

A new dawn for alternative investments

Navigating the challenges and opportunities
of the AIFM Directive

November 2010



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Foreword

The Alternative Investment Fund Managers (AIFM) Directive will have a profound structural impact on the fund industry, both in Europe and internationally.

While the main focus of the AIFM Directive (the Directive) is on managers of funds, the Directive will not only impact European Union (EU) and non-EU AIFM, but also EU and non-EU domiciled Alternative Investment Funds (AIF), service providers to these funds and their investors.

The Directive covers all alternative sectors such as hedge funds, real estate and private equity, but also traditional sectors where the funds are not registered as UCITS¹. It applies to funds and certain corporate collective investment vehicles. Such products are generally for professional investors, but may also be sold to retail investors.

The Directive lays down requirements which must be met by AIFM, covering authorization, capital, marketing, remuneration, conduct of business, conflicts of interest, functions and service providers and transparency. Specific provisions cover the use of leverage and acquisition of major holdings and control.

In return for more regulation of AIFM, their service providers and funds, the proposed Directive provides for the introduction of passports enabling AIFM to offer their management services and market their AIF throughout the EU.

Following intense debate, the Directive was adopted by the European Parliament on 11 November 2010. Member States will be required to implement this Directive within two years of its entry into force.

We believe that the Directive has ramifications far beyond achieving basic compliance:

- ▶ Alternative investment groups (including promoters, sponsors, advisers, general partners and managers of all types of non-UCITS funds) should conduct a strategic review of their fund ranges and their operating models.
- ▶ Service providers, especially depositaries, custodians, administrators and valuers, will also need to assess the strategic impact on their service offering and operating model and consider how they will react to new obligations and risks introduced by the Directive.
- ▶ Investors will need to consider the accessibility of products, and the Directive's impact on their portfolio diversification models. The Directive will also have consequences for their investment process.

Overall, the Directive will mean new opportunities and challenges for all the key stakeholders in the alternatives sectors' value chain.

This publication provides you with a simple guide to the complex AIFM Directive, and outlines its major strategic and compliance implications for key alternative industry stakeholders. We also set out how we can help you with your strategic challenges so that you are ready to meet the requirements of the Directive.

¹ Undertakings for collective investment in transferable securities, subject to the UCITS Directive, Directive 2009/65/EC

I. Background

The European Commission proposed an initial draft of a new Directive introducing a harmonized EU regulatory and supervisory framework for Alternative Investment Fund Managers (AIFM) in April 2009.

The AIFM Directive is designed to address a number of risks identified by the Commission relating to AIF, including systemic risk. The Commission is of the view that coordinated EU regulatory oversight is a better mechanism to deal with the potential danger of systemic risk that may arise from the activities of AIF than current fragmented national approaches.

The objectives of the proposed AIFM Directive are to:

- ▶ Extend appropriate regulation and oversight to all actors and activities that embed systemic risks
- ▶ Improve financial stability
- ▶ Ensure that AIFM are subject to a regulatory framework
- ▶ Increase transparency towards regulators and investors, and public accountability for the actions of AIFM
- ▶ Enhance investor protection
- ▶ Develop the EU internal market in the area of alternative investment

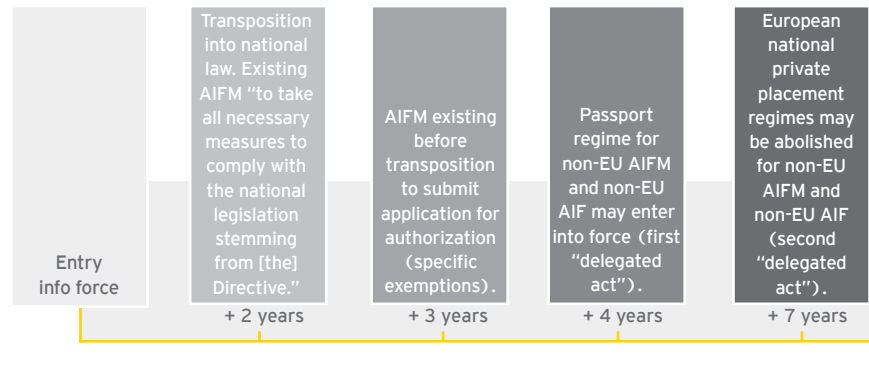
The initial draft issued in April 2009 subsequently entered into the EU co-legislative process, which involved the European Parliament and the Council of the European Union. As several of the provisions in the Commission's draft were highly controversial, both the European Parliament and the Council worked hard to define their own positions on the Directive, based on the Commission's draft. This was followed by trilogue negotiations involving the European Parliament, the Council and the Commission in order to reach a compromise position acceptable to the three institutions.

On 19 October 2010, the Economic and Financial Affairs Council (ECOFIN) reached informal agreement on a compromise text. A slightly modified version of this text was agreed at the final trilogue of 26 October 2010, and the European Parliament voted the Directive on 11 November 2010.

Member States will be required to implement this Directive within two years of its entry into force.

II. Implementation

The following is an indicative timeline of the key milestones following entry into force:

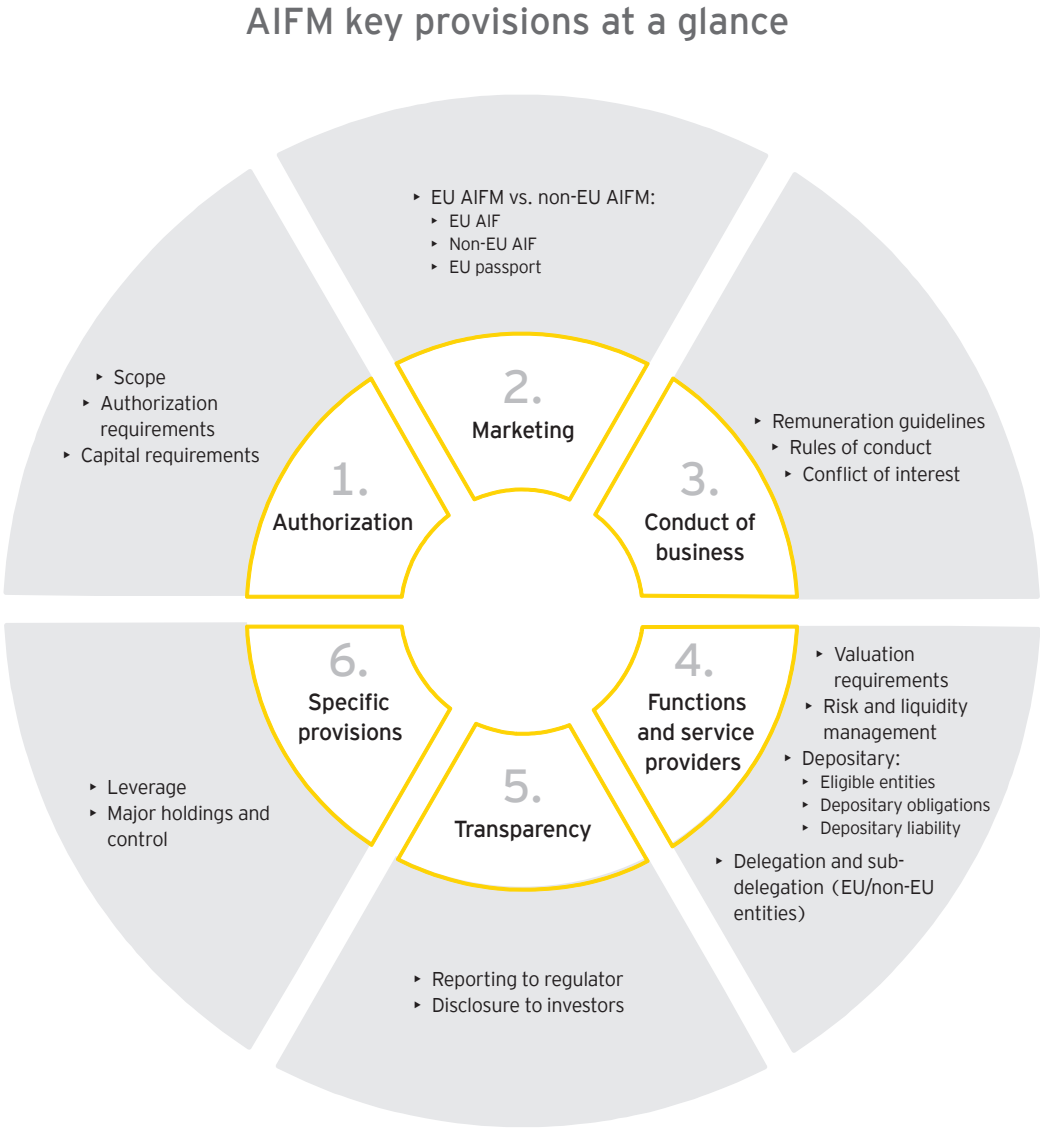


The Commission is required to adopt "delegated acts" (also known as "Level 2" or "implementing" measures) clarifying certain elements of the Directive.

