A Guide to AIFMD in Ireland

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The European alternative investment funds industry is dealing with what is perhaps the most fundamental change in its history as it now comes to terms with the significant implications and potential opportunities offered by the EU Directive 2011/61/EU on Alternative Investment Fund Managers (the "**Directive**" or “**AIFMD**”).

The subject of daily information releases from regulators, advisors, industry representative bodies, the AIFMD could perhaps be best described as "Big Bang" for the hedge and private equity and real estate fund communities. Not only will fund managers be faced with a broad swathe of new regulation as to how they run their businesses, the changes introduced also involve significant powers of regulatory intervention, additional investor disclosure and regulatory reporting obligations, an onerous liability regime for depositaries, limits on remuneration arrangements, new notification and asset stripping limitations for the private equity industry as well as limiting investment in securitisations to those where originators retain "skin in the game".

However, the Directive also opens up Europe as a single market place for alternative funds whether these are hedge funds, private equity funds, real estate funds or simply those structures which are unable to fit within the UCITS regime due to liquidity or portfolio concentration issues. The Directive should offer investors access to a broader range of asset classes, create greater competition between fund managers and offer greater protection to investors through transparency obligations, custody liability rules, fund valuation and fund manager level organisational requirements. Although causing quite some level of pain for fund managers, it should ultimately be to their advantage as they will be able to operate on a more level playing field and will have a greater market to target. They will however need to offer investors something more, in particular greater transparency.

In many ways some level of anxiety about AIFMD is warranted. Those of us who have been working in the UCITS and MiFID sectors for years realise the restrictions placed by working in a regulated environment. There are also legitimate concerns that the benefits offered by the single market will come with ever more co-ordinated and harmonised regulation and, perhaps even more relevant, co-ordinated and centralised interpretation through European supervisory bodies such as the European Securities and Markets Authority (”**ESMA**”). Although AIFMD offers opportunities, it also creates challenges and in many ways it is a good example of the challenges, frustrations and opportunities which are the reality of the European Union.

The principal aim of the AIFMD is to establish common requirements across the EU Member States for the authorisation and supervision of the managers of investment funds, other than UCITS funds, to address the potential prudential risks which might arise from the activities of “alternative investment fund managers” or "**AIFMs**" and to create a single market for the marketing of non-UCITS collective investment schemes or "**AIFs**" to EU professional investors. In addition to managers based in the EU, the Directive applies to any non-EU based fund manager (including for example US or Asian based fund managers) who manages one or more alternative investment funds (AIFs) domiciled in the EU and/or who markets AIFs, irrespective of their domicile, to investors in the EU. For instance, US based fund managers that manage Cayman based offshore funds marketed to EU investors in a master-feeder structure would typically fall under the scope of the Directive.

As noted above, the Directive will also create, for the first time, a single marketplace within the EU for the marketing of AIFs, known as a marketing "passport", something which until now was only available to UCITS funds. Initially, until at least October 2015, only entities established in the EU can be authorised as AIFMs to obtain the marketing passport for their EU domiciled AIFs. In or around October 2015, the European Commission may decide to "switch on" certain provisions of the AIFMD, which will enable a non-EU based manager to apply to become authorised as an AIFM under the Directive and to market its funds in the EU under the marketing passport. Until then, non-EU based managers may continue to market in an EU Member State under the EU Member State's own national private placement rules (as amended by the Directive) without the marketing passport.

No-EU managers do, however, need to bear in mind that the European Commission has stated in its Q & A documents that from July 22, 2013 non-EU managers marketing AIFs, irrespective of their domicile, to investors in the EU will nevertheless need to comply with certain marketing restrictions, additional disclosure requirements and transparency provisions under the Directive.

Although sometimes portrayed as exclusively manager related, AIFMD also impacts on the funds, or AIFs, they manage. That impact is not only structural (for example, depositary requirements, valuation rules and, for self-managed funds, a variety of organisational rules) but it also adds new layers of reporting obligations (to investors and to regulators) as well as some restrictions on certain types of strategies, particularly in the private equity space.

In Ireland, the implementation of AIFMD is grounded not only on the Directive and the European Commission's Delegated Regulation (EU) 231/2013 (the "**Level 2 Regulation**") but importantly builds on the almost quarter century old international alternative funds industry in Ireland. Sitting side by side with the UCITS industry, the international alternative funds business in Ireland has grown from a standing start in 1990 to over 2,100 domiciled funds with in excess of EUR 260 billion of assets under management (AUM) and if you include non-Irish alternative funds administered from Ireland, to approximately 8,500 funds and over USD 1 trillion in AUM.

Prior to AIFMD becoming a "twinkle in the eye" of European regulators, the Irish regulator, the Central Bank, had created a three pronged regulatory regime for non-UCITS schemes, applying its investment and borrowing/leverage restrictions by reference to the type of investors targeted – retail, professional or qualifying investors. As this regime evolved, the professional investor structure became somewhat redundant and the retail structure predominantly focused on the domestic market. The qualifying investor fund (or "**QIF**") structure, however, became one of the principal European regulated fund products for all types of alternative strategy and liquidity profile. In setting out its rules for AIFs and AIFMs, Ireland is building on that strong foundation.

Finally, when considering the new regime and how it might affect your business, it is important to recognise some fundamental differences between the AIFMD regime and the other two pillars of the European asset management industry – UCITS and MIFID.

UCITS was originally a product related regime, where the original UCITS "passport" attached to the UCITS fund itself. It was only much later – with UCITS III and IV – that it developed a second limb as a manager related directive, adding not only MIFID style organisational requirements for the managers of UCITS but also granting them a passport to act as manager to UCITS domiciled in other EU Member States.

MIFID, which grew out of the original EU Investment Services Directive, was always a service, not product, related directive and granted a passport to investment firms to provide a wide range of investment services to clients in other EU Member States, including portfolio management and investment advice.

Although AIFMD is principally a manager/service related directive, it also has elements which directly relate to the product (i.e. the AIF). However, the "passport" under AIFMD is not a product passport (i.e. unlike UCITS), rather the passport is granted to the AIFM and it is a passport to manage and/or market (i.e. a service passport) on a cross-border basis.

Given the fact, however, that AIFMs "manage" and "market" AIFs, one cannot focus exclusively on the service. One has to look at the product and, for that reason, our analysis looks at both the treatment of the manager - the AIFMs - as well as at the product – the AIF – and how AIFs can be set up in Ireland under the new AIFMD regime.

As the implementation process for AIFMD continues to evolve, with almost daily updates, and as domestic Irish implementing legislation has yet to be finalised, we do intend to update this Guide regularly.

Asset Management and Investment Funds Group
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1. Who, What and When?

In this Section we explain who the AIFMD applies to, what an AIFM can do and from when. We explain who is exempt from the AIFMD, the difference in capacity between an *authorised* AIFM and a *registered* AIFM and what is involved in the activity of "managing AIFs".

In order to make it, hopefully, easier to understand, in a later Section titled "Managing and Marketing under AIFMD" we explain the different scenarios for EU based AIFMs and for AIFMs based outside the EU who wish to manage EU AIFs or market AIFs, wherever based in the EU.

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1.1 Who does AIFMD apply to?

Unless a partial or complete exemption is available or the activities in question fall outside the scope of the Directive, the Directive applies to:

(i) any legal person (an "alternative investment fund manager" or "**AIFM**") established in an EU Member State whose regular business is managing one or more "alternative investment funds" or "**AIFs**", meaning any collective investment undertaking, including investment compartments thereof, established within or outside the EU:

(a) 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

(b) which does not require authorisation pursuant to Article 5 of Directive 2009/65/EC (the UCITS Directive ;

(ii) any non-EU AIFM managing one or more AIFs established in the EU, irrespective of whether they are marketed in the EU or not; and

(iii) any non-EU AIFM marketing within the EU any AIF (wherever domiciled) that it manages.

See Section 2.1 for more detail on the definition of "AIF".

1.2 Out of Scope

The Directive does not apply to the following entities (i.e. they are outside its scope):

- holding companies;

- institutions which are covered by Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP), including, where applicable, the authorised entities responsible for managing IORP and acting on their behalf referred to in Article 2(1) of that Directive or the investment managers appointed pursuant to Article 19(1) of the same Directive, insofar as they do not manage AIFs;

- supranational institutions such as the ECB, the European Investment Bank, the European Investment Fund, the European Development Finance Institutions and bilateral development banks, the World Bank, the IMF, other supranational institutions and similar international organisations, in the event such institutions or organisations manage AIFs and in so far as those AIFs act in the public interest;

- national central banks;

- national, regional and local governments and bodies or other institutions which manage funds supporting social security and pension systems;

- employee participation schemes or employee saving schemes; and

- securitisation special purpose entities.

1.3 Exemptions

The Directive provides certain full and partial exemptions from its scope depending on the nature of the entity or the relationship between the entity and the investors.

Full Exemptions

The full exemption provides that the Directive will not apply to AIFMs insofar as they manage one or more AIFs whose <u>only</u> 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.

Partial Exemption: Registration

The following AIFMs will be subject to a lighter *registration* (not full *authorisation*) regime in their home Member State:

- AIFMs which either directly or indirectly through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manage portfolios of AIFs whose assets under management, including any assets acquired through use of leverage, in total do not exceed a threshold of EUR 100 million; or

- AIFMs which either directly or indirectly through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manage portfolios of AIFs whose assets under management, in total do not exceed a threshold of EUR 500 million when the portfolio of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of 5 years following the date of initial investment in each AIF.

Although registration is a lighter regime by comparison to authorisation, registered AIFMs will still need to comply with certain requirements, including those relating to monitoring of systemic risk. The Irish rules for registered AIFMs are set out in Section 10.9.

Note also that registered AIFMs do not benefit from any of the rights granted under the Directive unless they choose to “opt-in” to full authorisation. That means that they cannot manage AIFs in other EU Member States, nor can they market their AIFs in other EU Member States.

The European Commission has issued Implementing Regulation No. 474/2013 which establishes the “opt-in” procedure.

1.4 What can an AIFM do?

The principal scenarios dealing with the different types of AIFM and their capacities to manage and/or market AIFs are addressed in Section 3 of this Guide, but, in summary, an AIFM can manage AIFs and can market them to professional investors in the EU either under a marketing passport or, if available, a private placement regime. What is meant by “managing AIFs” and “marketing AIFs” is addressed in detail in Section 2 of this Guide.

However, it is important to appreciate that the capacity to manage or market AIFs on a cross-border basis within the EU will depend on whether the AIFM is an EU AIFM or a non-EU AIFM, whether it is authorised or registered, the types and domiciles of the AIFs it manages or markets as well as when certain of the capacities under the Directive – particularly relevant for non-EU AIFMs – are “switched on”. It will also depend on whether the AIFM is an external AIFM or an internally managed AIF and whether it also holds a UCITS authorisation. Initially, only EU authorised AIFMs will be able to use a marketing passport and initially only in respect of EU AIFs.

Non-EU AIFs can, however, continue to be marketed by EU and by non-EU AIFMS under a private placement regime in EU Member States until at least 2018, provided the individual EU Member State allows for private placement. Once the private placement regime is turned off, the marketing passport should be available to all.

EU authorised AIFMs can also manage non-EU AIFs and non-EU AIFMS can manage EU AIFs, in each case subject to compliance with the Directive, again as detailed in Section 3 of this Guide.

1.5 Authorisation Required

From July 22, 2013, an EU AIFM must be authorised in the Member State in which it has its registered office and it will be responsible for ensuring compliance with the requirements of the Directive. However, it is not only an EU AIFM which will require authorisation.

A non-EU AIFM managing an EU AIF or seeking to use a passport to market an AIF (wherever domiciled) into an EU Member State will in the future (from no earlier than 2015) require prior authorisation from the regulator of an EU "**Member State of reference**" (i.e. either the Member State in which the AIF is established or the Member State in which the AIF is principally marketed). The European Commission has issued Implementing Regulation No. 448/2013 which establishes the procedure for determining the Member State of reference.

In that regard, it is worth noting that the Irish Central Bank has indicated that a non-EU AIFM of an Irish QIAIF will be able to seek authorisation in Ireland from July 22, 2013. In other words, if the non-EU AIFM wants to obtain an authorisation, it can do so once the AIFMD is implemented – it does not have to wait until 2015. We understand however that such an authorisation will be an authorisation to manage an Irish QIAIF, not the granting of a passport to market such a QIAIF. In the event that any common EU position on authorisation of non-EU AIFMs were to emerge before July 2013, the Central Bank has indicated that it intends to conform to any such approach.

From July 22, 2013, where a non-EU AIFM seeks to market a non-EU AIF into an EU Member State on a private placement basis, it will have to comply with certain requirements of the Directive dealing with production of annual and audited financial statements, disclosures to investors and regulatory reporting obligations.

1.6 When does it apply from?

The Directive comes into force on July 22, 2013, with certain activities or requirements being governed by transitional provisions for a 12 month period as provided for in Article 61.

The interpretation and practical impact of the interpretation of the Directive's transitional provisions has created quite an amount of confusion. However, as we get closer to July 22, 2013, greater clarity has become available from both the European Commission and the Central Bank of Ireland ("**Central Bank**"). We have outlined a number of different practical scenarios below.

- *New AIFM (including new internally managed AIF) launching post July 22, 2013*

Any new EU AIFM established after July 22, 2013 will need to be authorised or registered as an AIFM. This will include self-managed investment companies which will need to be authorised under fund legislation as an AIF and under the Irish implementing AIFMD Regulations as an internally managed AIF. Pending the introduction of the domestic Irish regulations implementing the Directive in Ireland, the Central Bank of Ireland ("**Central Bank**") has issued its application forms for new applicants and has stated that it has put in place an informal process to receive and process applications. This process will be formalised once the domestic implementing regulations are introduced.

- *EU AIFMs which exist pre-July 22, 2013*

The Directive indicates that AIFMs of AIFs which exist pre July 23, 2013 must "take all necessary measures to comply with national law stemming from this Directive and shall submit an application for authorisation within" 12 months of July 22, 2013. In response to questions on this point, the Commission has stated: "*Compliance with the Directive has to be ensured on a best efforts basis as of the date of transposition into national law. In general, existing AIFMs will be expected to start reporting as of the date of the application of the AIFMD in accordance with the reporting frequencies foreseen in Level 1 and Level 2 rules. Also, compliance with e.g. reporting obligation or other obligations does not depend on having obtained an authorisation with the competent authorities.*"

The expectation, therefore, is that existing AIFMs (including internally managed AIFs) and their providers will need to start to take meaningful steps towards establishing and documenting their organisational and contractual arrangements to demonstrate a move towards compliance and then onwards to authorisation over the coming 6 to 12 months. However, pre-existing AIFMs/AIFs and their promoters do need to be aware of and to ensure that they are in a position to meet reporting obligations from the outset (i.e. from July 22, 2013) and that their service providers are in a position to assist them in doing so. Those reporting obligations apply irrespective of whether authorisation has been obtained.

The Central Bank has indicated that it will continue to apply its NU (Non-UCITS) Series of Notices to Irish AIFs until its AIFM is authorised at which point the Central Bank's AIF Rulebook will become applicable to both the AIFM and its AIFs.

- *Irish umbrella QIFs launching new sub-funds post July 22, 2013*

The principal Irish regulatory category of alternative investment fund has, to date, been the Irish qualifying investor fund (the "**QIF**"). The QIF will be considered an AIF (or if the QIF is a self-managed investment company it will also be considered an internally managed AIF). For those QIFs established as umbrella schemes, the Central Bank has indicated that it (if internally managed) or its AIFM may continue to establish new sub-funds post July 22, 2013 pending the AIFM becoming authorised. Those new sub-funds will be subject to the NU Series of Notices until the AIFM is authorised, at which point the AIF Rulebook will apply to both the AIF and its AIFM.

- *Irish AIFMs launching new AIFs post July 22, 2013*

The Central Bank has also confirmed that an Irish AIFM can, during the 12 month transitional period, launch new AIFs even though the Irish AIFM is not yet authorised under the Irish AIFMD Regulations. However, noting the compliance on a "best efforts" requirement, such AIFMs need to prepare to comply and be able to show that their plans to do so demonstrate best efforts.

Importantly, the Central Bank has also clarified recently that the depositary to such an AIF will be permitted, pending the authorisation of the AIFM, to comply with the depositary regime applicable to start-up AIFMs. We understand that to be a reference to "registered" AIFMs.

- *Irish QIAIFs with Non-EU AIFM*

The Central Bank has also stated that the fact that a QIAIF (an Irish qualifying investor AIF) would have a non-EU AIFM will not be an obstacle to its application for authorisation post July 22, 2013 being processed. In other words, the non-EU AIFM can seek authorisation in Ireland from July 22, 2013. Notwithstanding this approach, the Central Bank has said that it intends to conform to any common EU position on this point, if one were to emerge before July 2013.

We understand however that such an authorisation will be an authorisation to manage an Irish QIAIF, not the granting of a passport to market such a QIAIF.

The Central Bank will allow a two year transition benefit to non-EU AIFMs. The explanation given by the Central Bank is that any QIAIF which was authorised prior to July 22, 2013 and which designates a non-EU entity as its AIFM will only be obliged to ensure that it has an AIFM capable of carrying out all the tasks of an authorised AIFM by July 22, 2015. The QIAIF will be allowed to avail of the 2 year period provided that it and its non-EU AIFM comply with the provisions of the AIF Rulebook that apply in the case of QIAIFs with registered AIFMs.

Any QIAIF which is authorised on or after July 22, 2013 on the basis of designating a non-EU AIFM must only ensure that the non-EU AIFM is capable of carrying out all the tasks of an authorised AIFM within 2 years from the QIAIF's date of launch (i.e. the date when the initial offer period closes or, where there are multiple closings, the date of first closing). This is subject to the proviso that, at all times the QIAIF can show that its management company and AIFM arrangement, when considered in their entirety, at least meet the standard which would have applied under the non-UCITS regime which applied in Ireland immediately prior to July 22, 2013.

The Central Bank intends to keep the extent of this transition benefit under review with a view to extending the transitional period to align with the coming into effect of Article 37 of the AIFMD, unless these are strong reasons not to do so in the light of intervening experience in relation to the regulation of AIFs which have non-EU AIFM.

- *Transitional provisions for certain Closed-ended AIFs*

The Directive has specific transitional provisions for AIFMs who, pre-July 22, 2013, are managing closed-ended AIFs. Two different scenarios are addressed in the Directive.

The first is that AIFMs, in so far as they manage AIFs of the closed-ended type before July 22, 2013 which do not make additional investments after July 22, 2013, may however continue to manage such AIFs without authorisation under the Directive.

The Commission has explained its position as follows: *"Article 61(3) aims to avoid a regulatory burden for AIFMs that manage closed-end funds and who neither receive new money from investors nor make additional investments. AIFMs of such closed-end funds should not be subject to authorisation or material compliance. However, it is very important that the concept of "additional investments" is interpreted in a way that does not create opportunities for circumvention of the AIFMD."*

The Commission has interpreted this further as follows: "*The interpretation of "additional investment" has to take place in the context of the specific investment strategy and in the context of the legal provisions of the AIFMD.Ttherefore "additional investments" should be interpreted widely. We generally understand "make additional investments" as implying a new contract, involving investment of capital for the purpose of obtaining a gain. However, the management of the portfolio falling under the provision in Article 61(3) for the sole purpose of maintaining the value of the portfolio should be possible. Hence limited amounts of financial injection should be possible provided they are arising out of existing commitments, they represent a negligible percentage of the AIF's portfolio and they aim only to maintain the value of the portfolio."*

The second transitional provision scenario relating to closed-end funds is that the Directive also provides that AIFMs, in so far as they manage AIFs of the closed-ended type whose subscription period for investors has closed prior to the entry into force of the Directive and are constituted for a period of time which expires at the latest 3 years after July 22, 2013, may continue to manage such AIFs without needing to comply with the Directive or to submit an application for authorisation under the Directive, except for the Directive's annual report provisions and, where relevant, those relating to where major holdings in or control of non-listed companies are acquired.

It is also of note that such funds should not be counted for the purpose of calculating the assets under management of an AIFM managing also other types of AIFs.

Although the Directive does not define "closed-ended" for this purpose, ESMA has issued draft regulatory technical standards, to be incorporated into a further Commission Delegated Regulation, which do, but it is important to note that not only are the definitions only relevant for AIFMD (i.e. they have no relevance for the Prospectus Directive), but the definition of an "AIFM of closed-ended AIFs" is wider than one might expect and is also different to how that term is used for other purposes by the Irish Central Bank. This is explained in Section 2.6 below.

Note that the Directive does not limit an AIFM to the management of only open-ended AIFs or only closed-ended AIFs. For the avoidance of doubt, an AIFM can manage both.

2. Key Concepts

In this Section we explain a number of the key AIFMD concepts, essential for understanding the new regime (and the rest of this Guide !).

As the focus of the Directive is on AIFMs "managing" and "marketing" AIFs, we start by explaining what an AIF is and then the concepts of managing and marketing AIFs.

Note that Section 3 sets out the different managing and marketing capacities (and their timings) under the Directive.

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2.1 What is an AIF?

Under the Directive, AIFs are collective investment undertakings (excluding UCITS) which raise capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of investors.

The phrase "collective investment undertaking" is not defined but it is clear that a fund may be an AIF whether it is open or closed-ended and whether it is constituted under contract law, trust law, under statute or any other legal form. ESMA issued a discussion paper of 23 February, 2012 titled "Key concepts of the AIFMD and types of AIFM" and a subsequent consultation paper of 19 December, 2012 titled "Guidelines on Key Concepts of the AIFMD" on this topic and has now released its Final Report – Guidelines on key concepts of the AIFMD of 24 May 2013 ("**ESMA Key Concept Guidelines**"). The Key Concept Guidelines set out criteria in order to assist in identifying the AIF, elaborating on the terms used in the Directive's definition of AIF which include "raising capital", "collective investment", "number of investors" and a "defined investment policy". ESMA also includes some criteria which are not expressly included in the Directive, for example the nature of ownership and control over the underlying assets.

The Final Report contains final Guidelines on the different elements of the AIF definition as follows:

- *"collective investment undertaking"*

In relation to the term "collective investment undertaking", the Key Concept Guidelines provide that the following characteristics, if all of them are exhibited by an undertaking, should show that it is a "collective investment undertaking" for the purposes of AIFMD:

(i) the undertaking does not have a *general commercial or industrial purpose*.

The term "general commercial or industrial purpose" is defined as "the purpose of pursuing a business strategy which includes characteristics such as running predominantly (i) a commercial activity, involving the purchase, sale, and/or exchange of goods or commodities and/or the supply of non-financial services, or (ii) an industrial activity, involving the production of goods or construction of properties; or (iii) a combination thereof."

(ii) the undertaking pools together capital raised from its investors for the purpose of investment with a view to generating a *pooled return* for those investors.

The term "pooled return" is defined as "the return generated by the pooled risk arising from acquiring, holding or selling investment assets – including the activities to optimise or increase the value of these assets – irrespective of whether different returns to investors, such as under a tailored dividend policy, are generated.

(iii) the unitholders or shareholders of the undertaking, as a collective group, have no *day-to-day discretion or control*. The fact that one or more but not all of the aforementioned unitholders or shareholders are granted day-to-day discretion or control should not be taken to show that the undertaking is not a collective investment undertaking.

The term "day-to-day discretion or control" is defined as "a form of direct and on-going power of decision – whether exercised or not – over operational matters relating to the daily management of the undertakings' assets and which extends substantially further than the ordinary exercise of decision or control through voting at shareholder meetings on matters such as mergers or liquidation, the election of shareholder representatives, the appointment of directors or auditors or the approval of annual accounts.

- *"raising capital"*

In considering what is meant by "*raising capital*", the Key Concept Guidelines indicate that the commercial activity of taking direct or indirect steps by an undertaking or a person or entity acting on its behalf (typically, the AIFM) to procure the transfer or commitment of capital by one or more investors to the undertaking for the purpose of investing it in accordance with a defined investment policy should amount to the activity of raising capital.

Whether such an activity takes place only once or on several occasions or the transfer or commitment of capital takes the form of subscriptions in cash or in kind should be immaterial.

The Key Concept Guidelines also provide that, without prejudice to the following sentence, when capital is invested in an undertaking by a member of *a pre-existing group*, for the investment of whose private wealth the undertaking has been exclusively established, this is not likely to be within the scope of raising capital. The fact that a member of a pre-existing group invests alongside investors, not being members of a pre-existing group, should not have the consequence that the criterion "raising capital" is not fulfilled. Whenever such a situation does arise, all the investors should enjoy full rights under the AIFMD.

The term "*pre-existing group*" is defined as "a group of family members, irrespective of the type of legal structure that may be put in place by them to invest in an undertaking and provided that the sole ultimate beneficiaries of such legal structure are family members, where the existence of the group pre-dates the establishment of the undertaking. This shall not prevent family members' joining the group after the undertaking has been established.

For the purpose of this definition, "family members" means the spouse of an individual, the person who is living with an individual in a committed intimate relationship, in a joint household and on a stable and continuous basis, the relatives in direct line, the siblings, uncles, aunts, first cousins and the dependents of an individual.

- *"a number of investors"*

For the purposes of the reference to "a number of investors" within the AIF definition, ESMA notes that where the undertaking's national law, its rules or instruments of incorporation or any other provision or arrangement of binding legal effect do not prevent the undertaking from raising capital from more than one investor, the undertaking should be regarded as an undertaking which raises capital from a number of investors. This should be the case even if it has in fact only one investor.

It goes on to explain however, that in the case of an undertaking which is prevented by its national law, the rules of instruments of incorporation, or any other provision or arrangement of binding legal effect, from raising capital from more than one investor, it should be regarded as an undertaking which raises capital from a number of investors if the sole investor:

(a) invests capital which it has raised from more than one legal or natural person with a view to investing it for the benefit of those persons; and

(b) consists of an arrangement or structure which in total has more than one investor for the purposes of the AIFMD.

Examples of such arrangements or structures include master/feeder structures where a single feeder fund invests in a master undertaking, fund of funds structures where the fund of funds is the sole investor in the underlying undertaking, and arrangements where the sole investor is a nominee acting as agent for more than one investor and aggregating their interest for administrative purposes.

- *"defined investment policy"*

The Key Concept Guidelines also set out a series of factors which would, singly or cumulatively, tend to indicate the existence of a "defined investment policy" as follows:

(i) the investment policy is determined and fixed, at the latest by the time that investors' commitments to the undertaking become binding on them;

(ii) the investment policy is set out in a document which becomes part of or is referenced in the rules or instruments of incorporation of the undertaking;

(iii) the undertaking or the legal person managing the undertaking has an obligation (however arising) to investors, which is legally enforceable by them, to follow the investment policy, including all changes to it;

(iv) the investment policy specifies investment guidelines, with reference to criteria including any or all of the following:

(a) to invest in certain categories of assets, or conform to restrictions on asset allocation;

(b) to pursue certain strategies;

(c) to invest in particular geographical regions;

(d) to conform to restrictions on leverage;

(e) to conform to minimum holding periods; or

(f) to confirm to other restrictions designed to provide risk diversification.

It is important to give careful consideration to these issues in the context of considering whether a particular fund is or is not an AIF given that the obligations imposed on AIFMs result directly from the activity of "managing one or more AIFs".

One note of warning - ESMA has also stated that competent authorities and market participants should not consider that the absence of all or any one of the characteristics under each of the concepts in the definition of "AIF" (i.e. "collective investment undertaking", "raising capital", "number of investors" and "defined investment policy), as set out in the Guidelines, conclusively demonstrates that an undertaking does not fall under the relevant concept. Competent authorities and market participants should consider an undertaking to be an "AIF" if the presence of all the concepts in the definition is otherwise established.

2.2 Who is or can be an AIFM?

The Directive defines "AIFMs" as legal persons whose regular business is "managing" one or more "AIFs". Depending on the structure of the AIF, there may be more than one legal entity which could be appointed as AIFM to the AIF. However, there can only be one AIFM to an AIF. The Directive provides that the AIFM shall be either:

- an external manager, which is the legal person appointed by the AIF or on behalf of the AIF and which, through this appointment, is responsible for managing the AIF (referred to as an external AIFM); or

- the AIF itself, where its legal form of the AIF permits an internal management and where the AIF's governing body chooses not to appoint an external AIFM. In such a case, the AIF shall then be authorised as the AIFM (referred to as an internally managed AIF).

There are no provisions in the Directive which impose particular conditions or criteria on the AIF for the appointment or selection of the AIFM. The AIF is free to appoint any legal person as AIFM, provided that that entity is authorised under the Directive.

AIFM of Irish QIAIF

It is worth revisiting who might be the chosen AIFM for an Irish qualifying investor AIF ("**QIAIF**"), the Irish fund vehicle which is the most suitable AIF structure. Options might include:

- an external AIFM authorised in Ireland by the Central Bank;

- an external AIFM authorised by a competent authority of another EU Member State (managing on a direct or branch basis);

- a self-managed QIAIF investment company (i.e. as an internally managed AIF);

- the management company of a QIAIF unit trust or CCF (authorised as an external AIFM);

- a non-EU AIFM authorised by the Central Bank.

Dual AIFM/UCITS authorisation

An AIFM may also act as a UCITS management company if it also holds an authorisation under the UCITS Directive. A UCITS management company which manages an AIF will not be subject to the UCITS Directive for that activity but will instead be required to obtain an additional authorisation under the AIFMD.

It will also be possible for a UCITS management company authorised for individual portfolio management under the UCITS Directive to provide services such as portfolio management to AIFs (ie. under a delegation arrangement) but not to have to be appointed as the AIFM. For such an activity, the UCITS management company would not be authorised under

AIFMD but would continue to be authorised under the UCITS Directive. Remember, however, that to obtain a UCITS management company authorisation, the entity must manage at least one UCITS.

- *MiFID firms*

MiFID firms and credit institutions cannot be the appointed AIFM for an AIF or obtain authorisation under the AIFMD. A dual authorisation is only permitted in the case of a UCITS management company.

If an entity which currently holds a MiFID portfolio management authorisation is contemplating giving up its MiFID authorisation and converting to AIFM status, it should bear in mind that it will lose the capacity to utilise a passport for cross - border individual portfolio management of clients other than AIFs. It can still be authorised for individual non-AIF portfolio management but, unlike under UCITS and MiFID, that is not a passportable activity under AIFMD.

MiFID firms and credit institutions are not, however, required to obtain authorisation under the AIFMD to provide investment services such as individual portfolio management to or in respect of AIFs as they can be authorised to provide such services under MiFID in any event. This allows MiFID firms and credit institutions to continue to provide MiFID services such as portfolio management and investment advice to AIFs under delegation arrangements, subject to the rules on delegation.

MiFID firms may however only offer/place units/shares of an AIF with investors in the EU (ie. as a distributor/placement agent) to the extent that such units/shares can be marketed in accordance with the Directive.

2.3 What is "managing AIFs" under the Directive?

The term "managing AIFs" is defined as "performing at least investment management functions referred to in point 1(a) [*portfolio management*] or (b) [*risk management*] of Annex I of the Directive for one or more AIFs".

- *Annex I Services*

The Annex I investment management services are:

- portfolio management;
- risk management.

Although only one of these activities needs to be present in order to render an entity an AIFM, an AIFM cannot be authorised to carry out portfolio management without also providing risk management and vice versa.

Provided that it is doing so in the course of its collective management of an AIF, an authorised AIFM may also perform the following additional Annex I functions:

- administration:

  (i) legal and fund management accounting services;
  (ii) customer inquiries;
  (iii) valuation and pricing, including tax returns;
  (iv) regulatory compliance monitoring;
  (v) maintenance of unit/shareholder register;
  (vi) distribution of income;
  (vii) unit/shares issues and redemptions;
  (viii) contract settlements, including certificate dispatch;
  (ix) record keeping;

- marketing;

- activities related to the assets of AIFs, namely 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 in which it has invested.

When reference is made to "**Annex I**" services, that is a reference to at least investment management (portfolio management / risk management) but also covers the administration, marketing and other activities related to the assets of AIFs, referenced above.

Other Services

The Directive also provides that an AIFM should not be prevented from:

- acting as a UCITS management company, or

- providing individual portfolio management in accordance with mandates given by investors on a discretionary client-by-client basis, or

- providing "non-core" services of investment advice; safe-keeping and administration in relation to units of collective investment undertakings; or reception and transmission of orders in relation to financial instruments.

In each case, the AIFM would need to be authorised for these additional activities either under AIFMD or under the UCITS Directive. Non-core services can only be provided where the AIFM is authorised to provide individual portfolio management.

Somewhat bizzarely, unlike the position under UCITS or under MIFID, an AIFM which is also authorised to provide individual portfolio management does not have any capacity to use a passport to provide that service into other EU Member States. Its capacity to provide such services to clients in Member States, other than its own Member State, will depend on the laws of that other Member State. This is a significant problem for entities currently authorised under the MIFID regime who may be contemplating converting their authorisation to an AIFM authorisation. They may need to contemplate, instead, either keeping their MIFID authorisation and setting up a new AIFM or else converting to AIFM status and seeking a dual UCITS authorisation (but that is only available if they actually "manage" UCITS structures).

- *Internally managed AIF*

An internally managed AIF is only permitted to perform the functions listed in Annex I to the AIFMD Regulations.

- *Authorised v Registered*

An AIFM "authorised" in one EU Member State can manage AIFs established in other EU Member States, provided that it is authorised to manage that type of AIF. A "registered" AIFM cannot do so, however. It can only manage AIFs established in its own Member State.

2.4 What is "marketing" under the Directive?

The activity of "marketing" is defined under the Directive "*a 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 or with a registered office in the [European] Union*".

As it says, it covers both direct and indirect offerings or placements and not only covers activities of the AIFM but also those of others such as intermediaries or placement agents acting "on behalf of the AIFM". However, we do not consider it to apply to "reverse solicitation" (i.e. where the applicant for shares approaches the AIFM on its own initiative).

