MAYER • BROWN

AIFMD Update: Impact on Fund Managers Outside the European Union

Welcome

MAYER • BROWN

Alternative Investment Fund Managers Directive (AIFMD) – Overview of Scope

July 2013

Angela Hayes
Partner
+44 (0)20 3130 3311
ahayes@mayerbrown.com

Overview of the AIFMD

- Fundamental change for the funds industry
- Implementation on 22 July 2013 – what does this mean?
- Who is affected and when?

Vocabulary

AIF	=	Alternative Investment Fund
AIFM	=	Alternative Investment Fund Manager

What is an AIF?

- Any collective investment undertaking which
  - raises capital from a number of investors
  - with a view to investing it
  - in accordance with a defined investment policy
  - for the benefit of those investors

  but not UCITS funds

- It does not matter
  - what legal form the AIF takes
    - "whether constituted under the law of contract, under trust law, under statute, or has any other legal form"
  - whether it is open-ended or closed-ended
  - whether it is internally managed or externally managed

AIFs: what's in?

- Private equity funds
- Hedge funds
- Investment trusts
- Non-UCITS regulated funds

AIFs: what's out?

- UCITS funds
- Pension funds
- Supranational institutions (e.g. European Central Bank)
- National central banks
- National, regional and local governments and bodies managing funds supporting social security and pension systems
- Employee participation schemes or employee savings schemes

AIFs: what about?

- Single investor funds and managed accounts
  - Should not normally be an AIF
    - Provided constitutionally limited to one investor
    - Unless there are overarching co-investment arrangements
- Ordinary commercial business
  - Should not normally be an AIF
    - Unless business is ‘investing’
    - Not always clear, e.g. how to distinguish a property development company from a real estate fund?
- Joint ventures
  - Should not normally be an AIF, but consider
    - Does it raise external capital?
    - Does it carry on ordinary commercial business?
    - Is there a defined investment policy?
- Securitisation special purpose entities

AIFs: what about? (continued)

- Debt issuers
- Listed companies
- Holding companies
- Group exemption (only investors are group companies)
- Fund-related vehicles such as
  - Carried interest vehicles
  - Co-investment vehicles
  - AIVs
  - AcquisitionCos
    - with/without co-investors

Identifying the AIFM

- What is an AIFM?
  - A legal person whose regular business is managing one or more AIFs
  - 'Managing AIFs' means performing at least portfolio management or risk management for one or more AIFs
- Each AIF must have a single AIFM
- Issues
  - Non-discretionary advisers
  - 'Letter box' entities

Introducing the geographical dimension

	EU AIFM	Non-EU AIFM
EU AIF		
Non-EU AIF		

EU AIF or non-EU AIF?

- ‘EU AIF’ means an AIF which:
  - is authorised or registered in an EU Member State; or
  - has its registered office and/or head office in an EU Member State
- ‘Non-EU AIF’ means an AIF which is not an EU AIF

EU AIFM or non-EU AIFM?

- ‘EU AIFM’ means an AIFM which has its registered office in an EU Member State

- ‘Non-EU AIFM’ means an AIFM which is not an EU AIFM

So what does it all mean?

	EU AIFM	Non-EU AIFM
EU AIF	• AIFM must be authorised under the Directive • EU marketing passport • Depositary requirement	
Non-EU AIF		

So what does it all mean?

	EU AIFM	Non-EU AIFM
EU AIF	• AIFM must be authorised under the Directive • EU marketing passport • Depositary requirement	
Non-EU AIF	• AIFM must be authorised under the Directive (but not subject to all Directive requirements) • EU marketing under private placement regimes (subject to conditions) and, from 2015 at earliest, EU marketing passport • "Depositary light" • ESMA reviews in 2015 and 2018	

So what does it all mean?

	EU AIFM	Non-EU AIFM
EU AIF	• AIFM must be authorised under the Directive • EU marketing passport • Depositary requirement	• No authorisation under the Directive required or available until 2015 at earliest • EU marketing under private placement regimes (subject to conditions) but access to EU marketing passport once authorised • ESMA reviews in 2015 and 2018
Non-EU AIF	• AIFM must be authorised under the Directive (but not subject to all Directive requirements) • EU marketing under private placement regimes (subject to conditions) and, from 2015 at earliest, EU marketing passport • "Depositary light" • ESMA reviews in 2015 and 2018	

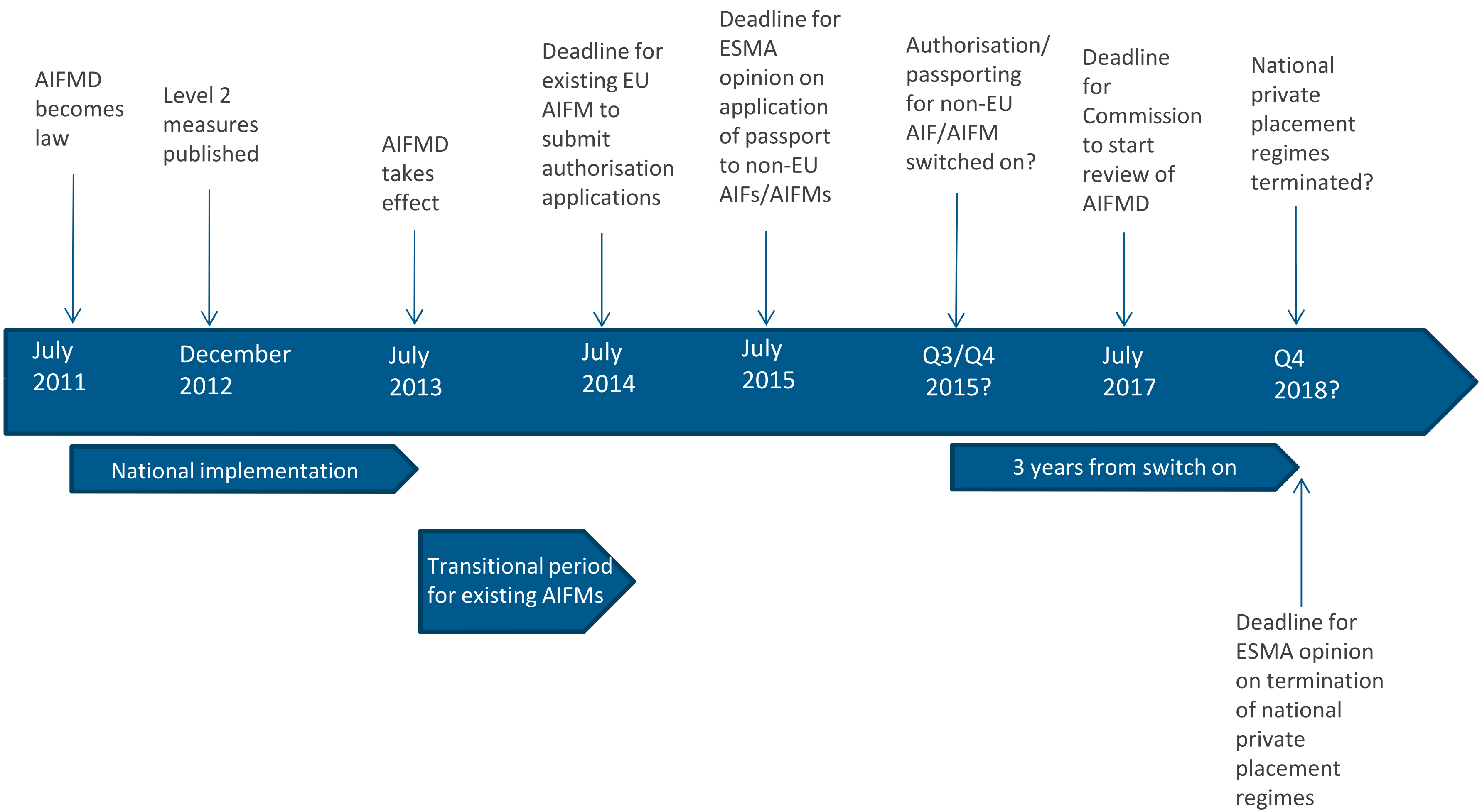
So what does it all mean?