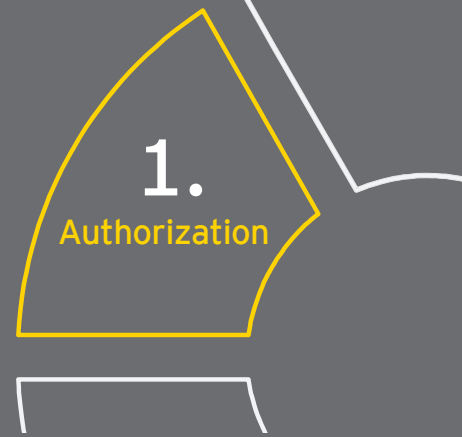
The Commission may also review the application and scope of the Directive four years after implementation.

III. Key provisions

The key provisions of the AIFM Directive are summarized in the following diagram:



In this section, we provide a brief overview of the key provisions of the Directive.



1. Authorization

1.1 Scope

The AIFM Directive applies to all:

- ▶ EU AIFM, which manage one or more AIF irrespective of whether the AIF is an EU AIF or a non-EU AIF
- ▶ Non-EU AIFM, which either:
 - ▶ Manage one or more EU AIF
 - ▶ Market one or more AIF in the European Union, irrespective of whether the AIF is an EU AIF or a non-EU AIF

An AIFM is any legal person whose regular business is managing one or more AIF. 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 AIF means providing at least investment management services of portfolio management or risk management to one or more AIF. AIFM may additionally provide administration, marketing and other services not regulated by the Directive related to the assets of AIF². External AIFM may also be UCITS management companies, if they are authorized under both the UCITS and the AIFM Directives.

Member States may authorize external AIFM to provide additional services of:

- ▶ Management of portfolios of investments, including those of pension funds and institutions for occupational retirement provision, on a discretionary, client-by-client basis
- ▶ As non-core services:
 - ▶ Investment advice
 - ▶ Safe-keeping and administration in relation to shares or units of collective investment undertakings
 - ▶ Reception and transmission of orders in relation to one or more financial instruments

An AIF is any collective investment undertaking, including investment compartments thereof, 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 and which is not a UCITS. All AIFs are covered, independent of their open-ended or closed-ended nature, legal form and structure. Investment undertakings, such as family office vehicles, which invest the private wealth of investors without raising external capital, should not be considered to be AIF in accordance with this Directive.

Each AIF is required to have a single AIFM, which is responsible for ensuring compliance with the requirements of the Directive.

The Directive provides for several exemptions from the Directive's provisions. Full exemptions apply to holding companies, securitization special purpose entities, institutions for occupational retirement provision (IORP) and their managers insofar as they do not manage AIF and to certain group AIFM entities³.

Providing certain registration and regulatory reporting conditions are met, the provisions of the Directive do not apply to:

- ▶ AIFM which manage portfolios of AIF whose assets under management, including any assets acquired through use of leverage, in total do not exceed a threshold of €100 million
- ▶ AIFM which manage portfolios of AIF whose assets under management, in total do not exceed a threshold of €500 million when the portfolio of AIF consists of AIF that are not leveraged and have no redemption

The AIFM Directive captures practically all non-UCITS funds, be they alternative funds or not, as well as other vehicles, and their AIFM.

As an AIFM will have to be identified for each AIF, a case-by-case analysis of where and how portfolio management and risk management activities are conducted will be required.

AIFM may need to review their products and operating models, *inter alia*, to benefit from exemptions.

AIFM which fall under the scope of the Directive will then need to perform a gap analysis between their current regulatory requirements and those of the AIFM Directive.

rights exercisable during a period of five years following the date of initial investment in each AIF.

However, such AIFM may choose to opt-in under the Directive in order to benefit from the rights granted to AIFM (in particular passports); in this case, they must comply with all the provisions of the Directive.

² Services necessary to meet the fiduciary duties of the AIFM, facilities management, real estate administration activities, advice to undertakings on capital structure, industrial strategy and related matters, advice and services relating to mergers and the purchase of undertakings and other services connected to the management of the AIF and the companies and other assets it has invested in.

³ AIFM insofar as they manage one or more AIF whose only investors are the AIFM or the parent undertakings or the subsidiaries of the AIFM or other subsidiaries of those parent undertakings, provided that none of those investors itself is an AIF.

1.2 Authorization requirements

AIFM in scope of the Directive must be authorized and supervised in accordance with the provisions of the Directive, in order to provide management services in respect of AIF.

The application for authorization must include:

- ▶ Information on the persons effectively conducting the business of the AIFM
- ▶ Information on the identities of the AIFM shareholders that have qualifying holdings and the amounts of those holdings
- ▶ A program of activity setting out the organizational structure of the AIFM, including information on how the AIFM intends to comply with its obligations under the Directive
- ▶ Information on the remuneration policies and practices
- ▶ Information on arrangements made for the delegation and sub-delegation to third parties of functions
- ▶ Information about the investment 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 it manages or intends to manage, including information about the Member States or third countries in which they are established or are expected to be established
- ▶ Information on where the master AIF is established if the AIF is a feeder AIF
- ▶ The fund rules or instruments of incorporation of each AIF the AIFM intends to manage
- ▶ Information on the arrangements made for the appointment of the depositary for each AIF the AIFM intends to manage
- ▶ Additional information which the AIFM must disclose to the investors in the AIF

The Directive lays down the conditions which must be met in order for the competent authorities of the home Member State of the AIFM to grant authorization. In general, authorization must be granted within three months.

AIFM existing before transposition of the Directive must submit an application for authorization within one year of transposition. Specific exemptions apply in the case of AIFM managing closed-ended AIFs.

The competent authorities of the home Member State of the AIFM may restrict the scope of the authorization, in particular as regards the investment strategies of AIF which the AIFM is allowed to manage.

EU AIFM intending to manage an AIF established in another Member State (a host Member State), either directly through the free provision of services, or via the establishment of a branch, must submit the following documentation to their competent authorities:

- ▶ The name of the Member State in which they intend to provide management services, or establish a branch
- ▶ A program of operations stating the services they intend to perform and identifying the AIF they intend to manage
- ▶ If a branch is established: organizational structure of the branch, addresses in the home Member State from which documents may be obtained and contact details of the persons responsible for the management of the branch

The authorization process will require significant additional compliance resources.

There is substantial alignment between the regulation of AIFM and UCITS management companies.

The competent authorities of the AIFM's home Member State shall transmit the complete documentation within one month to the competent authorities of the Member State where the management services will be provided, together with an attestation that they have authorized the AIFM concerned. They shall immediately notify the AIFM of the transmission. The AIFM may start providing management services in the host Member State upon receipt of the notification.

EU AIFM may manage non-EU AIF which are not marketed in the EU provided that the AIFM complies with all the requirements of the Directive, except those on the depositary and the annual report, and that there are appropriate cooperation arrangements between EU AIFM home Member State and the non-EU AIF third country supervisory authorities at least for efficient exchange of information.

Non-EU AIF managed and marketed in the EU by EU AIFM are covered in 2. *Marketing*.

The requirements for non-EU AIFM managing EU AIF or marketing their AIF in the EU are also covered in 2. *Marketing*.



1.3 Capital and liability insurance

Internally managed AIF will be required to hold an initial capital of €300,000.