Caution is advised if seeking to rely on a reverse solicitation argument. The AIFM would, we believe, need to consider whether it had, for example, followed up with prospective investors after a conference or road show or it had corresponded with prospective investors in a way which would be considered "indirect" offering or placement. It would also need to take care in preparing offering and marketing materials, web portals etc. to ensure express and appropriate selling restrictions are included.

2.5 What is the marketing "passport"?

From July 22, 2013, an EU authorised AIFM will have a "**passport**" to freely market its EU domiciled AIFs to "**professional investors**" in its own Member State and in other EU Member States, subject to a straightforward notification process. In other words, once the AIFM is authorised in one EU Member State it does not need any further authorisation in any other EU Member State to market its EU AIFs to professional investors in the other Member States. Unlike UCITS, the passport does not attach to the AIF as it is a passport granted to the AIFM.

Note that a "*professional investor*" is any investor which is considered to be a professional client or may be treated as a professional client on request within the meaning of Annex II of Directive 2004/39/EC (i.e. the "**MiFID Directive**"). Such investors comprise:

(a) credit institutions

(b) investment firms

(c) other authorised or regulated financial institutions

(d) insurance companies

(e) collective investment schemes and management companies of such schemes

(f) pension funds and management companies of such funds

(g) commodity and commodity derivatives dealers

(h) locals

(i) other institutional investors

(j) large undertakings meeting two of the following size requirements on a company basis:

- balance sheet total: EUR 20,000,000

- net turnover: EUR 40,000,000

- own funds: EUR 2,000,000.

(k) national and regional governments, public bodies that manage public debt, Central Banks, international and supranational institutions such as the World Bank, the IMF, the ECB, the EIB and other similar international organisations.

(l) other institutional investors whose main activity is to invest in financial instruments, including entities dedicated to the securitisation of assets or other financing transactions.

(m) clients other than those mentioned in sections (a) to (l) above, including public sector bodies and private individual investors, who, as a minimum, meet two of the following criteria and have opted to be treated as a professional client:

- the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters,

- the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds EUR 500,000,

- the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

Marketing to Retail Investors

Individual Member States may also allow marketing of AIFs to retail investors within their own territories and in this regard may impose stricter requirements on the AIF or AIFM than required by the Directive.

2.6 Closed-Ended AIFs

Whilst the term "closed-ended" is used in the Directive, the term is not defined in the Directive. Rather, ESMA has in its "Draft regulatory technical standards on types of AIFMs" ("**RTS**") provided definitions of "an AIFM of open-ended AIF(s)" and of "an AIFM of closed-ended AIF(s)”. These terms are to be included in a further Level 2 Commission Delegated Regulation.

The relevance of these definitions is to the correct application of the Directive’s rules on liquidity management, the valuation procedures and the Directive’s transitional provisions. These definitions are relevant only for AIFMD purposes.

The ESMA RTS provide that an “*AIFM of open-ended AIF(s)*” shall be considered to be an AIFM which manages at least one AIF, some or all of whose unitholders or shareholders have the right to redeem their units or shares out of the assets of the AIF where all of the following conditions are present:

(i) the right to redeem may be exercised at least once a year; and

(ii) in accordance with the rules or instrument of incorporation of the AIF or any prospectus the redemption is to be carried out at a price that, before any redemption fee is applied, does not vary significantly from the net asset value per unit/share of the AIF available at the time when the price is determined in accordance with the rules or instrument of incorporation of the AIF.

For the purposes of (i) above, action taken by the AIFM to ensure that the stock exchange value of the units/shares of the AIF(s) it manages does not significantly vary from their net asset value shall be regarded as equivalent to the right to redeem out of the assets of the AIF and no account is to be taken of any of the following:

(a) any holding period provided for in the rules or instrument of incorporation of the AIF or any prospectus during which unitholders/shareholders shall not have the right to redeem their units or shares out of the assets of the AIF, whether that period is set with reference to the date of creation of that AIF or the date of commencement of its activities;

(b) any power provided for in the rules or instrument of incorporation of the AIF or any prospectus to restrict exercise of the right to redeem, in so far as that power, whether it is exercised or not, applies any special arrangements, such as side pockets, gates, suspensions or other similar arrangements arising from the illiquid nature of the AIF’s assets.

An “*AIFM of closed-ended AIF(s)*” shall be an AIFM which manages at least one AIF <u>other</u> than of the type described above.

3. Managing and Marketing AIFs under AIFMD

The main focus of the AIFMD is on AIFMs who manage AIFs and/or market AIFs. In the previous Section of this Guide we have explained what is meant by "managing AIFs" and what is meant by "marketing AIFs". In this Section we address the different capacities available (and when available) to EU AIFMs to manage and / or market AIFs (wherever domiciled) in the EU.

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3.1 EU authorised AIFM marketing EU AIFs in the EU

The rights of an EU AIFM to market EU AIFs in the EU are dealt with in Chapter 6 of the Directive. In summary, an AIFM which is established in an EU Member State and which has been authorised by the competent regulatory authority in that Member State will have the right under the Directive to:

(i) market shares of any EU AIF that it manages to professional investors in the AIFM's home Member State, subject to providing a prescribed notification file to its home EU Member State regulator; and

(ii) market shares of an EU AIF that it manages to professional investors in another EU Member State, subject to providing a prescribed notification file to its home EU Member State regulator (i.e. the marketing passport).

The home EU Member State regulator may only prevent marketing of shares in EU AIFs where the information provided in the notification demonstrates that the AIF concerned will not be managed in accordance with the Directive.

Where the EU AIF is a feeder AIF *(i.e. one which invests not less than 85% of its assets in shares of another AIF or invests at least 85% of its assets in more than one master AIF where those master AIFs have identical investment strategies or has otherwise an exposure of at least 85% of its assets to one or more such master AIF)*, then the right to market referred to above is subject to the condition that the master AIF is also an EU AIF and is managed by an authorised AIFM.

3.2 EU authorised AIFM managing EU AIFs in the EU

The Directive enables an EU AIFM, authorised in one EU Member State, to manage EU AIFs established in any other EU Member State and it can do so "either directly or by establishing a branch, provided that the AIFM is authorised to manage that type of AIF". The process to be followed to enable an authorised AIFM manage an AIF in another EU Member State directly or by establishing a branch is reasonably similar to freedom of services/branch establishment provisions of MIFID.

An AIFM intending to manage EU AIFs established in another Member State for the first time must communicate the following information to the competent authorities of its home Member State:

(a) the Member State in which it intends to manage AIFs directly or establish a branch;

(b) a programme of operations stating in particular the services which it intends to perform and identifying the AIFs it intends to manage.

If the AIFM intends to establish a branch, it must provide the following information, in addition to that referred to above:

(a) the organisational structure of the branch;

(b) the address in the home Member state of the AIF from which documents may be obtained; and

(c) the names and contact details of the persons responsible for the management of the branch.

The AIFM's home Member State competent authorities shall, within 1 month of receiving the complete services documentation or within 2 months of receiving the complete branch documentation, transmit the complete documentation to the competent authorities of the host Member State of the AIFM (i.e. into which it is providing the service). Such transmission shall occur only if the AIFM's management of the AIF complies, and will continue to comply, with the Directive and the AFIM otherwise complies with the Directive.

The AIFM's home Member State competent authorities shall enclose a statement to the effect that the AIFM concerned is authorised by them and shall immediately notify the AIFM about the transmission. Upon receipt of the transmission notification, the AIFM may start to provide its services in its host Member State.

The host Member State of the AIFM must not impose any additional requirements on the AIFM concerned in respect of the matters covered by the Directive.

3.3 EU authorised AIFM managing a non-EU AIF which is not marketed in the EU

The Directive allows an authorised EU AIFM to manage non-EU AIFs which are not marketed in the EU provided that:

(i) the AIFM complies with all the requirements of the Directive (except for Article 21 and Article 22 – see below) in respect of those AIFs; <u>and</u>

(ii) appropriate EU co-operation arrangements are in place between the regulator of the AIFM's home Member State and the supervisory authority of the third country where the AIF is established in order to ensure an efficient exchange of information to allow the AIFM's home EU Member State regulator to carry out its duties.

Article 21 and 22 of the Directive deal, respectively, with the requirement for an AIF to have a depository and for each AIF to publish an annual audited set of financial statements to be made available to investors and the AIFM's home EU Member State regulator.

For more detail on "co-operation arrangements" see Section 3.11 below.

3.4 EU authorised AIFM marketing its non-EU AIFs in the EU under each Member State's individual private placement rules (up to at least 2018)

The Directive provides that each EU Member State may allow an authorised EU AIFM to market a non-EU AIF to professional investors in that EU Member State under that EU Member State's own national private placement rules, **without a passport**, provided that:

(i) the AIFM complies with all of the requirements of the Directive with the exception of Article 21 but subject to a requirement that one or more entities are appointed to carry out the basic custody requirements set out in Article 21 (including safe-keeping of assets and supervision of specific administrative type management functions);

(ii) there is a co-operation arrangement for the purpose of systemic risk oversight between the regulator of the home EU Member State of the AIFM and the supervisory authority of the third country where the AIF is established; and

(iii) the third country where the AIF is established is not listed as a non-co-operative country and territory by the Financial Action Task Force on anti-money laundering and terrorist financing.

The Directive envisages that in 2015 ESMA will issue an opinion on the functioning of the European passport then in force and on the functioning of national private placement regimes and an advice on the extension of the European passport to EU AIFMs marketing non-EU AIFs in the European Union and to non-EU AIFMs managing and/or marketing AIFs in the European Union.

If ESMA considers that there are no significant obstacles regarding matters such as investor protection, market disruption and distortion in competition impeding the application of the European passport to the marketing of non-EU AIFs by EU AIFMs or the management and/or marketing of AIFs by non-EU AIFMs in the Member States, then it will issue a positive advice.

Based on this advice, the Commission should adopt rules within three months specifying the date when the European passport shall be available to EU AIFMs in respect of their non-EU AIFs and to non-EU AIFMs in respect of their management and/or marketing of AIFs in the EU.

In summary, the Directive envisages that, subject to a favourable opinion by ESMA, authorised EU AIFMs shall, no earlier than 2015, be entitled to market non-EU AIFs managed by them to EU professional investors using an EU marketing passport. The Directive envisages that three years after the European passport becomes available to EU AIFMs marketing non-EU AIFs in the European Union and to non-EU AIFMs managing and/or marketing AIFs in the European Union (i.e. 2018, assuming the European passport becomes available to such AIFMs in 2015), ESMA will issue an opinion on the functioning of the European passport for such AIFMs and on the continuing functioning of the national private placement regimes and an advice on the termination of such national regimes.

If ESMA considers that there are no significant obstacles regarding matters such as investor protection, market disruption, monitoring of systemic risk and distortion in competition impeding the termination of the national private placement regimes and to maintain the availability of the European passport for the marketing of non-EU AIFs by EU AIFMs or the management and/or marketing of AIF by non-EU AIFM in the EU Member States, then it will issue a positive advice.

Based on this advice, the Commission is meant to adopt rules within three months thereafter specifying the date when the national regimes will terminate and the European passport will become the sole and mandatory regime applicable in all EU Member States.

3.5 EU authorised AIFMs marketing non-EU AIFs in the EU under the European passport (available no sooner than 2015 and only if ESMA agrees)

Subject to ESMA having issued the favourable advice referred to above, and the European Commission having adopted the appropriate rules, the Directive provides that an EU authorised AIFM may market its non-EU AIFs in the EU under the European passport provided that;

(i) the AIFM complies with all of the requirements of the Directive with the exception of Chapter 6 (which applies to EU AIFMs managing and marketing EU AIFs);

(ii) the jurisdiction where the non-EU AIF is established has appropriate co-operation arrangements in place with the AIFM's home EU Member State regulator;

(iii) the jurisdiction where the non-EU AIF is established is not listed as a non-co-operative country and territory by the Financial Action Task Force; and

(iv) the jurisdiction where the non-EU AIF is established has a tax agreement in place with the home EU Member State of the AIFM which complies with the OECD Model Tax Convention.

There is a facility under the Directive for another EU Member State to disagree with the assessment made under (i) and (ii) above by the AIFM's EU home Member State regulator, in which case the matter may be referred to ESMA.

The national private placement regimes (if any), as mentioned above, will continue to be in place until at least 2018.

3.6 Non-EU AIFMs managing only non-EU AIFs which are not marketed in the EU

The Directive does not apply to such AIFMs.

3.7 Non-EU AIFMs managing EU AIFs none of which are marketed in the EU

It would appear that, by virtue of Article 68(1) and Article 67(6) of the Directive, such AIFMs may not be subject to the Directive until Article 37 of the Directive comes into force, which is not until a positive opinion is issued by ESMA on the extension of the European passport to EU AIFM marketing non-EU AIF in the European Union and to non-EU AIFM managing and/or marketing AIF in the European Union.

Whereas Article 37 provides that non-EU AIFMs which seek to manage EU AIFs (whether or not such AIFs are marketed in the EU) must obtain the prior authorisation of the regulator of the EU "Member State of reference" (i.e. either the Member State in which the AIF is established or the Member State in which the AIF is principally marketed), Article 68(1) and Article 67(6), taken together, appear to mean that Article 37 (among other "third country" provisions) will only apply, subject to a favourable opinion by ESMA, from 2015.

However, as noted in Section 1.5 of this Guide, the Central Bank has indicated that it will accept applications for such non-EU AIFMs from July 22, 2013.

3.8 Non-EU AIFMs marketing non-EU AIFs into an EU Member State under that Member State's individual private placement rules (up to at least 2018)

The Directive provides that each EU Member State may allow non-EU AIFMs to market a non-EU AIF to professional investors in that Member State under that Member State's own national private placement rules (i.e. without a passport) provided that:

(i) the AIFM complies with Articles 22, 23 and 24 in respect of each AIF marketed by the AIFM in that way and with Section 2 of Chapter V of the Directive where an AIF marketed in that way falls under the description of Article 26, paragraph 1;

(ii) there is a co-operation arrangement for the purpose of systemic risk oversight between the regulator of the EU Member State where the AIF is marketed, the supervisory authorities of the third country where the non-EU AIFM is established and the supervisory authority of the third country where the AIF is established; and

(iii) the third country where the AIF is established is not listed as a non-cooperative country and territory by the FATF.

Article 22 deals with the requirement of AIFM to produce an annual audited set of financial statements for AIF which it manages and to deliver it to the investors and the home Member State regulator of the AIFM.

Article 23 deals with disclosure to investors of certain information prior to investment in the AIF as well as any material changes to that information, including a description of the investment strategy and objectives of the AIF, a description of all fees, charges and expenses directly or indirectly borne by investors, etc.

Article 24 provides for detailed reporting obligations to the home Member State, including as to the risk profile of the AIF, its risk management tools, the main categories of assets in which the AIF is invested and the overall level of leverage employed by the AIF.

3.9 Non-EU AIFMs marketing AIFs into an EU Member State under the European passport (available no sooner than 2015 and only if ESMA agrees)

Subject to ESMA having issued the favourable advice referred to in the previous sections, and the European Commission having adopted the appropriate rules, the Directive provides that a non-EU authorised AIFM may market its AIFs in the EU under the European passport provided that:

(i) the AIFM acquires a prior authorisation from the regulator of the "Member State of reference" and complies with all of the requirements of the Directive with the exception of Chapter VI (which applies to EU AIFMs managing and marketing EU AIFs);

(ii) the non-EU AIFM must have a legal representative in its Member State of reference which shall be the contact point of the AIFM in the EU and which shall perform the compliance function relating to the management and marketing activities performed by the AIFM under the Directive, in conjunction with the AIFM;

(iii) the jurisdiction where the non-EU AIFM is established has appropriate co-operation arrangements in place with the regulator of the AIFM's Member State of reference;

(iv) the jurisdiction where the non-EU AIFM is established is not listed as a non-cooperative country and territory by FATF;

(v) the jurisdiction where the non-EU AIFM is established has a tax agreement in place with the non-EU AIFM's home Member State of reference which complies with the OECD Model Tax Convention; and

(vi) the effective exercise by the European authorities of their supervisory functions under the Directive is not prevented by the laws or regulations or supervisory or investigative powers of the third country governing the AIFM.

In the case of a non-EU AIF, the following additional conditions apply:

(a) the jurisdiction where the non-EU AIF is established has appropriate co-operation arrangements in place with the AIFM's Member State of reference regulator;

(b) the jurisdiction where the non-EU AIF is established is not listed as a non-cooperative country and territory by the FATF; and

(c) the jurisdiction where the non-EU AIF is established has a tax agreement in place with the Member State of reference of the AIFM which complies with the OECD Model Tax Convention.

As part of its application for authorisation, the non-EU AIFM must suggest the Member State of reference which it believes to be relevant. The "**Member State of reference**" will be responsible for compliance with its management and marketing related obligations under the

Directive. The choice of the Member State of reference depends on the Member State in which the AIF is established and the Member State in which the AIF is principally marketed. ESMA is required to advise on the appropriateness of the choice of Member State of reference.

As part of its application for authorisation, the non-EU AIFM must supply a list of the provisions of the Directive for which compliance is impossible together with evidence that the relevant third country law provides equivalent rules with the same regulatory purpose and level of investor protection.

If compliance by the non-EU AIFM with a particular provision of the Directive would be incompatible with the law to which the non-EU AIFM is subject, the AIFM will be exempted from compliance with the provision of the Directive if it can show that it is impossible to comply with the Directive's provision and a mandatory provision of the law to which the non-EU AIFM is subject and the latter provision is equivalent to the Directive's provision having regard to its regulatory purpose and the level of investor protection to investors of the AIF which it provides. Again, ESMA is required to give advice on the appropriateness of exemption in case of incompatibility with an equivalent rule.

3.10 Member State of reference

Commission Implementing Regulation No. 448/2013 provides a procedure for determining the Member State of reference for a non-EU AIFM intending to manage EU AIFs without marketing them or intending to market AIFs (wherever domiciled) managed by it in the EU.

3.11 Co-operation Arrangements

ESMA has recently approved co-operation arrangements between EU securities regulators, with responsibility for the supervision of AIFs, and 34 of their global counterparts. ESMA has negotiated the agreements on behalf of all 27 EU Member State securities regulators as well as the authorities from Croatia, Iceland, Liechtenstein and Norway.

These arrangements are a key element in allowing EU securities regulators to supervise efficiently the way non-EU AIFMs comply with the rules of the AIFMD, and are a pre-condition in allowing non-EU AIFMs access to EU markets or to perform fund management activities on behalf of EU managers. These arrangements will apply to non-EU AIFMs that manage or market AIFs in the EU and to EU AIFMs that manage or market AIFs in third countries. The arrangements also cover co-operation in the cross-border supervision of depositaries and AIFMs' delegates.

The approved co-operation agreements are with the following third-country regulators: Alberta Securities Commission (Canada), Australian Securities and Investments Commission, Autorité des Marchés Financiers du Quebec (Canada), Bermuda Monetary Authority, British Columbia Securities Commission (Canada), British Virgin Islands Financial Services Commission, Capital Markets and Securities Authority of Tanzania, Capital Markets Authority of Kenya, Cayman Islands Monetary Authority, Comissão de Valores Mobiliários do Brasil, Conseil Déontologique des Valeurs Mobilières of Morocco, Dubai International Financial Centre Authority, Emirates Securities and Commodities Authority, Federal Reserve Board (US), Financial Services Commission of Mauritius, Financial Supervision Commission of the Isle of Man, Financial Supervisory Authority of Albania, Guernsey Financial Services Commission, Hong Kong Monetary Authority, Hong Kong Securities and Futures Commission, Israel Securities Authority, Jersey Financial Services Commission, Labuan Financial Services Authority, Monetary Authority of Singapore, Office of the Comptroller of the Currency (US), Office of the Superintendent of Financial Institutions (Canada), Ontario Securities Commission (Canada), Republic of Srpska Securities Commission, Securities and Exchange Board of India, Securities and Exchange Commission (US), Securities and Exchange Commission of Montenegro, Securities and Exchange Commission of Pakistan, Securities and Exchange Commission Thailand, and the Swiss Financial Market Supervisory Authority (FINMA).

The arrangements, which will apply from July 22, 2013, will facilitate the exchange of information, cross-border on-site visits and mutual assistance in the enforcement of the respective supervisory laws.

The key elements of the cooperation arrangements are:

- EU and non-EU authorities will be able to supervise fund managers that operate on a cross-border basis both within the EU and outside;

- The co-operation between authorities includes the exchange of information, cross-border on-site visits and assistance in the enforcement of the respective laws;

- EU securities regulators will be able to share relevant information received from non-EU authorities with other EU authorities, ESMA and the European Systemic Risk Board, provided appropriate safeguards apply;

- The existence of co-operation arrangements between the EU and non-EU authorities is a precondition of the AIFMD for allowing managers based outside the EU to access EU markets or perform fund management by delegation from EU managers; and

- The co-operation arrangements are applicable from 22 July 2013 and enable cross-border management and marketing to professional investors of alternative investment funds.

Although while ESMA has negotiated the memoranda of understanding (“ MoU”S) centrally, they are in fact bilateral agreements which must be signed between each EU securities regulator (i.e.in Ireland, the Central Bank) and the relevant non-EU authorities.

As the actual supervision of AIFMs lies with the national securities regulators, it is therefore for each individual Member State authority to decide with which non-EU authorities it will sign an MoU.

3.12 Private Placement

AiFMs seeking to privately place AIFs within the EU need to be aware that many EU jurisdictions may turn off or restrict their private placement regimes.

Although it is not currently certain which EU jurisdictions may decide to do so, it seems that those where private placement may not be available or may be restricted may include Germany, France, Italy, Spain and Finland. Further clarification may be available shortly.

To the extent that they do turn off or restrict private placement, that will make full AIFMD compliance necessary to access those markets.

4. Legislative Framework for AIFMD in Ireland

In this Section we outline the European legislative framework for AIFMD and its domestic implementation in Ireland, both of which continue to evolve.

Although the Directive and the Level 2 Regulation are finalised and a number of Implementing Regulations and Guidelines have been issued by the European Commission and ESMA, respectively, more are to follow and in some areas are still at consultation phase.

In Ireland, the Central Bank has issued its AIF Rulebook which sets out the conditions which will be applied to an Irish AIF and to an Irish AIFM and to other relevant Irish entities (depositaries, management companies and fund administrators) when an authorisation is issued. It has also issued a Q&A document which contains useful information as to how the Central Bank will address various different transitional scenarios. Certain matters do remain to be clarified which will be done either by means of updating the AIF Rulebook or through the Central Bank's Markets Updates (on its website). We also expect that it may clarify, or at least bring into a single document, certain previously indicated guidance which came out of its AIFMD consultation process.

We also await the Irish domestic implementing legislation and we expect certain amendments to existing Irish funds legislation as part of the AIFMD implementation.

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4.1 The European Framework

By way of background, the text of the Directive [EU Directive 2011/61/EU on Alternative Investment Fund Managers] was agreed in a trialogue meeting of October 26, 2010 between co-legislators, the European Council's Economic and Financial Affairs Council ('**ECOFIN**') and the European Parliament's Committee on Economic and Monetary Affairs ("**ECON**").

It was then agreed by the Committee of Permanent Representatives ("**COREPER**") on November 3, 2010 and was the subject of a successful plenary vote in the European Parliament on November 11, 2010. It was finally adopted on July 21, 2011, with Member States being given until July 22, 2013 to implement its provisions.

The Directive runs to over 200 pages and is divided into ten chapters covering:

Chapter 1: The scope of the Directive and exemptions

Chapter 2: Rules governing the authorisation of AIFM

Chapter 3: Operating conditions for AIFM (including principles of governance, risk management, liquidity management, valuation and custody)

Chapter 4: Transparency requirements

Chapter 5: Rules for AIFM managing specific types of AIF (leveraged AIF and private equity type AIF)

Chapter 6: The rights of EU AIFM managing and marketing EU AIF

Chapter 7: Third Country Rules

Chapter 8: Marketing to retail investors

Chapter 9: Designation of competent regulatory authorities; and

Chapter 10: Transitional and final provisions.

4.2 The Lamfalussy Process

AIFMD is subject to an EU legislative process known as the "Lamfalussy Process" involving:

(a) the adoption of the framework Directive by the European Council of Ministers and European Parliament ("**Level 1**");

(b) technical implementing measures adopted by the European Commission and approved by the European Securities Committee, in consultation with the European Parliament, on the basis of advice from the European Securities and Markets Authority ("ESMA") ("**Level 2**");

(c) recommendations from ESMA on interpretation to ensure consistent implementation and application ("**Level 3**"); and

(d) Commission enforcement of the timely and correct transposition of EU legislation into national law ("**Level 4**").

The Directive itself constitutes the Level 1 measure.

The principal Level 2 measures are contained in Commission Delegated Regulation (EU) 231/2013 of 19 December 2012 supplementing Directive 2011/611 EU of European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (referred to generally as the "**Level 2 Regulation**").

As of the date of issuance of this Guide, the Commission has issued two further Implementing Regulations. The first, Commission Implementing Regulation (EU) No. 474/2013, establishes the procedure for AIFMs which choose to "opt-in" under AIFMD. This applies to AIFMs which were either registered AIFMs under AIFMD or were authorised as UCITS management companies. The second, Commission Implementing Regulation (EU) No. 448/2013 establishes the procedure for determining the Member State of reference of a non-EU AIFM

The Level 3 measures are currently ESMA's Guidelines on sound remuneration policies under the AIFMD [ESMA 2013/201] ("**ESMA Remuneration Guidelines**") and its Final Report Guidelines on key concepts of the AIFMD [ESMA/2013/600] ("**ESMA Key Concepts Guidelines**") ESMA has also issued its draft regulatory technical standards on types of AIFMs ("**ESMA RTS**") and has issued the following consultation paper(s):

- Consultation paper, Guidelines on reporting obligations under Article 3 and Article 24 of the AIFMD [ESMA/2013/592].

The Commission has also published on its website a series of answers to specific questions on AIFMD matters (the "**Commission Q&A**") which is updated regularly.

4.3 Irish Legislation

The AIFMD is to be implemented into domestic Irish law by the European Communities (Alternative Fund Managers Directive) Regulations (S.I. No. [•] of 2013) (the "**AIFMD Regulations**"). In addition, the following pieces of domestic legislation are expected to be amended to facilitate AIFMD implementation:

(a) Part XIII, Companies Act, 1990 (as amended) – for variable capital investment companies;

(b) Unit Trusts Act, 1990 (as amended) – for unit trusts;

(c) Investment Limited Partnership Act, 1994 – for regulated investment limited partnership structure;

(d) Investment Funds, Companies and Miscellaneous Provisions Act, 2005 – for common contractual funds.

Ireland will also introduce legislation later this year facilitating a new form of investment fund structure to be known as the ICAV which will be a corporate structure but which will not be subject to many of the company law provisions which currently apply to Irish variable capital investment companies. In addition, a significant overhaul of the Irish investment limited partnership structure is envisaged, designed to bring that structure more in line with similar limited partnership structures in other jurisdictions.

4.4 The AIF Rulebook

The Central Bank of Ireland has issued its detailed AIF Rulebook which sets out the conditions which will be applied to Irish AIFs and AIFMs.

The AIF Rulebook deals with:

(a) Retail Investor AIF Requirements (Chapter 1);

(b) Qualifying Investor AIF Requirements (Chapter 2);

(c) AIFM Requirements (Chapter 3);

(d) AIF Management Company Requirements (Chapter 4);

(e) Fund Administrator Requirements (Chapter 5); and

(f) AIF Depositary Requirements (Chapter 6).

The main provisions of the AIF Rulebook are summarised later in Sections 9 and 10 of this Guide.

It is important to note that the AIF Rulebook does not include legislative requirements which apply directly. In addition, although the AIF Rulebook is stated to set out the rules which apply to the Central Bank authorised as AIFs and AIFMs, the "definitive rules" for each such AIF and AIFM will be set out in the letter of authorisation for the individual AIF or AIFM issued by the Central Bank.

4.5 Central Bank Guidance

The move from the current pre-AIFMD domestic Irish regime for non-UCITS funds to the new AIFMD regime will represent quite a fundamental change in approach, albeit phased in for existing funds over a transitional period.

To date, under the pre-AIFMD regime, we have had a detailed set of NU Notices, supplemented by Central Bank Guidance Notes. The NU Notices and Guidance Notes have addressed retail, professional and qualifying investor schemes across a broad range of fund types such as property funds, venture and development capital funds, fund of funds, feeder funds, futures and options funds, guaranteed funds, funds of unregulated funds etc.

AIFMD, however, does not regulate AIFs in that fashion. In fact, it is not designed to regulate AIFs at all (at least not directly) as its focus is on AIFMs. It does impose certain obligations (principally notification/disclosure and anti-asset stripping provisions) on what might usually be considered private equity funds, leverage disclosure (and regulatory intervention powers) and rules on acquiring securitisation provisions but otherwise does not impose rules relating to individual fund or strategy types.

As a result, once the new regime is fully implemented and all transitional periods have ended, the NU Notices/Guidance Notes will disappear and we will have, instead the AIFMD Regulations (the law) and the AIF Rulebook (the rules) plus guidance either via Q&A documents or the Central Bank's Markets Update.

Whereas the current pre-AIFMD regime has NU Notices/Guidance Notes on a wide range of fund types, under the new regime for QIAIFs (qualifying investor AIFs) the AIF Rulebook only deals with money market funds, with funds which invest more than 50% of net assets in another investment fund, and with the use of wholly owned subsidiaries. However, it is expected that a QIAIF's letter of authorisation will set out whatever other parameters applicable to the individual QIAIF are negotiated as part of its authorisation. These parameters may, for example, address matters such as investment in joint ventures, development capacities, investing partly by equity, party by loan etc.

5. AIFM Requirements

The AIFMD is, as its name suggests, principally focused on the alternative investment fund manager or AIFM. It imposes limitations on the activities which an AIFM can carry on, obligations regarding how an AIFM conducts its business, organisational and capital requirements, rules around delegation generally and delegation of investment management functions specifically as well as other obligations in areas such as risk and liquidity management, record keeping, financial control and conflicts of interest. These requirements have the Directive as their source, are explained in granular detail in the Level 2 Regulation, are the subject of additional Implementing Regulations (such as for the opt-in procedure and Member State of reference) and Guidelines (such as the ESMA Remuneration Guidelines) and continue to be subject to consultation in certain areas.

As seen in previous Sections, there are different types of AIFM, including an authorised AIFM, a registered AIFM, an external AIFM and a internally managed AIF which is also an AIFM. We have addressed registered AIFM's separately but otherwise, save where indicated, the obligations summarised in this section apply to authorised EU AIFMs and given that this is a Guide to AIFMD in Ireland, this Section assumes the AIFM will be <u>an Irish authorised AIFM</u> or <u>Irish authorised internally managed AIF</u>.

Irish AIFMs will be subject to the Irish domestic implementing AIFMD Regulations and the Central Bank's AIF Rulebook and, upon authorisation by the Central Bank, the "definitive rules" (but not legislation) to which an Irish AIFM will be subject will be set out in its letter of authorisation.

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5.1 Permitted Activities

The permitted activities of AIFMs are set out in Section 2 of this Guide.

5.2 Who can apply?

An applicant for authorisation by the Central Bank as an AIFM must be a body corporate which has its registered and head office in Ireland. It must comply with the capital requirements set out below and its shareholders (other than in the case of internally managed AIF), its directors and its managers must comply with Irish fitness and probity requirements.

Its directors and managers must be sufficiently experienced in relation to the types of AIF that it intends to manage and its group structure must be such as not prevent effective supervision by the Central Bank. The Central Bank must also be satisfied prior to granting an authorisation that the AIFM will be in a position to meet with the conditions imposed under both the Irish AIFMD Regulations and the Level 2 Regulation.

5.3 Capital Requirements

An AIFM (other than an internally managed AIF) must have at all times a minimum capital requirement which is the higher of:

(i) initial capital of at least EUR 125,000 ("Initial Capital Requirement") plus the Additional Amount (if required), as set out below; or

(ii) one quarter of its total expenditure taken from the most recent annual accounts ("Expenditure Requirement");

plus, if relevant, own funds appropriate to cover potential liability risks from professional negligence ("Additional Own Funds") or hold appropriate professional indemnity insurance cover against such liability. The Level 2 Regulation explains that the professional liability risks to be covered are risks of loss or damage caused by a relevant person through the negligent performance of activities for which the AIFM has legal responsibility. It also sets out a non-exhaustive list of such professional liability risks and how they can be covered through additional own funds or through professional indemnity insurance.

When the net asset value of its AIFs under management exceeds EUR 250 million, an AIFM must provide an additional amount of own funds equal to 0.02% of the amount by which the net asset value exceeds EUR 250 million ("Additional Amount"). An AIFM need not, however, provide up to 50% of the Additional Amount if it benefits from a guarantee of the same amount given by a credit institution or insurance undertaking and the form of guarantee is approved by the Central Bank. The total of the Initial Capital Requirement and the Additional Amount required to be held by an AIFM is subject to a maximum of EUR 10 million.

The AIFM must hold the Minimum Capital Requirement, the Additional Amount and Additional Own Funds in liquid assets or assets readily convertible to cash in the short term and must not include speculative positions.

In the case of an internally managed AIF (such as a self-managed QIAIF investment company), the minimum initial capital requirement for an internally managed AIFM (e.g. self-managed QIAIF) is EUR 300,000. It is not subject to any additional expenditure or additional amount requirements but is subject to the requirement to have additional own funds or insurance cover as outlined above to cover potential professional liability risks.

5.4 Operating Conditions

Similar to obligations imposed on MiFID firms and on UCITS management companies, AIFMs are subject to conduct of business type operating conditions which require that they:

(i) act honestly, with due skill, care and diligence and fairly in conducting their activities;

(ii) act in the best interests of the AIFs or the investors of the AIFs they manage and the integrity of the market;

(iii) have and employ effectively the resources and procedures that are necessary for the proper performance of their business activities;

(iv) take all reasonable steps to avoid conflicts of interest and, when they cannot be avoided, to identify, manage and monitor and, where applicable, disclose, those conflicts of interest in order to prevent them from adversely affecting the interests of the AIFs and their investors and ensure that the AIFs they manage are fairly treated;

(v) comply with all regulatory requirements applicable to the conduct of their business activities so as to promote the best interests of the AIFs and the investors of the AIFs they manage and the integrity of the market; and

(vi) treat all AIF investors fairly.

