Proskauer

Possible Changes to the AIFM Directive for Venture Capital

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Introduction

Many U.S. managers of alternative investment funds are aware of the EU Alternative Investment Fund Managers Directive (the Directive), which will require some managers to become authorised under the Directive and others to comply with discrete parts of the Directive. The Directive establishes an EU-wide regulatory regime for managers of alternative investment funds.

The text of the Directive was approved by the European Parliament in November 2010, with no specific carve-outs for managers of venture capital funds.

On June 15, 2011, an EU consultation paper was published that, for the first time, suggested that a more light-touch regime may be appropriate for managers of venture capital funds.

AIFM Directive

What is the status of the Directive?

Having been approved by the European Parliament in November 2010, the text of the Directive was formally adopted by the Council of the EU on May 27, 2011 and we are now awaiting the publication of the Directive in the Official Journal of the European Union. The Directive will come into force 20 days after such publication.

The Directive will not become effective in individual Member States until those Member States have passed their own legislation implementing the Directive. Assuming that the Directive comes into force in mid-2011, individual Member States have until mid-2013 to implement it in their own territory through domestic legislation. Before individual Member States can implement the Directive, a significant amount of “Level 2” rulemaking is required from various EU bodies, fleshing out a number of the provisions of the Directive.

Which investment funds does the Directive apply to?

The Directive applies to managers of most types of funds, including private equity funds, venture funds, hedge funds, real estate funds and funds of funds.

There are some limited exemptions, including (a) for managers who have AUM of €500 million or less in the case of unleveraged, closed-ended funds, (b) some limited grandfathering provisions for funds which are, broadly, no longer marketing their interests and no longer making investments, (c) for arrangements structured as managed accounts rather than pooled funds and (d) for certain captive funds and family offices.

What are the implications for EU-based managers of funds?

After implementation of the Directive, EU-based managers of private investment funds will be required to become authorised under and comply with the Directive. Firms with EU-based advisers or performing other activities in the EU should carefully consider whether or not those activities can be construed as "managing" from the EU for the purposes of the Directive.

What are the implications for non-EU-based managers of funds?

The Directive also has implications for non-EU-based managers of funds (whether or not the funds themselves are EU-based) who, after implementation of the Directive, intend to actively market private investment funds to EU-based investors. The position is complex but, essentially, until at least 2018, the manager can continue to market its fund to EU-based professional investors under the national private placement rules in the Member States in which it is marketing, but only if:

(a) certain regulatory cooperation agreements are in place between (i) the regulatory authorities of the non-EU manager and, if the fund is non-EU, of the fund and (ii) the regulatory authorities of the Member States in which the fund is to be marketed;

(b) the jurisdictions of the non-EU manager and, if the fund is non-EU, of the fund are not designated as a non-cooperative country or territory by the Financial Action Task Force on anti-money laundering and terrorist financing; and

(c) the non-EU manager must comply with the so-called "transparency" and "portfolio company" requirements of the Directive although, importantly, it need not comply with the other Directive requirements, many of which are onerous.

Alternatively, from 2015 the non-EU manager can apply to become authorised under the Directive and be subject, essentially, to full compliance with the Directive, in the same way as for EU managers, and thereby access an EU-wide “marketing passport” which will allow it, following pre-notification to the applicable EU regulatory authorities, to market to professional investors in any Member State under common EU-wide rules, rather than under the differing national private placement rules for individual Member States. Note, however, that this option will only become available if, following a review of the functioning of the passport for EU managers, the newly established European Securities and Markets Authority (ESMA) recommends that its availability be extended to non-EU managers and, in addition, after secondary implementing legislation has been passed by the European Commission.

Finally, but not before 2018, the Directive contemplates that the national private placement rules for marketing to EU professional investors may be terminated if, following a review by ESMA, ESMA recommends such termination. If this were to happen, a non-EU manager intending to market to EU professional investors would only be able to do so if it is authorised under and complies with the Directive in full.

A number of the obligations imposed by the Directive are onerous and many non-EU managers will, where they can, want to avoid the regulatory burden imposed by authorisation under the Directive and compliance with the full Directive.

Venture capital consultation document

With little fanfare, on June 15, 2011, the European Commission Internal Market and Services Directorate General published for public consultation a staff working paper entitled “A new European regime for Venture Capital”.

The paper noted the dramatic reduction in investment by European venture funds in European smaller and medium-sized enterprises since the financial crisis and suggested proposals to facilitate cross-border fundraising and investing by venture capital funds.

The paper acknowledges, with not a little understatement, that the Directive "does not always appear the ideal instrument" for the promotion of cross-border venture capital activity. The paper does not contain firm proposals, but does suggest a light-touch regulatory regime for managers of venture capital funds. It envisages a voluntary regime under which venture capital fund managers which wish to access an EU-wide marketing and investing "passport" can register in the EU. Once registered, the manager could provide services and raise and invest capital across all 27 Member States. Some basic information would need to be included with the registration application, but much less information than would otherwise be required to be submitted as part of an application to become authorised under the Directive. The paper suggests the following additional requirements:

(a) that there are basic requirements on the manager to act fairly, with due skill and in the best interests of investors while avoiding conflicts of interest;

(b) that the manager satisfies basic organisational requirements such as in relation to accounting procedures and internal control mechanisms;

(c) that the persons who control the manager's business should be of "good repute and experience" and the significant owners of the manager should be "suitable" (this follows the equivalent requirements in the Directive);

(d) an annual report including audited financial accounts would need to be produced each year for the venture fund and disclosed to investors and the regulator.

This regime would only apply to unleveraged funds that invest the "biggest part" of their assets in SMEs or in start-up projects that are intended to become SMEs. SMEs are the EU equivalent of SMBs in the U.S. and are essentially companies with fewer than 250 employees and which have an annual turnover not exceeding €50 million and/or an annual balance sheet total not exceeding €43 million. It is also suggested that it would only apply to managers of funds making "seed, start-up or expansion" investments, but would not apply to acquisitions of shares from founders or other early stage investors or to buyouts. The paper seeks responses on whether the EU should "draw inspiration" from the SEC exemption for venture capital funds for the purposes of the Dodd-Frank Act.

It further recommends that the light-touch regime should be open to non-European managers and funds as well as European managers and funds.

The deadline for receiving submissions on the consultation paper is August 10, 2011. We will keep you updated on further developments in relation to this positive initiative.

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