AIFM which are appointed as external managers of one or more AIF will be required to hold an initial regulatory capital of at least €125,000.

Additional capital will be required for AIFM who manage in excess of €250m. The additional own funds will be calculated as 0.02% of the amount by which the value of the portfolios of the AIFM exceeds €250m, with a €10m cap. AIFM can be exempt from up to 50% of the additional capital if they benefit from a guarantee of the same amount by a credit institution or an insurance undertaking under EU or equivalent supervision. These provisions apply to both internally and externally managed AIFM.

Portfolios of the AIFM means AIF managed by the AIFM, including portfolios of AIF for which the AIFM has delegated functions, but excluding portfolios which the AIFM is managing under delegation.

At a minimum, AIFM are required to hold own capital equivalent to 25% of their preceding year's fixed overheads.

To cover potential professional liability risks resulting from professional negligence of the AIFM, both internally managed AIF and externally appointed AIFM shall either have an appropriate amount of additional own funds, or hold appropriate professional indemnity insurance.

Own funds must be invested in liquid assets or assets readily convertible to cash in the short term.

Overall, capital requirements are aligned with those of UCITS. AIFM may need additional capital injections which will increase financing costs and trap money. This could represent a barrier to entry for small and mid-size players.



2. Marketing

The following is a brief summary of the main principles of the marketing provisions of the Directive:

- ▶ Authorized EU AIFM have a **passport** to market EU AIF to **professional investors** in their home Member State and in other Member States. They will no longer be allowed to use national private placement regimes.
 - ▶ For **non-EU AIF managed by EU AIFM** and **non-EU AIFM marketing EU and non-EU AIF**, two regimes will coexist for marketing: continuation of national **private placement regimes**, which may be phased out, and a **passport** regime, which may be phased in, following the issue of opinions and advice by the newly created European Securities and Markets Authority (ESMA) and the adoption of “delegated acts”.
 - ▶ Non-EU AIFM intending to market AIF they manage in the EU with a passport must acquire prior authorization from their **Member State of reference**.
 - ▶ All marketing with a passport of EU and non-EU AIF to **professional investors** by EU and non-EU AIFM in home Member State/Member State of reference or another Member State is subject to a **notification procedure**.
 - ▶ Member States may permit marketing of EU or non-EU AIFs by AIFM to **retail investors** on their territory – stricter requirements may be applied.
-



2.1 Marketing EU AIF by EU AIFM

Marketing covers any direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled in the EU.

Authorized AIFM are entitled to market their AIF to professional investors in any EU Member State - they benefit from a "passport."

Member States may permit the marketing of AIF to retail investors on their territory. The requirements of the Directive must be met, and, in addition, Member States may impose stricter requirements on the AIFM or the AIF than those applicable to marketing to professional investors. These requirements must not be stricter for EU AIF marketed cross-border than for AIF marketed domestically.

When an EU AIFM intends to market its EU AIF in an EU Member State (its home Member State or a host Member State), it must submit a notification to its home Member State for each AIF. EU feeder AIF must have an EU master AIF managed by an EU AIFM. The notification must include:

- ▶ Notification letter, identifying the AIF it intends to market and information on where they are established
- ▶ AIF rules or instruments of incorporation
- ▶ Identity of depositary

- ▶ A description of, or information on, the AIF available to investors, as well as information which must be provided to investors before they invest
- ▶ Information on the master AIF, if the AIF is a feeder
- ▶ Identification of the Member State in which it intends to market the AIF (if relevant)
- ▶ Measures to prevent the fund from being marketed to retail investors (if relevant)
- ▶ Information on arrangements made for marketing the AIF, in the case of marketing in a host Member State

Providing that the provisions of the Directive are met, in the case of marketing in the AIFM's home Member State, the competent authority shall inform the AIFM within 20 days that it may start marketing the AIF. In the case of cross-border marketing, the competent authorities of the AIFM's home Member State shall transmit the complete documentation to the competent authorities of the host Member State, together with an attestation that the AIFM is authorized to manage AIF with that particular investment strategy within 20 days; upon transmission, they shall notify the AIFM of the transmission. The AIFM may start marketing the AIF in the host Member State as of the date of the notification.

Arrangements made for marketing the AIF and measures to prevent the fund from being marketed to retail investors in the host Member State are subject to the laws and supervision of the host Member State.

EU AIFM will be required to comply with notification procedures to obtain authorization to market AIF to professional or retail investors in a Member State, including their home Member State. Authorized EU AIFM will benefit from a passport for their EU funds from the date of transposition in their home Member State legislation, which will supersede current arrangements under national private placement regimes.

2.2 Non-EU AIF managed and marketed by EU AIFM

Two regimes apply to the marketing in the EU of non-EU AIF managed by EU AIFM:

- ▶ Marketing *with a passport*, once the passport for non-EU funds is phased in: EU AIFM wishing to market non-EU AIF they manage, or EU feeder AIF which do not have EU master AIF managed by an EU AIFM in the EU, must comply with all the relevant requirements of the Directive. In addition, three conditions shall be fulfilled:
 1. There must be appropriate cooperation arrangements between EU AIFM home Member State competent authorities and the non-EU AIF country supervisory authorities at least for efficient exchange of information
 2. The non-EU AIF country must not be listed as a non-cooperative country and territory (NCCT) by FATF
 3. The non-EU AIF country must have signed an OECD Article 26 Model compliant Tax Convention with AIFM home Member State and any other Member State in which the non-EU AIF is proposed to be marketed

The AIFM must submit a notification to its home Member State for each non-EU AIF, similar to that required for each EU AIF.

- ▶ Marketing *without a passport*, under national private placement regimes: EU Member States may permit EU AIFM to market non-EU AIF they manage, or EU feeder AIF which do not have EU master AIF managed by an EU AIFM, provided that the AIFM complies with all the relevant requirements of the Directive. An entity must be appointed to carry out depositary functions, although the full requirements of the Directive on depositaries do not have to be met. The Member State may impose stricter requirements on marketing to investors on their territory. Furthermore, there must be appropriate cooperation arrangements to ensure efficient exchange of information for systemic risk oversight between the EU AIFM home Member State competent authorities and the non-EU AIF third country supervisory authorities and also the non-EU AIF country must not be listed as an NCCT by FATF.

2.3 Non-EU AIFM marketing their AIF in the EU or managing EU AIF

Non-EU AIFM intending to market EU or non-EU AIF they manage in EU *with a passport* (once it is phased in), or to manage EU AIF must acquire a prior authorization by the competent authorities of their EU "Member State of reference". To obtain authorization it must comply with the requirements of the Directive, or equivalent rules.

The "Member State of reference" is determined in accordance with a complex series of rules; in summary, the Member State of reference is generally the Member State where it carries out most management or marketing.

Furthermore, the following conditions must be met.

- ▶ The non-EU AIFM must appoint a legal representative in the Member State of reference. The legal representative has, alongside the AIFM itself, the role of a contact person for investors and the authorities in the EU and shall also jointly perform with the AIFM the compliance functions relating to the management and marketing activities of the AIFM under the Directive
- ▶ There must be appropriate cooperation arrangements between EU Member State of reference competent authorities, EU AIF competent authorities (if relevant) and the non-EU AIFM third country supervisory authorities at least for efficient exchange of information



- ▶ The non-EU AIFM third country must not be listed as an NCCT by FATF
- ▶ The non-EU AIFM third country must have signed an OECD Article 26 Model compliant Tax Convention with AIFM home Member State and any other Member State in which the non-EU AIF will be marketed
- ▶ The effective exercise by the competent authorities of their supervisory functions is not prevented by laws, regulations or administrative provisions of the third country governing the AIFM, nor by limits on the supervisory and investigatory powers of the third country regulator

Once the non-EU AIFM has obtained authorization, the marketing *with a passport* regime works as follows:

- ▶ EU AIF: where an authorized non-EU AIFM intends to market its EU AIF in an EU Member State (its Member State of reference or another Member State) with a passport, it must submit a notification to its Member State of reference for each EU AIF. The procedure is similar to that applicable to EU AIFM intending to market EU AIF.
- ▶ Non-EU AIF: the regime is similar to that for EU AIF except that, in addition, the conditions applicable to EU AIFM wishing to market non-EU AIF they manage with a passport also apply (see 2.2 *Non-EU AIF managed and marketed by EU AIFM*).