	EU AIFM	Non-EU AIFM
EU AIF	• AIFM must be authorised under the Directive • EU marketing passport • Depositary requirement	• No authorisation under the Directive required or available until 2015 at earliest • EU marketing under private placement regimes (subject to conditions) but access to EU marketing passport once authorised • ESMA reviews in 2015 and 2018
Non-EU AIF	• AIFM must be authorised under the Directive (but not subject to all Directive requirements) • EU marketing under private placement regimes (subject to conditions) and, from 2015 at earliest, EU marketing passport • "Depositary light" • ESMA reviews in 2015 and 2018	• No authorisation under the Directive required to manage • No authorisation under the Directive to market available until 2015 at earliest • EU marketing under private placement regimes (subject to conditions) but access to EU marketing passport once authorised • ESMA reviews in 2015 and 2018

Thresholds, transitional provisions, grandfathering

- Thresholds for mandatory authorisation
  - €500m for managers of non-leveraged funds with no redemption rights in the first 5 years
  - €100m for managers of leveraged funds
- Transitional provisions
  - Existing AIFMs prior to 22 July 2013 have one year to comply
- Grandfathering
  - Closed-ended funds under management before 22 July 2013 that will not make any additional investments after 22 July 2013
  - Closed-ended funds that had a final closing prior to 21 July 2011 and whose fund term expires no later than 22 July 2016 (partial grandfathering)
- Also relevant for non-EU AIFMs

Timeline


AIFMD becomes law
July 2011
Level 2 measures published
December 2012
AIFMD takes effect
July 2013
Deadline for existing EU AIFM to submit authorisation applications
July 2014
Deadline for ESMA opinion on application of passport to non-EU AIFs/AIFMs
July 2015
Authorisation/ passporting for non-EU AIF/AIFM switched on?
Q3/Q4 2015?
Deadline for Commission to start review of AIFMD
July 2017
National private placement regimes terminated?
Q4 2018?
National implementation
Transitional period for existing AIFMs
3 years from switch on
Deadline for ESMA opinion on termination of national private placement regimes

The Implementation of the AIFM-Directive in Germany – What Third Country Managers Should Know

Dr. Thorsten Voss
Rechtsanwalt
+49 69 7941 1150
tvoss@mayerbrown.com

I. Overview

The German Capital Investment Act

- **The new German Capital Investment Act (*Kapitalanlagegesetzbuch, „KAGB“)* enters into force on July 22, 2013.**
- **While the AIFM Directive (*“AIFMD”*) aims at creating a harmonized regulatory framework and an internal market for the managers of alternative investment funds, the German legislation goes beyond the goals of the AIFMD and provides for a comprehensive regulatory framework for all sorts of fund products:**
  - Implementation of the AIFMD
  - Integration of the UCITS-Directive
  - Replacing the previous Investment Act (*Investmentgesetz, „InvG“*)
  - Regulation of closed-end funds

Sphere of Application

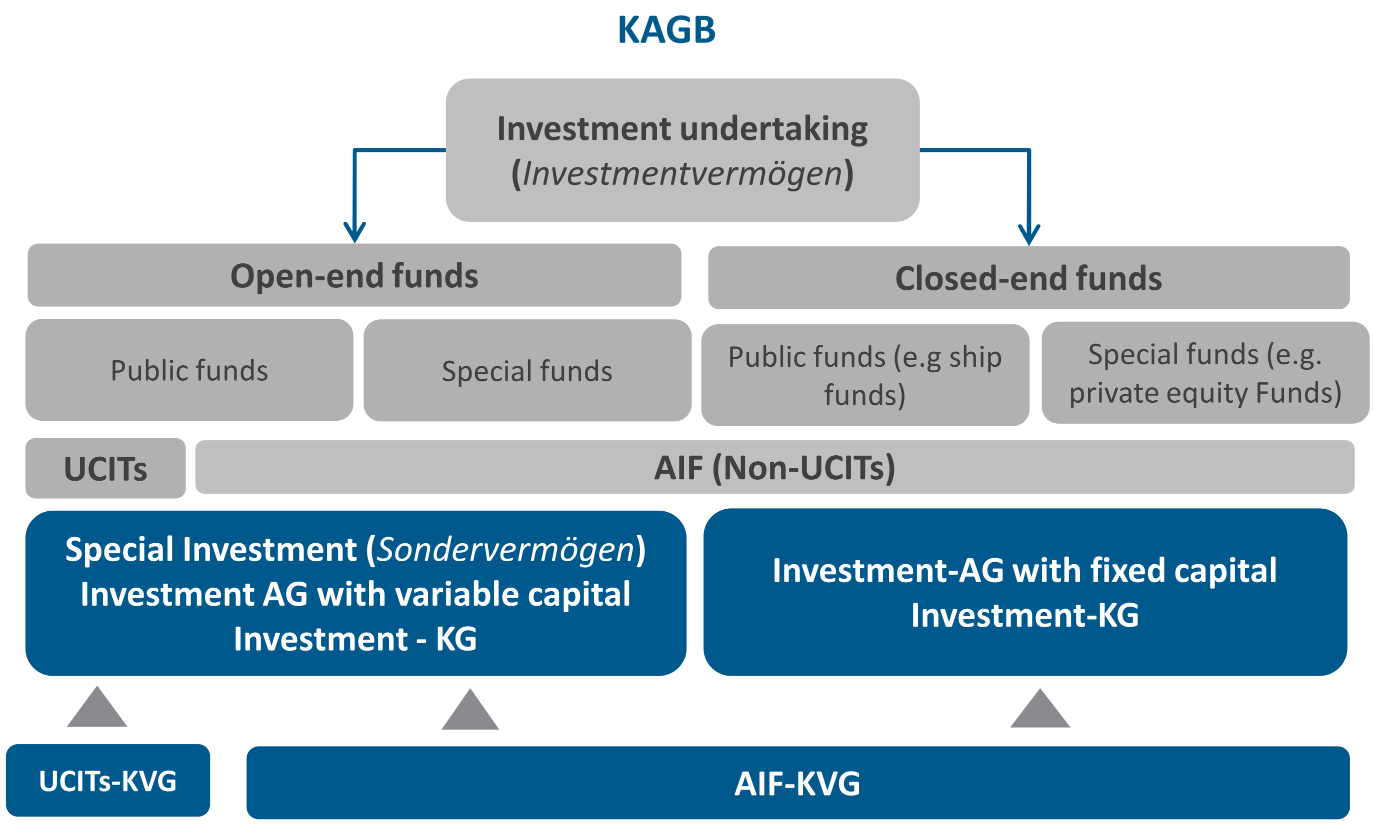
An “investment undertaking” (*Investmentvermögen*) as laid down in Sect. 1 para. 1 KAGB:

- Any entity for collective investment
- which collects capital
- from a number of investors
- in order to invest it following a defined investment strategy
- for the benefit of these investors
- and which is no operating company outside the financial sector

A recently published paper by the German Federal Financial Supervisory Authority („*BaFin*“) indicates how BaFin will interpret the individual elements of this definition

- Joint Ventures
- REITs
- Project Bonds

III. Definition of the investment fund



MAYER • BROWN

II. Supervisory requirements on the KVG

Supervisory Requirements on the KVG

A capital investment company (*Kapitalverwaltungsgesellschaft, KVG)* is a company with its head office and central administration in Germany whose business activities aim at the management of investment undertakings on its own responsibility (not acting as an outsourcing company) is considered a KVG and requires approval by BaFin.

