions of AIFMs, were among the key objectives pursued by the European legislator when drafting the AIFM Directive. To this end, the AIFM Directive aims to develop a harmonized set of rules with regard to format and content of annual reporting, for instance, or reporting to regulators. A series of information shall be disclosed to investors before they invest in an AIF and where there are material changes thereto (such as a description of the AIF investment strategy, the identity of the AIFM, the AIF’s depositary, auditor and any other service providers, and how the AIFM ensures a fair treatment of investors). No later than six months following the end of the financial year, the AIFM must make available to investors (on request) and competent authorities an audited annual report for each EU AIF that it manages and for each AIF marketed in the EU. It shall include a report on the activities for the financial year and information on remuneration (see section 6.3, above, “Remuneration”). In addition, an AIFM is required to report to its home Member State competent authorities on the principal markets and instruments in which it trades on behalf of each AIF it manages, on the principal exposures and most important concentrations of each AIF it manages, the actual risk profile of the AIF and the risk management tools employed by the AIFM to manage the market risk, liquidity risk, counterparty risk and other risks, including operational risk, and the results of the stress tests in order to monitor systemic risk.

**Increased transparency toward investors is not an issue**

A vast majority of participants assess the impact of transparency provisions in the annual report as minimal. Most point out that the information required is to a large extent already provided to investors, and even more extensively than required under the AIFM Directive. However, and as we have seen for remuneration disclosures, some adjustments will be required as compared to current practice. Some respondents also see a positive impact for investors through getting increasingly standardized information.

Seventy-four percent of participants have not yet listed the gap between the disclosures they currently provide to investors and those required by the AIFM Directive, but most of them plan to do so in 2012. Those having done it reported that they are largely compliant. The main area of additional work would relate to presentation (how the information is disclosed) rather than content (collecting the necessary information).
How do you assess the impact of transparency provisions in the annual report with respect to the “report of the activities of the financial year” and “any material changes in the information which has to be disclosed to investors”?  

- Minimal: 9%  
- Comprehensive/large: 91%

Have you started listing the gap between current disclosure to investors practices and those required by the AIFM Directive?  

- Yes: 26%  
- No: 74%
6.9. Control over non-listed companies

6.9.1. Additional reporting and notification requirements

Background

The AIFM Directive sets down specific requirements on the acquisition of major holdings or control of non-listed companies and issuers. The provisions on acquisition of control apply to AIFMs acting individually or cooperating with one (or more) other AIFMs managing one or more AIFs that, either individually or jointly, acquire control of a non-listed company, and for certain limited provisions to issuers. Control is defined as more than 50% of the voting rights for non-listed companies and by reference to Article 5(3) of the Takeover Bids Directive for issuers. The provisions are not applicable to small and medium-sized-enterprises (SMEs).

When an AIF acquires, disposes or holds shares of a non-listed company, the AIFM must notify the competent authorities of its home Member State of the proportion of voting rights of the non-listed company held by the AIF any time when that proportion reaches, exceeds or falls below the thresholds of 10%, 20%, 30%, 50% and 75%.

When an AIF acquires, individually or jointly, control over a non-listed company, the AIFM is required to: i) notify, within 10 working days, the non-listed company, its shareholders and its competent authority of the resulting situation in terms of voting rights and the conditions under which control has been reached and ii) disclose to the non-listed company, its shareholders and its competent authority, the identity of the AIFM which either individually or in agreement with other AIFMs manages the AIF that has reached control, the policy for preventing and managing conflicts of interests, and the policy for external and internal communication relating to the company, in particular as regards employees. These provisions also apply to issuers. In addition, the AIFM shall disclose i) to the non-listed company and its shareholders its intentions regarding the future business of the non-listed company and the likely repercussion on employment, and ii) to its competent authorities and the AIF investors information on the financing of the acquisition.

In the notification and disclosure to the non-listed company, the AIFM must request the board of directors of the company to inform the representatives of employees or the employees themselves, of the acquisition of control by the AIF managed by the AIFM and provide the information notified and disclosed. This also applies to issuers.

The annual report of the non-listed company or the AIF should “give an indication” of any important events that have occurred since the end of the financial year and the company’s likely future development.

Reporting requirements will not affect the business

The majority of the participants (78%) manage one or more AIFs that have control over portfolio companies. Out of these, 40% have control over large EU companies. Most participants already have control procedures to comply with notification requirements due to national legislation in certain jurisdictions, such as the Netherlands, for instance. For those who do not have such procedures in place yet, it is generally not perceived as problematic to put in place by transferring the model applicable to listed companies.

Thirty-nine percent of respondents consider the additional disclosures, including disclosures on future intentions and likely repercussions on employment, as an issue. One respondent expressed the fear of reputational damage each time something is said that does not turn out to be true. But overall, participants are not concerned about additional reporting required. They stress that when acquiring controlling stakes into a company, a private equity house already has to commit on the future of the company. Moreover, the requirements remain quite generic and therefore would not result in disclosing strategic information. Finally if they admit that such requirements may increase the workload from an operational perspective, it will not in the end prevent operations being completed.

A vast majority (67%) believe compliance with the additional reporting requirements is primarily an obligation of the managing board of the portfolio company. However, the AIFM Directive clearly specifies the manager shall use its best efforts to ensure the portfolio company’s annual report is drawn up in accordance with the requirements of the AIFM Directive. Moreover, the AIFM Directive regulates managers and not portfolio companies.
Does the AIF managed by you have a major holding or, individually or jointly (on the basis of an agreement aimed at acquiring control), have control (i.e., more than 50% of the voting rights) over portfolio companies?

- Yes: 78%
- No: 22%

Is the disclosure of future intentions and likely repercussion on employment to the non-listed company and its shareholders in case of acquisition of control an issue?