The Directive states that no investor in an AIF can obtain preferential treatment, unless such preferential treatment is disclosed in the relevant AIF’s rules or constitutional document. AIFMs are also subject to disclosure to investors obligations regarding preferential treatment, as summarised in Section 7 of this Guide.

The Level 2 Regulation expands upon each of the above general principles in considerable detail. In summary, the Level 2 Regulation requires AIFMs:

(a) to apply policies and procedures for preventing malpractices (including those that might reasonably be expected to affect adversely the stability and integrity of the market) and to ensure that the AIFs they manage or the investors in such AIFs are not charged undue costs (*duty to act in best interests*);

(b) to apply a high standard of diligence in the selection and ongoing monitoring of investments, to have adequate knowledge/understanding of the assets invested in; to have and implement and update written due diligence policies and procedures to ensure investment decisions are carried out in compliance with the objectives / strategies / risk limits of the AIFs; and set out additional due diligence obligations when investing in assets of limited liquidity and when selecting and appointing counterparties and prime brokers (*due diligence*);

(c) to be able to demonstrate that the AIFM's governing body has adequate knowledge, skill and experience to understand the AIFMs activities, risks and the assets its AIFs invest in; that the members of the governing body act with honesty, integrity and independence of mind and commit sufficient time to properly perform their functions (*acting honestly, fairly and with due skills*);

(d) to employ sufficient personnel with the skills, knowledge and expertise necessary for discharging their allocated responsibilities, taking into account the nature, scale and complexity of the AIFM's business and the nature and range of services / activities undertaken in the course of that business (*resources*);

(e) to ensure that its decision making procedures and organisational structure ensure fair treatment of investors and that any preferential treatment afforded to one or more investors shall not result in an overall material disadvantage to other investors (*fair treatment*).

The Level 2 Regulation also applies MiFID like rules relating to inducements paid or received, including disclosure obligations; order handling rules; reporting obligations in respect of execution of investor subscription and redemption orders; best execution obligations and rules; rules regarding the placement of orders to deal on behalf of AIFs with other entities for execution; as well as rules relating to trading orders aggregation and allocation.

5.5 Organisational Requirements

AIFMs are also subject to a series of organisational requirements which require an AIFM to use, at all times, adequate and appropriate human and technical resources necessary for the proper management of the AIFs it manages.

An AIFM must, having regard to the nature of the AIFs under management, have sound administrative and accounting procedures and control and safeguard arrangements for electronic data processing. It must also have adequate internal control mechanisms including, in particular, rules for personal transactions by its employees or for the holding or management of investments in order to invest on its own account. It is also required to have mechanisms to ensure that each transaction involving the AIFs under management may be reconstructed according to its origin, the parties to it, its nature, and the time and place at which it was effected and to ensure that the assets of the AIFs managed by the AIFM are invested in accordance with the AIF's constitutional document and legal provisions in force.

The organisation of an AIFM must be structured such that no one person can decide on the direction of the AIFM without the endorsement of another and decision making procedures and an organisational structure which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities must be established, implemented and maintained.

Contained within the section of the Directive dealing with organisational requirements are general principles and the valuation requirements. These are expanded upon in the Level 2 Regulation which sets out in detail obligations regarding decision making procedures, organisational structure, internal controls and reporting and communication of information and records maintenance, which should take into account the nature, scale and complexity of the AIFM's business and the nature and range of services and activities undertaken. We do not further summarise here the Level 2 Regulation treatment of the organisational requirements.

For Irish authorised AIFMs, the Central Bank has set out in its AIF Rulebook that, in accordance with good corporate governance principles, the board of directors of an AIFM is responsible for the following managerial functions:

(i) *decision making*: The board must have clear responsibility and competence in relation to all material decisions affecting the operation and conduct of the business of the AIFM;

(ii) *monitoring of investment policy, investment strategies and performance*: The board must put in place procedures to ensure and verify that the investment policies and strategies of each AIF are complied with and to ensure availability of up to date information on portfolio performance;

(iii) *monitoring compliance*: The board must put in place procedures designed to ensure compliance with all applicable legal and regulatory requirements of the AIFM itself and all AIFs under management;

(iv) *risk management;* The board must put in place procedures designed to ensure that all applicable risks pertaining to the AIFM and to AIFs under management can be identified, monitored and managed at all times;

(v) *liquidity management*: The board must put in place procedures designed to ensure that all applicable liquidity risks pertaining to the AIFs under management can be identified, monitored and managed at all times;

(vi) *operational risks*: The board must put in place procedures designated to ensure that all applicable operational risks pertaining to the AIFM can be identified, monitored and managed at all times;

(vii) *conflicts of interest*: The board must put in place procedures designed to ensure that all applicable conflicts of interest pertaining to the AIFM and to the AIFs under management can be identified, monitored and managed at all times;

(viii) *supervision of delegates*: The board must have clear structures in place for the ongoing monitoring of work delegated to third parties;

(ix) *financial control*: The board must put in place procedures to ensure all relevant accounting records of the AIFM and of the AIFs under management are properly maintained and are readily available, including production of annual and half-yearly financial statements;

(x) *monitoring of capital*: The board must put in place procedures to ensure compliance with capital adequacy requirements;

(xi) *internal audit*: The board must put in place procedures to ensure effective internal audit procedures for the AIFM and for AIFs under management;

(xii) *complaints handling*: The board must have arrangements in place to ensure that complaints from investors are addressed promptly and effectively;

(xiii) *accounting policies and procedures*: The board must have procedures in place to ensure that proper accounting policies and procedures are employed in respect of the AIFM and all AIFs under management;

(xiv) *recordkeeping*: The board must put in place procedures designed to ensure that all recordkeeping requirements pertaining to the AIFM and to the AIFs under management can be complied with at all times;

(xv) *remuneration*: The board must put in place remuneration policies designed to ensure that any relevant conflicts of interest can be managed appropriately at all times; and

(xvi) *AIFMD reporting process*: The board must put in place procedures designed to ensure that the AIFM complies with its obligations under the AIFMD Regulations to report to the Central Bank.

Delegates to be appointed by the AIFM must be approved by the board of the AIFM acting in good faith in the interests of the AIFs under management. Where an AIFM delegates activities, its programme of activity (a document which sets out its organisational structure and reporting procedures as outlined in further detail later in this Section) shall identify the board member or other individual ("**designated persons**") who will, on a day-to-day basis, monitor and control each of the individual activities identified above. The board of the AIFM must formally adopt a statement of responsibility in relation to the functions and the procedures which will apply in each case.

The AIF Rulebook explains further that where an AIFM delegates activities, its programme of activity must provide for the following requirements in relation to the reports to be received by the designated person and the required action, in the context of each managerial function identified above:

(a) *types of reports received*: A list of reports which the designated person will receive from parties who have an involvement, by delegation or otherwise, in the performance of the function and the identity of those third parties;

(b) *frequency of the reports*: The provisions relating to frequency must include procedures for immediate reporting to the designated person of all material issues which arise;

(c) *action carried out*: Circumstances in which action by a designated person is required and procedures to be followed by the designated person in this event, including escalation to the board; and

(d) *exceptional Reporting*: In addition to (a) to (c), the programme of activity must also provide for the following:

- delegates are required to submit exceptional reports to the designated person in accordance with thresholds/trigger events which the board will from time to time determine, details of which are provided to the Central Bank;

- the programme of activity should set out details of thresholds/trigger events and procedures which must be adopted on receipt of exceptional reports;

- reports must be maintained where they can be subject to inspection by the Central Bank.

5.6 Conflicts of Interest

An AIFM must take all reasonable steps to identify conflicts of interest that arise in the course of managing AIFs between:

(i) the AIFM, including its managers, employees or any persons directly or indirectly linked to the AIFM by control, and the AIF managed by the AIFM or the investors in that AIF;

(ii) the AIF or the investors in that AIF, and another AIF or the investors in that AIF;

(iii) the AIF or the investors in that AIF, and another client of the AIFM;

(iv) the AIF or the investors in that AIF, and a UCITS managed by the AIFM or the investors in that UCITS; or

(v) two clients of the AIFM.

It must also maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to identify, prevent, manage and monitor conflicts of interest in order to prevent them from adversely affecting the interests of the AIFs and their investors. It is also obliged to segregate, within its own operating environment, tasks and responsibilities which may be regarded as incompatible with each other or which may potentially generate systematic conflicts of interest. AIFMs must also assess whether their operating conditions may involve any other material conflicts of interest and disclose them to the investors of the AIFs.

The Level 2 Regulation indicates the types of matters to be taken into account for the purpose of identifying the types of conflict of interest that arise in the course of managing AIFs. It also requires an effective written conflicts of interest policy to be established, implemented and applied, appropriate to the size and organisation of the AIFM and the nature scale and complexity of its business. This should take account, if part of a group, of circumstances where conflicts may arise involving other group members and should also address conflicts which may arise through use of delegates, external valuers and counterparties. The Level 2 Regulation also sets out further detail in relation to conflicts that may arise as between redeeming investors and those wishing to remain invested within open-ended AIFs and between an AIFM's incentive to invest in illiquid assets and the AIF's redemption policy. It also deals in greater detail with the AIFM's procedures and measures adopted for the prevention or management and monitoring of conflicts of interest, the disclosure of conflicts of interest and regarding strategies for the exercise of voting rights.

Where organisational arrangements made by an AIFM to identify, prevent, manage and monitor conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to investors' interests will be prevented, the AIFM is required to clearly disclose the general nature or sources of conflicts of interest to the investors before undertaking business on their behalf, and develop appropriate policies and procedures.

Where the AIFM on behalf of an AIF uses the services of a prime broker, the terms must be set out in a written contract and any possibility of transfer and reuse of AIF assets must be provided for in that contract and must comply with the AIF rules or instruments of incorporation. The contract must also provide that the depositary be informed of the contract.

5.7 Due Diligence

An AIFM must also have and implement an appropriate, documented and regularly updated due diligence process when investing on behalf of an AIF consistent with the investment strategy and the objectives and risk profile of the AIF. It is also required to ensure that it can properly identify, measure, manage and monitor on an ongoing basis (including through the use of appropriate stress testing procedures) the risks associated with each investment position of the AIF and the overall effect of those risks on the AIF's portfolio.

In addition, an AIFM is required to exercise due skill, care and diligence in the selection and appointment of prime brokers. The Central Bank has not set out specific credit rating or other criteria in respect of the appointment of counterparties and prime brokers. However, the AIFM is required to carry out due diligence on such entities, included ensuring that they are subject to ongoing supervision by a public authority, are of financial soundness and have the necessary organisational structure for the services provided. The prime brokers used must be approved by the board and a record of such entities must be maintained.

Where an AIFM on behalf of an AIF uses the services of a prime broker, the terms shall be set out in a written contract. In particular, any possibility of transfer and reuse of AIF assets shall be provided for in that contract and shall comply with the AIF constitutional document.

The contract shall provide that the depositary be informed of the contract.

5.8 Risk Management

AIFMs are required to implement adequate risk management systems to identify, measure, manage and monitor appropriately all risks relevant to each AIF investment strategy and to which each AIF is or may be exposed. The risk management systems must be reviewed by the AIFM with appropriate frequency, but at least annually, and adapt them whenever necessary. The functions of risk management should be functionally and hierarchically separate from the operating units, including from the functions of portfolio management, in accordance with the principle of proportionality.

The AIFM must also ensure that the risk profile of the AIF corresponds to the size, portfolio structure and investment strategies and objectives of the AIF as laid down in the AIF constitutional document, prospectus and offering documents.

Again, the Level 2 Regulation addresses risk management requirements in detail. Not only does it require the establishment of a permanent risk management function (and set out what function must do, must monitor and must report upon) and the establishment, implementation and maintenance of an adequate and documented risk management policy (requiring it to address at a minimum certain elements / safeguards), it requires the AIFM to establish and implement quantitative or qualitative risk limits (or both) for each AIF it manages taking into account all relevant risks. It requires the AIFM to take into account the strategies and assets employed in respect of its AIFs when setting risk limits and requires that the risk limits at least cover market risks, credit risks, liquidity risks, counterparty risks and operational risks.

Rules are also set down for the assessment, monitoring and periodic (at least annually) review of risk management systems, for the functional and hierarchical separation of the risk management function from the operating units, as well as regarding the actual risk measurement and management arrangements, processes and techniques of AIFMs.

5.9 Leverage

A maximum level of leverage which an AIFM may employ on behalf of each AIF it manages should be set by the AIFM as well as the extent of the right to reuse collateral or guarantee that could be granted under the leveraging arrangement, taking into account, *inter alia,* the type of AIF, its investment strategy and sources of leverage and any other interlinkage or relevant relationships with other financial services institutions, which could pose systemic risk.

It should also take into account the need to limit the exposure to any single counterparty and the extent to which the leverage is collateralised. The asset-liability ratio and the scale, nature and extent of the activity of the AIFM on the markets concerned should also be taken into account.

As set out in the Level 2 Regulation, the leverage of an AIF must be expressed as the ratio between the exposure of the AIF and its net asset value. The exposure of the AIF must be calculated using two different methods – the gross method and the commitment method - as set out in detail in the Level 2 Regulation (Articles 7 and 8). Duration netting rules apply when using the commitment method.

5.10 Liquidity Risk Management

For each AIF that it manages which is not an unleveraged closed-ended AIF, the AIFM must employ an appropriate liquidity management system and adopt procedures which enables it to monitor the liquidity risk of the AIF and to ensure that the liquidity profile of the investments of the AIF complies with its underlying obligations. It must also regularly conduct stress tests, under normal and exceptional liquidity conditions, which enable it to assess the liquidity risk of the AIFs and monitor the liquidity risk of the AIFs accordingly.

The AIFM must also ensure that, for each AIF that it manages, the investment strategy, the liquidity profile and the redemption policy are consistent.

The Level 2 Regulation addresses these requirements in further detail, including as to what the liquidity management system and procedures must, at least , ensure; that liquidity management policies and procedures should be documented and reviewed at least annually and should indicate escalation measures; and where appropriate, for the implementation, maintenance and monitoring of adequate liquidity or illiquidity limits.

5.11 Financial Control and Management Information

The Central Bank's AIF Rulebook sets out quite detailed rules in respect of the maintenance of records by an AIFM adequate for the purpose of financial control and management information. These cover financial records (monies received/expended; income/expenditure; assets/liabilities; investment instrument purchases and sales for own account and for AIFs under management and management inform certain records) and company secretarial records.

In addition, any charge of auditor (and the reasons therefor) must be notified in advance to the Central Bank.

5.12 Recordkeeping

An AIFM is required to retain, in a readily accessible form, for a period of at least six years, a full record of each transaction entered into by it (whether on its own behalf or on behalf of AIF under management) and all records required to demonstrate compliance with the provisions of the AIFMD Regulations, the AIFM chapter of the AIF Rulebook and any other conditions imposed by the Central Bank.

In the event of the termination of its authorisation by the Central Bank, an AIFM must retain those records for the outstanding term of the six year period.

5.13 Valuation Obligations

Under the Directive, AIFMs are obliged to establish appropriate and consistent procedures for proper and independent valuation of an AIF's assets. Those obligations are further clarified in the Level 2 Regulations. See Section 6 of this Guide for further details on the AIFM valuation requirements.

5.14 Depositary

An AIFM is required to ensure that for each AIF which it manages, a single depositary has been appointed in accordance with Article 21 of the Directive. Again, these requirements are further clarified by the Level 2 Regulation and are summarised in greater detail in Section 9 of this Guide.

5.15 Transparency Obligations

The Directive imposes transparency obligations in respect of the activities of AIFMs and their AIFs in their dealings with investors and with competent authorities. The Directive and Level 2 Regulations, taken together, impose obligations concerning the annual report which an AIFM is required to produce for each AIF it manages and requirements as to the minimum level of information to be made available to investors both prior to an investment and on an ongoing and periodic basis. Although much of the information required to be disclosed to investors prior to an investment should be addressed by prospectus disclosure, other required information to be disclosed should normally be dealt with by means of periodic reporting to investors and either accompany the prospectus or the annual report (or be circulated at the same time as they are provided to investors).

AIFMs are also under reporting obligations to competent authorities regarding the principal markets and investments traded by the AIFM on behalf of its AIFs; the principal exposures and important concentrations within those AIF portfolios; as well as disclosures regarding illiquidity and risk management systems and leverage. Additional reporting may be required regarding systemic risk.

The AIFM's transparency obligations are dealt with in greater detail in Section 7 of this Guide.

5.16 Remuneration

AIFMs are also required to implement remuneration policies and practices in line with Annex II of the Directive and the ESMA Remuneration Guidelines. See Section 7 of this Guide for further discussion of the remuneration rules.

5.17 Delegation: Generally

The Directive permits AIFMs delegate activities such as portfolio management, risk management, administration, marketing and other activities related to management of fund assets subject to certain parameters which are expanded upon in detail by the Level 2 Regulation.

In summary, the provisions of the Directive and the Level 2 Regulation subject the delegation of such activities to a series of general principles and specific conditions including:

(i) the AIFM must be able to justify its entire delegation structure on objective reasons (for example, if the AIFM can demonstrate that the delegation is made for the purpose of a more efficient conduct of the AIFM's management of the AIF such as optimising business functions and processes; cost saving; expertise of the delegate; access of delegate to global trading capabilities);

(ii) the delegate must have sufficient resources to perform the respective tasks and employ sufficient personnel with the necessary skills, knowledge and expertise for the proper discharge of the delegated tasks and have an appropriate organisational structure supporting the performance of those tasks;

(iii) the persons who conduct the business of the delegate must be of sufficiently good repute and sufficiently experienced. The Level 2 Regulation requires the persons who effectively conduct the delegated activities to have sufficient experience, appropriate theoretical knowledge and practical experience in the relevant functions and imposes a number of additional, related obligations;

(iv) the delegation must not prevent the effectiveness of supervision of the AIFM and must not prevent the AIFM from acting, or the AIF from being managed, in the best interests of its investors. The scenarios where delegation shall be deemed to prevent effective suspension are set out in the Level 2 Regulation and relate to access of the AIFM / its advisors / competent authorities to the delegate's data / business premises; delegate non-cooperation with the AIFM's competent authorities (ie. the Central Bank) and failure by the AIFM to make information available on request to its competent authorities relating to performance of delegated functions;

(v) the AIFM must be able to demonstrate that the delegate is qualified and capable of undertaking the functions in question, that it was selected with all due care and that the AIFM is in a position to monitor effectively at any time the delegated activity, to give at any time further instructions to the delegate and to withdraw the delegation with immediate effect when this is in the interest of investors;

(vi) the services provided by each delegate must be reviewed by the AIFM on an ongoing basis;

(vii) where the delegation concerns portfolio management or risk management, it must be conferred only on undertakings which are authorised or registered for the purpose of asset management and subject to supervision or, where that condition cannot be met, only subject to prior approval by the Central Bank;

(viii) where the delegation concerns portfolio management or risk management and is conferred on a third-country undertaking, in addition to the requirements in point (vii) above, cooperation between the Central Bank and the supervisory authority of the undertaking must be ensured.

The general principles applicable to delegation set out in Level 2 Regulations include requirements that the delegation arrangement take the form of a written agreement setting out the respective rights and obligations of both parties. The AIFM must contractually ensure its rights regarding the giving of information, the capacity to inspect and get access to books and records, its termination rights and must provide that there can be no sub-delegation without the AIFM's consent.

Obligations regarding protection of confidential information, disaster recovery / business continuity, disclosure of development of material impact on delegate's ability to carry out delegated functions must also be included.

The AIFM must also ensure that the delegate carries out the delegated functions effectively and in compliance with applicable law and regulatory requirements and the AIFM must supervise effectively the delegated functions and manage the risks associated with delegation. It must also be able to ensure continuity / quality of the delegated functions / tasks where the delegation is terminated (i.e. do it itself or transfer to another delegate).

It is important to be aware that the AIFM's obligations towards the AIF and its investors are not altered by the fact that the AIFM has delegated functions to a third party or by any further sub-delegation and the delegation structure must not allow for circumvention of the AIFM's responsibilities or liability.

Finally, an AIFM is not permitted to delegate its functions to the extent that, in essence, it can no longer be considered to be the "manager" of the fund and to the extent that it becomes a letter-box entity.

5.18 Delegation of Investment Management Functions

Additional requirements and criteria need to be taken into account when an AIFM – internally managed AIF or external AIFM – delegates investment management functions.

The principal requirement is that the AIFM cannot delegate the performance of investment management functions to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself. Criteria are set out in the Level 2 Regulation which regulators are required to take into account in this regard including the assets under delegation; types of assets; importance of assets under delegation to the risk/reward profile; risk profile; strategies; types of tasks delegated in relation to those retained; configuration of delegates/geographical space of operation and their corporate structure including whether the entity belongs to the same corporate group as the AIFM.

5.18.1 Investment Management?

As noted above means *"managing AIFs performing at least investment management functions referred to in point 1(a) or (b) of Annex 1"* of the Directive. Investment management is, in Annex I, broken down into portfolio management and risk management. Neither term is defined.

The Directive contemplates the delegation of portfolio management or risk management. However, we do not consider that that should be read as meaning that an AIFM which delegates portfolio management cannot also delegate risk management or vice versa (provided as a result it does not become a "letter-box entity"). In its explanatory text to the Level 2 Regulation, the Commission states "*in particular, the extent to which an AIFM is allowed to delegate is laid down in Article 82. The AIFM has at least to keep the decision making functions which are in fact its primary business role. It therefore has to perform at least functions relating to either risk or portfolio management. The ability to manage and control the AIF would not be ensured if the AIFM was not closely involved in the decision* *making of its delegates*."

5.18.2 Either, in whole or in part?

Although an AIFM can delegate both portfolio management and risk management functions, it cannot delegate the entirety of both at the same time. In paragraph 8 of its Discussion Paper "Key Concepts of the Alternative Investment Management Fund Managers Directive and types of AIFM" (23 February 2012), ESMA states *"…ESMA considers that an AIFM may delegate the two functions (i.e portfolio management or risk management) either in whole or in part, in the understanding that an AIFM may not delegate both functions in whole at the same time".*

5.18.3 Performance?

What the AIFM must do is to keep the decision making functions (its primary business role) and to perform at least certain functions relating to either risk or portfolio management. In this context, Recital (91) of the Level 2 Regulation states *"To ensure that in any event the AIFM performs investment management functions, the AIFM should not delegate its functions to the extent that, in essence, it can no longer be considered to be the manager of the AIF and to the extent that it becomes a letter-box entity.*

The AIFM should at all times keep sufficient resources to supervise the delegated functions efficiently. AIFM has to perform itself investment management functions, to have the necessary expertise and resources, to keep the power to take decisions which fall under senior management responsibility and to perform senior management functions which could include implementation of the general investment policy and investment strategies."

5.18.4 The Qualitative Criteria

Whilst clearly one needs to look at the overall delegation structure (i.e. not only that relating to investment management), the key provision is contained in Article 82 of the Level 2 Regulation entitled "Letter – Box Entity and AIFM no longer considered to be managing an AIF". Article 82 indicates that an AIFM shall be deemed a letter- box entity and shall no longer be considered to be the manager of the AIF at least in any of four listed situations. The first three refer to delegation generally (i.e. not specifically in relation to the investment management).

The fourth deals specifically with where the AIFM delegates the performance of investment management functions. It indicates that the AIFM shall be deemed to be a letter box entity and shall no longer be considered to be the manager of the AIF where it delegates investment management functions to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself. This would appear to envisage that certain functions contained within "investment management functions" can be delegated but that certain functions must be retained and those which are delegated should not exceed by a substantial margin those which are retained. Further, when "assessing the extent of delegation, competent authorities must assess the entire delegation structure".

Where the structure contains sufficient controls and operative functions to be performed by the AIFM such arrangements cannot be ignored in considering the "substantial margin" test.

In particular, the competent authorities are required to carry out an assessment of the extent of delegation taking into account a series of qualitative criteria, namely:

- the types of assets the AIF or the AIFM acting on behalf of the AIF is invested in, and the importance of the assets managed under delegation for the risk and return profile of the AIF;
- the importance of the assets under delegation for the achievement of the investment goals of the AIF;
- the geographical and sectoral spread of the AIF's investments,
- the risk profile of the AIF;
- the type of investment strategies pursued by the AIF or the AIFM acting on behalf of the AIF;
- the types of tasks delegated in relation to those retained; and
- the configuration of delegates and their sub-delegates, their geographical sphere of operation and their corporate structure, including whether the delegation is conferred on an entity belonging to the same corporate group as the AIFM.

An AIFM would also be considered to be a letter-box entity where the AIFM no longer retains necessary expertise and resources to supervise the delegate and manage key risks, where the AIFM no longer has the power to take decisions in key areas or where it loses its contractual right to enquire, inspect or give instruction to delegate in key areas.

5.19 Sub-Delegation

A delegate of the AIFM may in turn sub-delegate subject to:

(i) the prior consent of the AIFM;

(ii) prior notification to the Central Bank;

(iii) the conditions set out in Section 3.12 above where all references to “delegate” are to be read as references to “sub-delegate”.

No sub-delegation of portfolio management or risk management may be conferred on the depositary or a delegate of the depositary or any other entity whose interests may conflict with those of the AIFM or the investors of the AIF, unless such entity has functionally and hierarchically separated the performance of its portfolio management or risk management tasks from its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the unitholders of the AIF; and the relevant delegate must review the services provided by each sub-delegate on an ongoing basis.

5.20 Monitoring of Delegates

See Section 5.6 above as to what the Central Bank requires to be provided for in relation to monitoring of delegates.

5.21 Investment in Securitisation Positions

The Directive also imposes requirements on AIFMs who seek to invest on behalf of their AIFs in securitisation positions, as well as obligations on originators, sponsors and original lenders.

The requirements for AIFMs are set out in the Level 2 Regulation where the obligations imposed on the AIFM include requirements to have a comprehensive and thorough understanding of the relevant positions and to have implemented formal policies and procedures appropriate to the risk profile of the relevant AIF's investments in securitised positions. Requirements to regularly perform stress tests, create and establish formal monitoring procedures and risk management type procedures as well as specific rules regarding when corrective action must be taken in the best interests of the investors in the relevant AIF are imposed.

5.22 Leveraged AIFs

An AIFM must be able to demonstrate to the Central Bank that the leverage limit set by it for each AIF which it manages is reasonable and that it complies with that limit at all times.

5.23 Obligations for AIFMs managing AIFs which acquire control of non-listed companies/issuers

When an AIF acquires, disposes of or holds shares of a non-listed company within the scope of the Directive at, above or below various thresholds, its AIFM will be obliged to make certain regulatory notifications.

Notifications and disclosures to the affected company, its shareholders, employees and to regulators will also be required where AIFMs which manage one or more AIFs which (either individually or jointly) acquire "control" of a non-listed company or issuer within the scope of the Directive.

Non-listed companies and issuers which fall outside of the scope of the Directive are (a) small and medium-sized enterprises within the meaning of Article 2(1) of the Annex to Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises; and (b) special purpose vehicles whose purpose is the purchasing, holding or administering of real estate.

For the purposes of these obligations, "control" is defined to mean more than 50% of the voting rights of the company. When calculating the percentage of voting rights held by the relevant AIF, one must take into account not only any voting rights held directly by the AIF but also of any undertaking controlled by the AIF or by any natural or legal person acting in its own name but on behalf of the AIF or of an undertaking controlled by it.

Disclosure and Notification Obligations

When an AIF acquires, disposes of or holds shares of a non-listed company, its AIFM (if Irish) must notify the Central Bank 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 %.

AIFMs which manage one or more AIFs which (either individually or jointly on the basis of an agreement aimed at acquiring control) acquire "control" of a non-listed company must notify the non-listed company, its shareholders to which the AIFM has or can obtain access and the Central Bank of:

(i) the resulting situation in terms of voting rights;

(ii) the conditions subject to which control was acquired (certain minimum information required); and

(iii) the date control was acquired.

The AIFM must also request that the board of directors of the non-listed company inform the employees' representatives or, where there are none, the employees themselves, without undue delay of the acquisition of control by the AIF managed by the AIFM and the AIFM must use its best efforts to ensure that the employees' representatives or, where there are none, the employees themselves, are duly informed by the board of directors of such change of control. The notifications must include certain specified information, including the repercussions on employment, including any material change in the conditions of employment for employees of the non-listed company.

The AIFM must also notify the relevant company, its shareholders and the AIFM's own competent authority of:

(a) the identity of the AIFMs which either individually or in agreement with other AIFMs manage the AIFs that have acquired control;

(b) the policy for preventing and managing conflicts of interest, in particular between the AIFM, the AIF and the company, including information about the specific safeguards established to ensure that any agreement between the AIFM and/or the AIF and the company is concluded at arm's length; and

(c) the policy for external and internal communication relating to the company in particular as regards employees.

The AIFM managing such an AIF must also ensure that the AIF, or the AIFM acting on behalf of the AIF, discloses its intentions with regard to the future business of the non-listed company and the likely repercussions on employment, including any material change in the conditions of employment. It must also provide the competent authorities of its home Member State and the AIF's investors with information on the financing of the acquisition.

The annual report of the non-listed company must also include, in relation to the non-listed company, an indication of any important events that have occurred since the end of the financial year, the company's likely future development. The annual accounts of the AIFM or AIF must include disclosures in relation to the non-listed companies in which it invests.

(ii) Anti-asset stripping measures

AIFMs which manage one or more AIFs which (either individually or jointly) acquire(s) control of a non-listed company or issuer must, for a period of 24 months following the acquisition of control of the non-listed company:

(a) not facilitate, support or instruct any distribution, capital reduction, share redemption and/or acquisition of own shares by the non-listed company;

(b) not vote in favour of a distribution, capital reduction, share redemption and/or acquisition of own shares by the company;

(c) use its best efforts to prevent distributions, capital reductions, share redemptions and/or the acquisition of own shares by the company.

These obligations relate to the following:

(a) any distribution to shareholders made when on the closing date of the last financial year the net assets as set out in the company's annual accounts are, or following such a distribution would become, lower than the amount of the subscribed capital plus those reserves which may be not distributed under the law or the statutes, on the understanding that where the uncalled part of the subscribed capital is not included in the assets shown in the balance sheet, this amount shall be deducted from the amount of subscribed capital;

(b) any distribution to shareholders the amount of which would exceed the amount of the profits at the end of the last financial year plus any profits brought forward and sums drawn from reserves available for this purpose, less any losses brought forward and sums placed to reserve in accordance with the law or the statutes;

(c) to the extent that acquisitions of own shares are permitted, the acquisitions by the company, including shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company's behalf, that would have the effect of reducing the net assets below the amount mentioned in point (a).

The term "distribution" shall include, in particular, the payment of dividends and of interest relating to shares. The provisions on capital reductions shall not apply on a reduction in the subscribed capital, the purpose of which is to offset losses incurred or to include sums of money in a non-distributable reserves provided that, following that operation, the amount of such reserve is not more than 10% of the reduced subscribed capital.

5.24 Irish Client Money Rules

Where, as part of the provision of collective portfolio management functions, an Irish AIFM maintains client asset accounts for processing investor subscription and redemption monies, it must comply with the Central Bank's Client Asset Requirements issued under the European Communities (Markets in Financial Instruments) Regulations, 2007 (the "**MiFID**

Regulations"), as well as any other related conditions which may be imposed by the Central Bank pursuant to the AIFMD Regulations.

An Irish AIFM which is authorised to provide individual portfolio management services must, also, with respect to that activity, comply with certain provisions of the MiFID Regulations and, where applicable, with the Client Asset Requirements.

5.25 Relationship with Central Bank

The Central Bank's AIF Rulebook obliges an AIFM to notify the Central Bank as soon as it becomes aware of any breaches of the AIFMD Regulations, the Level 2 Regulations or other Central Bank requirements (including the AIF Rulebook) applicable to the AIFM; similarly breaches of other Irish legislation which may be of prudential concern to the Central Bank or which may impact on the reputation or good standing of the AIFM; the commencement of any significant legal proceedings by or against the AIFM; any situations or events which impact, or potentially impact, on the AIFM to a significant extent. In addition, if an AIFM is subject to imposition of fines by another supervisory authority or is subject to a visit by another supervisory authority, the AIFM must notify the Central Bank as soon as it becomes aware of same.

Other obligations imposed by the Central Bank include a requirement to obtain prior Central Bank approval in respect of proposed change of name/address/contact details; any proposed change in direct or in indirect ownership or in "qualifying holdings"; and to notify the Central Bank in advance of any proposed change of auditor and the reasons for the change. The AIFM must also comply with the regulatory disclosures requirement for its headed notepaper (and references to the Central Bank in publicity material).

Where the AIFM provides management services to an AIF which is not authorised by the Central Bank, the AIFM must be satisfied the prospectus issued by that AIF does not imply that it is regulated by the Central Bank. Where the AIFM provides administration services to such AIFs, it is required to submit a quarterly return to the Central Bank regarding the AIFs domicile, number of such AIFs, number of investors involved and total NAV figures.

5.26 Irish AIFM Authorisation Process

An entity seeking authorisation as an AIFM in Ireland must submit an application to the Central Bank containing information and documentation regarding its ownership, management, organisational structure and additional information as to how it intends to comply with the various obligations imposed on AIFMs. The Central Bank has issued draft (to be finalised once the AIFMD Regulations come into force) application forms for this purpose which are available on its website.