External KVG	Internal KVG
AG, GmbH, GmbH & Co. KG • UCITS KVG • AIF KVG	• *Investmentaktiengesellschaft* • *Investmentkommanditgesellschaft*

Licensing Requirements

- All AIF-KVGs have to apply for a (new) business permission
  - Newly incorporated KVGs
  - First regulated KVGs (i.e., for closed-end funds)
  - Already regulated KAGs in accordance to the German InvG

- Content of the applications for authorization for UCITS-KVG and AIF-KVG is almost identical.
- This concerns aspects such as proof of initial capital, information on the managing directors and owners of important participations, presentation of a business plan including a description of the organization and control procedures, and a presentation of the company agreement of the KVG.

Supervisory Requirements

- The KAGB imposes a great number of ongoing supervisory requirements on the KVG regarding their organization and conduct, parts of which correspond to existing specifications to capital investment companies in accordance with the repealed Investment Act.
- A new factor is the legal emphasis that a misuse of market practices (*e.g.*, late trading or market timing) must be prohibited (Sect. 26 para. 6 KAGB in conjunction with Art. 17 EU Regulation).
- Particularly the unregulated managers of closed fund vehicles (with the exception of small KVG) face a considerably increasing intensity of regulation. The supervisory requirements apply equally on UCITS-KVG and AIF-KVG.
- The supervisory requirements on AIF-KVG are specified in the EU Directive. Each KVG is obliged to perform its tasks solely in the interest of the investors and independent of the depository (Sect. 26 para. 1 KAGB in conjunction with Art. 18 EU -Regulation).

Supervisory Requirements

- The organizational tasks of KVG comprise an appropriate risk management and complaint system, the necessary resources, provisions on personal businesses, an extensive documentation, and appropriate control procedures, including the development of an internal audit and a compliance function (Sect. 28 para. 1 and 2 KAGB in conjunction with Art. 57 et seq. EU Regulation).
- An organizational focus of the KVG is the development of a risk management system and a risk controlling function which is independent of the operational area and must be separated from it (so-called *separation rule*).
- The risk management system must be capable of identifying, measuring, controlling and monitoring the essential risks of each investment strategy (Sect. 29 para. 2 KAGB).
- The KVG must monitor the liquidity risks to ensure that the liquidity profile of the investments is in line with the underlying liabilities of the investment fund in consideration of the investment strategy and the principles of return; this must be ensured by stress tests (Sect. 30 KAGB in conjunction with Art. 47 et seq. EU Regulation).

Supervisory Requirements

- AIF-KVG have to define a remuneration system for their managing directors and for employees whose activity has a considerable influence on the risk profile (risk bearers), who exercise a control function or whose total remuneration is equivalent to that of the managing directors and risk bearers (Sect. 37 para. 1 KAGB).
- The remuneration system may not offer incentives for taking risks that are incompatible with the risk profile and the investment conditions. Attachment II of the AIFMD provides further detail on the requirements on the remuneration system, *inter alia*, with regards to the long-term orientation, the relevant remuneration factors, and the arrangement of variable remuneration components.
- The KAGB also provides for extensive provisions for the assessment of assets for all types of investment undertakings and requires the development of internal valuation guidelines (Sect. 168 et seq. KAGB in conjunction with Art. 67 et seq. EU Regulation, Sect. 271, 278, 286 KAGB).

Supervisory Requirements

- The valuation can be done by an independent, external evaluator or – if the evaluation is done functionally independent – by the AIF-KVG itself or the depository (Sect. 216 para. 1 KAGB).
- With regard to closed public AIF, stricter requirements apply for the first evaluation of assets. In these cases, it is mandatory that the evaluation is done by an external evaluator.
- The KVG must particularly be able to justify its entire outsourcing structure based on objective reasons (Sect. 36 para. 1 no. 1 KAGB).
- Specific requirements apply when portfolio management and risk management are outsourced (Sect. 36 para. 1 no. 3 and 4 KAGB). They may by no means be outsourced to the depository, subdepository or another company having a conflict of interest (Sect. 36 para. 3 KAGB).
- Outsourcing is not possible in an extent that the KVG becomes a letter-box company and cannot be considered as a management company any longer (Sect. 36 para. 5 KAGB).

Supervisory Requirements

Initial equity

- Internal KVG at least 300.000 €
- External KVG at least 125.000 €

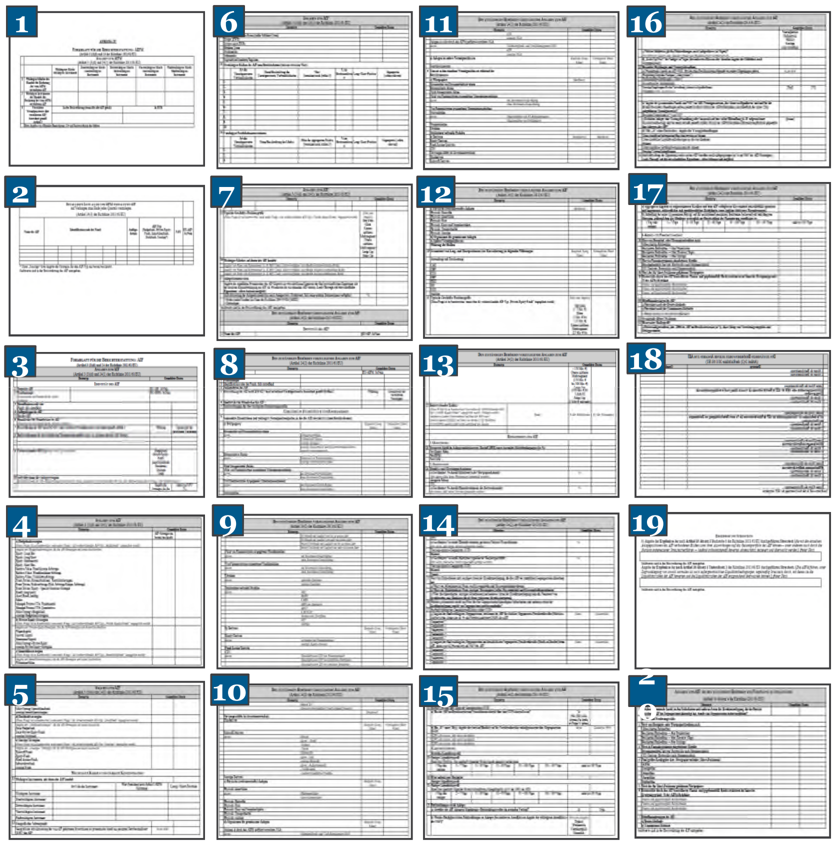
Additional equity

- 0,02% of the amount exceeding the fund volume of 250 Mio. €, a maximum of 10 Mio.
- 1/4 of the costs according the budgeted profit and loss statements

Sufficient capital to cover:

- Personal pension
- Employer's liability risks (alt. covered by insurance policies

Authorities reporting



The quarterly authority report in accordance with Level 2–VO Annex IV includes 20 pages.