EU Member States may permit non-EU AIFM to market the AIF they manage (be they EU or non-EU AIF) *without a passport* under national private placement regimes, provided that the annual report, disclosure to investors and reporting to competent authorities provisions of the Directive, as well as where relevant the provisions on acquisition of control (see 6.2 *Requirements on acquisition of major holdings and control over portfolio companies*) are complied with. Member States may impose stricter requirements on marketing to investors on their territory. It is unclear whether the Directive or Member States will require an entity to be appointed to carry out depositary functions for non-EU AIF managed by non-EU AIFM. Furthermore, there must be appropriate cooperation arrangements to ensure efficient exchange of information for systemic risk oversight between the competent authorities of the Member States where the AIF are marketed, the EU competent authorities or the third country supervisory authorities of the AIF, and the third country supervisory authorities of the non-EU AIFM; also the non-EU AIFM country, and the non-EU AIF country (if relevant), must not be listed as NCCT by FATF.

Authorized non-EU AIFM may manage AIF in EU Member States other than their Member State of reference. The procedures to be followed are similar to those applicable to EU AIFM intending to manage an AIF established in another Member State.

The Directive foresees a pan-European fundraising regime which may become available to non-EU managers and non-EU funds from or after 2015. Meanwhile, and for the upcoming seven years at least, national private placement regimes will remain available for the distribution in Europe of non-EU funds and to non-EU managers. However, Member State may impose stricter rules in an effort to respond to the perceived needs to protect investors.



3.

Conduct of business

Introducing remuneration policies that do not promote undue risk taking and are based on long-term incentives can only be supported; in many cases, such requirements only formalize already existing best practices. However, guidelines may require significant interpretation. Moreover, detailed disclosures may contain sensitive information.

3. Conduct of business

3.1 Remuneration

AIFM are required to have remuneration policies and practices that are consistent with and promote sound and effective risk management and do not encourage risk-taking which is inconsistent with the risk profiles, fund rules or instruments of incorporation of the AIF it manages. The policies and practices must cover those categories of staff whose professional activities have a material impact on the risk profiles of AIF they manage.

AIFM that are significant in terms of their size or the size of the AIF they manage, their internal organization and the nature, the scope and the complexity of their activities are required to establish a remuneration committee. The remuneration committee shall act independently and be responsible for the preparation of decisions regarding remuneration. It shall directly oversee the remuneration of the senior officers in the risk management and compliance functions.

AIFM shall comply with a series of principles set out in Annex to the Directive in a way that is appropriate to their size, internal organization and the nature, scope and complexity of their activities. For example:

- ▶ Where remuneration is performance related, the total amount of remuneration must be based on a combination of the assessment of the

performance of the individual and of the business unit or AIF concerned and of the overall results of the AIFM; when assessing individual performance, financial as well as non-financial criteria must be taken into account. The assessment of performance is set in a multi-year framework appropriate to the life-cycle of the AIF managed by the AIFM.

- ▶ Fixed and variable components of total remuneration must be appropriately balanced and the fixed component must represent a sufficiently high proportion of the total remuneration.
- ▶ In general, at least 50 % of any variable remuneration must consist of units or shares of the AIF concerned, or equivalent non-cash instruments.
- ▶ At least 40 % of the variable remuneration component must be deferred over a period which is appropriate in view of the life-cycle and redemption policy of the AIF concerned and is correctly aligned with the nature of the risks of the AIF in question (generally three to five years).

Disclosure in AIF annual report must include total amount of remuneration, split into fixed and variable, paid by the AIFM, number of beneficiaries and where relevant carried interests paid by the AIF, aggregate amount of remuneration broken down by senior management and staff impacting risk profile of the AIF.



3.2 Rules of conduct

As general principles, an AIFM shall act honestly, with due skill, care and diligence and in the best interests of the AIF or the investors of the AIF it manages and promote the integrity of the market. The AIFM shall have appropriate resources necessary to perform its management activities. It shall also ensure that investors are treated fairly.

Whenever an investor obtains a preferential treatment or the right to obtain preferential treatment, the AIFM must provide to investors before they invest a description of that preferential treatment, the type of investors who obtain such preferential treatment as well as, where relevant, their legal or economic links with the AIF or AIFM; furthermore, no investor may obtain a preferential treatment, unless this is disclosed in the AIF rules or instruments of incorporation.

AIFM will need to formalize conduct of business requirements, and may be required to review side-letters arrangements.

3.3 Conflicts of interest

AIFM must take all reasonable steps to avoid conflicts of interests and, when they cannot be avoided, to identify, prevent, manage and monitor, and where applicable, disclose, those conflicts of interest in order to prevent them from adversely affecting the interests of the AIF and its investors and to ensure that the AIF it manages are fairly treated.

They must take all reasonable steps to identify conflicts of interest that arise in

the course of managing one or more AIF between:

- ▶ AIFM, including their managers, employees or any person directly or indirectly linked to the AIFM by control, and the AIF managed by the AIFM or the investors of this AIF
- ▶ One AIF or the investors of this AIF and another AIF or the investors of this AIF
- ▶ The AIF or the investors of the AIF and another client of the AIFM
- ▶ The AIF or the investors of the AIF and a UCITS managed by the AIFM or the investors of such UCITS
- ▶ Two of the AIFM's clients

It will be a challenge to identify and track conflicts of interest, especially for AIFM with a large investor and client base. It will also be crucial to understand from the Level 2 measures what "taking all reasonable steps to identify conflicts of interest" means in practice for the AIFM.

4.

Functions and service providers

AIFM may need to formalize valuer selection and valuation processes. The authorization requirements and liability provisions will impact external valuers.

4. Functions and service providers

4.1 Valuation

The AIFM is required to ensure that, for each AIF that it manages, appropriate and consistent procedures are established so that a proper and independent valuation of the assets of the AIF can be performed in accordance with the requirements of the Directive and the applicable national and AIF rules.

The assets must be valued and the net asset value per share or unit calculated at least once a year. If the AIF is of the open-ended type, such valuations and calculations must be carried out at a frequency which both is appropriate to the assets held by the fund and its issuance and redemption frequency. The net asset value per share shall be disclosed to investors.

The valuation function must be either performed by:

- ▶ An external valuer subject to mandatory professional registration, independent from the AIF and the AIFM. Sub-delegation to a third party is not allowed.
- ▶ The AIFM 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 employees is prevented.

The depositary shall ensure that the value of the shares or units of the AIF is calculated in accordance with the applicable law and AIF rules or instruments of incorporation.

When the valuation function is not performed by an independent external valuer, the competent authorities of the home Member State of the AIFM may require the AIFM to have its valuation procedures and/or valuations verified by an external valuer or, where appropriate, an auditor.

The AIFM is responsible towards the AIF and its investors for the proper valuation of AIF assets, the calculation of the net asset value and its publication. However, when an external valuer is appointed, it should be liable to the AIFM for any losses suffered by the AIFM as a result of its negligence or intentional failure to perform its tasks.



4.2 Risk and liquidity management

The Directive requires AIFM to:

- ▶ Functionally and hierarchically separate the functions of risk management from the operating units, including the portfolio management
 - ▶ Implement adequate risk management systems in order to identify, measure, manage and monitor appropriately all risks relevant to each AIF investment strategy and to which each AIF is or can be exposed
 - ▶ Implement an appropriate due diligence process when investing on behalf of the AIF, according to the investment strategy, the objectives and risk profile of the AIF
 - ▶ Ensure that the risks associated to each investment position of the AIF and their overall effect on the AIF's portfolio can be properly identified, measured managed and monitored on an ongoing basis including through the use of appropriate stress testing procedures
 - ▶ Ensure that the risk profile of the AIF corresponds to the size, portfolio structure, investment strategies and objectives of the AIF as laid down in the AIF rules or instruments of incorporation, prospectus and offering documents
- ▶ Employ an appropriate liquidity management system which enables it to monitor the liquidity risk of the AIF, except for unleveraged closed-ended AIF. This includes regularly conducting stress tests, under normal and exceptional liquidity conditions, which enable it to assess the liquidity risk of the AIF and monitor the liquidity risk of the AIF accordingly. It must also ensure that for each AIF it manages the investment strategy, the liquidity profile and the redemption policy are consistent.