In particular, the applicant for authorisation as an AIFM must:

(i) submit a completed application form signed by 2 directors of the applicant (the application form comes in a standard format);

(ii) submit completed individual questionnaires (online) in respect of each proposed director and each proposed senior manager of the applicant, as well as in respect of any individual with a direct or indirect shareholding or other interest representing 10% or more of the capital or voting rights in the AIFM (other than an internally managed AIFM) and for any other individual in a position to exercise significant influence over its management;

(iii) submit a programme of activity which needs to set out the AIFM's organisational structure, as well as giving information on how the AIFM intends to comply with the various obligations imposed under the AIFM Regulations, including:

  (a) operating conditions (governance, risk management, the management and valuation of assets, and custody obligations);

  (b) transparency requirements;

  (c) obligations imposed on AIFMs who manage leveraged AIFs and those which seek to acquire control of non-listed companies;

  (d) how it intends to manage and market EU AIFs and marketing generally.

(iv) submit information on its proposed remuneration policies and practices;

(v) submit information on its delegation and sub-delegation arrangements; and

(vi) submit information on the AIFs it intends to manage.

A statement of responsibility will also be required of the AIFM addressing internal managerial controls.

5.27 Directors

Prior Central Bank approval is required for the appointment of directors and alternate directors, a minimum of two directors must be Irish resident and the AIFM board must not have any directors in common with the board of the depository.

The AIFM's board must also appoint a chairperson on a permanent basis.

Departures from the board (and reasons therefor) must be notified to the Central Bank immediately.

In all cases where a director wishes to resign and prior to completing the relevant Central Bank form, the board or its chair must form a view as to the impact of the resignation on the AIFM having regard to the current and prospective financial state of the AIFM and the AIFs under management. In the event that the board or, in the absence of a board meeting, the Chair forms the view that the situation is one which could create such concern on the part of the Central Bank, it shall state this on the relevant Central Bank form. The board or its Chair may consult the Central Bank in order to help it form a view on that matter.

In addition to the Central Bank pre-approval requirement, directors are also subject to obligations under the Irish fitness and probity regime and are required to disclose to the AIFM board any concurrent directorships which they hold.

5.28 Irish Regulatory Levies

It is expected that Irish AIFMs will be subject to annual regulatory levies similar to UCITS management companies and MiFID firms where a tiered levy will depend on aggregate assets under management and number of AIFs managed (by number of sub-funds).

6. The Valuation Provisions of AIFMD

The rules imposed on AIFMs in relation to the valuation of the assets of the AIFs which they manage are found in Article 19 of the Directive and in Section 7 of the Level 2 Regulation. The Central Bank's AIF Rulebook does not impose rules on valuation as it is expected that the Directive and Level 2 Regulation requirements will be set out in the Irish AIFMD Regulations.

The Directive requires that appropriate and consistent procedures are put in place by AIFMs so that proper independent valuation of the assets of each AIF that they manage can be performed in accordance with Article 19 of the Directive, national law and the AIF's constitutional document. These obligations are further clarified in the Level 2 Regulation and are summarised below.

The AIFM is responsible for the proper valuation of the assets, for the calculation of the NAV and for its publication. The fact that the AIFM has appointed an external valuer does not affect the AIFM's liability towards the AIF and its investors. Accordingly, when establishing AIFs, AIFMs will need to decide whether they will appoint an external valuer, with the requisite professional guarantees, or whether they will perform the function themselves. In either case, the AIFM remains responsible.

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6.1 Policies and Procedures around Valuation

The AIFM is responsible for the proper valuation of the AIF assets, the calculation of the NAV, and the publication of the NAV. The Directive requires that appropriate and consistent written policies and procedures must be put in place by an AIFM for proper and independent valuation of the assets of each AIF that it manages.

These policies and procedures must be established, maintained, implemented and reviewed in order to seek to ensure a sound, transparent, comprehensive and appropriately documented valuation process.

In order to meet the above requirement, the Directive requires the following in respect of such policies and procedures:

(i) The valuation policy and procedures must cover all material aspects of the valuation process and valuation procedures and controls in respect of the relevant AIF.

(ii) The AIFM must ensure that fair, appropriate and transparent valuation methodologies are applied for each of the AIFs it manages. The policies must identify and the procedures must implement the valuation methodologies that will be used for each of the types of asset in which the AIF may invest. An AIFM shall not invest in a particular type of asset for the first time unless appropriate valuation methodologies have been identified in advance.

(iii) The policies and procedures setting out valuation methodologies must include inputs, models (see further information on the use of models below) and the selection criteria for pricing and market data sources. They must provide that prices shall be obtained from independent sources whenever possible and appropriate. The selection process of a particular methodology must include an assessment of the available relevant methodologies, taking into account their sensitivity to changes in variables and how specific strategies determine the relative value of the assets in the portfolio.

(iv) The policies should set out the obligations, role and duties of all parties involved in the valuation process, including senior management. The procedures must reflect the organisational structure as set out in the valuation policies.

The valuation policies and procedures shall address at least the following:

(a) the competence and independence of personnel who are effectively carrying out the valuation of assets;

(b) the specific investment strategies of the AIF and the assets the AIF might invest in;

(c) the controls over the selection of valuation inputs, sources and methodologies;

(d) the escalation channels for resolving differences in values for assets;

(e) the valuation of any adjustments related to the size and liquidity of positions, or to changes in the market conditions, as appropriate;

(f) the appropriate time for closing the books for valuation purposes;

(g) the appropriate frequency for valuing assets.

(v) Where an external valuer is appointed (see below for further detail), the polices must set out a process for exchange of information between the AIFM and the external valuer to ensure that all necessary information required for performing valuation tasks is provided.

The valuation policies and procedures shall ensure that the AIFM conducts initial and periodic due diligence on third parties that are appointed to perform valuation services.

(vi) Where the valuation is performed by the AIFM itself, the policies must include a description of the safeguards for functionally independent performance of the valuation task, including measures to prevent or restrain any person exercising inappropriate influence over how someone carries out valuation.

6.2 Use of Models to Value Assets

The Directive requires that rules applicable to the valuation of assets and calculation of the NAV of the AIF must be set down in the law of the place of establishment of the AIF or in the constitutional documents of the AIF. Given that valuation and NAV calculation procedures are usually set out in offering documents or constitutional documents, and not in national legislation, the Directive does not prescribe methodology. However, where models are used, the following rules apply:

(i) Where a model is used to value the assets of an AIF, the model and its main features must be explained and justified in the valuation policies and procedures. The reason for the choice of the model, the underlying data, the assumptions used in the model and the rationale for using them, and the limitations of the model-based valuation must be appropriately documented.

(ii) The valuation policies and procedures must ensure that before being used a model is validated by a person with sufficient expertise who has not been involved in the process of building that model. The validation process must be appropriately documented.

(iii) The model must be subject to prior approval by the senior management of the AIFM. Where the model is used by an AIFM that performs the valuation function itself, the approval by the senior management must be without prejudice to the competent authority's right to require that the model be verified by an external valuer or an auditor.

6.3 Consistent Application

As a general rule, the AIFM must ensure that the valuation policies and procedures and methodologies are applied consistently and are applied to all assets within the AIF, taking into account the investment strategy, type of assets and existence of different external valuers.

Where no update is required, the policies and procedures must be applied consistently over time and valuation sources and the rules must remain consistent over time. The valuation procedures and the designated valuation methodologies must be applied consistently across all AIFs managed by the same AIFM, taking into account the investment strategies and the types of asset held by the AIFs, and, if applicable, the existence of different external valuers.

6.4 Periodic Review

Valuation policies and procedures must provide for periodic review of such policies and procedures, including review of the valuation methodologies. This review should be carried out at least annually and prior to the engagement of the AIF with a new investment strategy or new asset not already covered.

Policies should outline how a change to the valuation policy, including a methodology, can be affected and in what circumstances this would be appropriate and recommendations for changes should be made to senior management who should review and approve the changes.

The AIFM's Risk Management Function must also review and provide appropriate support concerning the policies and procedures adopted for the valuation of assets.

6.5 Requirement to Review Individual Values of Assets

AIFMs are obliged to ensure that each individual asset of an AIF is valued and must apply the following principles in ensuring this:

(i) The AIFM should ensure that the value of all assets is fair and appropriate and must document, by type of asset, the manner in which the appropriateness and fairness of the individual values is assessed. The AIFM must be able to demonstrate that the portfolio of each AIF it manages has been properly valued.

(ii) The valuation policies and procedures must set out a review process for the individual values of assets where a material risk of an inappropriate valuation exists, such as in the following cases:

(a) the valuation is based on prices only available from a single counterparty or broker source;

(b) the valuation is based on illiquid exchange prices;

(c) the valuation is influenced by parties related to the AIFM;

(d) the valuation is influenced by other entities that may have a financial interest in the AIF's performance;

(e) the valuation is based on prices supplied by the counterparty who originated an instrument, in particular where the originator is also financing the AIF's position in the instrument;

(f) the valuation is influenced by one or more individuals within the AIFM.

(iii) The valuation policies and procedures must describe the review process including sufficient and appropriate checks and controls on the reasonableness of individual values. Reasonableness shall be assessed in terms of the existence of an appropriate degree of objectivity. Such checks and controls must include at least:

(a) verifying values by a comparison amongst counterparty-sourced pricings and over time;

(b) validating values by comparison of realised prices with recent carrying values;

(c) considering the reputation, consistency and quality of the valuation source;

(d) a comparison with values generated by a third party;

(e) an examination and documentation of exemptions;

(f) highlighting and researching any differences that appear unusual or vary by valuation benchmark established for the type of asset;

(g) testing for stale prices and implied parameters;

(h) a comparison with the prices of any related assets or their hedges;

(i) a review of the inputs used in model-based pricing, in particular of those to which the model's price exhibits significant sensitivity.

(iv) The policies should include appropriate escalation measures to address differences on the valuation of assets.

6.6 Frequency of Valuation

AIFMs are required to ensure that the NAV per unit of each AIF is calculated and disclosed to investors, at least once a year, or at dealing frequency or, for closed ended funds, on increase or decrease of capital. The valuation of assets that are financial instruments has to take place every time the NAV is calculated. The valuation of assets that are not financial instruments has to take place at least once a year and every time there is evidence that the last determined value is no longer fair or proper.

In calculating the NAV per unit in an AIF, the AIFM should ensure:

(i) that the NAV is calculated for each subscription/redemption or cancellation of units in the AIF and at least once a year;

(ii) that the procedures and methodology for calculating the NAV is fully documented and such documentation is regularly verified and documentation amended accordingly;

(iii) that remedial procedures are in place in the event of an incorrect calculation of NAV; and

(iv) that the number of units/shares in issue is subject to regular verification at least as often as the unit or share price is calculated.

6.7 Performing the Valuation Function

AIFMs are required to ensure that the valuation function is carried out impartially and with skill, care and diligence either by:

(i) an external valuer, being an entity or person independent from the AIF, AIFM or other persons with close links to the AIF and AIFM; or

(ii) the AIFM itself, provided that the valuation task is functionally independent from portfolio management and remuneration policy and other measures are taken to ensure that conflicts of interest, undue influence risks (on employees) are mitigated.

Note that the valuation function (ie. carrying out proper and independent valuation of the assets of an AIF) is separate and distinct from the function of the calculating an AIF's NAV. A third party which carries out the calculation of NAV for an AIF but does not provide valuations for individual assets is not considered to be an external valuer for the purposes of the Directive.

Where an external valuer (which cannot itself delegate to a third party) is appointed, the AIFM must notify the appointment to the competent authorities of its home Member State, which may require that another external valuer be appointed instead if it is of the view that the following conditions are not met:

(i) the valuer is subject to mandatory professional registration, recognised by law or to legal or regulatory provisions or rules of professional conduct;

(ii) the valuer can provide sufficient professional guarantees to be able to perform effectively the relevant valuation function; and

(iii) the appointment of the valuer complies with the Directive.

The statement of professional guarantee provided to the AIFM has to be provided in written form and must include evidence of the valuer's qualification and capability to perform proper and independent valuation, including evidence of sufficient personnel and technical resources, adequate procedures safeguarding proper and independent valuation, adequate knowledge and understanding of the investment strategy of the AIF and of the assets the external valuer is appointed to value. It must evidence a sufficiently good reputation and sufficient experience with valuation.

Where the external valuer is subject to mandatory professional registration with the competent authority or with another entity of the state where it is established, the professional guarantee must contain the name of this authority or entity, including the relevant contact information. The professional guarantee must also indicate clearly the legal or regulatory provisions or rules of professional conduct to which the external valuer is subject.

Where the valuation function is not carried out by independent external valuer then, in accordance with the Directive, the competent authority of the AIFM can require the AIFM to have its valuation procedures and/or valuations verified by an external valuer or an auditor.

6.8 Responsibility and Liability for Valuation

AIFMs will be responsible for the proper valuation of AIF assets, the calculation of NAV, and the publication of NAV. The AIFM's liability to the AIF and its investors will not be affected by the appointment of an external valuer. However, the external valuer will be liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer's negligence or intentional failure to perform its tasks.

7. The Transparency Provisions of AIFMD

Increased transparency for investors and for regulators is another objective of the Directive.

The Directive deals with transparency in three ways – by imposing requirements as to the annual report of an AIF, required disclosure to investors, and reporting obligations to competent authorities. These requirements apply not only to EU AIFMs but also to non EU AIFMs marketing in the EU without a passport (i.e. marketing within the EU on a private placement basis).

The Directive provisions, as further clarified by the Level 2 Regulation, are summarised in this Section. Readers should also note that ESMA has recently issued a consultation paper on reporting obligations titled "Guidelines on reporting obligations under Article 3 and Article 24 of the AIFMD" [ESMA/2013/592].

As the Guidelines are at consultation phase only, we do not address them here.

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7.1 Annual Reports

An AIFM is required to produce for each AIF it manages and for each AIF it markets in the EU an annual report ("**Annual Report**") which must be made available no later than 6 months after the financial year end, must be provided to investors on request, and must be made available to competent authorities of the home Member State of the AIFM and, where applicable to the competent authorities of the home Member State of AIF.

All information provided in the annual report must be presented in a manner that provides materially relevant, reliable, comparable and clear information that investors may need in relation to particular AIF structures.

7.1.1 Content of Annual Report

The Directive prescribes certain minimum content requirements for the annual report, as follows:

(i) a balance sheet or a statement of assets and liabilities;

(ii) an income and expenditure account for the financial year:

(iii) a report on activities of the financial year;

(iv) any material changes in relation to the required disclosures to investors (e.g. changes in strategies, delegation arrangements etc.) during the financial year;

(v) the total amount of remuneration paid to AIFM staff for the financial year (split into fixed and variable) number of beneficiaries, and any carried interest; and

(vi) the aggregate amount of remuneration broken down by senior management and staff of the AIFM whose actions have a material impact on risk profile of the AIF.

The Level 2 Regulation sets out in detail (see Article 104) requirements as to the content and format of the balance sheet or statement of assets and liabilities and of the income and expenditure account.

The report on activities of the financial year must include an overview of investment activities during the year or period and an overview of the AIF's portfolio at year-end or period-end and overview of AIF performance over the period and any material changes in the information disclosed. It should also include a "fair and balanced" review of the activities and performance of the AIF and describe the principal risks and investment or economic uncertainties that the AIF may face. Where necessary, the analysis should include both financial and (where applicable) non-financial key performance indicators relevant to the AIF. The information provided in the report must be consistent with the national rules where the AIF is established. The information in the report on activities of the financial year must form part of the directors' or investment manager's report insofar as this is usually presented alongside the financial statements of the AIF.

The accounting information in the annual report must be audited and prepared in accordance with accounting standards of the home Member State of the AIF, or of the third country where the AIF is established, and with the accounting rules laid down in the AIF's own constitutional document.

7.1.2 Disclosure of "Material Changes"

The annual report is required to include disclosure of any material changes in the information that is required to be disclosed to investors (e.g. changes in strategies, in delegation arrangements, identity of AIFM/depositary/auditors/service providers etc.).

The Level 2 Regulation explains that any changes in information shall be deemed to be "material" if there is a substantial likelihood that a reasonable investor, becoming aware of such information, would reconsider its investment in the AIF, including because such information could impact an investor's ability to exercise its rights in relation to its investment, or otherwise prejudice the interests of one or more investors in the AIF.

To comply with the requirement relating to "material changes", the AIFM must assess changes in the information to be disclosed. Such information should be disclosed in line with accounting standards requirements adopted by the AIF, together with a description of any potential or anticipated impact on the AIF and its investors. Additional disclosures must be made when compliance with specific requirements of the accounting standards and accounting rules may be insufficient to enable investors understand the impact of the change. Where changes to material information required to be disclosed are not covered by the accounting standards applicable to the AIF, or its accounting rules, a description of the material change must be provided together with any potential or anticipated impact on the AIF and/or investors in the AIF.

7.1.3 Content and Format of Remuneration Disclosure

The information in the annual report concerning remuneration must include information on the total amount of remuneration for the financial year, split into fixed and variable components.

Where remuneration details are disclosed, the annual report should specify whether the total remuneration disclosed (which should also mention the carried interest paid by the AIF) relates to:

(i) the total remuneration of the entire staff of the AIFM, with an indication of number of beneficiaries;

(ii) the total remuneration of those staff of the AIFM who in part or in full are involved in the activities of the AIF with an indication of the number of beneficiaries; or

(iii) the proportion of the total remuneration of the staff of the AIFM attributable to the AIF and an indication of the number of beneficiaries.

Where relevant, the total remuneration for the financial year shall also mention the carried interest paid by the AIF.

Where information is disclosed at the level of the AIFM, an allocation or breakdown must be provided in relation to each AIF insofar as that information exists or is readily available. As part of that disclosure, a description of how the allocation or breakdown has been provided must be included. AIFMs must provide general information relating to the financial and non-financial criteria of the remuneration policies and practices for relevant categories of staff to enable investors to assess the incentives created. AIFMs must disclose at least the information necessary to provide an understanding of the risk profile of the AIF and the measures they adopt to avoid or manage conflicts of interest.

7.2 Disclosure to Investors

The Directive requires that a certain minimum level of information be made available to investors in AIFs marketed within any Member State of the EU and must be made available to investors prior to any investment and on an on-going basis.

7.2.1 Pre-investment information to be made available to Investors

The minimum level of information to be made available in accordance with the Directive must include a description of the following:

(i) the investment strategy and objectives of the AIF; information on where any master fund is or, if a fund of funds, where the underlying funds are, established; the types of assets in which the AIF may invest and techniques it may employ and associated risks; investment restrictions; use of leverage (including types and sources of leverage permitted and maximum leverage permitted); and collateral and asset reuse arrangements;

(ii) the procedures by which the AIF may change its investment strategy and/or policy;

(iii) the main legal implications of the contractual relationship entered into for the purpose of investment, including information on jurisdiction, applicable law and the existence or not of any legal instruments providing for the recognition and enforcement of judgements in the territory where the AIF is established;

(iv) the identity of the AIFM, and the AIF's depositary, auditor and other service providers and a description of their duties;

(v) how the AIFM is complying with the requirement to cover professional liability risks;

(vi) any delegated management function relating to investment management functions and any delegation of safekeeping function by the depositary, the identity of the delegate and any conflicts of interest from such delegation;

(vii) valuation procedures, pricing methodology, methods used in valuing hard to value assets;

(viii) the AIF's liquidity risk management, including redemption rights in both normal and exceptional circumstances and existing redemption arrangements;

(ix) the fees, charges and expenses and the maximum amounts thereof borne directly or indirectly by investors;

(x) how fair treatment of investors is ensured by the AIFM and, whenever an investor obtains preferential treatment or the right to obtain such treatment, a description of that preferential treatment, the type of investors who obtain such treatment and their legal or economic links with AIF or AIFM;

(xi) the latest annual report;

(xii) the procedure and conditions for issuing units;

(xiii) the latest NAV of AIF or latest market price of unit;

(xiv) where available, the historical performance of AIF;

(xv) the identity of prime broker(s) and any material arrangements with prime brokers and a description of how conflicts of interest are managed, description of the provision in the contract with the depositary on the possibility of transfer and reuse of

AIF assets, and information about any transfer of liability to the prime broker that may exist;

(xvi) a description of how and when information required regarding assets subject to special arrangements arising from illiquidity, liquidity management, risk profile and leverage related matters (see further discussion below) is disclosed.

In addition to the above, the AIFM must inform investors before investment in the AIF (though the Directive does not prescribe how such information is provided), of any arrangement made by the depositary to contractually discharge itself of liability. Any changes to depository liability must be notified to investors without delay.

7.2.2 Periodic information to be made available by AIFMs

AIFMs are required to periodically disclose, in a clear and presentable way, to investors for each EU AIF they manage, and for each AIF marketed by them in the EU:

(i) the percentage of AIF assets which are subject to special arrangements due to their illiquid nature.

The disclosure on assets subject to special arrangements arising from illiquidity must provide an overview of any special arrangements in place, including whether they relate to side pockets, gates or other similar arrangements, the valuation methodology applied to assets which are subject to such arrangements and how management and performance fees apply to these assets. The disclosure should be made as part of the AIF's periodic reporting to investors, as required by the AIF's constitutional document, or at the same time as the offering document and, as a minimum, at the same time as the annual report is made available.

The percentage of the AIF's assets which are subject to special arrangements shall be calculated as the net value of those assets subject to special arrangements divided by the net asset value of the AIF.

(ii) any new arrangements for managing liquidity of the AIF

For any such new arrangements, the AIF must notify investors (a), whenever they make changes to the liquidity management systems and procedures of each AIF that they manage which is not an unleveraged closed-ended AIF which are material and (b) immediately where a gate, side pocket or similar special arrangement is activated or where redemptions are suspended.

AIFs must also provide an overview of the changes to arrangements concerning liquidity, whether or not these are special arrangements. Where relevant, the terms under which redemption is permitted and circumstances determining when management discretion applies must be included. Any voting or other restrictions exercisable, the length of any lock-up or any provision concerning 'first in line' or 'pro-rating' on gates and suspensions must also be included.

(iii) the current risk profile of the AIF and risk management systems employed by the AIFM to manage those risks

The disclosure of the risk profile and risk management systems must contain measures to assess the sensitivity of the AIF's portfolio to the most relevant risks to which the AIF could be exposed. The disclosure should also outline whether risk limits set by the AIFM have been or are likely to be exceeded. Where the limits are exceeded, disclosure should include a description of the circumstances and remedial measures taken.

The risk management systems employed by the AIFM must outline the main features of the risk management systems employed by the AIFM to manage the risks to which each AIF it manages is or may be exposed. Where there is a change the disclosure must include the information relating to the change and its anticipated impact on the AIF and its investors.

The disclosures on risk profile and risk management systems should be made as part of the AIF's periodic reporting to investors, as required by the AIF's rules or instruments of incorporation, or at the same time as the offering document and, as a minimum, at the same time as the annual report is made available or made public.

7.2.3 Regular Disclosure on Leverage

Where AIFMs manage EU AIFs employing leverage or where they market AIFs (wherever established) in the EU which employ leverage, they must disclose regularly, in a clear and understandable way:

(i) any changes to the maximum leverage that the AIFM may employ on behalf of the AIF as well as any right of the reuse of collateral or any guarantee granted under the leveraging arrangement; and

(ii) total leverage employed by that AIF.

Information on changes to the maximum level of leverage and any right of re-use of collateral or any guarantee under the leveraging arrangements shall be provided without undue delay and must include:

- the original and revised maximum leverage level. The level of leverage should be calculated in each case as the relevant exposure divided by the NAV of the AIF;

- the nature of the rights granted for the re-use of collateral;

- the nature of guarantees granted; and

- details of changes in any service providers relating to any of the above items.

The disclosures on the total amount of leverage must be disclosed as part of the AIF's periodic reporting to investors, as required by the AIF's constitutional document or at the same time as the offering document and, as a minimum, at the same time as the annual report is made available.

7.3 Reporting Obligations to Competent Authorities

AIFMs of all types are required to provide certain information on a regular basis to their home supervisors for each EU AIF they manage and for each AIF they market in the EU.

7.3.1 Reporting Obligations

In relation to required reporting to competent authorities, the Directive imposes on AIFMs the following obligations:

(i) an AIFM must regularly report to the competent authorities of its home Member State on the principal markets and instruments traded by it on behalf of AIFs. The information should include the following:

   (a) the main instruments it is trading including a break-down of financial instruments and other assets, taking into account the AIFs' investment strategies and their geographical and sector investment focus;

   (b) the markets of which it is a member or where it actively trades;

   (c) the principal exposures and most important concentrations of each AIF it manages; and

   (d) the diversification of the AIF's portfolio, including, but not limited to, its principal exposures and most important concentrations.

That information should be provided to the competent authority as soon as possible and no later than one month after the end of the relevant period, though for a fund of funds, this period may be extended by the AIFM by 15 days.

(ii) An AIFM must provide to its home Member State's competent authority for each EU AIF it manages and for each AIF it markets within EU:

(a) the percentage of AIF's assets subject to special arrangements arising from their illiquid nature;

(b) any new arrangements for managing liquidity of AIF;

(c) the risk management systems employed by the AIFM to manage the market risk, liquidity risk, counterparty risk and other risks including operational risk;

(d) the current risk profile of the AIF and risk management systems employed by AIFM to manage the market, liquidity, counterparty, operational, and other risks;

(e) the main categories of assets in which AIF is invested;

(f) the results of stress tests performed in line with the Directive.

The risk profile of the AIF should include (i) the market risk profile of the investments of the AIF, including the expected return and volatility of the AIF in normal market conditions; (ii) the liquidity profile of the investments of the AIF, including the liquidity profile of the AIF's assets, the profile of redemption terms and the terms of financing provided by counterparties to the AIF; (iii) information on the main categories of assets in which the AIF invested including the corresponding short market value and long market value, the turnover and performance during the reporting period; and (iv) the results of periodic stress test, under normal and exceptional circumstances.

The above information must be reported as follows:

(a) on a half-yearly basis by AIFMs managing portfolios of AIFs whose assets under management in total exceed the threshold of either EUR 100 million or EUR 500 million but do not exceed EUR 1 billion, for each of the EU AIFs they manage and for each of the AIFs they market in the Union;

(b) on a quarterly basis by AIFMs managing portfolios of AIFs whose assets under management in total exceed EUR 1 billion, for each of the EU AIFs they manage, and for each of the AIFs they market in the Union;

(c) on a quarterly basis by AIFMs which are subject to the requirements referred to in point (a) above, for each AIF whose assets under management, including any assets acquired through use of leverage, in total exceed EUR 500 million, in respect of that AIF;

(d) on an annual basis by AIFMs in respect of each unleveraged AIF under their management which, in accordance with its core investment policy, invests in non-listed companies and issuers in order to acquire control.

The competent authority of the home Member State of the AIFM may deem it appropriate and necessary for the exercise of its function to require all or part of the above information to be reported on a more frequent basis.

Where an AIFM is managing one or more AIFs which they have assessed to be employing leverage on a substantial basis (as described more fully below) it will make all relevant disclosures on employing leverage on a substantial basis within the above time frames.

All of the above information will be provided in accordance with a pro-forma template.

7.3.2 Reporting by Non-EU AIFMs

For non-EU AIFMs, any reference to the “competent authorities” of the home Member State shall mean the competent authority of the Member State of reference.

The AIFM must, on request, provide the following documents to competent authorities of its home Member State:

(a) an annual report of each EU AIF and each AIF marketed in EU; and

(b) for end of each quarter, a list of all AIFs managed by the AIFM.

An AIFM managing AIFs employing substantial leverage must make information on the overall level of leverage employed by each AIF it manages available to competent authority of its home Member State including:

(a) a break-down between leverage from borrowing and leverage embedded in financial derivative instruments;

(b) the extent to which AIFs assets have been reused under leveraging arrangements

This information must include the identity of the 5 largest sources of borrowed cash or securities for each AIF and amounts of leverage received from each.

Leverage will be considered to be employed on a substantial basis for the purposes of the above, when the exposure of the AIF as calculated according to the commitment method exceeds three times its net asset value.

The competent authorities of a home Member State may require additional information to that required abovefor monitoring of systemic risk where this is deemed necessary. The competent authority will inform ESMA about additional information requirements and in exceptional circumstances, ESMA may request competent authorities to require additional information.

The Directive also requires that the Commission adopt by means of delegated acts (taking into account the need to avoid an excessive administrative burden on competent authorities), measures specifying:

(a) when leverage is to be considered to be employed on a substantial basis; and

(b) the obligations to report and provide information provided for in the Directive.

8. AIFM Remuneration Rules

In addition to rules as to how an AIFM must conduct its business, organise itself, report to investors and to regulators, value assets, etc., the Directive requires AIFMs to implement remuneration policies designed to address what the recitals to the Directive refer to as "*the potentially detrimental effect of poorly designed remuneration structures on the sound management of risk and control of risk-taking behaviour by individuals*."

The remuneration rules do not relate to management or to performance fees charged by an AIFM or investment manager, rather they rebate to the remuneration of "identified staff" of the AIFM and, as explained below, of its delegates.

The remuneration rules are imposed by Article 13 of the Directive, with Annex II of the Directive setting out a series of principles which must be complied with by AIFMs "*in a way and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities*". In other words, a proportionality principle does apply.

As contemplated by the Directive, ESMA has issued its Guidelines on Sound Remuneration Policies under the AIFMD (the "**Remuneration Guidelines**"), a surprising element of which is ESMA's decision to indirectly apply the rules to the delegates of an AIFM. Whilst this may be of concern (with some element of resignation) to delegates based within the EU given the broad applicability of similar remuneration policies in the UCITS, MiFID and banking sectors, it is of greater concern to non-EU managers engaged as delegates to provide investment management services to AIFMs. Some of the concerns which non-EU managers have expressed include that the indirect imposition of the Remuneration Guidelines could cause the non-EU managers to be in breach of contractual obligations under employment contracts, could breach local employment legislation and that they may be impossible to introduce where the affected individuals run multiple portfolios, some of which are within the scope of the Remuneration Guidelines and others which are not. In addition, the Remuneration Guidelines which affect, for example, pension arrangements could be contrary to local pensions legislation in jurisdictions outside the EU.

We refer to the Annex II principles and the ESMA Guidelines together as the "Remuneration Rules".

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8.1 When do the Remuneration Rules apply?

Consistent with the requirement that, from July 22,2013, an EU AIFM must, be authorised under the Directive, subject to the transitional provisions, the Remuneration Rules apply to EU-AIFMs from July 22, 2013 but also subject to the Directive's transitional provisions.

In the case of non-EU AIFMs, the ESMA Guidelines provide that that the Remuneration Rules will not apply, other than certain disclosure obligations, for as long as the capacity exists (and this will depend on the individual EU Member States) for a non-EU AIFM to privately place an AIF with professional investors in the relevant EU Member State (i.e. on a private placement basis without using the passport). Once private placement regimes come to end, the non-EU AIFMs will be subject to the full remuneration provisions set out in the Guidelines.

However, we understand that if a non-EU AIFM obtains an authorisation from an EU Member State of reference before then, it will then become subject to the Remuneration Rules. As explained previously, the Irish Central Bank has indicated that a non-EU AIFM of an Irish QIAIF will be able to seek authorisation in Ireland from July 22, 2013.

Otherwise, the Remuneration Guidelines apply to external AIFMs and also to internally managed AIFs. Where an AIF is not internally managed and has appointed an external AIFM, the AIF itself it is not subject to the Remuneration Guidelines.

8.2 To whom do the Remuneration Rules apply?

The Remuneration Rules apply in respect of any type of remuneration paid by the AIFM or paid directly by the AIF, including carried interest, and to unit or share transfers made to those categories of AIFM staff, including senior management, risk takers, control functions, and any employees receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the risk profiles of the AIFMs or of the AIFs they manage. As noted above, there is an indirect application also to staff within delegates of the AIFM, even non-EU delegates.

ESMA expands upon this, explaining that its Guidelines apply in relation to the remuneration policies and practices for AIFMs and their "*identified staff*". Annex II of the Guidelines sets out details on which of the Guidelines apply to AIFMs as a whole and which apply to their "*identified staff*" only. The AIFM must be in a position to demonstrate how it has assessed and selected "*identified staff*" subject to the Rules. AIFMs are not however required to report whether they comply with the Remuneration Guidelines.

The following definitions from the ESMA Guidelines are relevant in this regard:

(i) "*identified staff*" means categories of staff, including senior management, risk takers, *control functions* and any employees receiving total remuneration that takes them into the same *remuneration bracket* as senior management and risk takers, whose professional activities have a material impact on the AIFM's risk profiles of that AIF that it manages and categories of staff of the entity(ies) to which portfolio management or risk management activities have been delegated by the AIFM, whose professional activities have a material impact on the risk profiles of the AIF that the AIFM manages. Note: Includes executive / non-executive Board members.

(ii) "*control functions*" means staff (other than senior management) responsible for risk management, compliance, internal audit and similar functions within an AIFM (e.g. the CFO to the extent that he/she is responsible for the preparation of the financial statements).

(iii) *remuneration bracket*" means the range of the total remuneration of each of the staff members in the senior manager and the risk taker categories – from the highest paid to the lowest paid in these categories.

(iv) "*instruments"* means units or shares of the AIFs managed by the AIFM or equivalent ownership interests (including – for AIFs issuing only units – unit linked instruments), subject to the legal structure of the AIFs concerned and their rules or instruments of incorporation, or share-linked instruments or equivalent non-cash instruments.

(v) "*malus*" means arrangement that permits the AIFM to prevent vesting of all or part of the amount of a deferred remuneration award in relation to risk outcomes or performances of the AIFM as a whole, the business unit, the AIF and, where possible the staff member. Malus is a form of ex-post risk adjustment.

(vi) "*clawback*" means contractual agreement in which the staff member agrees to return ownership of an amount of remuneration to the AIFM under certain circumstances. This can be applied to both upfront and deferred variable remuneration. When related to risk outcomes, clawback is a form of ex-post risk adjustment.

(vii) "*supervisor function*" means the relevant person or body or bodies responsible for the supervision of the AIFM's senior management and for the assessment and periodical review of the adequacy and effectiveness of the risk management process and of the policies, arrangements and procedures put in place to comply with the obligations under the AIFMD. For those AIFMs that given their size, internal organisation and the nature, scope and complexity of their activities or their legal structure do not have a separate supervisory function, the supervisory function should be understood as the members of the *management body* responsible for these functions.