This means a substantial implementation work for all KVGs

Number of requirements to Annex IV are still not sufficiently characterized. Should the requirements be interpreted in another way by ESMA, there could be a significantly increased need of adaptions as a follow-up.

III. Product Regulation

Product Regulation

- For UCITS, basically the same rules remain effective that are known from the Investment Act for the funds that are in conformity with the Directive.
- Closed AIF may be launched only as an investment company limited by shares with fixed capital or as investment limited partnership (Sect. 139 KAGB).
- In the area of open public AIF, the previous investment fund types – employee participation funds and occupational pension funds – will be cancelled without substitution for lack of practical relevance, and infrastructure funds will be permitted only as closed AIF.
- The other types of open public investment undertakings of the Investment Act will be adopted with partial (editorial) adaptations to the AIFMD and the KAGB.

Product Regulation

- Closed AIF may be launched only as an investment company limited by shares with fixed capital or as investment limited partnership (Sect. 139 KAGB).
- The KAGB contains a catalogue of admissible assets for closed public AIF (Sect. 261 para. 1 KAGB). This catalogue comprises tangible assets such as real estate, ships and aircraft, forest, containers, private equity participations, shares in closed AIF, securities, money market instruments and bank balances.
- Further product restrictions exist for closed public AIF in the form of a maximum currency risk of 30 % (Sect. 261 para. 4 KAGB), a maximum debt ratio of 60 % (Sect. 263 para. 1 KAGB) and requirements on the risk-spreading (Sect. 262 KAGB).
- Investment undertakings without risk-spreading, *i.e.*, particularly one-object-funds, are only admissible with a minimum investment sum of EUR 20,000 and the qualification of the investors as semi-professional investors (Sect. 262 para. 2 KAGB). No product regulations are defined for closed special-AIF. Therefore, the fact is sufficient that an evaluation of the assets is possible (Sect. 285 KAGB).

IV. Depository (*Verwahrstelle*)

Depository

- While the Investment Act so far referred to the term “depository bank”, the KAGB uses the term “depository” and differentiates between UCIT depositories and AIF depositories Depositary for OGAW remains a credit institution.
- Depositaries for AIFs may be:
  - Credit institutions
  - Investment firms with MIFiD-Admission
  - Facilities that are subject to constant supervision and monitoring and which are compliant with Capital Requirement Regulation (*CRR-VO*)
- Each AIF-KVG must designate an AIF-depository for each AIF it manages (Sect. 80 para. 1 sentence 1 KAGB). Therefore, closed AIF are particularly and for the first time obliged to specify a depository.

Depository

- To designate a depository, a written agreement is required between the AIF-depository, AIF-KVG and, if necessary, the AIF (Sect. 80 para. 1 sentence 2 KAGB in conjunction with Art. 83 EU Directive).
- Art. 83 EU Directive contains a detailed catalogue on the minimum content of the depository agreement which comprises, among other things, a description of the services to be provided and the depository and supervisory function, the termination possibilities, a declaration on the liability of the depository, and regulations on the exchange of information.

Depository

- At first the AIF-depository deposits all financial instruments eligible for safe deposit of the AIF in a separate (blocked) account so that a clear identification is possible as to the belonging to the assets of the AIF (Sect. 81 para. 1 no. 1 KAGB in conjunction with Art. 89 para. 1 EU Directive).
- With regard to assets not eligible for safe deposit (*e.g.*, participations, real estate, unsecuritized receivables), the AIF-depository, based on information of the AIF or the AIF-KVG or a third party, is obliged to check whether or not the AIF or the AIF-KVG has effectively acquired ownership thereof, and to maintain and update written records (Sect. 81 para. 1 no. 2 KAGB).
- It must ensure that sufficient and reliable information is obtained, for instance an official proof of ownership (Art. 90 EU Directive).

V. Distribution

Distribution

- The placement of shares in investment undertakings in Germany, be it shares in domestic AIF, EU-AIF, or AIF located in a third country (foreign AIF), principally requires a previous reporting of the placement intention to BaFin or a corresponding foreign supervisory authority, some of which requires extensive prospect and other information obligations.
- **The placement to certain groups of investors (private placement) that previously was not subject to approval will be cancelled for UCITS and AIF.**
- The extensive concept of placement laid down in the KAGB comprises any direct and indirect offering or placement of shares or stocks of an investment undertaking (Sect. 293 para. 1 sentence 1 KAGB).
- In compliance with the AIFM Directive, the concept of placement to semi-professional and professional investors, however, is defined more narrowly and requires that it takes place on the initiative of the management company or on its behalf and is aimed at this circle of investors (Sect. 293 para. 1 sentence 3 KAGB).

Distribution

- It can be assumed from this that placement activities not based on the initiative of the management company fall under the so-called passive freedom to provide services.
- Unlike the placement of UCITS, the placement of AIF to investors in Germany will be completely redesigned. The placement of a domestic public AIF by an AIF-KVG requires a notification procedure which must be completed no later than 20 working days after the complete notification at BaFin (Sect. 316 KAGB).
- For all cross-border cases, the legislator requests for the admissibility of the placement to private investors that the AIF and the management company must be located in the same country (Sect. 317 para. 1 no. 1 KAGB.E).
- This request is justified with the risks arising from cross-border management of public AIF in view of a missing product harmonization.
- This does not conflict with the possibility of AIF-KVG and AIF management companies to manage AIF in another member state or a third country (European passport or third-country passport for management companies, see Sect.s 53 et seq. KAGB).

Distribution

- Special conditions of admissibility apply for the placement of EU-AIF to private investors. The EU-AIF management company and its management of the EU-AIF must comply with the requirements of the AIFM Directive; a representative and a paying agent in Germany must be designated; a depository must be appointed; moreover, the investment conditions or partnership agreements of the EU-AIF must contain regulations like those for comparable domestic AIF (Sect. 317 para. 1 KAGB).
- After submission of the complete notification to BaFin, a three-month processing period applies (Sect. 320 para. 2 no. 1 KAGB).
- The admissibility of the placement of foreign AIF furthermore requires that, (i) agreements between BaFin and the foreign supervisory authorities exist with regard to the cooperation, the efficient information exchange and the monitoring of systemic risks (cooperation agreements), (ii) the state of origin may not appear on the list of the non-cooperative countries of the Financial Action Task Force and (iii) effective agreements must have been concluded with the state of origin of the AIF regarding an efficient information exchange in tax matters (tax agreements) (Sect. 317 para. 2 KAGB).