For risk and liquidity management reporting and disclosure requirements, see 5. *Transparency*.

Formalizing risk and liquidity management procedures represents a significant challenge. Stress testing will require robust business modeling capabilities.

4.3 Depositary

The Directive requires, for each AIF, the appointment of a depositary. The depositary must act honestly, fairly, professionally, independently and in the interest of the AIF and the investors of the AIF. The Directive prohibits an AIFM from acting simultaneously as an asset manager and a depositary.

The depositary must in general be an authorized credit institution with its registered office in the EU, an EU MIFID authorized investment firm or another institution which is subject to prudential regulation and ongoing supervision and which is eligible to be the depositary of a UCITS. Member States may allow certain other entities to act as depositary where the AIF does not permit redemption within five years and either: generally does not invest in financial instruments that can be registered, or generally invests in non-listed companies and issuers with a view to achieving control.

For non-EU AIF, the depositary can also be a credit institution or investment firm subject to effective prudential regulation and supervision of the same effect as the provisions laid down in European Union law.

The depositary of an EU AIF must be established in the AIF's home Member State.

The depositary's duties include:

- ▶ Ensuring that the AIF's cash flows are properly monitored, and shall in particular ensure that all payments made by or on behalf of investors upon the subscription of shares or units of an AIF have been received and that all cash of the AIF has been booked in one or more cash accounts opened at a central bank, authorized EU credit institution or a bank authorized in a third country
- ▶ Performing the safe-keeping duties of:
 - ▶ Holding in custody all financial instruments that can be registered within segregated accounts and all financial instruments that can be physically delivered to the depositary
 - ▶ For all other assets of the AIF, verifying the ownership of such assets and maintaining a record of those assets for which it is satisfied that the AIF, or, as the case may be, the AIFM acting on behalf of the AIF, holds the ownership of such assets. The assessment whether the AIF, or, as the case may be, the AIFM acting on behalf of the AIF, holds the ownership must be based on information or documents provided by the AIF or the AIFM and, where available, on external evidence

- ▶ Ensuring that the sale, issue, repurchase, redemption and cancellation of shares or units of the AIF are carried out in accordance with the applicable national law and the AIF rules or instruments of incorporation
- ▶ Ensuring that the value of the shares or units of the AIF is calculated in accordance with the applicable national law and the AIF rules or instruments of incorporation
- ▶ Carrying out the instructions of the AIFM, unless they conflict with the applicable national law or the AIF rules or instruments of incorporation
- ▶ Ensuring that in transactions involving the AIF's assets any consideration is remitted to the AIF within the usual time limits
- ▶ Ensuring that an AIF's income is applied in accordance with the applicable national law and the AIF rules

Delegation is permitted for safe-keeping duties provided that:

- ▶ The depositary can demonstrate that there is an objective reason for the delegation
- ▶ The depositary has exercised all due skill, care and diligence in the selection, appointment, review and ongoing monitoring of the third party
- ▶ The third party has the structures and the expertise that are adequate and proportionate to the nature and complexity of the assets which have been entrusted to it



- ▶ In the case of custody of financial instruments, the third party must be subject to effective prudential regulation and supervision in the jurisdiction concerned and subject to periodic external audit. Some exemptions may apply where the law of a third country requires that certain financial instruments are held in custody by a local entity, under strict conditions.

The third party may in turn sub-delegate these tasks, provided that the same conditions are met.

The depositary is liable to the AIF or the AIF's investors for the loss by the depositary, or a third party to whom the custody has been delegated, of financial instruments held in custody. The depositary is required to return a financial instrument of the identical type or the corresponding amount without undue delay. The depositary is not liable if it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

The depositary is also liable for all other losses suffered as a result of the depositary's negligent or intentional failure to properly perform its obligations pursuant to the Directive.

The depositary's liability is not affected by any delegation. However, in case of a loss of financial instruments held in custody by a third party, provided that there is a written contract between the depositary and the AIF, or, as the case may be, the AIFM acting on behalf of the AIF, the depositary can discharge itself of its liability and transfer it to the third party if certain conditions are met. Arrangements made by the depositary to contractually discharge itself of the liability must be disclosed to investors before they invest.

Despite the improvement in the text over previous versions, the depositary requirements still represent a significant incremental cost in operating alternative investment vehicles for AIFM. The liability provisions, even if some carve-outs have been introduced for financial assets held in custody, still impose a heavy burden on depositaries:

- ▶ They may raise costs and prevent depositaries from covering more risky or less developed financial markets, thereby putting into question the range of coverage and constitute a barrier to new entrants.
- ▶ Concentrating liability on depositaries, even in situations beyond their control, with obligations of restitution, could also contribute to increase systemic risk in the EU market and lead to the depositary effectively becoming the fund's guarantor.
- ▶ There may be consolidation in the depositary space, which may not be to the advantage of the asset management industry. This will reduce choice and increase potential counterparty risk.

The specific depositary exemptions may open the door to a range of entities which are not traditional custodian banks to perform alternative fund depositary functions.



4.4 Delegation of AIFM functions

AIFM are required to inform their home Member State competent authorities before delegating functions.

The AIFM must be able to justify its entire delegation structure with objective reasons. The delegate must be selected with all due care. It must be qualified and capable of undertaking the functions in question, have sufficient resources to perform its tasks and be managed by persons of good repute. The AIFM must be in a position to monitor effectively at any time the delegated activity, to give at any time instructions to the delegate and to withdraw the delegation with immediate effect when this is in the interest of investors.

Where the delegation concerns the portfolio management or the risk management, the mandate may be given

only to delegates which are authorized or registered for the purpose of asset management and subject to supervision.⁴ Where this condition cannot be satisfied, delegation may only be given on the condition of prior approval by the competent authorities of the home Member State of the AIFM.

The delegate may sub-delegate any of the functions delegated to it as long as the AIFM gives prior consent, the competent authorities received prior notification and the above-mentioned requirements are complied with.

An AIFM cannot delegate to the depositary, or any other entity with conflicting interests. It cannot delegate to the extent that it becomes a letter-box entity and remains liable to the AIF and its investors in any case.

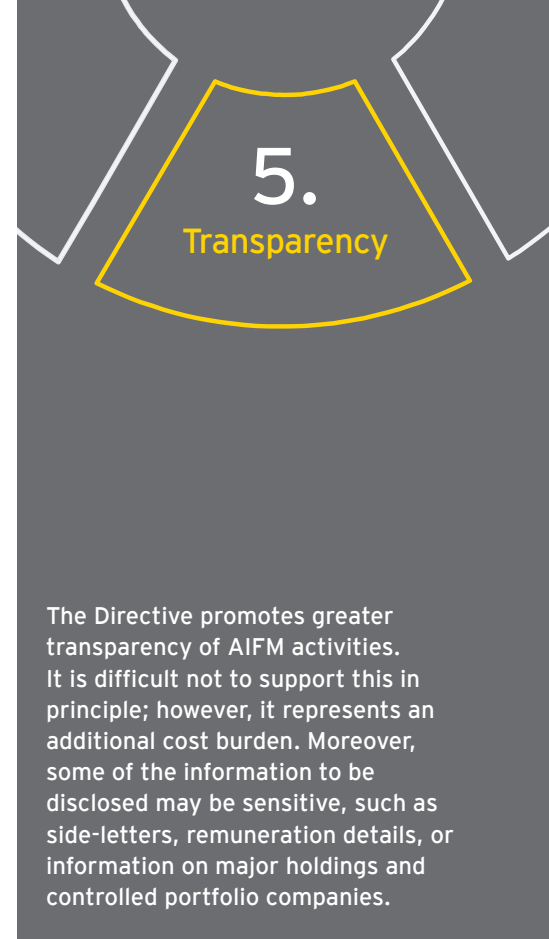
AIFM may need to carefully review their delegation arrangements to ensure a clear distinction between responsibility, execution and advice.