- Yes: 61%
- No: 39%

Who will be responsible for ensuring compliance with new reporting requirements at the portfolio company level?

- The portfolio company: 33%
- AIFM: 67%
6.9.2. Restrictions on asset stripping

**Background**

When an AIF acquires control over a large EU company, the AIFM cannot — within 24 months of the acquisition of control of the company by the AIF — facilitate, support or instruct any distribution, capital reduction, share redemption and/or acquisition of own shares by the company, or vote in favor of a distribution, capital reduction, share redemption and/or acquisition of own shares by the company. The AIFM is required to make its best efforts to prevent such actions if such action, in short, would result in: (i) the company's net assets becoming lower than the amount of the subscribed capital plus the reserves that cannot be distributed by law or by the company's articles of association or (ii) the amount of such “distribution” being in excess of the amount of the company's profits in the last financial year.

The anti-asset-stripping provisions will negatively impact the perception of private equity.

The vast majority of the participants (80%) also believe that they will be in scope of the anti-asset-stripping rules as they manage one or more AIFs that each control one or more large companies.

Forty-eight percent believes the anti-asset-stripping rules will make it more difficult for private equity to offer an attractive investment opportunity. Reasons mentioned in that respect include impact on deal structuring, exit strategies, and restructuring operations that could be needed in the first 24 months following an acquisition and that could become more complex as a result of the anti-asset-stripping rules. Seventy percent of participants believe that these provisions will translate into additional costs for the fund.

However, most participants hardly believe the anti-asset-stripping rules will materially affect their business models or the business models of other private equity houses, as these are driven by long-term goals and incentives (i.e., the carried interest) and pursue long-term value creation in their portfolio companies rather than "quick wins" or "corporate raider" strategies. As one respondent put it, "providing capital to companies will always remain attractive."

However, in terms of perception, 67% of respondents stressed the potential negative impact of anti-asset-stripping provisions on the perception of private equity ownership.
Are you in scope of the anti-asset-stripping rules? (Control of EU non-listed portfolio companies)

- Yes: 80%
- No: 20%

Do you think that the asset-stripping provisions will make it more difficult for private equity to offer attractive investment opportunities?

- Yes: 52%
- No: 48%

Could anti-asset-stripping rules lead to private equity being perceived as a less attractive owner (level-playing-field issue)?

- Yes: 67%
- No: 33%

Do you think that anti-asset-stripping rules will lead to additional costs for the funds, linked to new structuring mechanisms that could be needed to secure return to investors in the first two years of private equity ownership?

- Yes: 70%
- No: 30%
6.10. Other topics

**Increased compliance costs and pressure on manager’s remuneration**

Sixty-one percent of the participants believe the AIFM Directive will negatively impact the performance of AIFs. However, some stress that in private equity, the main driver of the fund performance lies in the capacity of its manager to buy well and sell well and that, as a result, the impact of costs on performance should not be overemphasized. Fifty-seven percent believe that compliance costs will lead to further pressure on the manager’s remuneration by investors as a way of transferring costs. A participant does, however, mention that the answer is not so straightforward in so far as the European passport, for instance, could also result in a decrease of compliance costs (no need to set up management companies in multiple jurisdictions).

A majority of participants (61%) expect that in the future, investors will restrict their investments to AIFM Directive-compliant managers. But many respondents stress that investors remain largely return-driven rather than regulatory-driven. The majority of respondents believe an AIFM Directive license will not act as a quality seal that would attract further investments from institutional investors such as pension funds. Indeed the asset allocation is a commercially driven and diversification-based decision in which regulatory compliance is only one among multiple factors considered.
Do you consider that the compliance costs will negatively impact the fund’s performance?

- Yes: 61%
- No: 39%

Do you think that the compliance costs could lead to further pressure on the remuneration of the AIFM by the investors?

- Yes: 57%
- No: 43%

Do you think that investors (especially institutional) will restrict their future commitments to AIFM Directive-compliant only funds? Will they embrace the AIFM Directive?

- Yes: 61%
- No: 39%

Could compliance with AIFM Directive lead to a bigger allocation to private equity from pension funds in the near future?

- Yes: 71%
- No: 29%
6.11. To conclude

The AIFM Directive will have a considerable impact on the business of private equity in Europe. Most industry players actively monitor the legislative developments both in their home Member States as well as at the EU level, although it does not appear that many were actively adapting their businesses at the time of the survey. However, all expressed their readiness to engage and roll up their sleeves.

This may remind us that although private equity managers in some European jurisdictions are not regulated at this time (such as in the Netherlands), they already have to comply with a considerable set of business standards that have become the rule for maintaining an existing investor base and for attracting new investors. For this reason, the gap between current business practices and the requirements of the AIFM Directive will probably be smaller for private equity than for other sectors of the alternative funds industry. Indeed, over 95% of participants express confidence that they will be able to meet the AIFM Directive requirements within deadline.

To what extent would you agree with the following statement: “I feel confident that my organization will be able to meet the requirements of the AIFM Directive within deadlines”? 

- 96% Agree
- 4% Other

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Ernst & Young private equity contacts

Alain Kinsch  
EMEIA Private Equity Funds Leader  
+352 42 124 8355  
alain.kinsch@lu.ey.com

Zaina Ahmed-Karim  
Partner, Private Equity  
+31 88 40 71051  
zaina.karim@nl.ey.com

Olivier Coekelbergs  
EMEIA Private Equity Funds Coordinator  
+352 42 124 8424  
olivier.coekelbergs@lu.ey.com

Axelle Ferey  
Director, Private Equity  
AIFM Directive subject matter expert  
+352 42 124 8329  
axelle.ferey@lu.ey.com

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