Distribution

- The period for processing the notification of foreign AIF is six months (Sect. 320 para. 2 no. 2 KAGB).
- The processing time will reduce to three months after the introduction of the third-country passport (probably end 2015). A notification to BaFin is required for the placement of special AIF or EU-AIF to professional and semi-professional investors by an AIF-KVG (Sect. 321 KAGB).
- The same applies to the placement of foreign AIF after introduction of the third-country passport. Here, it is mandatory that the requirements on third countries of the AIF must be fulfilled and the AIF be managed in compliance with the AIFM Directive (Sect. 322 KAGB).
- Prior to the introduction of the third-country passport, the placement is only admissible if the AIF-KVG and the management of the AIF correspond to the requirements laid down in the KAGB. The requirements on the depository, however, are different, as for the placement to professional investors, only one body must be designated which is independent of the AIF-KVG and takes on depository functions, whereas the placement to semi-professional investors requires a regulated depository pursuant to the KAGB (Sect. 329 para. 1 no. 1 and no. 1 KAGB).

Distribution

- Additionally, the requirements on third countries (with the exception of tax agreements) with regard to the AIF must be fulfilled. As of the coming into effect of the KAGB, the European passport will be available for the placement of EU-AIF by EU-AIF management companies (Sect. 323 KAGB).
- The placement then only requires a notification to the supervisory authority of the state of origin of the management company which within 20 days forwards to BaFin the AIFM confirmation and the AIF notification letter and which informs the management company about the forwarding of these documents.
- Prior to the introduction of the third-country passport, the placement of foreign AIF by EU-AIF management companies is admissible under the same conditions as the placement by an AIF-KVG. A difference is that the EU-AIF management company must comply with the implementation act of the AIFM Directive.

Distribution

- After introduction of the third-country passport, the notification about the placement intention will not be directed to BaFin anymore but to the supervisory authority of the state of origin of the EU-AIF management company (Sect. 324 para. 2 KAGB).
- The further procedure corresponds to the procedure associated with the European passport and, additionally, the requirements on third-countries for the AIF.
- Foreign AIF management companies may place EU-AIF to professional and semi-professional investors already prior to the introduction of the third-country passport.
- It is required that the foreign AIF management company complies with certain information and disclosure obligations and designates a body independent of the AIF management company that takes on the depository function (Sect. 330 para. 1 no. 1 KAGB).

Distribution

- If placement is intended also to semi-professional investors, the management company and the management of the AIF must completely comply with the AIFM Directive (Sect. 330 para. 1 no. 2 KAGB).
- Moreover, in both cases the requirements on third countries must be fulfilled (with the exception of the tax agreement).
- BaFin's evaluation period is between two and eight months (Sect. 330 para. 4 KAGB).
- After introduction of the third-country passport, the rules and regulations of the European placement passport will apply.
- The placement notification must be submitted to the competent supervisory authority of the relevant reference member state (Sects. 325 and 327 KAGB).

VI. Interim Provisions

Interim Provisions

- To allow sufficient time to the management companies to adapt their organization and the fund products they manage to the supervisory obligations of the KAGB, the KAGB provides for interim provisions applying to the management companies and the investment undertakings, and grants grandfathering to certain constellations.
- AIF-KVG that carried out activities of an AIF-KVG already before 22 July 2013, must apply for permission as AIF-KVG no later than 21 July 2014 or register as "small AIF-KVG" (Sect. 343 para. 1 KAGB).
- In a transition period lasting until 21 January 2015, however, they are permitted to launch new AIF prior to being granted approval (Sect. 343 para. 3 KAGB). Before submission of the permission application to BaFin, the AIF-KVG is subject to the Investment Act.
- Immediately after receipt of the application, however, the obligations laid down in the KAGB and the EU Directive must be completely complied with (Sect. 345 para. 2 KAGB).

Interim Provisions

- Particularly the KVG of closed AIF that were previously not regulated will face the challenge to reorganize their business operations in accordance with the new provisions of the KAGB until the submission of the permission application. The interim provisions of open AIF differentiate if the AIF was already regulated pursuant to the Investment Act (Sect. 345 KAGB) or not (Sect. 351 KAGB).
- The principle is that the investment conditions or the articles of association of the open AIF must be adapted to the KAGB no later than 21 July 2014 (Sect. 345 para.s 1 and 3 KAGB).
- Simple editorial changes of public AIF do not require approval of BaFin.
- The adaptation must be made at the time of the application for permission as AIF-KVG at the latest.
- Until the modified investment conditions come into force, the provisions of the Investment Act continue to apply for the AIF.

Interim Provisions

- The following applies to the placement of open AIF: Domestic public or special AIF launched already before 22 July 2013 can be further placed until 21 July 2014 at the latest or until the coming into effect of the adapted investment conditions pursuant to the provisions of the Investment Act (Sect. 345 para. 6 and 7 KAGB).
- Subsequently, a placement is only permitted following successful notification procedures in accordance with the KAGB.
- Pursuant to Sect. 139 Investment Act, AIF management companies can continue to distribute AIF which are eligible to placement until 21 July 2014.
- As of this point in time, a successful notification procedure is required for the further placement (Sect. 345 para. 8 KAGB).