8.3 What Remuneration is covered?

The Guidelines apply to remuneration of any type paid by the AIFM, any amount paid directly by the AIF itself, including carried interest, and to any transfer of units or shares of the AIF made to the "*identified staff*" in exchange for professional services rendered by them.

The Guidelines explain that remuneration can be divided into either fixed remuneration (payments or benefits without consideration of any performance criteria) or variable remuneration (additional payments or benefits depending on performance or, in certain cases, other contractual criteria). Both components of remuneration (fixed and variable) may include monetary payments or benefits (such as cash, shares, options, cancellation of loans to staff members at dismissal, pension contributions, remuneration by AIFs e.g. through carried interest models) or indirect monetary benefits (such as, discounts, fringe benefits or special allowances for car, mobile phone, etc.). Ancillary payments or benefits that are part of a general, non-discretionary, AIFM-wide policy and pose no incentive effects in terms of risk assumption can be excluded from this definition of remuneration.

The Guidelines also explain that any payment made directly by the AIF to the benefit of certain categories of staff which consists of a pro-rata return on any investment made by those staff members into the AIF should not be subject to any of the remuneration provisions set out in the Guidelines. However, in order for a return on an investment made by the staff member into the AIF to be considered as exempted from the remuneration provisions, the investment needs to consist of an actual disbursement made by the staff member (i.e. loans granted by the AIFM to the staff member in order to allow a co-investment into the AIF should not be considered as an investment for the purposes of the exemption if the loan has not been reimbursed by the staff member by the time the return is paid).

8.4 What do the Rules provide?

The principles set down in Annex II to the Directive cover matters such as the rationale behind such policies; who is to set, review and be responsible for the implementation of the policies and the annual review of same; distinctions between control functions and senior officers within the risk management and compliance functions; principles regarding performance related remuneration and guaranteed variable remuneration; the balance between fixed and variable components of total remuneration; limitations on termination payments (golden parachutes); the potential composition of variable remuneration; as well as principles regarding pensions.

Annex II to the Directive also contains anti-avoidance provisions.

8.4.1 High Level Principles

The remuneration policy is required to be consistent with and promote sound and effective risk management and not encourage risk taking inconsistent with the risk profiles, rules or instruments of incorporation of the AIFs managed.

In addition, the policy should be in line with the business strategies, objectives, values and interests of the AIFM and the AIFs it manages or the investors of such AIFs and should include measures to avoid conflicts of interest.

8.4.2 Adoption / Review / Implementation

Broadly speaking, the remuneration policy should be adopted by the management body of the AIFM (i.e. its board) which should periodically review the general principles of the policy and be responsible for its implementation. How it is implemented should, at least on annual basis, be subject to central and independent internal review for compliance with the adopted policies and procedures. These procedures are addressed at length in the Guidelines.

8.4.3 Different Staff Positions

The remuneration of senior officers within the risk management and compliance functions should be directly overseen by the AIFM's remuneration committee. Staff engaged in control functions should be compensated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control.

8.4.4 Performance Related Remuneration

Where remuneration is performance related, Annex II to the Directive indicates that the total amount of remuneration should be based on a combination of the assessment of the individual's performance and that of the business unit or AIF concerned <u>and</u> of the overall results of the AIFM. Financial as well as non-financial criteria should be taken into account when assessing individual performance.

It also indicates that the assessment of performance should be set in a multi-year framework appropriate to the life cycle of the AIFs managed and explains that the rationale behind such a requirement is to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-based components of remuneration is spread over a period which takes account of the redemption policy of the AIFs managed by the AIFM and their investment risks.

8.4.5 Fixed and Variable Components

Fixed and variable components of total remuneration should be appropriately balanced, with the fixed component representing a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy on variable remuneration components, including the possibility to pay no variable remuneration component.

The Directive does not impose a strict limit as to variable compensation versus fixed compensation in an absolute sense. Instead, one of the principles to be adhered to in formulating a remuneration policy is that *"fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy, on variable remuneration components, including the possibility to pay no variable remuneration component."* There is no strict limit as to the ratio between the two.

The Directive is more prescriptive in the case of the make-up of the variable remuneration itself, as discussed below under "Composition of Variable Remuneration".

There is no limit on fixed compensation and Annex II to the Directive envisages the possibility of paying no variable remuneration at all. AIFMs and their affected delegates will however still need to look at the general principles, being that the remuneration policy is consistent with and promotes sound and effective risk management / does not encourage risk taking which is inconsistent with the risk profile, etc.

Guaranteed variable remuneration should be exceptional and occur only in the context of hiring new staff and be limited to the first year of employment.

The principles also indicate that performance measurement used to calculate variable remuneration or pools of variable remuneration should include a comprehensive adjustment mechanism to integrate all relevant types of current and future risks.

8.4.6 Contractual provisions regarding Early Termination

Payments related to early termination of a contract should also reflect performance achieved over time and be designed in a way that does not reward failure.

"Golden parachute" arrangements for staff members who are leaving the AIFM and which generate large payouts without any performance and risk adjustment should be considered inconsistent with the principles. Any such payments should be related to performance achieved over time and designed in a way that does not reward failure. This should not preclude termination payments in situations such as early termination of the contract due to changes in the strategy of the AIFM or of the AIFs it manages, or in merger and/or takeover situations.

8.4.7 Composition of Variable Remuneration

Where the legal structure of the AIF and its rules or instruments of incorporation allow, the Annex indicates that a substantial proportion, and in any event at least 50% of variable remuneration, should consist of units or shares in the relevant AIF or equivalent ownership interest or share-linked instruments or equivalent non-cash instruments except where the management of AIFs accounts for less than 50% of the total portfolio managed by the AIFM in which case that minimum 50% figure does not apply.

Appropriate retention policies designed to align with the interests of the AIFM and the AIFs managed and the investors in AIFs should be applied and Member States are given some flexibility in this regard at least in so far as they may be able to restrict (or ban) the types of instruments which may comprise variable remuneration.

8.4.8 Deferral of Variable Remuneration

At least 40% of the variable remuneration component should be deferred over a period appropriate to the life cycle and redemption policy of the AIFs concerned and be aligned with the nature of the risks of the AIFs in question. Unless the lifecycle of the AIF concerned is shorter, the period of deferral should be at least 3 to 5 years with vesting limitations also being imposed. It is important to note the additional principle from Annex II which indicates that the total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the AIFM or the AIF concerned occurs when taking into account both current compensation and reductions in payouts of amounts previously earned, including through *malus* or *clawback* arrangements.

8.4.9 Pensions

In the case of discretionary pension benefits, as part of the variable remuneration, a staff member should not retire or leave the AIFM with such benefits vested, with no consideration of the economic situation of the AIFs that the AIFM manages or risks that have been taken by the staff member in the long term. In order to align this specific kind of pension benefits with the economic situation of the AIFs that the AIFM manages, discretionary pension benefits, where legally possible according to the relevant pension legislation, should be paid in the form of *instruments.*

Where a staff member leaves the AIFM before retirement, the discretionary pension benefits should not be vested before a period of five years and should be subject to performance assessment and ex post risk adjustment before pay out. Where the employee reaches retirement, pensions benefits vested to that employee must be subject to a 5 year retention policy.

8.4.10 Dividends

In relation to the issue of dividends received by an owner of a delegate investment manager, paragraph 17 of the Guidelines states that: *"Consideration should also be given to the position of partnerships and similar structures. Dividends or similar distributions that partners receive as owners of an AIFM are not covered by these Guidelines, unless the material outcome of the payment of such dividends results in a circumvention of the relevant remuneration rules, any intention to circumvent such rules being irrelevant for such purpose."*

In other words, the rules do not apply to dividends paid but if, irrespective of what the intention is, the "material outcome" (which is not defined in the Guidelines) of the payment of dividends results in a circumvention of the rules, then there is an issue. Clearly the dividends are paid to the partners as owners of the firm rather than as employees.

Although not entirely free of doubt, it does not seem that the dividend related rules apply to delegates.

8.4.11 Anti Avoidance

The Annex also indicates that variable remuneration should not be paid through vehicles or methods that facilitate the avoidance of the requirements of the Directive and that staff are required not to undertake to use hedging strategies or remuneration and liability related insurance to undermine the risk alignment effects embedded in the remuneration arrangements.

8.5 What about Delegates?

As noted above, the remuneration rules indirectly apply to the same categories of identified staff within the delegates of an AIFM.

In its response to discussion of this issue, the Guidelines indicate that the remuneration rules are <u>not directly</u> imposed on third party delegates. Rather, ESMA has indicated that what it is seeking to achieve is that through the delegation of activities the remuneration rules set out in the Directive are not circumvented.

What the Guidelines actually say is that: "When delegating portfolio management or risk management activities …, the AIFM should ensure that:

(i) the entities to which portfolio management or risk management activities have been delegated are subject to regulatory requirements on remuneration that are equally as effective as those applicable under these Guidelines, or

(ii) appropriate contractual arrangements are put in place with entities to which portfolio management or risk management activities have been delegated in order to ensure that there is no circumvention of the remuneration rules set out in the present Guidelines; these contractual arrangements should cover any payments made to the delegate's identified staff as compensation for the performance of portfolio or risk management activities on behalf of the AIFM."

Therefore, the obligation falls on the AIFM to ensure that delegates comply with the remuneration rules outlined above or, alternatively, are subject to equally effective remuneration policies under their home authorisation. If a non-EU delegate is "subject to regulatory requirements on remuneration that are equally as effective as those applicable" under the Guidelines, then that should be sufficient. Arguably, one may be subject to regulatory requirements but may be able to avail of an exemption or be below a threshold imposed by such regulatory requirements. In other words, if there are US regulations on remuneration to which a US delegate is subject, even if the delegate is below the threshold for the application of those regulations, arguably it may be able to avail of (i) above.

In any event, on the assumption that the delegate enters into contractual arrangements with the AIFM, the provisions of paragraph (ii) above suggest that delegates will be obliged to observe the Remuneration Guidelines by virtue of the contractual arrangement between the AIFM and the delegate.

8.6 The Role of the Remuneration Committee

A remuneration committee must be established where an AIFM is significant in terms of size or the size of the funds it manages or its internal organisation or nature and scope of complexity of its activities. However, the Remuneration Guidelines suggest that the establishment of a remuneration committee should be considered good practice for AIFMs which are not necessarily required to establish same under the Directive. The Annex to the Directive sets out rules that should be followed when establishing such a remuneration committee and the responsibilities of any such committee.

8.7 Proportionality

The principles governing remuneration policies recognise that AIFMs are able to apply those policies in different ways according to their size and the size of the AIFs they manage, their internal organisation and the nature, the scope and the complexity of their activities.

Accordingly, not all AIFMs should have to give substance to the remuneration requirements in the same way and to the same extent. Proportionality should operate both ways: some AIFMs will need to apply more sophisticated policies or practices in fulfilling the requirements; other AIFMs can meet the requirements of the AIFMD in a simpler or less burdensome way.

The Remuneration Guidelines recognise that, proportionality may lead, on an exceptional basis and taking into account specific facts, to the disapplication of some requirements if this is reconcilable with the risk profile, risk appetite and the strategy of the AIFM and the AIFs it manages and within the limits set by the present guidelines.

The following are the only requirements that may be disapplied and then only if it is proportionate to do so:

(i) the requirements on the pay-out process. This means that some AIFMs, either for the total of their *identified staff* or for some categories within their *identified staff*, may decide not to apply the requirements on:

- variable remuneration in *instruments*;
- retention;
- deferral;
- ex post incorporation of risk for variable remuneration;

(ii) the requirement to establish a remuneration committee.

If AIFMs deem a dis-application from these requirements appropriate for their type of AIFM or *identified staff*, they should be able to explain to competent authorities, if requested, the rationale for each requirement which has been disapplied.

8.8 Remuneration Disclosure in the Annual Report

An AIFM shall, for each of the EU AIFs it manages and for each of the AIFs it markets in the EU, make available an annual report for each financial year no later than 6 months following the end of the financial year. The annual report disclosure shall at least contain the total amount of remuneration for the financial year, split into fixed and variable remuneration, paid by the AIFM to its staff, and number of beneficiaries, and, where relevant, carried interest paid by the AIF. It must also disclose the aggregate amount of remuneration broken down by senior management and members of staff of the AIFM whose actions have a material impact on the risk profile of the AIF.

It is not clear whether this disclosure obligation also covers the staff of delegates of the AIFM. We note however that in the relevant part of the Guidelines dealing with disclosure ESMA refers to the staff of the AIFM, not the wider term "*identified staff*".

Where information is disclosed at the level of the AIFM, an allocation or breakdown shall be provided in relation to each AIF, insofar as this information exists or is readily available. As part of this disclosure, a description of how the allocation or breakdown has been provided shall be included.

AIFMs shall provide general information relating to the financial and non-financial criteria of the remuneration policies and practices for relevant categories of staff to enable investors to assess the incentives created. In accordance with the principles set out in Annex II of Directive 2011/61/EU, AIFMs shall disclose at least the information necessary to provide an understanding of the risk profile of the AIF and the measures it adopts to avoid or manage conflicts of interest.

9. AIFMD Depositary Requirements and Depositary Liability

One of the Directive's means of achieving greater levels of investor protection is to require the appointment of a depositary to carry out specific functions including the monitoring of cash flows and safekeeping of assets as well as general regulatory oversight responsibilities and to impose stringent liability provisions on depositaries.

The Directive requires every AIFM to ensure that, for each AIF it manages, a single depositary has been appointed and that the appointment is formalised in a written contract regulating at least the flow of information necessary to enable the depositary to perform its functions.

The depositary requirements as set out in the Directive and as clarified by the Level 2 Regulation are summarised in this Section as are the additional rules imposed by the Irish Central Bank on Irish depositaries.

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9.1 Criteria for Appointment of a Depositary

The entities eligible to act as depositary to an AIF will depend on whether the AIF is an EU AIF or a non-EU AIF and on the types of assets to be kept. The AIFM cannot be the depositary.

9.1.1 Who can act as depositary?

For EU AIFs, the depositary must be one of the following:

(i) an EU credit institution;

(ii) a MiFID investment firm authorized to provide custodial services and which meets certain capital requirements;

(iii) other entities subject to prudential regulation and ongoing supervision which are eligible to act as UCITS depositaries.

For non- EU AIFs, the depositary may also be a credit institution or other entity of the same nature as the entities referred to in (i) and (ii) above, provided it is subject to effective prudential regulation including minimum capital requirements and supervision which have the same effect as EU law.

Member States may also allow an entity such as a notary, lawyer or registrar to be appointed to carry out the depositary function of AIFs which have no redemption rights exercisable for 5 years and which either do not invest in assets that must be "held in custody" or generally invest in issuers or non-listed companies for the purpose of acquiring control (such as private equity, venture capital and real estate funds), provided the entity in question is subject to professional registration or mandatory rules of conduct in respect of the depositary function and can provide sufficient financial and professional guarantees.

A prime broker acting as counterparty to an AIF may act as depositary where it has separated the performance of its depositary functions from its tasks as prime broker and all potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF. In addition the depositary may delegate its custody related functions to such prime broker, subject to compliance with the delegation rules.

9.1.2 Place of Establishment of Depositary

The depositary is required to be established in one of the following locations:

(i) for EU AIFs, in the home Member State of the AIF;

(ii) for non-EU AIFs, in the third country where the AIF is established or in the home Member State of the AIFM managing the AIF or in the EU Member State of reference of the AIFM managing the AIF.

9.1.3 Third Country Depositaries

The appointment of a depositary established in a third country is subject to the following additional requirements:

(i) co-operation and exchange of information arrangements must be in place between the regulator of the depositary and the regulators of the EU Member States in which the shares/units of the non-EU AIFs are intended to be marketed, and, in so far as different, of the home Member State of the AIFM;

(ii) the depositary must be subject to effective prudential regulation, including minimum capital requirements, and supervision which have the same effect as EU law;

(iii) the third country where the depositary is established is not listed as a Non-Cooperative Country and Territory by FATF;

(iv) the EU Member States in which the shares/units of the non-EU AIF are intended to be marketed (and, in so far as different, the home Member State of the AIFM), have signed tax information exchange agreements with the third country which comply with required OECD standards; and

(v) the depositary must be liable by contract to the AIF or to its investors in a manner which is consistent with the liability provisions in the Directive and must expressly agree to comply with the requirements as to delegation of the safekeeping of assets as set out in the Directive.

9.1.4 Particulars of Contract of Appointment

The written contract pursuant to which the depositary is appointed (by the AIF or by the AIFM on behalf of the AIF) must include at least the following:

(i) a description of the services to be provided by the depositary and the procedures for each type of asset which will be entrusted to the depositary;

(ii) a description of how safekeeping and oversight functions are to be performed depending on the types of assets and the geographic regions in which the AIF plans to invest, to include country lists and procedures for adding to, and withdrawing countries from that list;

(iii) a statement that the depositary's liability shall not be affected by any delegation of custody functions unless there has been an express discharge of liability;

(iv) duration (term) of contract, conditions for amendment and termination of the contract and procedures to give effect to termination;

(v) confidentiality obligations applicable to both parties;

(vi) processes and procedures for communications as between depositary and the AIFM;

(vii) information on the extent to which the depositary or its sub-custodian may re-use assets which have been entrusted to it and the conditions attached to any such re-use;

(viii) procedures to be followed when there is an amendment to the AIF documentation, detailing situations when the depositary needs to be informed or where the prior agreement of the depositary is needed to proceed with the amendment;

(ix) all necessary information that needs to be exchanged between the AIF, the AIFM, a third party acting on behalf of the AIF or the AIFM and the depositary relating to the performance of the depositary's oversight and control functions;

(x) where the parties envisage the appointment of third parties to carry out parts of their respective duties, a commitment to provide, on a regular basis, details of any third party appointed and, upon request, information on the criteria used to select the third party and the steps envisaged to monitor the activities carried out by the selected third party;

(xi) information on the tasks and responsibilities of the parties to the contract in respect of obligations relating to the prevention of money laundering and the financing of terrorism;

(xii) information on all cash accounts opened in the name of the AIF and the procedures which ensure that the depositary will be informed when any new account is opened in the name of the AIF;

(xiii) details regarding the depositary's escalation procedures;

(xiv) a commitment on the part of the depositary to notify the AIFM when it becomes aware that segregation of assets is not sufficient to ensure protection from insolvency; and

(xv) procedures ensuring that the depositary, in respect of its duties, has the ability to enquire into the conduct of the AIFM or the AIF and to assess the quality of information transmitted including by way of having on site access to the books of the AIF and/or AIFM.

Note that the details of the means and procedures referred to above must be described in the contract.

9.2 Duties of Depositary

The depositary is required to carry out the following functions:

9.2.1 Monitoring of Cash Flows

The depositary must ensure that the AIF's cash flows are properly monitored and in particular that all subscription payments have been received and that cash belonging to the AIF is booked correctly in cash accounts opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF or in the name of the depositary acting on behalf of the AIF. Such cash must be booked at:

(i) a central bank, an EU credit institution or a bank authorized in a third country, or

(ii) another entity of the same nature in the relevant market where cash accounts are required, provided that such entity is subject to effective prudential regulation and supervision which have the same effect as EU law .

Where cash accounts are opened in the name of the depositary on behalf of the AIF, no cash of the entity holding the cash account and none of the depositary's own cash may be held in that cash account.

Article 86 of Level 2 Regulation provides additional clarity in relation to the obligations of the depositary in respect the monitoring of cash flows. The depositary must ensure effective and proper monitoring of the AIF's cash flows and further the depositary shall at least:

(i) ensure the cash of the AIF is booked in accounts with an appropriate third party and that such third party is subject to prudential supervision and supervision that has the same effect as EU law;

(ii) implement effective and proper procedures to reconcile all cash flow movements and perform such reconciliations on a daily basis or, in case of infrequent cash movements when such cash flow movements occur;

(iii) implement appropriate procedures to identify significant cash flows at the end of each business day and in particular those that would be inconsistent with the AIF's operations;

(iv) review periodically the adequacy of those procedures at least once a year and ensure that the AIF's cash accounts are included in that process;

(v) monitor on an ongoing basis the outcomes of the reconciliation process and actions taken and notify the AIFM and the competent authorities if any discrepancies cannot be clarified or corrected;

(vi) check the consistency of its own records of cash positions with those of the AIFM.

9.2.2 Safe-keeping of Assets

The Directive requires that the assets of the AIF shall be entrusted to the depositary for safekeeping. In respect of the safekeeping function, the Directive distinguishes between "financial instruments that can be held in custody" and "other assets" as follows:

(i) Financial instruments to be held in custody

The Directive provides that the depositary shall hold in its custody all financial instruments that can be registered in a financial instruments account opened in the depositary's books and all financial instruments that can be physically delivered to the depositary. These instruments must be registered in segregated accounts within the depositary's books so that they can be clearly identified as belonging to the AIF at all times.

The Level 2 Regulation (Article 88) provides that financial instruments which cannot be physically delivered to the depositary shall fall within the scope of the depositary's custody duties where:

(a) they are transferable securities including those which embed derivatives, money market instruments and units of collective investment undertakings;

(b) they are capable of being registered or held in an account directly or indirectly in the name of the depositary.

It is worth noting that this provision would appear to provide that assets which are to be used as collateral for obligations of the AIF but which are not transferred to a counterparty by way of a title transfer arrangement must be held in custody by or on behalf of the depositary.

Financial instruments which, in accordance with applicable national law, may only be registered in the name of the AIF with the issuer itself or its agent (e.g. a registrar or transfer agent) shall not be deemed to fall within the scope of the custody duties of the depositary.

The depositary's safekeeping duties in respect of financial instruments to be held in custody shall apply on a look-through basis to underlying assets held by financial and/or legal structures controlled directly or indirectly by the AIF or the AIFM acting on behalf of the AIF. Article 89 of the Level 2 Regulation also provides further clarity on the obligations of the depositary as regards the safekeeping of assets which may be held in custody including obligations to ensure that records and segregated accounts are maintained so as to ensure their accuracy, to ensure that appropriate steps are taken to identify and monitor custody risks and to implement adequate organisational arrangements to minimise the risk of loss of the financial instrument.

(ii) Other Assets

In the case of "other assets", the depositary's duty is to verify the AIF's ownership of such assets and to maintain a record of those assets for which it is satisfied that the AIF (or the AIFM acting on behalf of the AIF) holds ownership of such assets. The assessment of ownership must be based on information or documents provided by the AIF or the AIFM and, where available, on external evidence. The depositary must also keep its records up-to-date.

As to the meaning of "other assets", ESMA advices state that all financial instruments that do not comply with ESMA's criteria for "assets in custody" should be considered as 'other assets' and be subject to record keeping duties.

Article 90 of the Level 2 Regulation provides further clarity on the safekeeping duties of the depositary as regards ownership verification and record keeping. In particular the depositary shall at least:

(a) have access without undue delay to all information it requires in order to perform the ownership verification and record keeping duties;

(b) possess sufficient and reliable information for it to be satisfied of the AIF's ownership right or of the ownership right of the AIFM acting on behalf of the AIF;

(c) maintain a record of those assets for which it is satisfied the AIF or AIFM on behalf of the AIF holds ownership and be able at any time to provide a comprehensive and up-to-date inventory of the AIF's assets, including their respective notional amounts. In this regard the depositary is required to ensure that there are procedures in place so that registered assets cannot be assigned, transferred, exchanged or delivered without the depositary or its delegate having been informed of such transactions and the depositary shall have access without undue delay to documentary evidence of each transaction and position from the relevant third party;

(d) ensure that the AIFM has and implements procedures to verify that the assets are appropriately registered in the name of the AIF and to check consistency between AIFM's records and those of the depositary;

(e) provide for an escalation procedure where there is an anomaly detected between the two sets of records including notification to the AIFM and competent authority if the anomaly could not be clarified or corrected.

As in the case of "assets in custody", the above duties apply on a look-through basis to underlying assets.

9.2.3 Oversight Responsibility

In addition to the tasks referred to above, the Directive provides that the depositary has certain oversight responsibilities (similar to those set out in the UCITS Directive) as follows:

(i) to ensure that the sale, issue, re-purchase, redemption and cancellation of shares/units are carried out in accordance with the applicable national law and the AIF rules;

(ii) to ensure that the value of the shares/units is calculated in accordance with the applicable national law, the AIF rules and the valuation procedures set down in the Directive;

(iii) to carry out the instructions of the AIFM, unless they conflict with the applicable national law or the AIF rules;

(iv) to ensure that in transactions involving the AIF's assets any consideration is remitted to the AIF within the usual time limits;

(v) to ensure that an AIF's income is applied in accordance with the applicable national law and the AIF rules.

In order to comply with its oversight responsibilities, the Level 2 Regulation (Article 92) provides for certain general requirements so that, when appointed, the depositary must assess the risks associated with the AIF's strategy and formulate its oversight procedures in a manner appropriate to that AIF. In practical terms, one expects that the depositary will perform its oversight duties by way of *ex-post* controls and verifications and processes of the relevant parties and by ensuring that an appropriate verification and reconciliation procedure exists which is implemented and applied and frequently reviewed. Again there is a requirement for an appropriate escalation procedure to deal with any irregularities detected in the course of exercising its oversight function.

The Level 2 Regulation provide further granular detail in Articles 93 to 97 on the processes and procedures to be put in place for each of the specific oversight duties and functions.

9.2.4 Duty to act honestly and fairly / Conflicts

In its role, the depositary must act honestly, fairly, professionally, independently and in the interest of the AIF and the investors of the AIF.

A depositary is not permitted to carry out activities with regard to the AIF or the AIFM on behalf of the AIF which may create conflicts of interest between the AIF, the investors in the AIF, the AIFM and itself, unless the depositary has separated the performance of its depositary tasks from its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF.

9.3 Delegation

Subject to compliance with a strict set of conditions, the depositary can delegate its safe keeping functions but not any of its oversight responsibilities. However, there can be no delegation of safekeeping with the intention of avoiding the requirements of the Directive and the depositary must be able to demonstrate that there is an "objective reason" for the delegation and that it exercises all due skill, care and diligence in the selection and the appointment of any third party and in the periodic review and ongoing monitoring of such third party.

It is worth noting that Recital 42 of the Directive makes it clear that the delegation of supporting tasks, such as administrative or technical functions performed by the depositary as part of its depositary tasks, is not subject to the delegation requirements of the Directive.

9.4 Due Diligence

Article 98 of the Level 2 Regulation sets out in detail the requirements as to due diligence in the case of a delegation by the depositary. In summary, the depositary must implement and apply an appropriate documented due diligence procedure for the selection and on-going monitoring of the delegate. The procedure must be reviewed regularly, at least once a year, and made available on request to competent authorities. The due diligence requirements distinguish between (i) due diligence as to selection and appointment and (ii) due diligence as to on-going monitoring

9.4.1 Due Diligence in relation to selection and appointment

The depositary must assess the regulatory and legal framework including country risk, custody risk and the enforceability of the third party's contracts and such assessment must enable the depositary to determine the potential implication of an insolvency of the third party (and if segregation is insufficient to protect on insolvency, the depositary must immediately inform the AIFM).

It must also assess whether the sub-custodian's practice, procedures and internal controls are adequate to ensure the financial instruments will be subject to a high standard of care and protection and must assess whether the sub-custodian's financial strength and reputation are consistent with the delegated tasks. This assessment should be based on information provided by the potential sub-custodian as well as third party data and information, where available.

The Depositary must also ensure the sub-custodian has the operational and technological capabilities to perform the delegated custody tasks with a satisfactory degree of protection and security.

9.4.2 Due Diligence in relation to on-going monitoring

The depositary is required to monitor the sub-custodian's performance and its compliance with the depositary's standards. It must also ensure that the sub-custodian exercises a high standard of care, prudence and diligence in the performance of its custody tasks and particularly that it effectively segregates the financial instruments in line with the requirements set out in the Level 2 Regulation.

The depository must also review the custody risks associated with the decision to entrust the assets to the sub-custodian and promptly notify the AIF or AIFM of any change in those risks. This assessment should be based on information provided by the sub-custodian as well as third party data and information, where available. During market turmoil or when a risk has been identified, the frequency and the scope of the review should be increased. If the depositary becomes aware that the segregation of assets is no longer sufficient to ensure protection from insolvency because of the law of the country where the third party is located, it must immediately inform the AIFM.

A depositary must also devise contingency plans for each market in which it appoints a third party including the identification of an alternative provider, if any. The depositary must also take measures including termination of a contract where the delegate no longer satisfies the requirements for delegation.

9.5 Third Party Criteria

In addition to the due diligence requirements set out above, the Directive requires that the depositary must ensure that the third party delegate meets the following conditions:

(i) it must have the structures and the expertise that are adequate and proportionate to the nature and complexity of the assets of the AIF entrusted to it;

(ii) for custody tasks in respect of instruments that can be held in custody, the third party must be subject to effective prudential regulation, including minimum capital requirements, and supervision in the jurisdiction concerned and the third party is subject to an external periodic audit to ensure that the financial instruments are in its possession;

(iii) the third party must segregate the assets of the depositary's clients from its own assets and from the assets of the depositary in such a way that they can at any time be clearly identified as belonging to clients of a particular depositary;

(iv) the third party must not make use of the assets without the prior consent of the AIF or the AIFM acting on behalf of the AIF; and

(v) the third party complies with the general safekeeping obligations under the Directive and the duty to act honestly and fairly in the interests of investors and avoids conflicts of interest.

However, where the law of a third country requires that certain financial instruments be held in custody by a local entity and no local entities satisfy the delegation requirements laid down in the Directive, the depositary may delegate its functions to such a local entity only to the extent required by the law of the third country and only for as long as there are no local entities that satisfy the delegation requirements provided investors are duly informed of the situation and the AIF, or the AIFM on behalf of the AIF, has instructed the depositary to delegate the custody of such financial instruments to such local entity.

Note that a third party may in turn sub-delegate its safe-keeping duties, in which case the delegation rules set out in the Directive will also apply.

The Directive clarifies that the provision of services by securities settlement systems shall not be considered a delegation of custody functions.

9.6 Third Party Segregation Obligations

As set out above, delegation to a third party is only permitted if the third party can segregate its assets from client assets and those of the depositary. The main objective of the segregation obligations all along the custody chain is to prevent the loss of assets as a result of the insolvency of a sub-custodian. In order to satisfy the segregation obligations at the level of the sub-custodian, Article 99 of the Level 2 Regulation provides that that the depositary must verify that any third party to which the safekeeping of assets has been delegated will:

(i) keep such records and accounts as are necessary to enable it at any time and without delay to distinguish assets held on behalf of the depositary for its AIF clients from (a) its own assets (b) the assets of its other clients (c) the assets held by the depositary for its own account and (d) the assets held for the depositary's clients which are not AIFs;

(ii) maintain accurate records and accounts;

(iii) conduct regular reconciliations;

(iv) take the necessary steps to ensure that where the third party is an EU credit institution, central bank or bank authorised in a third country, cash belonging to the depositary's AIF clients is booked in accounts in accordance with the requirements of the Directive;

(v) introduce adequate organisational arrangements to minimise the risk of the loss or diminution of the financial instruments, as a result of misuse of the financial instruments, fraud, poor administration, inadequate record-keeping or negligence.

Having regard to the on-going monitoring obligations of the depositary, if at any time the depositary determines the above requirements are not sufficient to protect client assets in the event of an insolvency of the sub-custodian, then the depositary should assess what additional arrangements can be made to ensure an adequate level of protection.

Importantly, the Directive acknowledges that sub-custodians may use omnibus accounts, described in Recital 40 to the Directive as "a common segregated account for multiple AIFs".

9.7 Liability

The depositary liability regime is a central issue of the Directive and probably one of the most controversial. The Directive distinguishes between the "loss of financial instruments held in custody" (in which case, a near-strict liability standard is imposed) and any "other losses" (in which case a negligent / intentional failure standard applies).

9.7.1 Liability for Loss of Financial Instruments held in custody

The Directive provides that the depositary shall be liable to the AIF or to its investors for the "loss" by the depositary or by a third party to whom the custody of financial instruments held in custody has been delegated, unless it can prove that the loss is 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. In the case of "loss of a financial instrument", the depositary must return a financial instrument of identical type or the corresponding amount to the AIF or the AIFM acting on behalf of the AIF without undue delay. This is a significant step up in depositary liability compared to the UCITS IV framework.

As to the meaning of "loss", Article 100 of the Level 2 Regulation provides that a loss of a financial instrument held in custody shall be deemed to have taken place when <u>any</u> of the following conditions is met:

(i) a stated right of ownership of the AIF is demonstrated not to be valid because it either ceased to exist or never existed;

(ii) the AIF has been definitively deprived of its right of ownership over the financial instrument;

(iii) the AIF is definitively unable to directly or indirectly dispose of the financial instrument.

The definition of loss thus covers situations where the AIF has been permanently deprived of its ownership right over the financial instrument or is permanently unable to dispose of them. It further ensures that "loss" resulting from fraudulent behaviour is within the scope of the depositary's liability.

In the case of insolvency of a sub-custodian, financial instruments are to be considered lost if any of the above conditions are met with certainty. There shall be certainty as to when any of the conditions set out above are met at the latest at the end of the insolvency proceedings i.e. insolvency itself does not trigger liability on the part of the depositary. The AIFM and the depositary are required to monitor closely insolvency proceedings to determine whether all or some of the financial instruments entrusted to the sub-custodian are effectively lost. The assessment of loss must follow a documented process available to competent authorities and lead to notification to investors in a durable medium.

9.7.2 Avoidance of Liability due to Events beyond its reasonable control

Importantly, the Directive provides that the depositary will not be liable if it can prove that the loss of the financial instruments held in custody 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. Article 101 of the Level 2 Regulation sets the conditions which must be proved by the depositary in order to avoid its liability under the Directive as summarised below.

Firstly, the depositary must be able to prove that the event which led to the loss is not the result of any act or omission of the depositary or of its sub-custodian to meet its obligations.