Restrictions imposed on delegation may require burdensome changes to some current delegation arrangements.

AIFM will also need to formalize the information on delegation to be provided to regulators and to investors.

Overall, increased disclosure should benefit investors seeking enhanced transparency.

⁴ For delegation to a third country undertaking, cooperation between regulators shall also be ensured.



5. Transparency: disclosure to investors and reporting to competent authorities

Information to be disclosed to investors before they invest in an AIF, and where there are material changes thereto includes:

- ▶ A description of the investment strategy and objectives of the AIF, the types of assets which the AIF may invest in and of the techniques it may employ and of all associated risks, any applicable investment restrictions
- ▶ The identity of the AIFM, the AIF's depositary, auditor and any other service providers, including prime brokers, and a description of their duties and the investors' rights
- ▶ Information on any delegated management function and of any safekeeping function delegated by the depositary
- ▶ A description of the AIF's valuation procedure and of the pricing methodology for valuing assets
- ▶ A description of the AIF's liquidity risk management, including the redemption rights both in normal and exceptional circumstances, existing redemption arrangements with investors
- ▶ A description of all fees, charges and expenses and of the maximum amounts thereof
- ▶ How the AIFM ensures a fair treatment of investors
- ▶ The procedure and conditions of issue and sale of units or shares

The following information must be periodically disclosed to investors:

- ▶ The percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature
- ▶ Any new arrangements for managing the liquidity of the AIF
- ▶ The current risk profile of the AIF and the risk management systems employed by the AIFM to manage these risks

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 3.1 *Remuneration*).

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 and on the principal exposures and most important concentrations of each AIF it manages
- ▶ The main categories of assets in which the AIF invested, the percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature and any new arrangements for managing the liquidity of the AIF

The Directive promotes greater transparency of AIFM activities. It is difficult not to support this in principle; however, it represents an additional cost burden. Moreover, some of the information to be disclosed may be sensitive, such as side-letters, remuneration details, or information on major holdings and controlled portfolio companies.

- ▶ 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
- ▶ The results of the stress tests

The requirements above apply to EU AIF that the AIFM manages and AIF it markets in the EU.

For disclosure and reporting requirements on leverage, see 6.1 *Leverage*.

For notification and disclosure requirements related to the acquisition of major holdings and control over portfolio companies, see 6.2 *Requirements on acquisition of major holdings and control over portfolio companies*.

6. Specific provisions

AIFM will be required to set leverage caps, measure and report on leverage according to the definition in the Directive. However, no leverage cap will be placed on the use of leverage at the portfolio company level. AIFM may also need to comply with additional restrictions imposed by competent authorities. The impact will vary depending on the AIF business model.

6. Specific provisions

6.1 Requirements on leverage, re-hypothecation, prime broker

Leverage is defined as any method by which the AIFM increases the exposure of an AIF it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means.

The AIFM is required to set a maximum level of leverage which the AIFM may employ on behalf of each AIF it manages as well as extent of the right of the re-use of collateral or guarantee that could be granted under the leveraging arrangement.

The AIFM must demonstrate that the leverage limits for each AIF it manages are reasonable and that it complies at all times with the leverage limits set by it. The competent authorities of the AIFM may impose limits on the use of leverage for systemic risk mitigation purposes.

The Directive requires additional disclosures to investors and regulators for managers which manage leveraged AIF.

Information must be disclosed to investors before they invest in an AIF must include:

- ▶ The circumstances in which the AIF may use leverage, the types and sources of leverage permitted and the associated risks, any restrictions to the use of leverage and of any collateral and asset re-use arrangements, and information on the maximum level of leverage which the AIFM may employ on behalf of the AIF

- ▶ The identity of the prime broker and a description of any material arrangement of the AIF with its prime brokers and the way the conflicts of interests in relation thereof are managed and, as the case may be, the provision in the contract with the depositary on the possibility of transfer and reuse of AIF assets, and about any transfer of liability to the prime broker that may exist

The following information must be disclosed to investors on a regular basis:

- ▶ Any changes to the maximum level of leverage which the AIFM may employ on behalf of the AIF as well as any right of the re-use of collateral or any guarantee granted under the leveraging arrangement
- ▶ The total amount of leverage employed by that AIF

AIFM managing one or more AIF employing leverage on a “substantial basis” must make available information about the overall level of leverage employed by each AIF it manages, a break-down between leverage arising from borrowing of cash or securities and leverage embedded in financial derivatives, the five largest sources of borrowed cash or securities and the extent to which their assets have been reused under leveraging arrangements to the competent authorities of its home Member State.



6.2 Requirements on acquisition of major holdings and control over portfolio companies

The Directive sets down requirements on the acquisition of major holdings or control of non-listed companies and issuers.

The provisions on acquisition of control apply to AIFM acting individually, or cooperating with one or more other AIFM on the basis of an agreement, managing one or more AIF which either individually or jointly on the basis of an agreement aimed at acquiring control, 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 Art 5(3) of the Takeover Bids Directive for issuers.

The provisions are neither applicable to small and medium enterprises (SMEs) nor special purpose vehicles (SPVs) with the purpose of purchasing, holding or administering real estate.

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:

- ▶ Notify, within ten 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, including information about the identity of the different shareholders involved.

- ▶ 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 AIFM manage(s) the AIF that has/have reached control, the policy for preventing and managing conflicts of interests, 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.

In the case of acquisition of control of a non-listed company or issuer by one or

Provisions related to acquisition of major holdings and control over portfolio companies could represent an additional burden, impact post-transaction re-organizations and entail disclosing sensitive portfolio information.

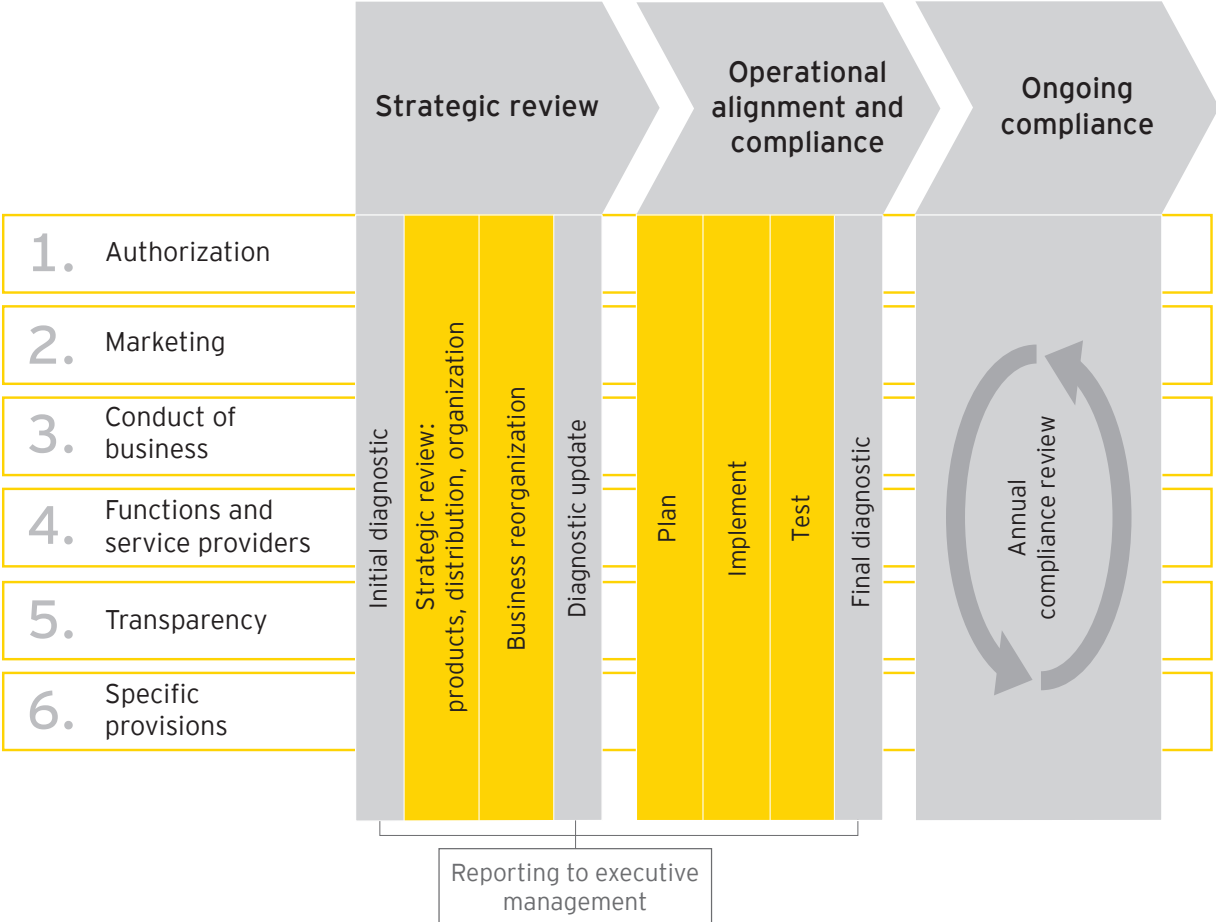
more AIFs, the AIFM cannot, within 24 months of the acquisition of control of the company by the AIF facilitate, support or instruct any distribution, capital reduction, share redemption and/or acquisition of own shares by the company or vote in favor of a distribution, capital reduction, share redemption and/or acquisition of own shares by the company. The AIFM is required to make its best efforts to prevent distributions, capital reductions, share redemptions and/or the acquisition of own shares by the company.