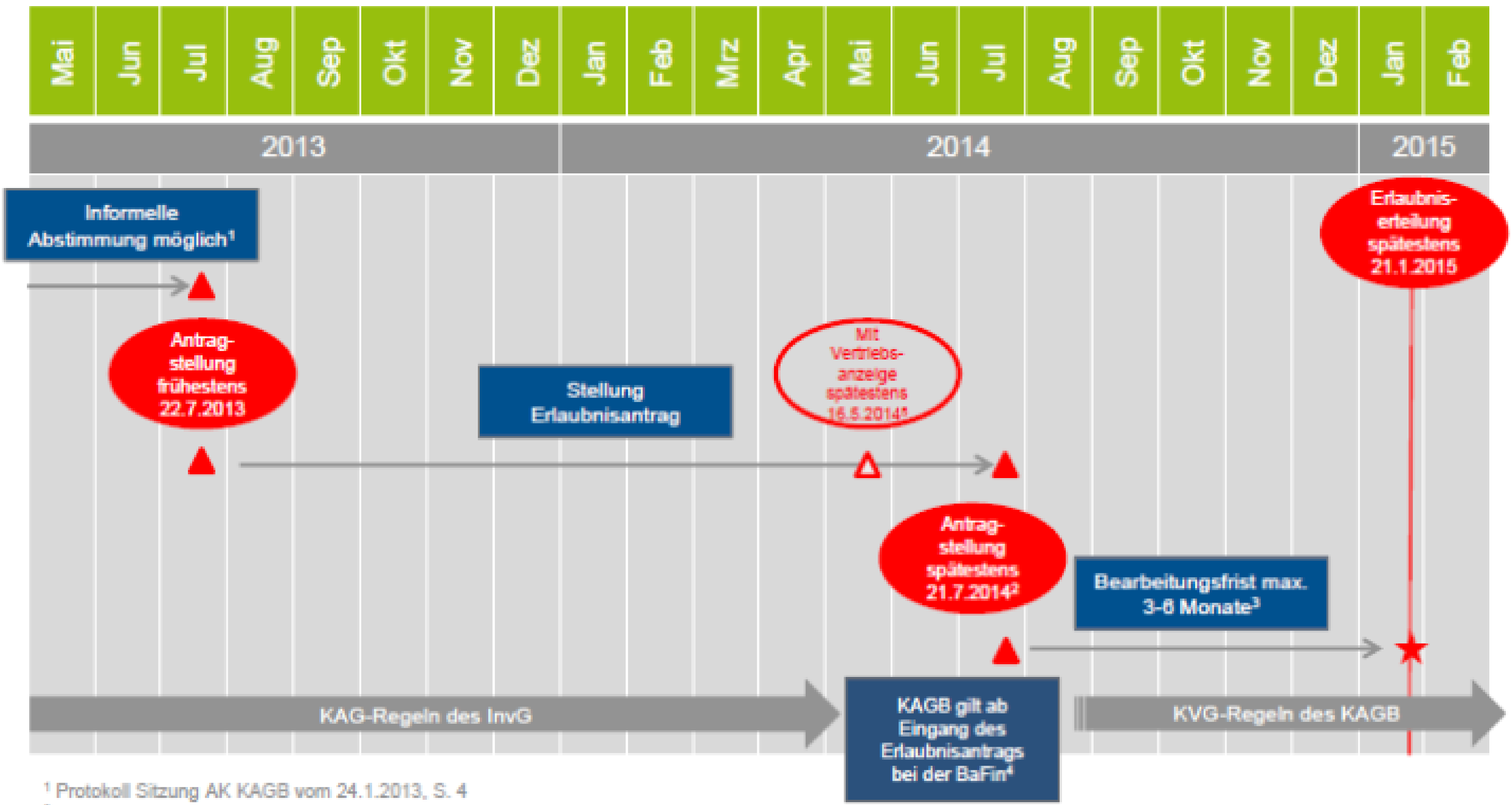
Interim Provisions

- The same applies to EU-AIF or foreign AIF that were previously placed privately (Sect. 345 para. 9 KAGB) and to EU-AIF or foreign AIF that were previously not to be qualified as investment undertakings in accordance with the Investment Act (Sect. 351 para. 5 KAGB).
- An AIF management company of closed AIF does not require approval und does not need to comply with the provisions of the KAGB as long as it exclusively manages closed funds which do not make any additional investments after 21 July 2013 (Sect. 353 para. 1 and 2 KAGB).
- "Making additional investments" means concluding a new agreement on an investment of capital to generate a profit, if the investment does not (i) result from an existing obligation, (ii) account for a minor share of the portfolio and (iii) exclusively serve the conservation of value.
- As soon as the activity of the management company is not exclusively limited to fully invested closed funds anymore, for instance because it also manages closed funds that make additional investments, a permission is required by 21 July 2014 ("risk of infection" – see Sect. 353 para. 7 in conjunction with Sect. 343 KAGB).

Interim Provisions

- Extensive product regulations do not apply to an AIF-KVG managing closed domestic AIF which in fact make additional investments until 21 July 2013, but whose subscription period expired before 22 July 2013, so that the AIF-KVG can maintain the investment strategy of the AIF (Sect. 353 para. 4 KAGB).
- Apart from that, the provisions of the KAGB apply. With regard to closed AIF which were launched before 22 July 2013 but whose subscription period does not expire before 22 July 2013 and which still make investments after 21 July 2013, the investment conditions and partnership agreements must be adapted to the KAGB by 21 July 2014 (Sect. 353 para. 6 in conjunction with Sect. 351 KAGB).
- Until this date, placements can be made in accordance with the previously applicable provisions (including private placements). Placements made after this date, however, require a notification procedure.

Timetable



[1] Protokoll Sitzung AK KAGB vom 24.1.2013, S. 4
[2] § 343 Abs. 1 Satz 2 KAGB
[3] § 22 Abs. 2 KAGB
[4] § 345 Abs. 2 Sätze 1 und 2, Abs. 3 Satz 2 KAGB; gilt auch für Level II, Protokoll Sitzung AK KAGB vom 15.2.2013, S. 3
[5] Wegen Wechselwirkung mit Zeitabläufen Publikums-AIF und ggf. Spezial-AIF (siehe Folgeseiten)

Source: BVI 2013

Conclusion / Future Outlook

Ihr Ansprechpartner

Dr. Thorsten Voß
Partner, Banking & Finance,
E.: tvoss@mayerbrown.com
T.: +49 69 79 41- 1150

Dr. Ingo Kleutgens
Partner, Transactions & Consulting
E.: ikleutgens@mayerbrown.com
T: +49 69 7941 2971

MAYER•BROWN

AIFMD – Tax Impacts

Sandy Bhogal
Head of Tax - London
+44 (0)20 3130 3645
sbhogal@mayerbrown.com

Dr. Ingo Kleutgens
Tax Partner - Frankfurt
+49 69 79 41 1591
ikleutgens@mayerbrown.com

July 2013

General tax implications

- AIFMD is not principally concerned with tax, but will have a number of significant tax implications which funds and fund managers will need to assess for their future operating models.
- A key area for decision-making following AIFMD will be tax residence of fund managers and fund entities.
- Expectation that AIFMD will lead to increased consideration of tax efficiency of fund structures based on domestic tax rules and double tax treaties (e.g. in view of AIFM requirements, rules on delegation and depositaries).
- This will include ensuring VAT neutrality where possible.
- AIFMD's remuneration requirements (e.g. deferral arrangements, non-cash remuneration and claw-back provisions) will also give rise to important tax considerations in many cases.

General tax implications (cont.)

Residence

- Given AIFMD's regulation of distribution/marketing of AIFs within EU member states, domiciliation of AIFs pursuant to AIFMD will have various regulatory and tax implications.
- Tax neutrality will be sought for AIFs, which will usually dictate where they are set up.
- The taxation of fund entities can also depend on the place of effective management, which is a matter of fact and substance. This is relevant to the tax profile of AIFs and the role and location of AIFMs and their delegates.
- Activities of AIFM and how/where those activities will be carried out pursuant to AIFMD could affect where effective management of AIF is exercised.
- Also relevant to question of whether activities of AIFM could result in fund entities being held to have taxable presence in certain jurisdictions in the shape of a permanent establishment.
- In some cases, it may be preferable to have self-managed funds (i.e. the AIFM is the AIF itself).
- Documentation procedures and decision-making protocol will also be essential – relevant to where decisions are taken and how delegation functions in practice.
- The requirement to appoint an AIFM will have a fundamental tax impact: AIFMs will generally want to locate in jurisdictions with low income taxation (relevant to the AIFM's advisory and management fees). The same will be true for delegates of AIFMs.
- Tax treatment of depositaries required under AIFMD will also need to be considered.

General tax implications (cont.)

VAT

- In determining where to set up AIFs and AIFMs, the VAT treatment of management services may be a relevant consideration (especially as VAT rates vary significantly across the EU).
- In certain jurisdictions, management of AIFs may or may not be a VAT exempt supply (though where there is no VAT exemption, fund entities may be in a position to recover input VAT depending on their activities).
- Place of supply rules also to be considered depending on context (i.e. general rule for 'B2B' supplies vs. special rules for specific asset classes such as real estate).
- VAT implications of AIFM delegation will need to be factored in.

General tax implications (cont.)

Remuneration

- Under AIFMD, AIFMs could be required to defer 40%-60% of variable remuneration over a period which reflects the life-cycle and redemption policy of the AIF, subject to a minimum of three years and vesting and forfeiture conditions.
- Not clear what element of AIFM 'profit' to be treated as variable remuneration subject to deferral requirements.
- Deferral of remuneration is a particular concern from a tax perspective for AIFMs structured as tax-transparent vehicles (e.g. LLPs in the UK), where profits are taxable on partners on an 'arising' basis irrespective of actual distribution.
- Mandatory requirement for AIFMs to defer proportion of profit deemed to be variable remuneration can create a 'dry tax charge' – i.e. partners in tax transparent structures required to fund cash tax payments on profit not yet received.
- Even more of a concern where deferred remuneration is subject to claw-back/forfeiture pursuant to AIFMD principles – tax will have been paid without the possibility of credit.
- Requirement to implement non-cash remuneration under AIFMD (e.g. shares/units of the AIF) also needs to be considered from a tax perspective.

