



Ensuring Successful Private Equity Fundraising in the US and Europe

AIFMD




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AIFMD - BACKGROUND

- Alternative Investment Fund Managers Directive - Directive 2011/61/EU of 8 June 2011 (**the Directive**)
- response to financial crisis
- alternative investment funds *‘account for significant amounts of trading in markets and can exercise an important influence on markets and companies in which they invest’* – Systemic Risk
- the Directive aims to create a *‘harmonised and stringent regulatory and supervisory framework’* for alternative investment funds

excerpts from recitals of the Directive



- the Directive regulates managers of AIFs (**AIFMs**)
- introduces more onerous requirements for AIFMs, touching on areas such as leverage; valuation methods; remuneration structures; disclosures of financial information; regulatory capital; depositories; delegation; risk and liquidity management.
- needed to be implemented by EU Member States by 22 July 2013. Implemented in UK by HM Treasury Regulations and FCA Handbook. Transitional period ended 22 July 2014.



WHO DOES THE DIRECTIVE APPLY TO?

Under the Directive:

- ‘AIF’
 - collective investment undertaking
 - not a UCITS
 - more than one investor
 - defined investment policy
- ‘AIFM’
 - legal persons whose regular business is to manage one or more AIFs
- Size Matters – ‘sub-threshold’ AIFMs
- Less onerous requirements for AIFMs managing AIFs:



- whose AUM do not exceed €100 million (where AIF is leveraged)
- whose AUM do not exceed €500 million (where AIF is unleveraged, and no redemption for 5 years)
- Other exemptions:
 - group vehicles
 - holding companies
 - occupational pension funds
 - supranational institutions e.g. EIB, ECB, World Bank, etc.
 - central banks
 - governments and sovereign wealth funds
 - regional/local governments
 - employee participation/saving funds
 - securitisation vehicles
 - family offices
 - joint ventures
- Application to fund managers who are managing AIFs; and/or marketing AIFs in EU.



AIFMD MATRICES

1. Consider thresholds and exemptions
2. If above threshold; and not exempt, consider below:

Managing AIFs

| | EU AIFM | Non-EU AIFM |
|------------|---------|---|
| EU AIF | ✓ | x (before July 2015, manage in accordance with AIFM's national law) ✓ (after July 2015, will have to comply with Directive's requirements re capital, remuneration, depositories, etc.). |
| non-EU AIF | ✓ | x |

Marketing AIFs

| | EU AIFM | Non-EU AIFM |
|------------|---------|---|
| EU AIF | ✓ | ✓ |
| non-EU AIF | ✓ | x (before July 2015, national private placement regimes apply, but subject to certain requirements) (Expected that NPPRs will be abolished in July 2018) |

Matrix Key: ✓ applies
x does not apply



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MARKET REACTION

- From managers
 - Upside:
 - EU-wide marketing passport, which will (hopefully) simplify the selling process throughout the European bloc
 - Downsides:
 - expensive due to increased compliance costs
 - increased public scrutiny (e.g. remuneration)
- From investors
 - Some investors may press for funds to be authorised – best practice/gold standard
- From ‘third country’ (non-EU) managers and investors



PRACTICAL IMPLICATIONS

- Investors
 - ‘Marketing’ – ‘a direct or indirect *offering* or *placement at the initiative of the AIFM* or *on behalf of the AIFM* of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union’ – AIFMD, Article 4.
 - ‘reverse solicitation’
 - investors to be pro-active - enquiries of fund managers
 - the rules defining ‘reverse solicitation’ vary with each jurisdiction
 - for example, UK investor needs to do more than make general enquiries; needs to name particular fund(s)



- Fund managers
 - internal due diligence on funds and fund structures to verify Directive’s application
 - short-term decisions
 - decide on which funds are caught by Directive – look at investor profile – decide in relation to each jurisdiction whether to apply for authorisation; or rely on reverse solicitation
 - if you want a significant presence in Europe – better to get authorised?
 - be wary of “gold-plating” in certain jurisdictions e.g. Germany