Further provisions clarify when such restrictions are applicable (the portfolio company is not an SME, the AIF has control and the effect of such distributions, capital reduction, share redemption and/or acquisition of own shares would result in the portfolio company net assets being lowered below the subscribed capital (excluding uncalled capital) and legally non-distributable reserves and when distributions would exceed the amount of available profits), as well as to what is meant by "distribution" and the scope of "capital reduction".

IV. Strategic and compliance considerations

A. Alternative investment groups

Alternative investment groups (including promoters, sponsors, advisers, general partners and managers of all types of non-UCITS funds, whether standalone or part of a larger financial services organization), should consider a strategic review of their fund ranges and operating models before implementing a value-adding compliance process. At Ernst & Young, we summarize this process as follows:



Products and distribution

This phase will focus on:

- ▶ **Investor base:** meeting the changing needs of European and international, professional and retail investors under the new regulatory regime
- ▶ **Marketing:** benefiting (where possible) from the EU passport for AIF
- ▶ **Product styles:** choosing the right mix of regulated/unregulated, open/closed-ended, single fund/fund of funds (FoF), offshore/onshore, etc.
- ▶ **Investment strategies:** changes to target asset class/sector, geographic area and use of leverage

Alternative investment groups may consider, *inter alia*, the following options:

- ▶ **Re-domiciliation of existing AIFM/AIF:**
 - ▶ Onshore to the EU
 - ▶ Offshore outside the EU
- ▶ **Restructuring of existing AIFM/AIF:**
 - ▶ Some AIFM may need to be wound up, with AIF entering a run-off process
 - ▶ Some AIFM may choose to offer their investors shares or units in another AIF or product
 - ▶ Some AIFM may wish to negotiate with investors to merge existing AIF
- ▶ **Creation of new AIF onshore in the EU or offshore**
- ▶ **Establishment of master-feeder or FoF structures**
- ▶ **Review of products to benefit from exemptions (by type, size or sector)**

Operating models

Alternative investment groups will need to determine the optimal platform to service their fund range, and benefit from the passport for AIFM and any relevant exemptions available. The options open relate to:

- ▶ **Configuration:** the optimal combination of own and third-party or joint venture service providers

- ▶ **Delegation:** the functions which will remain in-house, and those which may be outsourced by the AIFM, such as administration, valuation and marketing. The depositary must be independent of the AIFM
- ▶ **Domicile:** the choice of domicile or location of the AIFM, AIF and service providers. The AIFM passport enables an AIFM to manage EU AIF directly or via the establishment of a branch. AIFM may also delegate functions to service providers on a cross-border basis.

The strategic choice of domiciles to be made will be heavily dependent on factors including:

- ▶ **Reputation**, in particular with regard to distribution channels and reputation of investors
- ▶ **Regulatory environment** such as accessibility, knowledge and responsiveness of the regulator, as well as local practice in areas such as outsourcing
- ▶ **Stability** of the political, economic, and social environment
- ▶ **Achieving tax neutrality** for products by considering direct and indirect taxation implications at AIFM, fund and investor levels
- ▶ **Operational factors** such as relocation costs, local infrastructure, and the qualifications and knowledge of the workforce
- ▶ **Service provider considerations** such as their expertise, ability to work with AIFM from an operational and business perspective and their ability to meet specific local market requirements. For the depositary, risk management will be critical; the strength of its network in markets serviced will be crucial
- ▶ **Location influencers** such as proximity to investors, language and cultural alignment are also key. In addition, the attractiveness of the location for key management, the accessibility and ease of the business environment will play a role

- ▶ **Internal factors** such as risk management and compliance considerations

Adequate information must be provided to investors about the changes required to comply with the AIFM Directive. The AIFM Directive may change their investment allocations.

Investors will also be interested in changes to the operating platform, and in particular the cost and benefits of enhanced procedures and controls as a result of the new regulation.

Overall, Ernst & Young recommends that the objectives of this strategic review should primarily focus on how to realign the operating model to add value for the longer term, rather than ensuring compliance with the AIFM Directive and other interdependent regulatory changes. Handled in the right way, change brought about by the Directive can generate positive returns on investment from what would otherwise be a pure “sunk cost” to comply with a mandatory regulatory change – some elements of which will constitute a recurring annual cost to the business.

Business reorganization

Alternative investment groups' optimization of their strategy and organizational model could represent a significant structural change in the sector. Ernst & Young believes that a significant number of mergers, acquisitions, spin-offs, liquidations, relocations and outsourcing initiatives could be triggered as result of this regulation and other regulatory changes both within Europe and overseas, in the broader context of the new global landscape that is emerging as the financial crisis subsides.

Strategic review

Operational
alignment and
compliance

Ongoing
compliance

Once reorganized, AIFM will need to complete a compliance exercise to ensure that all of the requirements of the Directive are met. Compliance considerations for AIFM include:

- 1. Authorization**
 - ▶ Review current scope of activities of management entities
 - ▶ Establish/upgrade AIFM entities
 - ▶ Boost capital and liability insurance to meet requirements
 - ▶ Review structure and products to benefit from exemptions (by type, size or sector)
- 2. Marketing**
 - ▶ Review eligibility of fund ranges for EU passport or private placement
 - ▶ Review of strategy in relation to EU and international/professional and retail investors
 - ▶ Review of fund ranges with a view to re-domiciliations, mergers, etc.
 - ▶ Complying with provisions on marketing in home and other Member States
- 3. Conduct of business**
 - ▶ Update of remuneration policies, and disclosure of previously confidential information
 - ▶ Formalize conduct of business procedures to meet requirements
 - ▶ Formalize conflicts of interest identification, management and disclosure
- 4. Functions and service providers**
 - ▶ Formalize selection of independent valuers or functional independence (Chinese walls), and comply with additional valuation requirements
 - ▶ Formalize risk management functional independence or selection of third-party service provider
 - ▶ Formalize risk management procedures, stress testing and liquidity management
 - ▶ Review of depositary arrangements, including capacity to meet obligations and liability
 - ▶ Manage incremental depositary cost and invest resources to manage relationship with the depositary and provide it with evidence
 - ▶ Review service provider arrangements
 - ▶ Service provider Requests for Proposal (RFP), initial due diligence, selection and ongoing due diligence; review of current service provider agreements
 - ▶ Formalize information on delegation to be provided to regulators and to investors
- 5. Transparency**
 - ▶ Implementation of enhanced investor disclosure and periodic reporting requirements
 - ▶ Prepare for disclosure of previously confidential information
 - ▶ Implementation/upgrade of regulatory reporting process
- 6. Specific provisions**
 - ▶ Compliance with leverage provisions (limits, disclosure, reporting)
 - ▶ Compliance with acquisition of major holdings and control provisions (notification of major holdings, notification and disclosure of control and asset stripping)

Strategic review

Operational
alignment and
compliance

Ongoing
compliance

Going forward, AIFMs should also implement an annual compliance review process to ensure that they continue to meet the requirements of both the AIFM Directive and other regulatory changes.