UK specific considerations

UK Investment Management Strategy

- At Budget 2013, HM Treasury launched its investment management strategy paper which gave a very strong statement of intent to preserve and enhance the UK's position as a leading global investment management centre.
- The paper contained a commitment to take a sensible approach on implementation of AIFMD.
- In particular, it was announced that HMRC would consult on proposals to widen the application of section 363A Taxation (International and other Provisions) Act 2010. This provision allows UK managers to manage non-UK funds without the risk that the funds will become UK tax resident but currently only protects UCITS. With AIFMD in mind, it was announced that a consultation will be undertaken to extend this protection to certain non-UCITS. Proposed that legislation to this effect will be included in Finance Bill 2014.

UK specific considerations (cont.)

New tax transparent fund vehicles

- In its policy statement on the implementation of AIFMD, FCA confirmed the introduction of two new legal forms of collective investment schemes - the 'co-ownership scheme' and 'limited partnership scheme'.
- Intended that a UK-authorised fund may constitute a 'master fund' into which other funds from across Europe may combine their assets. These vehicles are also intended to accommodate certain tax-exempt institutional investors, such as pension funds.

UK specific considerations (cont.)

HMRC partnership taxation consultation

- Announcement made at Budget 2013 that HMRC wanted to consult on changes to the law in two areas related to partnership taxation: (i) the removal of the presumption of self-employment of members of LLPs, and (ii) anti-avoidance rules to prevent the manipulation of profit and loss allocations by partnerships (in particular, 'artificial' profit allocations to corporate members of LLPs). Consultation paper published on 21 May 2013. Changes in law expected to take effect from 6 April 2014 at the earliest.
- Corporate member planning is common in relation to UK hedge fund managers organised as LLPs, to manage effective rates of tax. These may already operate deferred remuneration policies for commercial reasons (e.g. regulatory, ensuring alignment of interests with investors, staff incentivisation).
- HMRC consultation would seem to catch existing corporate member structures using deferred remuneration policies and deferral arrangements required under AIFMD.
- Not yet clear how this issue will be addressed.
- A number of ideas exist – e.g. tax transparent AIFMs (authorised by FCA) could be permitted to elect to 'switch off' tax transparency so that the tax point for deferred remuneration is moved to the time of receipt (this would largely eliminate the need for corporate member planning) or AIFMs could be required to report details of deferred remuneration and conditions of deferral to HMRC with an agreed 'cash basis' of taxation for specific income streams.

German specific considerations

Principles of Fund Taxation

- A special tax regime is in place which is called the Investment Tax Act („ITA“)
- The purpose of the ITA is to make sure that a German qualifying fund („GQF“) is working as a tax transparent entity
- The GQF itself is considered a legal person, which makes it i.a. eligible for purposes of Double Taxation Treaties
- The tax transparency is reached by exempting the GQF from German taxation (Corporate Income and Trade Tax); so it is more a factual rather than a true tax transparency as it is the case for example with partnerships

German specific considerations

Principles of Fund Taxation (cont.)

- The investor of a GQF receives dividend distributions from the Fund. Dividends which an institutional investor receives from a corporation are usually 95% tax exempt (for shareholdings of more than 10% of the share capital) and private investors can obtain 40% tax exemption if they do not fall into the scope of capital withholding tax (*Abgeltungsteuer*). In the latter case the tax rate is 26.4%.
- However, as opposed to the regular tax regime dividends derived from a GQF are fully taxable except if the dividends itself consist of privileged dividend income the GQF has collected from its investments. All other income derived through the GQF would be taxable without limitation.

German specific considerations

Principles of Fund Taxation (cont.)

- So, if the investor for examples receives rental income through the GQF by means of tax exemption at funds level and unlimited taxation of dividends on the investor‘s level the GQF de facto provides for tax transparent status.
- One needs to know that not only dividend distributions are taxable but also accrued earnings of the GQF are subject to a deemed dividend taxation, i.e. they are taxed if they were distributed. This is another consequence of the tax transparency principle.

German specific considerations

Current status of tax legislation

- There is new tax legislation coming up along with the AIFM-D implementation (in the following referred to as „ITA-new“).
- The two houses of Parliament haven‘t yet found consensus on specific points of ITA-new and the legislative process has been slowed down.
- If no settlement can be reached the tax bill as a whole might fail because of upcoming elections to the Bundestag on September 21, 2013. If the bill hasn`t passed the two houses by then it will have failed completely.
- The tax authorities have no clear view on what will happen then because once the new AIFM regulatory regime will come into force, there will be no corresponding tax regime.

German specific considerations

Current status of tax legislation (cont.)

- From what we have heard from the tax authorities the idea right now is to provide for the interim period by way of regulation that the old fund regulatory law shall apply for tax purposes.
- This provides of course no sufficient legal grounds for the future but should be an interim solution until the elections will take place in early September, when it will be the last chance for both houses to get the ITA-new passed.
- There is no doubt that the reference to the old fund regime provides no long term solution.

German specific considerations

What makes a fund a qualifying fund?

- In particular with respect to foreign funds the tax regime is going to be changed fundamentally as the same criteria for qualification will apply to foreign as to domestic funds.
- ITA (current) applies to open-ended UCITs funds (securities funds)
- ITA-new applies to AIF and UCITS regardless of whether open- or closed-ended funds which fulfill the following definition:
  - any entity for collective investment which collects capital from a number of investors in order to invest it following a defined investment strategy for the benefit of these investors, and which is not an operating company outside the financial sector

German specific considerations

- Criteria for a qualifying foreign fund

		ITA (current)	ITA-new
1.	regulatory supervision	yes	yes, but qualified
2.	risk diversification	yes	yes
3.	annual redemption right	yes (or 2.)	yes
4.	not more than 10% of non-permitted assets	no	Yes
5.	no operative business	yes	yes
6.	not more than 20% of sharecapital in non-listed companies /exemption for property companies	no	yes
7.	leveraging only short term and not in excess of 30% of value of fund/50% for property funds	no	yes
8.	not more than 10% of equity in a corporate entity	no	yes
9.	all criteria mentioned above reflected in OC	no	yes

German specific considerations

- Criteria for a qualifying foreign fund (contd.)
  - List of permitted assets (4. above) includes i.a. stocks, money market instruments, real property, units in other funds
  - All qualifying funds must comply with reporting requirements; otherwise taxed on deemed return