- affecting marketing, and restricting German investor access
 - location of investor is relevant, not the office of fund manager. eg. German investor – German marketing rules become relevant
 - UK, Luxembourg, Sweden, Finland and Holland – no gold-plating
-
- if relying on reverse solicitation, keep proper records/paper trail
-
- breach – fines/imprisonment/potential litigation risk (investor mis-selling claims)



– longer term decisions

- restructuring to take funds out of scope
- pan-European passport is not available to Third Country managers
- consider establishing European operations or new “AIFM” platform?



MARKETING IN THE US

- RECENT DEVELOPMENTS -



OVERVIEW

- PE funds usually marketed under private placement rules – Section 4(a)(2) Securities Act 1933 (the Act)
- Regulation D of the Act – safe harbour
- Additional regulatory considerations
 - Investment Company Act 1940
 - Investment Advisers Act 1940



DEVELOPMENTS

- 10 July 2014, SEC adopted new Rule 506(c)
- Significant relaxation of restrictions on public offerings of unregistered securities
- General solicitation now permitted for many PE funds, hedge funds and VC funds



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RULE 506(c) CONDITIONS

- All investors must be ‘accredited investors’
 - high net worth individuals
 - organisations – minimum AUM
- ‘Reasonable steps to verify’
 - under new Rule, manager cannot rely solely on investor’s representation
 - Rule contains guidance on verification methods
- Form D filing
- Note ‘Bad Actor’ disqualification



OTHER CONSIDERATIONS

- Investment Advisers Act 1940 may restrict the actual content of public statements
 - Rule 206(4)-1: prohibition on use of past performance
 - prohibition against testimonials:
 - regarding the advisers, its advice or any services it offers
 - endorsements made by any former, existing or prospective client
 - not restricted to statements about the adviser's performance
- Other compliance issues
 - social media: the Rule applies to Twitter and all forms of social media, not just websites
 - websites: ensure you do not violate non-US securities laws



- Investment Company Act 1940 clarification
 - SEC have confirmed that funds relying on Rule 506(c) can still rely on their Section 3(c)(1) or 3(c)(7) exclusions
- Commodity Futures Trading Commission (CFTC)
 - be mindful of overlap with CFTC regime
 - review on fund-by-fund basis
- Regulation S clarification
 - SEC have confirmed that Regulation S selling will not taint fund's ability to rely on 506(c).



THE REALITY

- Only 5% PE funds have registered under 506(c)
- Additional costs; wrong 'audience'; increased scrutiny from SEC; too novel
- Advertising limitations in Rule 206(4)-1 of Advisers Act 1940 – use of past performance or testimonials in fund advertisements
- More likely changes resulting from 506 (c)
 - more accessible websites
 - freer use of social media
 - freer use of press/conferences and other speaking opportunities.



LIMITED PARTNERSHIP AGREEMENTS

- RECENT DEVELOPMENTS -



- Fund Economics

- increasing focus on management fees; expenses and abort costs
- escrow interim “true-ups” on carried interest

- Decision-making/control

- more active advisory committees
- rise in no-fault divorces (investors cite issues concerning loss of investor confidence/underperforming portfolio; poor communication; handling of conflicts of interest). Particularly in emerging markets space
- investor focus on handling of conflicts by managers – e.g. secondaries
- divestments - forcing disposals of poorly-performing portfolio companies



- Documentation
 - investors driving more rigorous observance of covenants
 - valuation and accounting methodology – investor input
 - transaction fee-sharing largely gone
 - increased due diligence – increasing fundraising cycle – timing/cost implications
- Changing attitudes to risk and regulation?
 - focus on corporate governance
 - perceptions of OECD non-compliant jurisdictions
 - perceptions of offshore tax structures
 - hedging products/foreign currency risk



OFFICE LOCATIONS

| | | | | |
|---|---|--|---|--|
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