B. Service providers

Service providers, such as depositaries and fund administrators, will need to re-assess their strategy and operations in the light of market changes triggered by the AIFM Directive.

Re-organization within the sector will create new opportunities and threats for service providers, such as:

- ▶ Restructuring of asset managers:
 - ▶ Concentrating activities in certain locations
 - ▶ More aggressive outsourcing strategies
 - ▶ The results of M&A activities
- ▶ Restructuring of service providers (e.g., mergers, acquisitions, spin-offs). Drivers may include, for example:
 - ▶ Financial services groups deciding to sell service provider businesses or set up new joint ventures
 - ▶ Underperforming service providers being taken over or wound down
- ▶ Relocation: a service provider may choose to relocate or concentrate activities in key hubs
- ▶ Outsourcing: depending on the final provisions of the Directive, and the subsequent Level 2 implementing measures in relation to sub-delegation, service providers may consider increased outsourcing of certain activities to reduce costs or improve geographical reach

A key challenge for service providers will be to meet the initial surge in demand for their services, whilst maintaining strict quality and risk management standards at competitive prices. Service providers may therefore need to attain critical mass and should certainly look to implement robust and efficient processes and procedures.

Depositaries

Strategic and compliance considerations for depositaries will include:

- ▶ Clear definition of professional responsibilities under the Directive and the development of a practical operating model
- ▶ Consideration of geographical markets covered
- ▶ Strategic review of market strategy and service offering, including related value added services offered by depositary network, in light of the opportunities and obligations of the Directive
- ▶ Review of capacity to perform all required functions
- ▶ Evaluation of the additional depositary costs due to the Directive
- ▶ Ensuring that arrangements for delegated functions meet the requirements of the Directive
- ▶ Ensuring sufficient professional indemnity cover in case of any litigation

Fund administrators

Strategic and compliance considerations for fund administrators will include:

- ▶ Strategic review of market strategy and service offering, including valuation services, in light of the opportunities and obligations of the Directive
- ▶ Review of operating model, including automated processes
- ▶ Compliance with provisions on delegation of AIFM tasks
- ▶ Ensuring sufficient professional indemnity cover in case of any litigation

Valuers

Strategic and compliance considerations for valuers will include:

- ▶ Strategic review of market strategy and service offering, in light of the opportunities and obligations of the Directive
- ▶ Implementation of appropriate and consistent valuation procedures, and appropriate disclosure thereof
- ▶ Compliance with provisions on delegation of valuation function
- ▶ Ensuring sufficient professional indemnity cover in case of any litigation

C. Investors

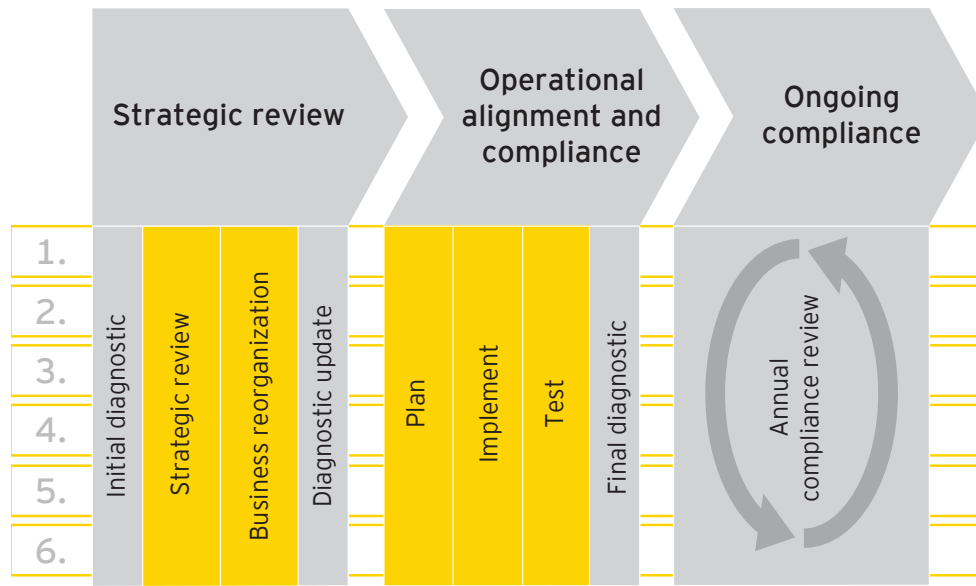
Investors, including FoFs, will need to carry out their own strategic review in view of the new requirements and opportunities.

As some specific markets and products may no longer be accessible to them, institutional and professional investors may review the investment options open to them in the light of the AIFM Directive.

Finally, compliance with this Directive is likely form a pillar of investor due diligence going forward.



Our services



A. Alternative investment groups

- ▶ Facilitate an effective strategic review
- ▶ Perform an initial diagnostic of current organization (products, distribution, organization and domicile of the management platform) and operational readiness against the Directive's key provisions (risk and liquidity models, key controls, financial framework and reporting, service provider arrangements, etc.), including recommendations based on gaps identified and potential areas for strategic change
- ▶ Analyze and provide tax advice on any potential re-organization and establish a step plan for change
- ▶ Assist in technical migration of entities and platforms to new structures, including advice on specific domiciles

- ▶ Assist in implementing key compliance work streams related to the Directive; amongst others, this would cover:
 - ▶ Review and upgrade of risk and liquidity management systems
 - ▶ Assist in establishing or upgrading compliance function
 - ▶ Update regulatory reporting and disclosures to investors
 - ▶ Review of depositary arrangements (risk/selection/delegation)
 - ▶ Provide advice on the portfolio valuation processes, including methodology and documentation
 - ▶ Assist in service provider selection
- ▶ Design and delivery of bespoke training
- ▶ Testing and assurance
- ▶ Assist with the application for authorization process

- ▶ Provide assurance on compliance with the Directive and any other relevant regulatory requirements on an ongoing basis; this could cover:
 - ▶ Test of automated reporting processes and controls
 - ▶ Provide statutory audit services for AIFs and AIFMs
 - ▶ Provide independent valuation opinions

B. Service providers

- ▶ Assist service providers to quickly assess the main strategic opportunities and risks triggered by the Directive
- ▶ Provide market entry support and development of an operational change program specifically for depositaries, custodians, administrators, valuers and other service providers
- ▶ Assess the adequacy of risk management processes

- ▶ Assist in definition of technical framework and roles and responsibilities of service providers under the Directive
- ▶ Assist in implementing efficient and effective operating models, including risk management, valuation reviews and delivery of value added services
- ▶ Review pricing structures

- ▶ Provide assurance on risk and control framework (e.g., SAS 70 or ISAE 3402 reports)
- ▶ Provide ongoing regulatory advice

C. Investors

- ▶ Perform an impact assessment by analyzing existing portfolio structures and investment processes in the light of changing investment options available under the Directive

- ▶ Assist in updating or developing investment policies and procedures to take account of Directive requirements
- ▶ Update due diligence protocols

- ▶ Provide transaction support services
- ▶ Provide ongoing regulatory advice

Our approach:

- ▶ Simple three-step approach
- ▶ Insightful high-level diagnostics to initiate and track progress
- ▶ Open, modular approach in terms of resourcing
- ▶ Tailored to clients:
 - ▶ Wishing to comply with the Directive's mandatory requirements on an ongoing basis
 - ▶ Wishing to maximize value added through organizational and operational changes triggered by the Directive

Our offer:

- ▶ A dedicated multidisciplinary service team with clear points of contacts and accountability
- ▶ Access to experienced professionals in the areas of tax, regulatory, performance improvement, risk management, valuation and business modeling
- ▶ Seamless coordination across EMEIA via our dedicated AIFM network
- ▶ A coordinated approach across private equity, hedge funds and real estate segments



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