Secondly, the depositary must prove that it could not have reasonably prevented the occurrence of the event which led to the loss despite adopting all precautions incumbent on a diligent depositary as reflected in common industry practice. Both of the above requirements will be deemed to have been fulfilled by (a) natural events beyond human control or influence or (b) the adoption of any law, decree, regulation, decision or order by any government or governmental body, including any court or tribunal, which impacts the financial instruments held in custody (c) war, riots or major upheavals. However they will not be deemed to have been fulfilled in a list of non-exhaustive circumstances such as accounting error, operational failure, fraud, failure to apply the segregation requirements by the depositary or its sub-custodian.

Finally, the depositary must prove that despite rigorous and comprehensive due diligence, the depositary could not have prevented the loss. In respect of this final arm of the liability test, the depositary will only be deemed to have fulfilled its obligations as to the required level of due diligence when the depositary has ensured that it and its sub-custodian have taken <u>all</u> of the following actions:

(i) establishing, implementing, applying and maintaining structures and procedures that are adequate and proportionate to the nature and complexity of the assets of the AIF in order to identify in a timely manner and monitor on an on-going basis external events which may result in loss of a financial instrument in custody;

(ii) assessing on an on-going basis whether any of the events identified presents a significant risk of loss of a financial instrument held in custody;

(iii) informing the AIFM of the significant risks identified and taking appropriate actions, if any, to prevent or mitigate the loss of financial instruments held in custody, where actual or potential external events have been identified which are believed to present a significant risk of loss of a financial instrument held in custody.

9.7.3 Other Losses

The Directive provides that the depositary shall also be liable to the AIF, or to the investors of the AIF, for all other losses suffered by them as a result of the depositary's negligent or intentional failure to properly fulfil its obligations pursuant to the Directive.

9.7.4 Discharge of Liability to a Third Party

The Directive provides that a depositary's liability will not be affected by any delegation. However, in the case of financial instruments held in custody by a third party, there are two situations where the depositary can discharge itself of liability.

Firstly, in the case of a loss of financial instruments held in custody by a third party, the depositary can discharge itself of liability if it can prove that:

(i) all requirements for the delegation of its custody tasks set out in the Directive have been met;

(ii) a written contract between the depositary and the third party expressly transfers the liability of the depositary to that third party and makes it possible for the AIF or the AIFM acting on behalf of the AIF to make a claim against the third party in respect of the loss of financial instruments or for the depositary to make such a claim on their behalf; and

(iii) a written contract between the depositary and the AIF, or the AIFM acting on behalf of the AIF, expressly allows a discharge of the depositary's liability and establishes the objective reason for contracting such a discharge of liability.

Article 102 of the Level 2 Regulation provides further clarity on what will constitute objective reasons for contracting a discharge of liability and provides that such objective reasons shall be limited to precise and concrete circumstances characterising a given activity and consistent with the depositary's policies and decisions. Such objective reasons shall be deemed to exist where the depositary can demonstrate that it had no other option but to delegate its custody duties to a third party. The Level 2 Regulation provides a non-exhaustive list of circumstances where this shall be the case as follows:

(a) the law of a third country requires that certain financial instruments be held in custody by a local entity and local entities exist that satisfy the delegation criteria set out in the Directive;

(b) the AIFM insists on maintaining an investment in a particular jurisdiction despite warnings by the depositary as to the increased risk this presents.

It is worth noting that the Central Bank has indicated that where a depositary seeks to contractually discharge liability to a third party it must determine the existence of any “objective reason” for th discharge by reference to the particular nature of its business model which is specific to it and which may also vary over time.

Secondly, where a third country legally requires assets to be held by a local entity and there are no local entities which satisfy the delegation requirements of the Directive, the depositary can discharge itself of its liability for the loss of financial instruments provided certain conditions are met, as follows:

(a) the rules of the AIF expressly allow for such a discharge in such circumstances;

(b) the investors of the relevant AIF have been duly informed of that discharge and of the circumstances justifying the discharge prior to their investment;

(c) the AIF or the AIFM on behalf of the AIF instructed the depositary to delegate the custody of such financial instruments to a local entity;

(d) there is a written contract between the depositary and the AIF or the AIFM acting on behalf of the AIF, which expressly allows such a discharge; and

(e) there is a written contract between the depositary and the third party that expressly transfers the liability of the depositary to that local entity and makes it possible for the AIF, or the AIFM acting on behalf of the AIF, to make a claim against that local entity in respect of the loss of financial instruments or for the depositary to make such a claim on their behalf.

Liability to the investors of the AIF may be invoked <u>directly or indirectly</u> through the AIFM, depending on the legal nature of the relationship between the depositary, the AIFM and the investors.

It should be noted that the Directive will not impose liability or require restitution of assets which are held by the depositary with a securities settlement system as this does not constitute a delegation of function.

9.8 Depositaries and Prime Brokerage

The Directive expressly recognises and contemplates the continued use of prime brokers in the provision of services to AIFs, particularly hedge funds. A "prime broker" is defined by the Directive as 'a credit institution, a regulated investment firm or another entity subject to prudential regulation and ongoing supervision, offering services to professional investors primarily to finance or execute transactions in financial instruments as counterparty and which may also provide other services such as clearing and settlement of trades, custodial services, securities lending, customised technology and operational support facilities"

9.8.1 Appointment of a Prime Broker.

The Directive requires that an AIFM must exercise due skill, care and diligence in the selection and appointment of prime brokers. Furthermore where a prime broker is to be appointed the terms of any such appointment shall be set out in a written contract. In particular the contract must include contractual provisions relating to any potential transfer and reuse of an AIF's assets which such use or transfer must be in accordance with the rules applicable to the AIF. The contract shall provide that the depositary be informed of the contract

9.8.2 Custody of Assets

As discussed in some detail above, a key requirement of the Directive is that a depositary is appointed with responsibility, inter alia, for the custody of assets of an AIF. The Directive permits a prime broker which is acting as a counterparty to an AIF to act as depositary provided that it has functionally and hierarchically separated the performance of its depositary functions from its tasks as prime broker and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF. The rationale for this is provided in Recital 43 to the Directive namely it is not possible for a prime broker which acts as counterparty to also act in the best interests of an AIF as is required by a depositary. However, the Directive expressly provides that a prime broker which acts as counterparty to an AIF may custody the assets of an AIF where it has been delegated such custody tasks by the relevant AIF's depositary.

9.8.3 Delegation of Custody by a Depositary to Prime Brokers – Operating Models

The conditions which must be met in respect of a delegation of custody tasks to a third party are set out in some detail above. Such conditions will apply equally to any proposed delegation of custody functions to a prime broker. It is these conditions which have raised a number of issues as regards the operating models which may be adopted by prime brokers in respect of Irish domiciled QIAIFs post implementation of AIFMD and in particular the allocation of the depositary's strict liability for loss of a financial instrument under the Directive.

The current operating model for an Irish domiciled fund appointing prime brokers requires that a prime broker is appointed as sub-custodian by the Irish fund custodian to hold such assets of the fund as are not subject to the right of use or transfer of title collateral arrangements afforded to the prime broker under the prime brokerage agreement. The prime broker in turn holds the assets of the fund in its own sub-custody network and the liability of the prime broker for any loss to the custodian/fund is governed under the terms of the relevant contracts. The extent to which the existing operating model may continue to be used has been the subject of much industry discussion in particular in respect of the manner in which the contractual arrangements as between a depositary and the prime broker may seek to address the strict liability of depositaries for loss of a financial instrument. Two variations on the existing model have emerged as follows:

- The depositary discharges its strict liability for loss of a financial instrument to the prime broker in accordance with AIFMD and the prime broker in turn discharges its liability to the sub-custodians in its own sub-custodial network;

- The depositary retains strict liability but is provided with an indemnity from the prime broker in respect of the loss of a financial instrument held in its custody.

Each variation of the existing model poses potential challenges both from a legal and operational perspective. In relation to the proposal to the discharge of liability referred to above, the arrangement would require compliance with the AIFMD requirements as to discharge of liability but would also on a more practical level require amendment and updating of the prime broker's existing sub-custodial contracts on a fund by fund basis to include either the depositary or AIF as a party and this may be difficult to implement and manage in an efficient and timely manner. On the other hand while the indemnity may seem like a simpler solution, it does require careful consideration of all parties as to the nature and scope of any such indemnity and ultimately leaves the depositary exposed to the prime broker's ability to pay out under that indemnity.

Additional operating models have also been discussed as follows:

- The depositary appoints the prime broker as sub-custodian retaining strict liability for loss of a financial instrument in custody but in turn the prime broker appoints the depositary's own sub-custodial network so as to minimise the risks of exposure to sub-custodians which have not been selected or monitored by the depositary in the first instance;

- The depositary holds all assets and transfers collateral to and recovers collateral from the prime broker on an ongoing basis.

Neither of the above mentioned models have gained any great traction due to the perceived operational complexity and cost implications for prime brokers in implementing such models.

There has been some engagement by industry (including the prime brokers themselves) with the Central Bank as to its preferred approach to the delegation of custody tasks to a prime broker and the operational models to be employed. To date the Central Bank has not provided any formal indication of its preferred approach and it appears that the Central Bank will rely on depositaries and prime brokers to determine the preferred approach having regard to the general rules on establishing “objective reasons” for any contractual discharge of liability to the depositary.

9.8.4 The Level 2 Regulation

It is worth noting that in any event the Level 2 Regulation has sought to address the perceived risks associated with the appointment of prime brokers by providing for detailed requirements as regards an AIFM’s due diligence in respect of their appointment and imposing detailed reporting obligations on any prime brokers appointed. In many cases, it may be that these enhanced due diligence and reporting requirements will go some way to mitigating concerns as to the correct allocation of the depositary’s strict liability.

9.8.5 Due Diligence

In particular Article 20 of the Level 2 Regulation requires that an AIFM should select and appoint only those prime brokers and counterparties, which are subject to ongoing supervision, are financially sound (including assessing whether the prime broker is subject to relevant prudential regulation including adequate capital requirements and effective supervision) and have the necessary organisational structure appropriate to the services to be provided to the AIFM or the AIF. Furthermore senior management of AIFM must approve a list of prime brokers and only in exceptional circumstances appoint a prime broker not so listed where it can demonstrate the reason for such a choice and that the required level of due diligence has been conducted.

9.8.6 Reporting

Article 91 of the Level 2 Regulation requires that an AIFM shall ensure that any agreement entered into by it pursuant to which a prime broker will be appointed will require that the depositary is provided with a statement as at the end of business day which includes detailed information as to, inter alia,

(i) the value of all assets held in custody;

(ii) total amount of all secured obligations;

(iii) the value of assets which cannot be held in custody pursuant to the Directive but which are held as collateral by the prime broker;

(iv) the value of the assets where the prime broker has exercised a right of use in respect of the AIF's assets;

(v) a list of all the institutions at which the prime broker holds or may hold cash of the AIF in an account opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF.

While much of the information required will already form part of a prime broker's suite of reporting documentation, the Regulation's express requirement as to the provision of information as to the value of assets in respect of which the prime broker has exercised its right of use may be problematic for some prime brokers whose systems may not be calibrated to provide such information.

9.9 Depositary Requirements and Private Placement

Under the Directive, Member States may allow an authorised EU AIFM to market a non-EU AIF to professional investors on a private placement basis without the need to comply with the depositary requirements provided that it ensures that one or more persons is appointed to carry out the cash monitoring and safekeeping of assets functions together with the regulatory oversight responsibilities set out in the Directive. Strict liability does not apply. This is often referred to as "Depositary Lite".

A Non-EU AIFM marketing EU AIFs or Non-EU AIFs within the EU on a private placement basis will not need to comply with the depositary requirements. However, it should be noted that as it is in the discretion of each Member State to allow marketing by private placement in its jurisdiction, and bearing in mind that marketing by private placement may be discontinued after 2018, this private placement depositary "exemption" may not be available in all circumstances.

It is also important to note that any marketing of AIFs to professional investors under the AIFMD marketing passport will require compliance with the depositary requirements.

9.10 Irish Depositary Requirements

In its AIF Rulebook, the Central Bank has imposed the following additional rules for Irish depositories:

9.10.1 Eligibility criteria

The depositary must have appropriate expertise and experience to carry out the functions as set out in the AIF Rulebook, the AIFMD Regulations and the Level 2 Regulation. It must have sufficient resources to effectively conduct its business and it must organise and control its internal affairs in a reasonable manner with proper records and adequate arrangements for ensuring that employees are suitable, adequately trained and properly supervised.

9.10.2 Capital requirements and financial reporting

The depositary must have at all times the initial capital of at least €125,000 ("Initial Capital Requirement") or one quarter of its total expenditure taken from the most recent annual accounts ("Expenditure Requirement"), whichever is higher ("Minimum Capital Requirement").

It must calculate its Minimum Capital Requirement in accordance with Annex I of the AIF Rulebook, must have financial resources at least equal of its Minimum Capital Requirement ("Financial Resources") and must hold its Minimum Capital Requirement in the form of Eligible Assets. It must also prepare and submit half-yearly financial and annual audited accounts to the Central Bank. The half-yearly accounts must be submitted within 2 months of the half-year end and the annual accounts within 4 months of the financial year-end. Both must be accompanied by the Minimum Capital Compliance Report.

Annual audited accounts of the corporate shareholder(s) of the company must also be submitted.

9.10.3 Directors/Shareholders

The depositary must have at least two directors that are Irish resident and must notify the Central Bank immediately of the departure of a director. It must not have directors in common with the board of directors of the AIFM or the management company, the fund administrator, the investment company or the general partner.

Approval by the Central Bank is required in respect of any proposed change in ownership or in significant shareholdings. A significant shareholding for the purpose of this condition is defined as a shareholding of 10% or more.

9.10.4 Operational Controls

A depositary must establish, implement, document and maintain accounting policies and procedures that enables the depositary to deliver a timely manner to the Central Bank financial accounts which reflect a true and fair view of its financial position and which comply with all applicable accounting standards and rules.

It must also establish, implement, document and maintain an adequate business continuity policy aimed at ensuring, in the case of an interruption to its systems and procedures, the preservation of essential data and functions, and the maintenance of services and activities, or where that is not possible, the timely recovery of such data and functions and the timely resumption of its services and activities. The business continuity policy must be subject to annual testing.

9.10.5 Depositary tasks

Where the depositary is acting as a depositary for an authorised AIF, the depositary must enquire into the conduct of the AIFM and the management company, investment company or general partner in each annual accounting period and report thereon to the investors. This report shall be delivered to the AIFM in good time to enable the AIFM to include a copy of the report in the annual report of the authorised AIF. This report shall state whether in the depositary's opinion the authorised AIF has been managed in that period:

(i) in accordance with the limitations imposed on the investment and borrowing powers of the authorised AIF by the constitutional document and by the Central Bank under the powers granted to the Central Bank by the investment fund legislation;

(ii) otherwise in accordance with the provisions of the constitutional document and the investment fund legislation.

If the AIFM, management company, investment company or general partner has not complied with (i) or (ii) above, the depositary must state why this is the case and outline the steps which the depositary has taken to rectify the situation.

Where there has been a change of depositary during the accounting period, the annual report must include a depositary report from both the retiring and new depositary to cover their respective periods of appointment.

A depositary must also notify the Central Bank promptly of any material breach of the investment fund legislation, the AIFMD Regulations or Level 2 Regulation, or of the requirements imposed on the AIF or the depositary by the Central Bank or provisions of the AIF's prospectus.

Where a QIAIF proposes to invest more than 50% of net assets in another investment fund, the depositary must, prior to the investment being made, (a) confirm in writing to the Central Bank that the authorised AIF has procedures in place to ensure that the underlying investment fund meets the requirements imposed by the Central Bank; and (b) confirm that the depositary will regularly review the operation of these procedures to ensure that the underlying investment fund continues to meet the requirements imposed by the Central Bank.

The depositary must not permit performance fees to be paid by or on behalf of the authorised AIF unless the calculation of the fee has been verified by the depositary or by a competent person appointed by the AIFM and approved for the purpose by the depositary.

Additionally, subscriptions and redemptions of units of AIF on an in specie basis may only be accepted if the depositary is satisfied that the terms of the exchange will not be such as are likely to result in any material prejudice to the AIF unitholders.

9.10.6 Delegation

The depositary must not delegate to third parties its functions, except in accordance with the Irish AIFMD Regulations. The functions which the depositary has not delegated must be carried out in the Ireland.

9.10.7 Acting as depositary to AIF not authorised by Central Bank

Where a depositary provides services to an AIF not authorised by the Central Bank, it must be satisfied that the prospectus issued by the AIF does not imply, in any way, that the AIF is regulated by the Central Bank and it must submit a quarterly return containing the following aggregate information, for all investment funds not authorised by the Central Bank to which services are provided, within each base currency category: domicile of the investment funds; number of investment funds; number of unitholders; and total net asset value.

10. The Irish QIAIF

At the AIF (or fund) level, the Irish regulatory regime recognises two types of AIF reflecting not only the provisions of the Directive but also building on the pre-existing and well known Irish qualifying investor fund ("**QIF**") structure which, to date, has been the principal Irish non-UCITS scheme used for hedge funds and other alternative fund products.

The two types of AIFs which can be established are the qualifying investor alternative investment fund (the "**QIAIF**") and the retail alternative investment fund (the "**Retail AIF**"). QIAIFs are subject to a EUR 100,000 (or equivalent in other currencies) minimum subscription requirement and can only be "marketed" (ie. using the passport) to "professional investors", although there is a higher EUR 500,000 figure for QIAIFs which invest more than 50% of net assets in unregulated funds. If they have an authorised AIFM, QIAIFs can be "marketed" cross-border within the EU to professional investors using the passport. QIAIFs are subject to few investment restrictions, the principal ones being those imposed by the Directive on certain private equity type strategies and on investments in securitisations and certain Central Bank imposed restrictions on investing in other funds. QIAIFs are not subject to borrowing or leverage limits but are subject to leverage disclosure requirements. QIAIFs are, accordingly, suitable structures for hedge funds, FoHFs, less liquid and illiquid alternatives, private equity, venture capital and development capital funds, real estate funds and most other types of investment fund, whether considered "alternative" or not.

The QIAIF does require its own authorisation, separate to that of the AIFM, with the exception of internally managed AIFs which will need both a QIAIF and an AIFM authorisation.

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10.1 QIAIFs

As noted above, QIAIFs are subject to a minimum initial subscription requirement of EUR 100,000 (or equivalent in other currencies) per investor, with a higher EUR 500,000 figure for QIAIFs which invest more than 50% of net assets in unregulated funds. If they have an authorised AIFM, QIAIFs can be "marketed" cross-border within the EU to professional investors using the passport as explained earlier in this Guide.

10.1.1 Subscription related Obligations on AIFM

A QIAIF must only accept subscriptions from an investor who:

(a) is a professional client within the meaning of Annex II of MiFID; or

(b) receives an appraisal from an EU credit institution, a MiFID firm or a UCITS management company that the investor has the appropriate expertise, experience and knowledge to adequately understand the investment in the Qualifying Investor IAF; or certifies that they are an informed investor by providing a confirmation (in writing) that the investor has such knowledge of and experience in financial and business matters as would enable the investor to properly evaluate the merits and risks of the prospective investment; or a confirmation (in writing) that the investor's business involves, whether for its own account or the account of others, the management, acquisition or disposal of property of the same kind as the property of the Qualifying Investor AIF.

Investors in a QIAIF must certify in writing to the QIAIF that they meet the above minimum criteria and are aware of the risk involved in the proposed investment and of the fact that inherent in such investments is the potential to lose all of the sum invested.

A QIAIF must not accept subscriptions from persons that group amounts of less than EUR 100,00 for individual investors. Although the Central Bank has not provided any guidance or what that means, we do not consider that it applies to, for example, other collective investment schemes, to unit-linked life assurance or to be investment managers investing client monies under discretionary mandates.

Irish QIFs (i.e. the predecessor to QIAIFs) allowed for a broader category of qualifying investor, namely:

(i) an investor who receives an appraisal from an EU credit institution, a MiFID firm or a UCITS management company that the investor has the appropriate expertise, experience and knowledge to adequately understand the investment in the QIAIF; and

(ii) an investor who certifies that they are an informed investor by providing the following:

(a) confirmation (in writing) that the investor has such knowledge of and experience in financial and business matters as would enable the investor to properly evaluate the merits and risks of the prospective investment; or

(b) confirmation (in writing) that the investor's business involves, whether for its own account or the account of others, the management, acquisition or disposal of property of the same kind as the property of the QIAIF.

As neither category (i) or (ii) above are contained within the definition of "professional investor" for AIFMD purposes, there is no capacity to use the passport to market QIAIFs to those categories of investor. The extent to which a QIAIF (and this will principally be of concern to QIFs which exist prior to July 22, 2013 and which then seek to be authorised under the new regime) will be able to continue to sell to such investors will depend on the private placement rules applicable in the jurisdictions where those investors are based.

10.1.2 Investing in Umbrellas/Subsequent Subscriptions

Where the QIAIF is an umbrella scheme, the investor's aggregate subscriptions across the entire umbrella can normally be taken into account in meeting the EUR 100,000 minimum subscription requirement and, unless otherwise provided in the relevant prospectus, the amounts of subsequent subscriptions are unrestricted.

However, in the case of a QIAIF which invests more than 50% of net assets in one other investment fund utilising the higher EUR 500,000 minimum subscription (see 10.5.4), the aggregate subscriptions across an umbrella cannot be taken into account.

10.1.3 Knowledgeable Employee Exemption

A QIAIF may grant an exemption from the EUR 100,000 minimum subscription requirement to the management company or general partner; to the investment manager or investment advisor; to directors of those entities; and to certain of their employees who are either directly involved in the QIAIF's investment activities or is a senior employee with experience in the provision of investment management services (the "*knowledgeable employee*" exemption).

In the case of investments by employees, the management company or investment company or general partner, as appropriate, must satisfy itself that the investing employees do fall within the criteria outlined above and the investing employees must certify to the QIAIF that they are availing of the exemption and that they are aware that the QIAIF is normally marketed solely to qualifying investors who are subject to a minimum subscription of EUR 100,000.

10.1.4 Retail AIFs

An AIF which has no minimum subscription requirement or has a minimum subscription which is less than EUR 100,000 (or equivalent in other currencies) per investor will be considered to be a Retail AIF.

Retail AIFs cannot be marketed cross-border using a passport as the Directive provides a passport only to AIFMs marketing to professional investors. In addition, whether to provide at all for domestic Retail AIFs is a matter of individual EU Member State choice. Having had a retail non-UCITS fund regime for many years, almost exclusively focused on domestic sales, Ireland does allow for Retail AIFs and in its AIF Rulebook, the Central Bank has imposed a detailed set of investment and borrowing/leverage restrictions on Retail AIFs.

10.2 Available Irish Legal Structures

QIAIFs can be established in Ireland as variable capital investment companies, as unit trusts, as tax transparent investment limited partnerships or as tax transparent common contractual funds.

Ireland expects to introduce legislation later this year (2013) facilitating a new form of investment fund, the ICAV, which will also be available for use as an QIAIF. Whilst the ICAV will be a corporate structure, it will not be subject to many of the company law provisions which applies to Irish investment companies set up under Part XIII of the Companies Act, 1990.

10.2.1 Choice of Legal Structure

The choice of legal structure for a QIAIF will usually depend on a number of issues, including:

(i) investor familiarity;

(ii) investor capacity to invest (for example, Japanese investors seem to be able to invest higher proportions of their portfolios in unit trusts);

(iii) tax treatment (for example, natural persons, or their nominees, cannot invest in a common contractual fund without undermining its tax transparency. Additionally, the choice of structure as between a unit trust and an investment company may be crucial for US tax purposes);

(iv) willingness to set up Irish management company (required for unit trust and common contractual fund but not for investment company) where that management company may become the AIFM;

(v) portfolio diversification (investment companies are subject to a statutory risk spreading requirement whereas unit trusts are not);

(vi) borrowing/leverage proposals (available in all structures but legal arrangements often clearer to counterparties dealing with investment companies); and

(vii) operational flexibility (for certain issues with unit trusts can be more flexible than with investment companies. For example, unit trusts do not need to hold an AGM and it is easier to amend a unit trust's constitutional documentation for non-material issues).

In the next section, we have summarised the principal features of the different legal structures – the investment company, the unit trust, the investment limited partnership and the common contractual fund.

10.2.2 Investment Company Structure

What the structure chart of an AIF established as an investment company will look like will ultimately depend on whether (and when) it appoints an authorised AIFM or registered AIFM, or is self-managed as an internally managed AIF or has no AIFM at all. The extent of delegation by the AIFM and the nature of its assets may also impact the structure.

The diagrams below illustrate what we expect to be the more frequently used structures, at least initially. They are by no means the only structures available however.

Diagram 1: Self-managed investment company (internally managed AIF)

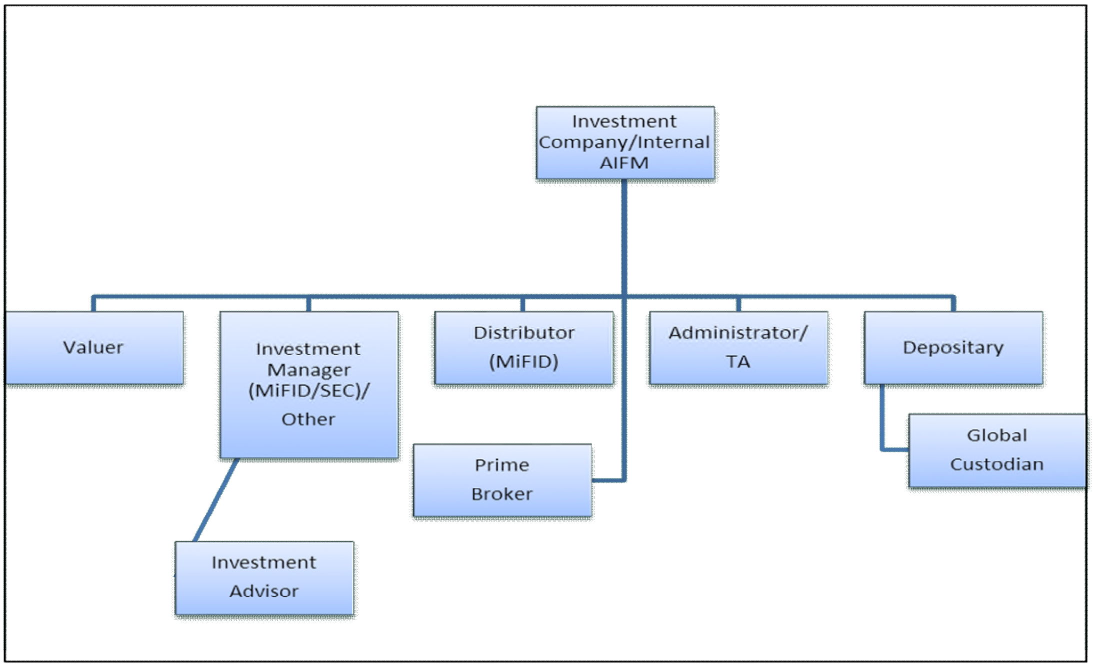
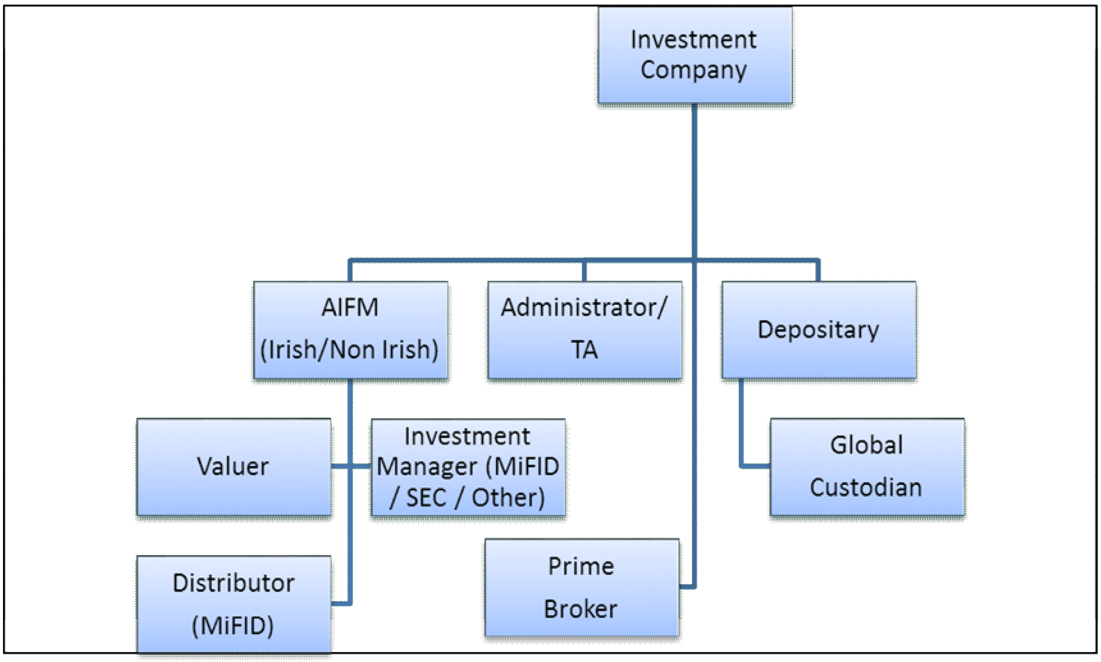


Diagram 2: Investment company with external AIFM



Investment companies are variable capital, public limited liability corporate vehicles. In addition to Part XIII of the Companies Act, 1990, they are subject to other Irish company law provisions (with several exceptions) as they apply to public limited companies.

The constitutional document for an investment company is its Memorandum and Articles of Association and ultimate managerial authority resides with its board of directors. Investment companies issue shares to investors. Shares do not represent a legal or beneficial interest in the investment company's assets, those assets being legally held by the depositary and beneficially by the investment company itself. Unlike unit trusts, investment companies are required to convene and hold an annual general meeting of shareholders and any changes to the Memorandum or Articles of Association require shareholder approval.

Investment companies have legal personality and can enter into contracts themselves and will do so, principally with the AIFM, with an investment manager, depositary, distributor and administrator.

Umbrella type investment companies benefit from statutory based segregated liability between sub-funds and it is possible for one sub-fund within an umbrella to invest in one or more sub-funds of the same umbrella provided that the investee sub-fund does not itself invest in other sub-funds of the same umbrella.

Investment companies are subject to a statutory requirement under Part XIII of the Companies Act, 1990 to aim to spread investment risk. It is for the directors of the investment company to determine compliance with this requirement but it is considered that an investment company, unlike the other legal structures, cannot be 100% exposed to a single asset.

10.2.4 Unit Trust Structure

What the structure of an AIF established as a unit trust will look like will ultimately depend on whether (and when) it has an authorised AIFM or registered AIFM, whether its management company is (or is not) the AIFM, or it has no AIFM at all.

The extent of delegation by its AIFM and the nature of its assets may also impact the structure. Again, the following diagrams are examples only.

Diagram 1: Unit Trust with Management Company authorised as AIFM

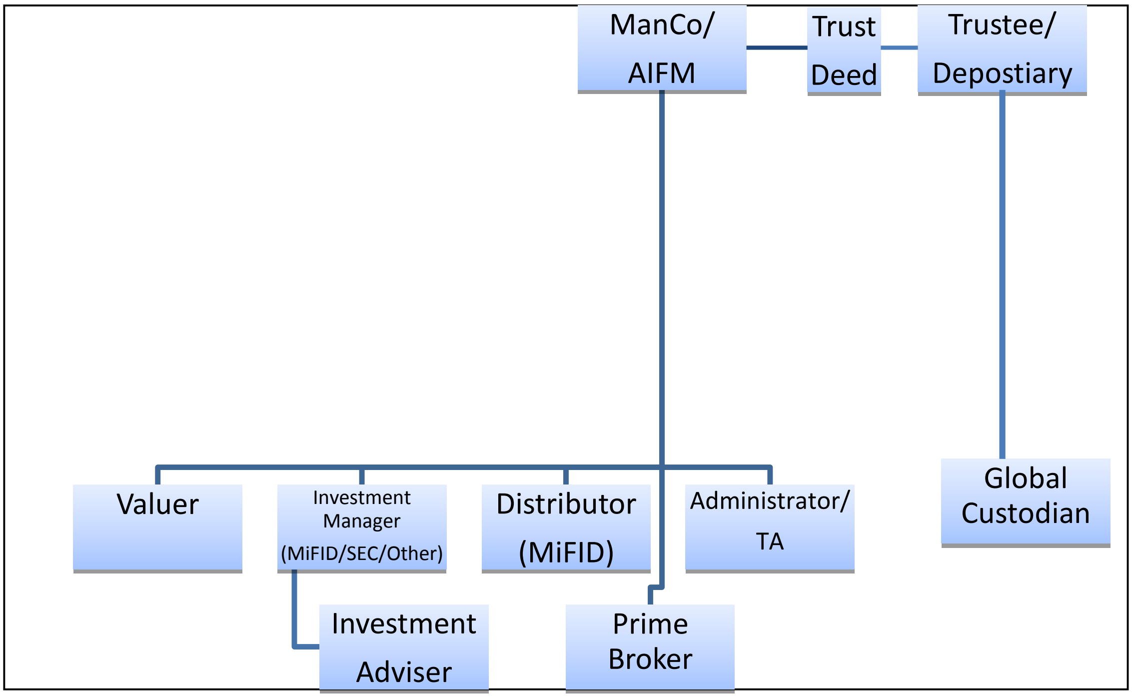
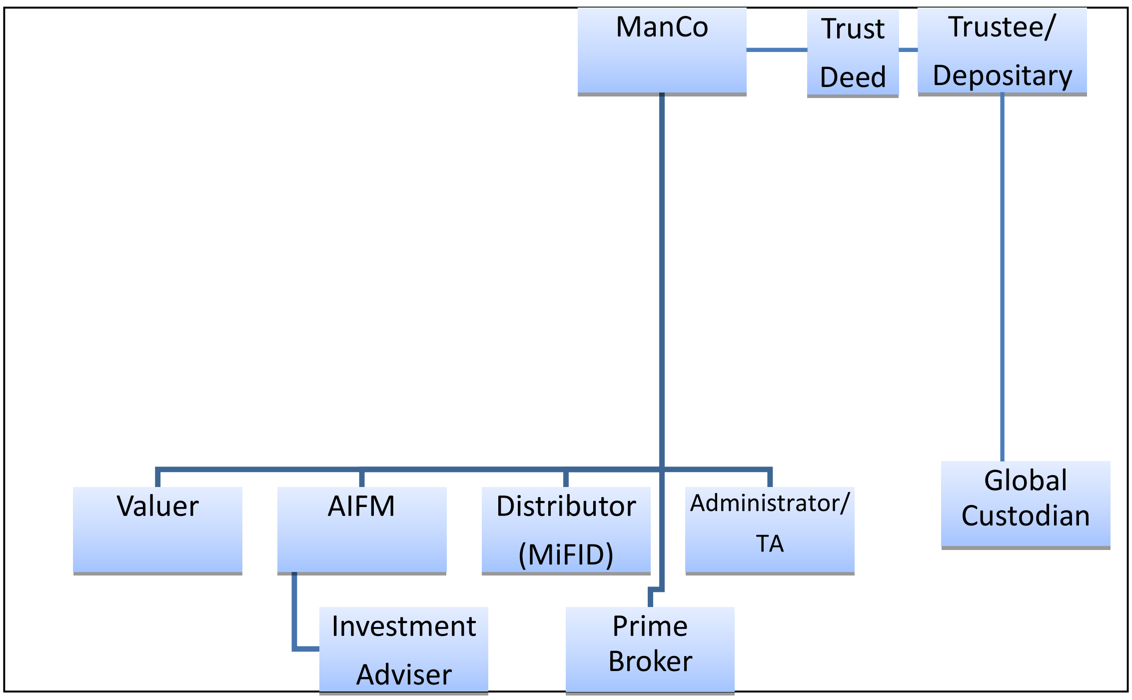


Diagram 2: Unit Trust with authorised AIFM (other than ManCo)



Unit trusts are created under a deed of trust (the "trust deed") made between the management company (or manager) and a trustee/depositary. Unit trusts do not have their own legal personality and contracts are entered into by the management company or its delegate(s) and, in certain cases, by the trustee.