German specific considerations

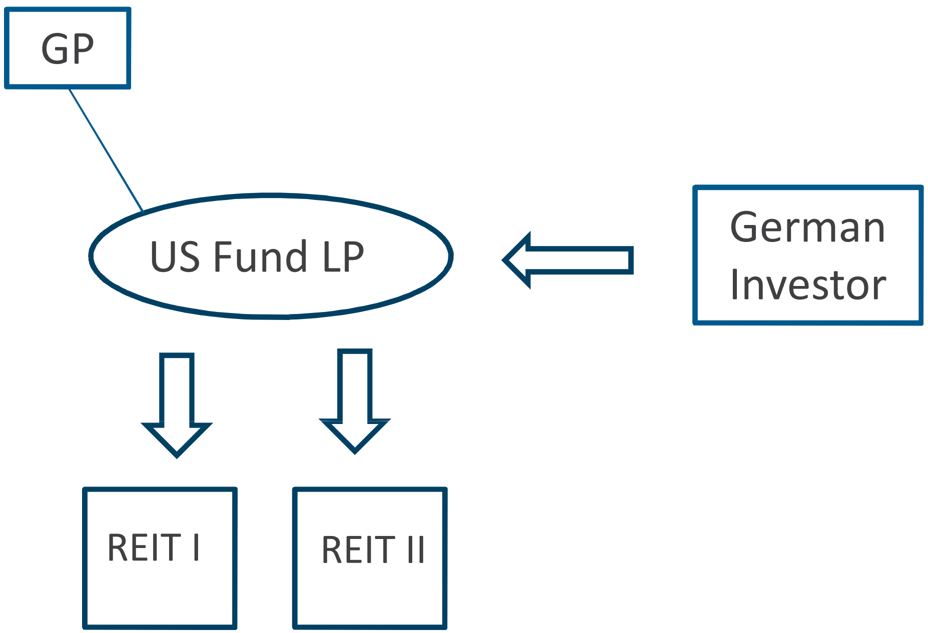
- What happens if your fund is non-qualifying?
  - If it is a corporate entity it is taxed like this with an important exception:
    - Non-German EU funds need to be subject to the regular corporate tax regimes in their country of residence (issues with Luxembourg privileged funds)
    - non-EU funds need to be subject to at least a 10% minimum taxation in their country of residence

    → otherwise German corporate investors will lose the benefit of the 95% tax exemption on dividends
  - In case of non-qualifying partnership it is tax transparent (except for trade tax)

German specific considerations

- What happens if your fund is non-qualifying? (cont.)
  - Practical experience: Luxembourg SICAV, US REITs
  - US REITs are considered corporate entities which will not meet the 15% mimimum taxation because of their ability to make deduction for their dividend distributions
  - Need for restructuring: feeder fund, blocker entities

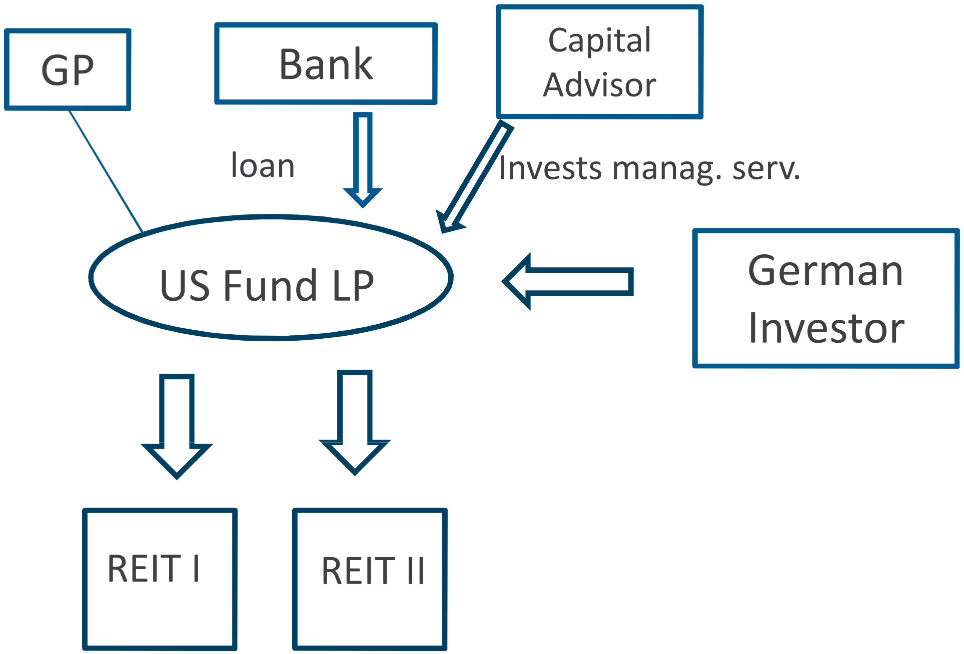
German specific considerations



- although the GP is constituting a p.e. in the U.S. in the absence of genuine commercial business of the U.S. L.P. there is no exemption from German taxation of income derived from the Fund

- In this scenario the German Investor would be treated as if he had received dividends from U.S. REITs directly

German specific considerations



- No flow status of the US LP as
  - GP constitutes a p.e. for the tax purposes
  - because of outsourcing of investment management to third party and debt leveraging there is a deemed commercial business

➢ income exempted from German taxation under Art. 5, 23 US/German Treaty

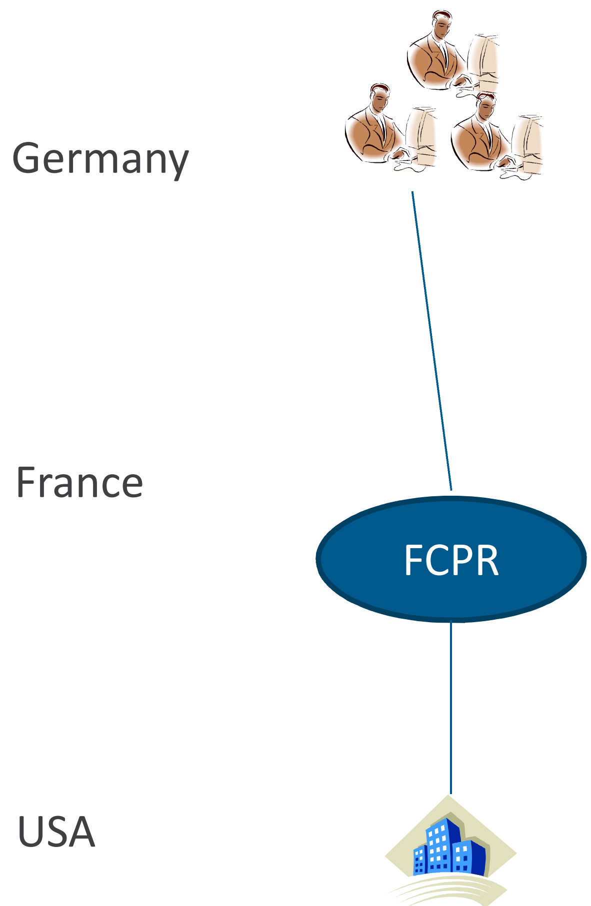
➢ no fall back into German taxation as ECI income in the U.S. and subject to tax in the U.S.

German specific considerations

What happens if your fund is non-qualifying? (cont.)

- Certain non-qualfying foreign funds which are presently treated as flow throughs will be re-characterized into corporate fund investments
- This for example affects structures which provide co-ownership rights to the investor (e.g. Fonds Commune de Placements – FCP)

German specific considerations



Under the current tax regime FCP is treated like flow through which generates tax exempt rental income

Under ITA-new he will be taxed as if he had earned dividends which would result in a double taxation in respect of the rents (taxed in the U.S.) and the dividends

German specific considerations

- Grandfathering
  - For qualifying funds under the existing regime a grandfathering period is granted until the end of the fiscal year ending after July 22, 2016.
  - During this period of time qualifying funds under the existing regime are required to make themselves compliant with the criteria under ITA-new.
  - The grandfathering period is not granted non-qualifying funds

German specific considerations

How can we help you?

- Tax opinion on tax transparent status
- Tax structural advice
- Binding Ruling