Unit trusts are governed by the Unit Trusts Act, 1990 and ultimate managerial authority rests with the board of directors of the unit trust's management company. Such a company may act as management company for different types of Irish collective investment schemes (UCITS and AIFs; investment companies, unit trusts and CCFs) and can be authorised as an AIFM, subject to complying with the AIFM requirements (or be a registered AIFM). The management company must itself be authorised separately to the unit trust's own authorisation, which is as an AIF.

Unit trusts issue units to investors and a unit represents an undivided beneficial interest in the assets of the unit trust. The assets are legally held by the trustee/depositary.

Unit trusts are not required to hold annual investor meetings and, provided both the management company and trustee/depository certify that a change to the trust deed does not prejudice the interests of investors, such a change can be made without having to obtain prior unitholder approval.

10.2.4 Investment Limited Partnerships

QIAIFs can also be established as investment limited partnerships under the Investment Limited Partnerships Act, 1994. An investment limited partnership is a partnership of two or more persons having as its principal business the investment of its funds in property of all kinds and consisting of at least one general partner and at least one limited partnership.

The limited partner receives participating partnership interests or units which entitle it to a share in the performance of the partnership while the general partner acts in a role roughly equivalent to that of a management company of a unit trust or investment company.

The main advantage of an investment limited partnership is that the partnership does not have an independent legal existence in the way that a company does. All of the assets and liabilities belong jointly to the individual partners in the proportions agreed in the partnership deed. Similarly, the profits are owned by the partners.

10.2.5 Common Contractual Funds

The final structure which can be used by QIAIFs is the common contractual fund (or "CCF"). CCFs were originally introduced under the UCITS regime to enable pension funds and trustees or custodians of pension funds to pool investments in a tax efficient manner. Non-

UCITS CCFs were introduced in 2005 by the Investment Funds, Companies and Miscellaneous Provisions Act, 2005. Subsequently, Irish tax law was amended to widen the investor base for CCFs to include not only pension funds, but all other types of institutional investors and corporate entities but not natural persons (or their nominees).

A CCF is constituted under contract law by means of a deed of constitution executed under seal by a management company. The deed provides for the safekeeping of assets of the CCF by a depositary who is also a party to the deed and the deed specifies the fiduciary responsibilities of the depositary.

As the CCF is an unincorporated body and does not have a legal personality it may act only through the manager (or investment manager, if authority is delegated to an investment manager). Participants in the CCF hold their participation as co-owners with each participant holding an undivided co-ownership interest with other participants.

The main driver for establishing a CCF is its capacity to provide participants with a tax transparent arrangement, where participants should be treated as investing directly in the pool of assets, and which benefits from all of the advantages of investing via a pooled arrangement. In order to benefit from the tax transparent treatment, CCFs have to impose several restrictions on their structure, cannot impose redemption charges and generally need to distribute all income on an annual basis. Tax transparency ultimately depends on whether that status is accepted by treaty counterparts. Positive rulings have been obtained from the tax authorities in several jurisdictions and tax opinions in several others supporting the tax transparent treatment.

10.3 Common Features

10.3.1 Stand-alone QIAIFs, Umbrellas and Sub-Funds

QIAIFs can be established as single, stand-alone funds or as umbrella funds with one or more sub-funds. Investment and borrowing limits apply at sub-fund level as each sub-fund is treated from a regulatory perspective as a separate QIAIF.

Within an umbrella, it is possible to have sub-funds with different liquidity profiles – open-ended, open-ended with limited liquidity or closed-ended – and one sub-fund can invest in another sub-fund of the same umbrella. Segregated liability between sub-funds within an umbrella exists either under statute (for investment companies), or under trust law (unit trusts) or can be imposed contractually.

Certain additional prospectus disclosure and constitutional documentation provisions are required for umbrellas, principally relating to segregation of assets/liabilities of one sub-fund from the others.

10.3.2 Share Classes

The general principles behind the Central Bank's approach to the creation of different share or unit classes with a QIAIF or sub-fund are that each QIAIF/sub-fund must consist of a single common pool of assets; assets cannot be allocated to individual classes; and income and capital gains/losses on the asset pool must be distributed to and/or accrue equally to investors in proportion to their respective holdings. Importantly, the Central Bank requires that investors within a class be treated equally and, where there are two or more classes in existence, that all investors in the different classes must be treated fairly.

Common class level distinguishing features include different target audiences, different management/performance fees, different entry/exit charges and minimum subscription or holding requirements. Hedged currency or interest rate classes can also be created which allow the gains/losses and costs on the hedging contracts to be attributed to the relevant hedged classes.

Notwithstanding the above, and subject to clear prospectus disclosure (including as to the attendant risks) and to there being power to do so under the constitutional documents of the QIAIF (including clear valuation and allocation provisions), it is possible to allocate assets (including derivatives) within a QIAIF/sub-fund to individual classes provided that the allocation arrangement is not made to pursue a separate investment objective at class level, does not result in the class operating as a *de facto* sub-fund and is not created to circumvent the general principles referred to above.

Where this latter capacity is used, provisions aimed at achieving segregation of liability between such a share class and the share classes participating in the QIAIF's or sub-fund's common pool of assets should, to the extent legally possible, be included in the constitutional document. Where it is not possible to ensure such segregation, prominent prospectus disclosure is required.

10.3.3 Voting Rights

A QIAIF's prospectus must describe the voting rights attaching to shares or units in the fund. The Central Bank does allow for non-voting shares and units, normally requiring that investors have the capacity to choose between investing in voting and non-voting shares/units.

10.3.4 Initial Offer Periods

The general Central Bank rule is that the initial offer period of a QIAIF cannot commence prior to the authorisation of the QIAIF or prior to approval in the case of a sub-fund and must be for a period no longer than six months. However, in the case of private equity, real estate, venture or development capital QIAIFs, the initial offer period may extend up to two years and six months provided that the terms of offer ensure that early investors are not prejudiced by the arrangements. Where such a QIAIF has multiple closings, the initial offer period must commence no later than the date of first closing.

Extensions to initial offer periods may be made without prior notification to the Central Bank provided that no subscriptions have been received at the date of the proposed extension. Notifications of any such extensions must be made to the Central Bank on an annual basis. Where subscriptions have been received, the initial offer period can only be extended with prior Central bank approval.

After the initial offer period, a QIAIF can launch share classes at a fixed price only where it has been confirmed to the Central Bank that existing shareholders in the QIAIF are not prejudiced.

10.3.5 Commitments/Partly Paid Shares/Units

Commonly found in closed-ended private equity and real estate schemes, QIAIFs can provide for partly-paid shares or units and for commitment arrangements (including through draw downs of commitments through the issue of fully paid shares/units), and can provide for standard forms of penalties for defaulting investors.

10.3.6 Valuation and Pricing

The assets of a QIAIF must be valued in accordance with rules laid down in the constitutional document which clearly define an expected method of valuation and which shall set out a framework for variation from this method of valuation. Additional details may be set out elsewhere (e.g. in the prospectus). In respect of open-ended QIAIFs, its assets must be valued as often as the QIAIF deals and the calculation procedures and methodologies must be subject to regular verification by the AIFM. Different rules apply for closed-ended funds. The AIFM also needs to ensure remedial action in the case of NAV error.

The AIFM is the entity who is responsible for the valuation of a QIAIF's assets and the publication of NAV. Procedures must be adopted for the valuation of a QIAIF's assets. Assets must be valued by a method clearly defined in the QIAIF's constitutional document and disclosed in the prospectus.

Valuations can be performed by the AIFM itself or by external valuers who meet certain specified criteria. Where the AIFM carries out the valuation function, this must be performed independently from portfolio management and any conflicts of interest must be managed. In practice, third party fund administrators will not be considered to be an "external valuer" on the basis that their role is restricted to fund accounting and calculation of the NAV, unless they provide actual valuations for individual assets (including those requiring subjective judgement) and are licensed to do so.

10.3.7 In-Kind Subscriptions and Redemptions

In-kind subscriptions are permitted provided that the assets being subscribed are consistent with the QIAIF's investment objectives, policies and restrictions; are vested in the depositary; and the number of shares/units being issued for those assets is no greater than for an equivalent cash subscription. The depositary must also be satisfied that the in-kind subscription will not result or is unlikely to result in material prejudice to existing investors.

In-kind redemptions are also allowed at the QIAIF's discretion but generally require the consent of the redeeming investor and asset allocation is subject to the approval of the depositary. However, where a redeeming investor requests redemption of a number of units representing 5% or more of the net asset value (NAV) of the QIAIF, the QIAIF may determine, at its sole discretion, to satisfy the redemption in-kind, in which case it must, if requested, sell the assets on behalf of the investor. The cost of the sale can be charged to the investor.

Where the QIAIF is an exchange traded fund and the investor's original subscription was in-kind the only requirement is that the asset allocation is subject to the depositary's prior approval.

10.3.8 Management and Depositary Fees

The nature of the costs to be borne by a QIAIF investment company should be set out in its articles of association. The constitutional documents of other types of QIAIF must prescribe the costs to be borne by the QIAIF and the remuneration/expenditure which can be charged to the QIAIF by the management company/general partner and depositary and the applicable calculation methodology.

The maximum annual fee (including performance fee) which can be charged by an AIFM, by a management company or by a general partner, must be set down in the QIAIF's constitutional document or management agreement and can only be increased if approved by majority vote of investors at a general meeting, with reasonable advance notice being given to enable investors redeem prior to the increase coming into force. This also applies to the fees of an investment manager where they are paid directly out of the QIAIF's assets. If the fee disclosed in the prospectus is less than the maximum fee permitted in the documents referred to above, investor approval will also be required for an increase in the fee disclosed in the prospectus unless the prospectus also provides that a higher fee may be charged.

The calculation of performance fees must be verified by the depositary or by a competent person appointed by the AIFM and approval for that purpose by the depositary.

The QIAIF must also specify in its constitutional document or prospectus the maximum charge relating to the redemption or repurchase of units.

10.3.9 Replacement of Management Company or Depository

The QIAIF's constitutional documentation must also set out the conditions/procedure for replacing the management company/general partner and depositary. Central Bank prior approval is required for replacing the depositary.

10.4 Liquidity Options

QIAIFs can be structured as *open-ended*, *open-ended with limited liquidity* or *closed-ended* schemes and can utilise a variety of features to address liquidity and/or valuation issues including gates, deferred redemptions, holdbacks, in-kind redemptions and side pockets. It is also possible to establish sub-funds with different liquidity profiles within a single segregated umbrella structure so as to take advantage of operational and other economies of scale.

The concepts of *open-ended*, *open-ended with limited liquidity* and *closed-ended,* explained below are those set down by the Central Bank in its AIF Rulebook.

10.4.1 Liquidity Categories

The concepts of open-ended, open-ended with limited liquidity and closed-ended QIAIFs are explained below. Note that the front cover of the QIAIF's prospectus must identify the category of scheme into which the QIAIF falls.

(i) *Open-Ended*

An *open-ended* QIAIF is one which provides redemption facilities for investors (at their request) on at least a quarterly basis, must redeem when requested at least 10% of net assets on a monthly basis or 25% of its net assets on a quarterly basis and must not impose redemption fees in excess of 5%.

While open-ended QIAIFs may provide for dealing on a quarterly basis, the Central Bank requires that the time between submission of a redemption request and payment of settlement proceeds must not exceed 90 calendar days. This period can however be extended to 95 calendar days in the context of a QIAIF which invests in other investment funds, including a QIAIF which provides for dealing on a more frequent basis (e.g. monthly, weekly, etc.).

(ii) *Open-Ended with Limited Liquidity*

An *open-ended with limited liquidity* QIAIF is one which offers redemption and/or settlement facilities on a less than quarterly basis or provides for a period of greater than 90 days between the dealing deadline and the payment of redemption proceeds. Although such open-ended with limited liquidity QIAIFs are not subject to any regulatory parameters in terms of dealing frequency, minimum redemption quotas or timeframe for settlement, the payment of redemption proceeds should normally be made by the redemption payment date specified in the prospectus but that may be dependent upon circumstances relating to, inter alia, investments in underlying assets.

The QIAIF's prospectus will normally provide that if the QIAIF does not receive sufficient funds from the liquidation of underlying assets in order to satisfy redemption requests in a timely manner, then the related payments may be limited or temporarily suspended and the QIAIF will pay redemption proceeds on the earliest practicable date following such funds being made available to it.

(iii) *Closed-Ended*

Closed-ended QIAIFs are funds which do not provide capacity for investors (at their request) to redeem during a finite closed-ended period set out in the prospectus. The constitutional document of a closed-ended QIAIF must provide that on a future date specified in either that document or in the prospectus, the QIAIF will either:

- wind-up and apply for revocation of authorisation;
- redeem all outstanding shares/units and apply for revocation of authorisation;
- convert into an open-ended scheme; or
- obtain investor approval to extend the closed-period for a further finite period.

Closed-ended QIAIFs may issue shares/units other than at NAV subject to prior Central Bank approval.

For the purposes of imposing requirements regarding the required investor approvals for certain changes to closed-ended funds the Central Bank makes a distinction between closed-ended QIAIFs which do and those which do not provide liquidity provisions which realistically contribute to the ability of an investor to realise its investment prior to the end of the finite closed-ended period.

For example, where a closed-ended QIAIF which does not provide realistic liquidity wishes to change the duration of the closed-ended period or where it wishes to make changes to its investment objective or a material change to its investment policy or to make changes to fees or charges, the vote in favour of any such change must represent at least 75% of the votes cast. In the case of QIAIFs that do provide realistic liquidity, votes in favour of the relevant change must represent at least 50% of votes cast.

In both cases, where there are non-material changes made to the investment policies, investors must be notified of the changes which can include by means of disclosure the next annual report.

Closed-ended funds may also have to comply with the EU Prospectus Directive as well as certain other EU Directives (the Transparency Directive, etc.) but QIAIFs can normally avail of exemptions, unless they list or are admitted to trading on a regulated market within the EU.

10.4.2 Gates

For open-ended QIAIFs, redemption gates can be applied (once provided for in the fund documentation) limiting the number of share/units to be redeemed on a dealing day to 10% or, in the case of a quarterly dealing fund, 25% of the total number of shares/units in issue on that day.

Gates should be applied on a pro rata basis and requests carried over from a prior dealing day as a result of the application of a gate must generally be complied with in priority to later requests.

10.4.3 FoF Holdbacks

A QIAIF which invests in other funds may retain up to 10% of redemption proceeds where this reflects the redemption policy of the underlying funds in which the QIAIF invests and may do so until such time as the full redemption proceeds from the underlying funds are received.

10.4.4 Side-pockets

Subject to being provided for in the QIAIF's constitutional document (with clear parameters) and to prior disclosure to investors (normally by prospectus disclosure), side-pockets are permitted for QIAIFs where assets which are illiquid or hard to value can be allocated to a separate side pocket class (or classes) of share until they can be realised. This is usually achieved by allocating the relevant assets into a separate portfolio represented by the side-pocket shares and by effecting a mandatory pro-rata reduction in the number of shares held by investors in the common pool and by creating for the benefit of such investors a corresponding pro-rata interest in the side-pocket share class.

The Central Bank will permit QIAIFs to use side-pockets not only for assets which become distressed or illiquid after purchase, but also to purchase distressed/illiquid assets and place them immediately into a side-pocket, subject to appropriate prospectus disclosure. QIAIFs which have that latter capacity must, as indicated above, be classified as either open-ended with limited liquidity or closed-ended. QIAIFs which can establish side pocket share classes into which they place assets that are illiquid when purchased must classify themselves as *open-ended with limited liquidity* or as *closed-ended*. The capacity to utilise side pockets must be contained in the constitutional document and disclosed to investors in advance, normally by prospectus disclosure.

Before establishing a side pocket, the QIAIF and its depositary must provide confirmations to the Central Bank that the proposed establishment is in accordance with the QIAIF's constitutional document and takes into account the interests of all investors and, on an annual basis, the AIFM must report to the QIAIF confirming that the parameters have been respected and future plans for side pocketing.

10.5 Investment Restrictions

QIAIFs are subject to few investment restrictions and no borrowing or leverage limits (subject to appropriate disclosure) apply. The restrictions which do apply are summarised below.

10.5.1 General Restrictions

QIAIFs are subject to the following general restrictions:

(i) QIAIFs may not raise capital from the public through the issue of debt securities. However, that does not preclude the issue of notes by QIAIFs, on a private basis, to lending institutions to facilitate financing arrangements. Details of the note(s) issued must be clearly provided for in the prospectus;

(ii) QIAIFs are not permitted to grant loans or act as a guarantor on behalf of third parties[1]. This is without prejudice to the right of a QIAIF to acquire debt securities. It will not prevent QIAIFs from acquiring securities which are not fully paid or from

[1] Note that the Central Bank is to give further consideration to permitting QIAIFs to grant loans, during the course of 2013

entering into bridge financing arrangements where the financing extended to the QIAIF is backed by sufficient legally binding commitments to discharge the financing within a time period determined by the at least simultaneous triggering of obligations on unitholders to make capital contributions which they are previously contractually committed to making at the time the bridge financing is entered into;

(iii) QIAIFs are not permitted to acquire shares carrying voting rights which would enable them to exercise significant influence over the management of issuing bodies, nor are they permitted to appoint an AIFM, management company or general partner who would do so. This requirement does not apply to investments in other investment funds. It is also disapplied where the QIAIF is a venture capital, development capital or private equity QIAIF provided its prospectus indicates its intention regarding the exercise of legal and management control over underlying instruments.

(iv) Where a QIAIF invests in funds managed by its AIFM or its management company or by an associated or related company of either the AIFM or management company, the manager of the underlying fund must waive any sales/initial charge/redemption charge it would normally charge in respect of the investment;

(v) QIAIFs structured as investment companies must comply with the principle of "spreading investment risk" as required under section 253(2)(a) of the Companies Act, 1990 Part XIII and must include this requirement in its constitutional document. It is left to the discretion of the Board of Directors to determine actual diversification with reference to particular strategies.

Other fund type QIAIF restrictions apply as considered further below.

The limits on investments contained in the AIF Rulebook <u>and</u> those set down in the QIAIFs prospectus apply at the time of purchase of the investments <u>and continue to apply thereafter.</u> If these limits are subsequently exceeded for reasons beyond the control of a QIAIF or as a result of the exercise of subscription rights, the QIAIF must record such matters and adopt as a priority objective the remedying of that situation, taking due account of the interests of its unitholders.

10.5.2 No Leverage Restrictions

QIAIFs are not subject to borrowing or leverage limits. It is a matter of prospectus disclosure only. QIAIFs must disclose in the prospectus the circumstances in which they may use leverage, the type/source of leverage, the maximum leverage levels and any collateral or asset re-use arrangements.

The QIAIF (if it is also the AIFM) must, however, be able to demonstrate that the leverage limit set by it (or the case of a QIAIF appointed as external AIFM, in respect of the underlying funds which it manages) is reasonable and that it complies with that limit at all times.

10.5.3 QIAIF Fund of Funds

A QIAIF FoF may invest up to 100% of its assets in other funds, subject to a maximum of 50% of net assets in any one underlying unregulated fund. A QIAIF must not make investments which circumvent this restriction, for example, by investing more than 50% of net assets in two or more unregulated investment funds which have identical investment strategies.

10.5.4 QIAIFs investing more than 50% of net assets in one other investment fund

Where a QIAIF invests more than 50% of net assets in one other investment fund, the underlying investment fund must be authorised in Ireland or in another jurisdiction by a supervisory authority established in order to ensure the protection of unitholders and which, in the opinion of the Central Bank, provides an equivalent level of investor protection to that provided under Irish laws, regulations and conditions governing QIAIFs, unless a minimum subscription requirement of EUR 500,000 is imposed.

A QIAIF may not invest in an investment fund which itself invests more than 50% of net assets in another investment fund and the annual report of the Qualifying Investor AIF must have the annual report of the underlying investment fund attached.

Acceptable investment funds are broken down into two categories:

Category 1 Investment funds:

- established in a Member State of the European Union which are authorised under Directive 2009/65/EC;
- established in a Member State of the European Economic Area which are authorised under domestic legislation implementing Directive 2009/65/EC;
- established in Guernsey and authorised as Class A Schemes;
- established in Jersey as Recognised Funds;
- established in the Isle of Man as Authorised Schemes;
- authorised AIFs.

Category 2 Investment funds:

- authorised in a Member State of the European Union;
- established in Guernsey and authorised as Class B Schemes;

- established in Jersey which are not Recognised Funds;
- established in the Isle of Man as unauthorised schemes;
- authorised by the US Securities and Exchanges Commission under the Investment Companies Act 1940;
- such other funds which the Central Bank may specify upon application and which comply, "*in all material aspects*", with the provision of these requirements in respect of Qualifying Investor AIFs.

The consideration of "all material respects" should include, inter alia, consideration of the following:

- supervision by the regulatory authority of the investment fund;
- the existence of an independent depositary with similar duties and responsibilities in relation to both safe-keeping and supervision;
- availability of pricing information and reporting requirements; and
- restrictions in relation to dealings by related parties.

In the case of Category 1 investment funds, the QIAIF must provide the Central Bank with the prospectus of the underlying investment fund in advance of investing more than 50% of net assets in one other investment fund.

In the case of Category 2 investment funds, the Qualifying Investor AIF must not invest more than 50% of net assets in one other investment fund without having obtained a confirmation in writing from the Central Bank that it has no objection. In addition, the Qualifying Investor AIF must provide the Central Bank with the prospectus of the underlying investment fund.

The Qualifying Investor AIF shall provide a letter to the Central Bank confirming that the underlying investment fund complies in all material respects with the provisions of the AIF Rulebook in respect of Qualifying Investor AIFs.

The oversight function of the depositary for Category 2 investment funds must, at a minimum, include requirements to:

- ensure that valuations of assets are carried out in accordance with the valuation policy;

- ensure that units of the underlying investment fund are issued and redeemed correctly; and

- ensure that the management of the assets is carried out correctly.

The Qualifying Investor AIF shall inform the Central Bank immediately it becomes aware that the underlying investment fund has materially breached any of its legal regulatory or constitutional obligations.

The periodic reports of the Qualifying Investor AIF must have the periodic reports of the underlying investment fund attached.

10.5.5 Disapplication where EUR 500,000 minimum subscription

The preceding requirements do not apply where the QIAIF has a minimum subscription limit of EUR 500,000 or its equivalent in other currencies. However, the aggregate of an investor's investments in the sub-funds of an umbrella QIAIF <u>cannot</u> be taken into account for the purposes of determining this requirement.

The prospectus for such a QIAIF must contain a detailed and prominent disclosure which identifies on an item-by-item basis those obligations and conditions which apply to the QIAIF and its AIFM but which do not apply to the underlying unregulated investment fund and its management company. The rule prohibiting investment into an investment fund which itself invests more than 50% of net assets in another fund does not apply.

10.5.6 QIAIF Private Equity Funds

QIAIFs structured as private equity funds will need to consider and comply with the new disclosure and notification obligations and anti-asset stripping which apply to AIFMs which acquire "control" of non-listed companies and issuers within the scope of the Directive.

10.5.7 QIAIF Real Estate Funds

Reflecting the position under the Directive, the Central Bank has not imposed any specific investment restrictions on QIAIFs investing in real estate or in real estate assets. Whereas Retail AIFs making such investments are subject to quite a number of real estate specific investment limits, QIAIFs investing in real estate or in real estate assets are simply subject to the general QIAIF restrictions set out above. Note that if structured as investment companies, QIAIFs will nevertheless need to comply with the statutory requirement to aim to spread investment risk.

10.5.8 QIAIF Money Market Funds

Although many QIAIFs may invest significantly or even principally in money market instruments, only those who meet the following additional requirements can label or market themselves as "money market funds". The Central Bank distinguishes between "Short-Term Money Market Funds" and "Money Market Funds", setting out detailed rules in its AIF

Rulebook as to the terms and basis upon which a QIAIF may label itself or market itself as a money market fund.

A Short-Term Money Market Fund may have either a constant or fluctuating NAV and is permitted to follow an amortised cost valuation methodology, as set out below.

A Money Market Fund must have a fluctuating NAV and is not permitted to follow an amortised cost valuation methodology.

Both types must have a primary investment objective of maintaining the principal of the fund and must aim to provide a return in line with money market rates. Both must limit investment to "high quality" money market instruments, as determined by the QIAIF, and deposits with credit institutions. The distinctions between the two types – Short-Term Money Market Funds and Money Market Funds – turn (i) on the maximum residual maturity of its investments; (ii) the Weighted Average Maturity ("**WAM**"); (iii) the Weighted Average Life ("**WAL**"); (iv) the capacity to have a fixed or floating NAV; and (iv) the capacity to use amortised cost valuation methodology.

(i) Disclosure Requirements

A QIAIF money market fund must indicate in its prospectus whether it is a Short-Term Money Market Fund or a Money Market Fund and must provide appropriate information to investors on the risk and reward profile of the fund so as to enable investors identify any specific risks linked to the investment strategy of the fund taking into account, where relevant, of investment in new asset classes, financial instruments or investment strategies with unusual risk and reward profiles.

It must also include a risk warning drawing attention to the difference between the nature of a deposit and the nature of an investment in a money market fund with particular reference to the risk that the principal investment in a money market fund is capable of fluctuation.

In the case of a QIAIF classified as a Money Market Fund, this must take into account the longer WAM and WAL (see further below). In the case of both types of QIAIF money market fund, the information provided must take account, where relevant, of investment in new asset classes, financial instruments or investment strategies with unusual risk and reward profiles.

(ii) Investment Objective

The primary investment objective of a QIAIF money market fund structured either as a Short-Term Money Market Fund or as a Money Market Fund must be to maintain the principal of the fund and aim to provide a return in line with money market rates.

(iii) Eligible Investments

The following conditions apply to both types of QIAIF money market funds:

(a) Investments must be limited to “high quality” money market instruments as determined by the QIAIF and deposits with credit institutions. To determine “high quality”, the following factors must at least be taken into account:

(i) the credit quality of the instrument (a money market instrument may not be considered to be of high quality unless it has been awarded one of the two highest available short-term credit ratings by each recognised credit rating agency that has rated the instrument, or, if the instrument is not rated, it is of an equivalent quality as determined by the QIAIF). Credit quality must be monitored on an ongoing basis;

(ii) the nature of the asset class represented by the instrument;

(iii) the operational and counterparty risk, in the case of structured financial instruments; and

(iv) the liquidity profile.

(b) Direct or indirect exposure to equities or commodities, including through financial derivative instruments, is not permitted.

(c) Where the QIAIF is a Short-Term Money Market Fund, financial derivative instruments may be used but only when they are in line with the QIAIF’s money market investment strategy. Financial derivative instruments which give exposure to foreign exchange may only be used for hedging purposes. Investment in non-base currencies is not permitted unless the exposure is fully hedged.

(d) Where the QIAIF is a Money Market Fund, only financial derivative instruments which give exposure to foreign exchange may be used and only for hedging purposes. Investment in non-base currencies is not permitted unless the exposure is fully hedged.

(e) Investment in other investment funds is not permitted unless they satisfy the following: (i) if the investing fund is a Short-Term Money Market Fund, the other fund must also be a Short-Term Money Market Fund (ii) if the investing fund is a Money Market Fund, the other fund must be either a Short-Term Money Market Fund or a Money Market Fund.

(iv) Daily NAV and Dealing

Both Short-Term Money Market Funds and Money Market Funds must provide daily NAV and price calculations and have daily subscription and redemption of units/shares.

(v) Residual Maturity

Investments are limited to securities or instruments with a residual maturity until the legal redemption date of less than or equal to 397 days in the case of Short-Term Money Market Funds. This is increased to 2 years in the case of Money Market Funds provided that the time remaining until the next interest reset date is less than or equal to 397 days. Floating rate securities must reset to a money market rate or index.

*(vi) Weighted Average Maturity ("**WAM**")*

The WAM of the portfolio of a Short-Term Money Market Fund must not exceed 60 days, whereas the WAM of the portfolio of a Money Market Fund must not exceed 6 months.

*(vii) Weighted Average Life ("**WAL**")*

The WAL of the portfolio must not exceed 120 days in the case of a Short-Term Money Market Fund, or 12 months in the case of a Money Market Fund.

When calculating the WAL for securities, including structured financial instruments, the QIAIF must base the maturity calculation on the residual maturity until the legal redemption of the instruments. However, when a financial instrument embeds a put option, the exercise date of the put option may be used instead of the legal residual maturity only if the following conditions are fulfilled at all times:

(a) the put option can be freely exercised by the QIAIF at its exercise date;

(b) the strike price of the put option remains close to the expected value of the instrument at the next exercise date; and

(c) the investment strategy of the QIAIF implies that there is a high probability that the option will be exercised at the next exercise date.

When calculating the WAM and WAL, the impact of financial derivative instruments, deposits and efficient portfolio management techniques must be taken into account.

(viii) Short-Term Money Market Funds - Valuation on the basis of amortised cost

Valuation on the basis of amortised cost is permitted in the case of Short-Term Money Market Funds provided the QIAIF or, where relevant, its delegate has demonstrable expertise in the operations of money market funds which follow this method of valuation. This condition is satisfied where:

(a) the Short-Term Money Market Fund has obtained a triple-A rating from an internationally recognised rating agency; or

(b) the management company or investment manager is engaged in the management, or has been engaged in the management, of a triple-A rated money market fund; or

(c) in circumstances other than (a) or (b), where the QIAIF has demonstrated to the Central Bank (through separate application) that appropriate expertise exists in the operation of this type of money market fund.

The QIAIF must ensure and be satisfied at all times that the persons responsible for the operation of the Short-Term Money Market Fund including under any delegation arrangements have and continue to have the necessary expertise.

A QIAIF Short - Term Money Market Fund must carry out a weekly review of discrepancies between the market value and the amortised cost value of its money market instruments and must put in place escalation procedures to ensure that material discrepancies are brought to the attention of the personnel charged with the investment management of the QIAIF.

Discrepancies in excess of 0.1% between the market value and the amortised value of the portfolio should be brought to the attention of the investment manager or management company.

Discrepancies in excess of 0.2% should be brought to the attention of the senior management/directors of the management company or of the QIAIF and the depositary. If discrepancies in excess of 0.3% between the market value and the amortised cost value of the portfolio occur, a daily review must take place. The QIAIF must also notify the Central Bank with an indication of the action, if any, which will be taken to reduce such dilution.

The constitutional document of the QIAIF must provide for the escalation procedures set out above or, alternatively, provide that a review of the amortised cost valuation vis-à-vis market valuation will be carried out in accordance with the requirements of the Central Bank. Weekly reviews and any engagement of escalation procedures must be clearly documented.

A QIAIF which uses amortised cost must also undertake and complete a monthly portfolio analysis (incorporating stress testing) to examine portfolio returns under various market scenarios to determine if the portfolio constituents are appropriate to meet pre-determined levels of credit risk, interest rate risk, market risk and investor redemptions. The results of the periodic analysis must be available to the Central Bank on request.

(ix) ECB Reporting

ECB Reporting rules also apply and are detailed in the AIF Rulebook.

10.5.9 QIAIFs Investing in Securitisations

The Directive provides for the adoption by the European Commission of requirements to be imposed on AIFMs who seek to invest on behalf of their AIFs in securitisation positions and for requirements to be imposed on the originator or sponsor or original lender.

The requirements adopted are set out in the Level 2 Regulation where, subject to certain exemptions, there is a requirement imposed on the originator, sponsor or original lender to retain on an ongoing basis, a material net economic interest which in any event shall not be less than 5%, with the 5% being given as a percentage of a number of different possibilities. This is the so called "skin in the game" requirement.

In addition, the requirements imposed on the AIFM include requirements to have a comprehensive and thorough understanding of the relevant positions and to have implemented formal policies and procedures appropriate to the risk profile of the relevant AIF's investments in securitised positions. Requirements to regularly perform stress tests, to create and establish formal monitoring procedures and risk management type procedures as well as specific rules regarding when corrective action must be taken in the best interests of the investors in the relevant AIF are also imposed.

10.5.10 QIAIFs Investing via Subsidiaries / Other SPVs / Conduits

QIAIFs may establish and invest through wholly-owned and controlled subsidiaries if that is provided for in the QIAIF’s constitutional document and if prior Central Bank approval to establish such a subsidiary is obtained. The subsidiary must not be an investment fund or issuing body, cannot appoint third parties or enter into contractual arrangements unless the QIAIF is also a party to such appointments/arrangements and the directors of the QIAIF must form a majority of the subsidiary board. The assets of the subsidiary must be valued in accordance with the QIAIF’s valuation rules and the subsidiary’s own constitutional document must include provisions which restrict the subsidiary from acting other than under the control of the QIAIF and which restrict any person or entity other than the QIAIF from holding shares in the subsidiary.

Neither the Directive nor the Central Bank's AIF Rulebook set out any specific prohibitions on other forms of non-wholly owned investment arrangements or conduits. For example, it has been previously accepted by the Central Bank under the QIF regime that co-investment arrangements (i.e. where the fund would invest side by side with other investors in an underlying asset, including potentially persons who are also invested in the fund) are acceptable where this is disclosed in the prospectus together with the basis on which co-investment opportunities are offered and the reasons why it is considered that such co-investment arrangements are in the interests of the fund/investors. The Central Bank has also previously required that the fund's investment could be dealt with (i.e. disposed of) independently of the co-investors.

The Central Bank has also previously permitted funds, particularly those in the private equity and real estate sectors, to enter into joint venture arrangements and to invest in underlying assets through other forms of conduit vehicles where the conduit vehicle was not wholly-owned by the fund. It also has allowed funds to have an interest in, for example, companies which control common areas of real estate developments.

We believe the Central Bank will continue to allow these types of arrangements but, as in the past, may likely treat investments in non-wholly owned arrangements/conduits as equivalent to investing in unregulated funds (and therefore be subject to the express limitations on investing in unregulated funds) as well as being subject to the AIFM's conduct of business type obligations (e.g. obligations to act in the best interests of the AIF and its investors) as well as the other requirements regarding investment due diligence and risk management in particular. We expect that this will fall to be negotiated in individual QIAIF's letters of authorisation.

Care will also need to be taken to ensure, if possible, that the conduit vehicle itself does not become an AIF. This will require consideration of the elements of the AIF definition discussed in the Key Concepts Section of this Guide.

10.6 General Regulatory and Ongoing Supervision Requirements

Set out below is a summary of the general regulatory and principal ongoing supervision requirements for AIFs.

10.6.1 Financial Resources/Capital

A QIAIF investment company must have sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities.

Although capital requirements are generally seen as being imposed only on the AIFM itself, it is important to bear in mind that a self-managed investment company may be considered to be an internally managed AIFM and as such will be subject to a EUR 300,000 initial capital requirement. In addition, an internally managed AIF is required to have either additional own funds appropriate to cover potential liability risk arising from professional negligence or have appropriate professional indemnity insurance coverage.

Where an investment company type QIAIF does not employ the services of a management company or an authorised AIFM, the investment company must have a minimum paid up share capital equivalent to EUR 125,000 within three months of authorisation and must satisfy the Central Bank on a continuing basis that it has sufficient management resources to effectively conduct its business and otherwise comply with Central Bank imposed provisions regarding AIF management companies as contained in the AIF Rulebook.

10.6.2 Prospectus

A QIAIF must publish a prospectus which must be dated and the essential elements of which must be kept up to date. The prospectus must contain sufficient information to enable investors to make an informed judgement of the proposed investment.

The minimum content requirements of the prospectus to be issued by a QIAIF are set out in the AIF Rulebook and include requirements to disclose specific information in relation to the QIAIF itself (name, form in law, registered/head office, date of establishment / incorporation and limited duration, if any). The prospectus must also disclose where the constitutional document and annual reports may be obtained; must provide a brief indication as to the tax system applicable to the QIAIF including as to whether deductions are made at source from income and capital gains paid to investors; accounting dates and distribution frequency; and a description of the rules for determining and applying income. The prospectus must also include specific details regarding the directors and their experience, must identify the persons who accept responsibility for information contained in the prospectus and must disclose the material provisions of material contracts with third parties types. It should also outline the main characteristics of the units/shares and, in the case of an investment company, disclose its authorised share capital. Descriptions of fees and charges and other applicable expenses, directly or indirectly borne by the investors should be disclosed as well as a description of the AIFM's remuneration policies and practices.

Additional disclosures are required for particular types of funds, including, for example, where a QIAIF issues partly-paid units/shares; where, if applicable, units or shares are listed or dealt in; capacity for cross-investment between sub-funds of an umbrella; as well other specific disclosures regarding investments in other funds. Disclosures regarding redemption facilities where a QIAIF is open-ended with limited liquidity; the rules applicable to in-kind redemptions; dealing procedures generally; as well as information regarding certain of the service providers (management company, general partner, investment manager and other service providers) are also required.

It is also required to have a specific authorisation legend, to disclose potential conflicts of interest (including any directed brokerage programmes, receipt of commissions by virtue of investing in other funds, soft commission arrangements), the potential for related party transactions, to disclose segregated liability between sub-fund provisions (for umbrella investment companies) and also any warehousing proposals and any capacity to invest through subsidiaries.

The prospectus must also comply with the AIFM's disclosure to investors obligations by including the information which AIFMs are required to make available to investors before they invest, as summarised in Section 6.2 (of this Guide).

The prospectus must be offered free of charge to prospective investors before a contract for the acquisition of shares/units is entered into and if the prospectus is translated into a language other than English, it can only contain the same information and with the same meaning as in the version submitted to the Central Bank.

The AIF Rulebook contains express requirements that the QIAIF comply with the terms of its prospectus and that details of any derogations granted to the QIAIF by the Central Bank are included within the prospectus.

10.6.3 Umbrella QIAIFs

If the QIAIF is an umbrella type investment company, the prospectus must state that it is "An umbrella fund with segregated liability between sub-funds".

Where an umbrella type QIAIF issues sub-fund specific supplements to its prospectus, the supplement must disclose that it is an umbrella and either name the other sub-funds or state that their names will be available upon request. The prospectus must also disclose the extent to which, and the conditions applicable to, investment can be made by one sub-fund in another and must also disclose switching charges if any.

10.6.4 Change in name of QIAIF

Prior Central Bank approval is required for a change in the name of a QIAIF.

10.6.5 Changes to QIAIF documentation

Prior notification to the Central Bank is required for changes to a QIAIF's documentation including its prospectus, constitutional document and material contracts. If the Central Bank objects to a change, the change may not be made.

10.6.6 Changes to objectives/material changes to investment policies

A change to the investment objectives, or a material change to the investment policies of a QIAIF, as disclosed in the prospectus, may not be effected without the prior written approval of all investors or approval on the basis of a majority of votes cast at general meeting. "Material" shall be taken to mean, although not exclusively, "*changes which significantly alter the asset type, credit quality, borrowing or leverage limits or risk profile of the QIAIF*".

In the event of a change of investment objectives and/or investment policy, on the basis of a majority of votes cast at a general meeting, a reasonable notification period must be provided by the QIAIF to enable investors redeem their shares/units prior to implementation of these changes.

10.6.7 Related Party Dealings

The Central Bank has set out specific rules for transactions carried out with a QIAIF by a general partner, manager, depositary, AIFM, investment manager and/or its delegate or associated or group companies. The general principle is that any such transaction has to be carried out as if effected on normal commercial terms, negotiated at arm's length and must be in the best interests of the investors. There are specific limitations imposed around such transactions.

10.6.8 Conflicts of Interest

The QIAIF's prospectus must include a description of the potential conflicts of interest which could arise between the AIFM, management company, general partner and investment manager and the QIAIF, for example, directed brokerage services and/or the receipt of commissions by virtue of an investment in the units of another investment fund with details, where applicable, of how these are going to be resolved. A description of soft commission arrangements which may be entered into by a QIAIF must also be included.

The QIAIF shall only enter into a transaction with, as appropriate, its general partner, management company, depositary, AIFM, investment manager and/or its delegate or associated or group companies, where there has been full disclosure in the QIAIF's prospectus.

10.6.9 Board Appointments

Board appointments to QIAIFs and to QIAIF management companies require prior Central Bank approval. This requires completion of an online questionnaire. Departures from the board of directors must be notified to the Central Bank immediately. Two directors must be Irish resident and there is a prohibition on common directors between the QIAIF (or its management company) and the board of directors of the depositary.

In all cases where a director wishes to resign and prior to completing the relevant Central Bank form, the Board or its Chair must form a view as to the impact of the resignation on the AIF Management Company having regard to the current and prospective financial state of the AIF Management Company and the AIFs under management. In the event that the Board or, in the absence of a Board meeting, the Chair forms the view that the situation is one which could create such concern on the part of the Central Bank, it shall state this on the relevant Central Bank form. The Board or its Chair may consult the Central Bank in order to help it form a view on that matter.

In addition to the Central Bank pre-approval requirement, directors are also subject to obligations under the Irish fitness and probity regime.

10.6.10 IFIA Corporate Governance Code

Although voluntary, there is an expectation on the part of the Central Bank that QIAIF's will adopt the Irish Fund Industry Association's (IFIA) Corporate Governance Code (the "Code"). The Code applies to the boards of investment companies and to the Boards of management companies/general partners of unit trusts, CCFs and investment limited partnerships.

10.6.11 Suspensions

Where a QIAIF temporarily suspends the calculation of its NAV and the redemption of shares/units, the Central Bank must be notified immediately, in any event within the working day on which the suspension took effect.

10.6.12 Financial Reporting

A QIAIF is required to publish an annual report for each financial year which must be submitted to the Central Bank within 6 months of the end of the financial year. The accounting information contained within the annual report must be audited and the full auditor's report to investors, including any qualifications, must be reproduced in the annual report.

The annual audited financial statements must comprise a balance sheet, income statement, a portfolio statement and statement of changes in the composition of the portfolio during the period and any significant information which will enable investors to make an informed judgement on the development of the QIAIF and its results. The annual report must also contain a report on activities during the financial year including an overview of the investment activities during the period and material changes in information disclosures.

The annual financial statement must be audited by one or more persons empowered to audit accounts in accordance with the Irish Companies Acts and the auditor's report to shareholders, including any qualifications, must be reproduced in full in the annual financials. The QIAIF shall prepare and submit to the Central Bank a set of accounts (whether an interim report or an annual report) within 12 months of the launch date and publish it within 2 months if an interim report or 6 months if an annual report. The first annual reports must be within 18 months of incorporation/establishment and published within 6 months.

The QIAIF shall, on request, supply investors with copies of the annual reports free of charge.

Where the QIAIF is an umbrella QIAIF constituted as a unit trust or common contractual fund, it may produce separate periodic reports for individual sub-funds. In such cases, the report of each sub-fund must name the other sub-funds and state that the reports of such sub-fund are available free of charge on request from the management company.

In accordance with company law, an investment company established as an umbrella QIAIF must include accounts for all sub-funds of that company in its periodic reports.

10.6.13 Other Reporting

QIAIF's must also submit a monthly return to the Statistics Division of the Central Bank, within 10 working days of the month-end to which it refers, setting out its total gross and net asset value, number of shares in issue, net asset value per share, subscription and redemptions during the month and net subscription/redemption receipts. This is normally dealt with by the Administrator.

An AIFM will also be required to report on a regular basis to the Central Bank on the principal markets and instruments traded by it on behalf of the QIAIF. The AIFM will also separately be required to report regularly on liquidity arrangements and risk management systems of the QIAIF.

An investment manager must also file a copy of its audited financial statements with the Central Bank annually.

10.6.14 Warehousing

A QIAIF may only acquire assets pursuant to a warehousing arrangement where the use of such arrangements is fully disclosed in the prospectus, including details of any fee payable in relation to such arrangements. The prospectus must also state that the QIAIF will pay no more than current market value for such assets.

10.6.15 Subsidiary disclosure

A QIAIF intending to invest through wholly-owned subsidiaries must disclose that ability in the prospectus and state that the names of any subsidiaries will be disclosed in the QIAIF's annual report.

10.6.16 Breaches of Investment Restrictions

The limits on investments set down in a QIAIF's prospectus are deemed to apply at the time of purchase of the investments. If the limits laid down are subsequently exceeded for reasons beyond the control of a QIAIF or as a result of the exercise of subscription rights, the QIAIF must adopt as a priority objective the remedying of that situation, taking due account of the interest of its unitholders.

10.6.17 Regulatory Levies

The Central Bank imposes an annual industry funding levy on collective investment schemes. Rates (at time of writing) include an annual fee of EUR 2,000 whether an umbrella or a single structure fund. Umbrella funds also pay a contribution of EUR 450 per sub-fund on the first five sub-funds resulting in a maximum contribution for umbrella funds of EUR 4,250.

10.7 Mergers of QIAIFs

A QIAIF may only merge or amalgamate with another investment fund where the proposed merger or amalgamation has received the prior approval of the Central Bank.

10.8 Authorisation Process

Before a QIAIF can be established or carry on business, prior Central Bank approval is required for the arrangements under which the QIAIF is to be operated. The Central Bank's website provides a link to the application forms which sets out the required information and accompanying documentation requirements. The Central Bank has put in place an informal process to receive and process these applications. Once the Central Bank has been appointed as the competent authority for issuing authorisations under the AIFMD, it will be in a position to formally consider applications which have been lodged and informally processed. This appointment will happen before July 22, 2013.

It is important to bear in mind that an internally managed QIAIF must also comply with the authorisation requirements (and application for authorisation process) for AIFMs as set out in Section 2 of this Guide.

(i) Information

The information required of an applicant QIAIF includes the name and a statement of the general nature of the investment objectives of the QIAIF; details of its proposed AIFM (and of its competent authority) and whether the AIFM is registered or authorised. Information on the proposed management company or general partner and on the proposed depositary, as well as on any proposed investment manager, is also required, as is information on the QIAIF's proposed auditor and on third parties who will be contracted by the QIAIF or its management company to carry out its work.

(ii) Accompanying Documentation

The application must be accompanied by the prospectus, the material contracts with third parties contracted by the QIAIF or its management company to carry out work on its behalf, as well as the QIAIFs constitutional document and the depositary agreement. Certain additional information is required depending on whether the QIAIF is established as an investment company, a unit trust, a common contractual fund or an investment limited partnership.

Investment management agreements and investment advisory agreements must also be submitted to the Central Bank as part of the authorisation process.

Where an authorised QIAIF umbrella scheme seeking to launch a new sub-fund, the application forms also specify the required filings.

(iii) Fast Track Process

The fast-track authorisation process that existed for the previous QIF regime applies equally to QIAIFs and, accordingly, applications should be filed no later than 3pm on the business day before the proposed date of authorisation. Assuming the application is complete and that the Central Bank raises no issues in relation to the application, then a letter of authorisation or approval (in the case of a sub-fund) will issue by close of business on the day of authorisation / approval.

(iv) Derogations

To the extent that derogations are sought from the AIF Rulebook requirements for a QIAIF or from other general policies applicable to QIAIFs, the derogation request should be made in sufficient time to allow the request be considered by the Central Bank. Details of derogations granted must be included not only in the application form for approval but also be set out in the QIAIF's prospectus.

(v) Who makes the Application?

The application for authorisation for a QIAIF should be made by the AIFM, together with the QIAIF (investment company or management company or general partner) and depositary.

(vi) Service Providers to be Pre-Cleared

Importantly, before the Central Bank will approve a QIAIF, the management company / general partner, AIFM, directors (in the case of an investment company), depositary and other service providers (fund administrator, investment manager) must have been pre-approved / pre-cleared by the Central Bank.

In the case of investment managers or sub-investment managers, if they fall into any of the following categories they will not, be subject to additional regulatory review by the Central Bank:

(a) UCITS management companies;

(b) MiFID firms authorised to perform portfolio management;

(c) credit institutions holding approvals to perform portfolio management under MiFID;

(d) externally-appointed AIFMs authorised under the AIFMD; or

(e) firms who are subject to regulation in other jurisdictions and recognised as such by the Central Bank.

Where the entity is a European firm but does not appear on the relevant passport register, the Central Bank may require a separate verification of its home EU Member State approval. However, it is important to note that the Central Bank has expressly stated that it is not necessary to utilise a passport in order to act as investment manager to a QIAIF.

In relation to investment advisors, the Central Bank does not apply an approval process but does require a confirmation from the management company or the QIAIF's directors that the investment advisor will only act in an advisory capacity and has with no discretionary powers over any of the assets of the QIAIF).

(vii) Closed-Ended QIAIFs

To the extent that the Prospectus Directive is applicable to a closed-ended QIAIF, then the application must also include a confirmation that the prospectus is being submitted separately for approval in accordance with the Prospectus Directive Regulations.

(viii) Requirement for a full AIFM

Finally, it should be noted that a QIAIF which is authorised by the Central Bank on or after July 22, 2013 is required to have [a full] AIFM within 2 years from the date of launch (ie. the date when the initial offer period closes or where there are multiple closings the first and closing date).

10.9 QIAIFs which have a Registered AIFM

Where a QIAIF has a registered (ie. not authorised) AIFM, the AIFM must be established in the same Member State as the QIAIF because a registered AIFM does not benefit from any of the rights (i.e. the right to manage an AIF domiciled in another EU Member State or the right to market the AIF which it manages in other EU Member States) under the Directive.

Where a QIAIF has a registered AIFM, the registered AIFM must comply with the following provisions of the AIFMD:

(a) Organisational requirements – Article 20(1)(f)
(b) Liquidity management – Article 16(2)
(c) Valuation – Article 19(1) to (3) and 1st sentence of Article 19(10)
(d) Transparency obligations – Article 22 excluding Article 22(2)(e) and Article 22(2)(f) and Article 23 excluding Articles 23(1)(e), 23(1)(p), 23(2), 23(4) and 23(5).

Where a QIAIF has a registered AIFM, the registered AIFM must ensure that a single depositary is appointed in accordance with Article 21(1).

Where a QIAIF has a registered AIFM, the registered AIFM must comply with the following provisions of the Level 2 Regulation:

Article 20	Due diligence in the selection and appointment of counterparties and prime brokers
Article 24	Inducements
Article 27	Execution of decisions to deal on behalf of the managed AIF
Article 28	Placing orders to deal on behalf of AIFs with other entities for execution
Article 49	Alignment of investment strategy, liquidity profile and redemption policy
Article 67	Policies and procedures for the valuation of the assets of the AIF
Article 68	Use of models to value assets

Article 69	Consistent application of valuation policies and procedures
Article 71(1)	Review of individual values of assets
Article 72(1)	Calculation of net asset value per unit or share
Article 74	Frequency of valuation of assets held by open-ended AIFs
Article 103	General principles for the annual report
Article 104	Content and format of the balance sheet or statement of assets and liabilities and of the income and expenditure account
Article 105	Report on the activities of the financial year
Article 106	Material changes

10.10 AIF Management Companies

Depending on the legal nature of a QIAIF, it may have or be required to have an Irish management company. For example, a unit trust scheme requires an Irish management company as part of its structure, as does a common contractual fund. In the case of an investment company, it can choose to have or not to have a management company.

It is possible for such a management company to itself be authorised as an AIFM in which case it would be subject to the AIFM authorisation requirements set out elsewhere in this Guide. To the extent, however, that the management company (if any) does not require to be authorised or is not authorised under the Irish AIFMD Regulations, it will be subject to the specific Central Bank requirements for AIF Management Companies as set out in the AIF Rulebook. The term “AIF Management Company” refers to any company whose regular business is the collective portfolio management of AIFs.

The requirements that are set out in the AIF Rulebook include capital requirements, operating conditions, the requirement to act honestly, fairly, professionally, independently and in the interest of the AIF and the investors of the AIF. An AIF management company is required to have at all times a minimum capital requirement being the higher of EUR 125,000 and one quarter of its total expenditure taken from its most recent annual accounts. That latter expenditure figure is subject to upward revision by the Central Bank where it is deemed not to reasonably reflect the AIF management company’s current position. It is also required to maintain financial resources at least equal to that minimum capital requirement and to hold that minimum capital requirement in assets of a particular type specified by the Central Bank.

The AIF management company must submit half-yearly financial and annual audited accounts of the AIF management company to the Central Bank. The half-yearly accounts must be submitted within 2 months of the half-year end and the annual accounts within 4 months of the year end and must be accompanied by the Minimum Capital Requirement Report.

A variety of organisational requirements are imposed, including a requirement to identify an individual at management level who must be located in Ireland with responsibility for compliance with all legal and regulatory requirements and for co-operation and liaison with the relevant regulatory authorities (to be designated as the "Compliance Officer"). This person must be responsible for the compliance function even if this function is performed by a third party. The AIF Rulebook requires that the compliance officer reports to the AIF management company's board at each board meeting, and at least quarterly.

The organisational requirements imposed by the Central Bank also include requirements to have, implement and maintain adequate control systems and accounting procedures; to develop and maintain policies and systems to identify, monitor and control risk; as well as internal reporting and communication of information requirements; requirements regarding maintenance of adequate and orderly records. Information security, integrity and confidentiality obligations are also imposed as are business continuity requirements. Accounting and financial reporting obligations are also set out in the AIF Rulebook which include requirements as to maintenance of records which contain at a minimum detailed financial and company secretarial records as set out in the AIF Rulebook.

An AIF management company must also (a) satisfy the Central Bank, on a continuing basis, that it has adequate management resources to conduct its activities effectively and (b) employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them.

Similar requirements as apply to the directors of AIFMs are applied to the directors of AIF Management Companies as are similar obligations in relation to the relationship with the Central Bank (regarding expansion of business activities etc., general requirements regarding openness and co-operation in its dealings with the Central Bank and, in particular, notification of breaches, legal proceedings, etc. and notifying the Central Bank as soon as it becomes aware of such matters) as well as a variety of requirements regarding changes in the ownership (10% threshold), change of name, extension of activities, change of auditor (and reasons therefor) etc.

The AIF Rulebook also sets out detailed notes as to the calculation of the minimum capital requirement obligations of AIF Management Companies.

10.11 Fund Administrators

The AIF Rulebook also sets out requirements imposed on Irish entities who provide fund administration services to investment funds. The provision of such a service in Ireland requires a specific authorisation under the Investment Intermediaries Act 1995 (as amended) (the "**IIA**"). This Guide does not discuss the authorisation requirements for fund administrators but rather simply notes that the AIF Rulebook contains specific rules regarding matters such as capital, internal organisational requirements, similar requirements regarding internal controls and systems to those applicable to management companies.

Additional obligations are imposed in respect of matters such as outsourcing of administration services, the imposition of client money rules under the Irish MiFID Regulations as well as linking certain of the obligations to those which arise under the Central Bank's separate Handbook for IIA investment firms.

11. Taxation of AIFs

All Irish AIFs, no matter what their legal form, are subject to the same taxation regime so long as they are designated as Investment Undertakings under Section 739B of the Taxes Consolidation Act, 1997 (as amended) (the "**TCA**").

All Irish regulated funds (other than CCFs and Investment Limited Partnerships – which are both treated as Irish tax transparent) are Investment Undertakings.

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11.1 Irish Direct Tax & Withholding Tax

AIFs are not subject to Irish taxation on any income or gains they may realise from their investments. In addition, no withholding tax arises on dividend or interest payments made by Irish companies to AIFs. The exemption in respect of dividend withholding tax in the case of AIFs is subject to a standard declaration being in place.

In addition, there are no Irish withholding taxes in respect of a distribution of payments in respect of units or any encashment, redemption, cancellation or transfer of units (units includes shares) by the AIF in respect of:-

(A) unitholders who are neither Irish resident nor ordinarily resident in Ireland provided either:

  (i) they have provided the AIF with the appropriate relevant declaration of non-Irish residence; or
  (ii) the AIF has availed of the Appropriate Equivalent Measures ("AEM") regime as introduced by Finance Act 2010 which when applicable effectively removes the need for non-resident declarations (see further below under "*Taxation of non-Irish residents*");

(B) unitholders which fall within the category of exempt Irish investors (e.g. approved pension schemes, charities, etc) who have also made an appropriate relevant declaration to the AIF.

However when a distribution is made by the AIF to Irish resident unitholders (or an ordinarily Irish resident unitholder) who do not fall within any of the exempt Irish investor categories, or such a unitholder disposes of units and realises a gain, tax must be deducted by the AIF at a rate of 33% on distributions (where payments are made annually or at more frequent intervals) or 36% on any other distribution or gain arising to the unitholder.

11.2 Taxation of Irish residents

Irish resident individual investors pay no further tax on distributions made to them unless the units are denominated in a currency other than EUR in which case they may be liable to tax on foreign currency gains.

Irish corporate unitholders who receive distributions from which tax has been deducted will not be subject to further Irish tax on the payments received. However, depending on whether the Irish corporate unitholder is taxed at 12.5% or 25% on such distributions then it may be entitled to a refund of part of the withholding tax deducted by the AIF. The AIF will be required to deduct tax at 33% or 36% (or 25% depending on whether the Irish corporate unitholder has completed an appropriate declaration permitting the 25% withholding tax to be applied). Such unitholders may also be liable to tax on foreign currency gains as outlined above.

11.3 Taxation of non-Irish residents

As above, there are no withholding tax on distributions made to non-residents (provided they complete a non-Irish tax resident declaration) or alternatively the AIF has availed of the AEM regime. The AEM regime is subject to approval by the Irish Tax Authority ("ITA") but in general it should apply to all AIFs which are not actively promoted in Ireland. For AIFs that avail of this exemption, it essentially means that non-resident declarations are not required in respect of non-Irish resident unitholders. For more on the AEM regime please see publication on our website entitled "*Funds - An Alternative to NRDs, Equivalent Measures*".

11.4 8 Year Rule

Ireland introduced in 2006 legislation to counteract Irish investors being able to roll-up (indefinitely) their share of the underlying income and gains of an Investment Undertaking for more than 8 years. Therefore, every time an Irish investor invests in a AIF, an 8 year clock will start running in relation to that particular investment in the AIF and if that investment is not returned before the 8th anniversary of making (or acquiring) that investment (being shares/units) in the AIF, then certain Irish investors will be taxed as if they had made a redemption or disposal (at market value) of their investment (being shares/units) in the AIF and consequently will be taxed on any deemed gain at 36%. This 8 year rule does not apply to non-Irish resident investors.

11.5 Stamp Duty

No stamp duty is payable in Ireland on the issue, transfer, repurchase or redemption of units in an AIF. Furthermore, no stamp duty is payable by the AIF on the conveyance or transfer of stock or marketable securities provided that the stock or marketable securities in question have not been issued by a company registered in Ireland and provided that the conveyance or transfer does not relate to any immovable real estate situated in Ireland or any right over or interest in such real estate or to any stocks or marketable securities of a company (other than a company which an Investment Undertaking) which is registered in Ireland. Where Irish securities or land is involved, Irish stamp duty will apply.

Where any subscription for or redemption of units is satisfied by the in specie transfer of securities, real estate or other types of assets, consideration should be given to whether Irish stamp duty may arise on the transfer of such assets.

11.6 VAT

There are wide ranging VAT exemptions with regard to the provision of services to AIFs (e.g. administration, transfer agency, investment management, custodial, etc) and to the extent that an AIF suffers Irish VAT on certain services it receives (e.g. audit and legal fees) the AIF may recover this VAT based on its recovery rate. The recovery rate will be based on either (i) the extent that investments of the AIF are invested outside the EU or (ii) the extent that the investors in the AIF are located outside the EU. The ITA typically has a preference to base an AIF's VAT recovery position by reference to where the investments of the AIF are invested, rather than where the investors in the AIF are located. Nevertheless, whichever basis is used, it must be applied consistently from one period to the next.

Certain services received from abroad (e.g. the service of non-Irish lawyers or accountants) will require an AIF to register and self account for VAT in Ireland. However, depending on the AIF's VAT recovery rate, the AIF may be able to recover some or all of this Irish VAT (although in respect of EU investments, no VAT recovery would be available). Once registered for Irish VAT the normal VAT filing and recording keeping obligations under Irish VAT law will apply.

11.7 Compliance requirements

AIFs have an obligation to register with the ITA so as to obtain a tax reference number as each AIF must file bi-annual tax returns. These tax returns should be accompanied by the payment of appropriate tax (if applicable) for the period in question. On the basis that there are no Irish resident or ordinarily resident unitholders (or such unitholders are exempt Irish investors) the appropriate tax should be nil.

11.8 AIFs in the form of a CCF or Investment Limited Partnership

Essentially CCFs and Investment Limited Partnerships are treated as tax transparent from an Irish tax perspective. So no withholding taxes will arise on distributions made by them. There is no need for any non-resident declarations or AEM. Other than that primary difference, most of the tax measures explained above which apply to corporate and unit trust AIFs equally apply to AIFs in the legal form of a CCF Investment Limited Partnership.

11.9 PAYE

Directors fees are subject to Irish PAYE unless an exemption order obtained.

12. Taxation of AIFMs

The Irish tax regime for AIFMs establishing in Ireland is outlined below.

Not only are corporate tax rates attractive, but Ireland also has a good personal tax regime for executives of the AIFM moving to Ireland.

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12.1 Irish Corporate Tax Rates

An AIFM will be taxed at either 12.5% or 25% on its profits. For AIFMs, typical profits qualifying for the 12.5% tax rate would be fee income and income arising from an investment of the AIFM's minimum regulatory capital requirements. An investment by the AIFM in an AIF which it manages may also qualify for the 12.5% tax rate. Typically passive income (non-trading income) will be taxable at the higher corporate tax rate of 25% and non-trading capital gains taxable at 33%.

12.2 Repatriation of After-Tax Profits

An AIFM can make dividend payments free of Irish dividend withholding tax.

Exemption from dividend withholding tax is available to non-resident shareholders in the following circumstances:

(i) under domestic law, where the dividend is paid to individual recipients resident in the EU or in a country with which Ireland has concluded a double tax treaty or in a country which Ireland has signed but not yet ratified a double tax treaty ("Qualifying Country");

(ii) under domestic law, where the dividend is paid to a company resident in a Qualifying Country and which is not controlled (more than 50%) by Irish residents;

(iii) under domestic law, where the dividend is paid to a company that is under the ultimate control of persons resident in a Qualifying Country;

(iv) under domestic law, where the dividend is paid to a non-resident company, the principal class of whose shares is listed and regularly traded on a recognised stock exchange in a treaty country or another Member State, or on another stock exchange approved by the Minister for Finance. This exemption also applies where the recipient of the dividend is a 75% or more subsidiary of such a listed entity;

(v) under domestic law, where the dividend is paid to a non-resident company that is wholly owned (directly or indirectly) by two or more companies, the principal class of each which is listed (and regularly traded) on a recognised stock exchange approved by the Minister for Finance; and

(vi) in accordance with the EU Parent-Subsidiary Directive, where the dividend is paid by a subsidiary company to its EU parent.

With the exception of a subsidiary company relying on the EU Parent-Subsidiary Directive (when making a payment to an EU parent), all of the foregoing persons must make a declaration in a specific format laid down in the legislation in order to avail of the above exemptions (i.e. no declaration is required if a company is relying on the EU Parent-Subsidiary Directive). If there are no changes in circumstances the exemption should remain operative for five years. Please note that on the making of a relevant dividend to which one of the above exemptions applies (including the EU Parent-Subsidiary Directive) it is still necessary to complete and file a nil Dividend Withholding Tax form with the Irish Revenue Commissioners by the 14th day of the month following the month in which the dividend is made (i.e. a return is required to be made with the Irish Revenue Commissioners even in the event where nil withholding tax applies).

Where a shareholder receives a distribution on liquidation such a distribution is not regarded as a dividend and instead may be subject to capital gains tax in the hands of the shareholder. It is however very unlikely that such a distribution to a non-resident shareholder would attract a liability to Irish capital gains tax given the fact that a liability to such only arises on shares deriving their value from Irish minerals or mining rights or from Irish real property.

12.3 Transfer Pricing

Ireland introduced transfer pricing legislation in 2010. The legislation seeks to increase understated receipts and reduce overstated expenses of companies and branches in Ireland. The sole aim of the legislation is to increase profits which have been understated in Ireland (not normally a common occurrence with a corporate tax rate of 12.5%).

Small or medium - sized enterprises are exempt from the transfer pricing measures. For the purpose of this exemption a person is regarded as a "*small or medium-sized enterprise*" if they fall within the definition of "***micro, small and medium-sized enterprises***" as outlined in the Annex to Commission Recommendations of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises. This essentially excludes an enterprise which employs fewer than 250 persons and which has an annual turnover not exceeding EUR 50 million **and/or** an annual balance sheet total not exceeding EUR 43 million. These figures are assessed, where appropriate, on a worldwide group wide basis.

12.4 VAT

To the extent an AIFM is providing services to persons located outside of Ireland then it will have full VAT recovery in respect of any VAT input costs that incurs in respect of activities directly attributable to the provision of such services.

To the extent an AIFM incurs VAT on input costs in respect of the provision of VAT exempt services to Irish AIFMs then it can recover all or a percentage of such VAT input costs on the same basis as the underlying Irish AIFMs it manages.

12.5 Personal tax regime for Executives of the AIFM

In certain cases carried interest will be taxable at a 12.5% or 15% tax rate instead of the normal capital gains tax rate of 33%.

Ireland like the UK also has the concept of non-doms and consequently it may be attractive for some investment managers to be tax resident in Ireland to the extent they have significant non-Irish income and gains. Likewise, non-doms can remit income and gains to Ireland tax-free which have been earned in the period before they move to Ireland.

There are also special tax reliefs for individuals moving to Ireland known as the Special Assignment Relief Programme (SARP) which can considerably reduce an individual's effective tax rate for 5 consecutive tax years.

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