

News Update

Asset Management

Implementation of the AIFM Directive in the Netherlands

1 Implementation AIFMD in Dutch Act on Financial Supervision

1. On 19 April 2012, the Dutch Government submitted to Parliament the legislative Act a proposal for the implementation of Directive 2011/61/EU on Alternative Investment Fund Managers (the “**AIFMD**”) in the Dutch Act on Financial Supervision (the “**AFS**”). After having been adopted by the Second Chamber, the bill was submitted to the Senate on 2 October 2012, and adopted by the Senate on 11 June 2013. The relevant act (the “**Act**”) will enter into force on 22 July 2013.

The Senate’s approval has taken significantly more time than was expected. This is due to the fact that the Second Chamber amended the bill. Pursuant to this amendment, managers of AIFs in which only pension funds may invest would not fall within the scope of the new legislation. Minister of Finance De Jager sent a letter to the Dutch Parliament, in which he explicitly advised against adoption of the amendment. Also, the Authority for the Financial Markets (“**AFM**”) and the Central Bank opposed the amendment.

The Ministry of Finance thereupon consulted the European Commission on the amendment. The European Commission considered that under article 2(3)(b) of the AIFMD only the following categories are exempted from the Directive:

- (i) Institutions for Occupational Retirement provisions, (“**IORPs**”);
- (ii) authorized entities responsible for managing IORPs and acting on their behalf, provided they are listed in article 2(1) of the MiFID and

provided they do not manage one or more AIFs; and

- (iii) investment managers appointed pursuant article 19(1) of the MiFID, provided they do not manage one or more AIFs.

The bill was thereupon amended again, whereby the exemption was deleted.

2. This News Update briefly summarizes the impact of the Act on the activities of alternative investment fund managers (“**AIFMs**”) subject to regulation in the Netherlands and their service providers, focusing on the following topics:

- a) scope;
- b) passporting;
- c) outsourcing by managers;
- d) depositary and custody structure;
- e) disclosure and reporting;
- f) implementing options;
- g) changes in the private placement regime;
- h) European regulation; and
- i) next steps.

Given the fact that the AIFMD harmonized framework for non-European managers and funds will not enter into force before Q3 2015 (at the soonest), this News Update does not deal with this particular aspect of the Act. However, we will outline the changes made in the private placement regime for non-European AIFMs pursuant to ancillary rules, which are further outlined in the section “Changes in the private placement regime” below.

3. The Ministry of Finance published on 30 May 2013 a draft of the Exemption Regulation in consultation form, and on 6 June 2013 the Ministry of Finance distributed among a selected group (including lawyers) the proposed amendments to the Decree on Conduct of Business Supervision of Financial Undertakings, thereby giving the market the opportunity to anticipate in regard of the upcoming changes.

2 The Act

Scope

4. Under the current national (non-harmonized) AFS framework, the main rule is that managers of collective investment schemes (“CISs”) are subject to a license requirement and ongoing regulations when offering participations to investors in the Netherlands. However, many CISs rely on certain (private placement) exemptions, including the “qualified investors’ exemption, the €100,000 exemption and the less than 150 offerees exemption. This means that in practice the AFS licensing and ongoing requirements are currently relevant only for CIS managers that target the “retail” market, and cannot rely on one of the exemptions. Institutional CISs and their managers are often unregulated. In most instances, it is sufficient to include a selling restriction in the CIS and marketing documentation in order to avoid a license requirement. Exempted CIS managers are not subject to ongoing AFS requirements.

5. The Act has a broad scope. It introduces a license requirement for managers of “investment institutions”, which term has the same meaning as “alternative investment funds” (“AIFs”) under the AIFMD, regardless of the type of investors targeted, the asset class and the closed end or open-end structure. Any undertaking (legal entity or contractual arrangement) that raises capital for collective investment from two or more investors and is not subject to Directive 2009/65/EC (the “UCITS Directive”) qualifies as an investment institution.¹

¹ UCITS (Undertakings for Collective Investment in Transferable Securities) are already subject to harmonized regulations. UCITS funds are bound by strict requirements in terms of, *inter alia*, authorised asset classes and risk-spreading and are usually aimed at retail investors.

Nearly all exemptions mentioned above will be repealed (the only exemption that will remain in place is the “qualified investors only” exemption). AIFMs currently relying on these exemptions will require a license. In addition, currently licensed AIFMs will need to obtain a new license from the AFM. The Act also introduces a large number of amendments to the existing regulatory framework for licensed managers of non-UCITS CISs, including:

- (i) new rules on “depositories”;
- (ii) changes in outsourcing rules;
- (iii) new (ongoing and incidental) reporting requirements;
- (iv) new investor disclosure requirements;
- (v) new governance and organizational requirements (risk management, liquidity, valuation, etc.); and
- (vi) new remuneration rules.

6. Under the Act, additional “Netherlands-specific” requirements will apply to the marketing of AIFs to retail investors in the Netherlands, regardless of the country of establishment of the AIFs and that of the manager. These requirements will relate to additional investor disclosures (e.g. a key investor information document) and further investor protection rules (e.g. affiliation to KiFiD, the Dutch dispute resolution institute).

7. Pursuant to the Act, AIFMs that are established in the Netherlands require a license from the AFM in order to manage an investment institution (in the Netherlands or abroad). The current exemptions will no longer apply (see however section 10 below). Nevertheless, in accordance with the AIFMD, specific types of AIFMs are excluded from the scope of the Act. For instance, the Act does not apply to (managers of) pension funds, holding companies and securitization special purpose entities.

8. According to the explanatory statements to the Act, pooling structures used by individual portfolio managers to pool the assets of different clients with parallel interests – such as pension funds – for efficiency purposes may or may not qualify as investment institutions, depending on the specific structure used. Pension funds and their managers will need to review their pooling arrangements to establish whether the Act applies to them. An asset pooling structure set up by an investment firm in the execution

of an investment management agreement (i.e. a discretionary mandate) for administrative purposes only, will not qualify as an investment institution.

9. The (optional) AIFMD exemption for smaller AIFMs has been implemented. In the Act That exemption will only apply to Netherlands-based AIFMs if the total of the assets under management does not exceed €100 million or (if all relevant investment institutions have no redemption rights for five years and do not use any form of leverage) €500 million. AIFMs wishing to rely on this exemption need to register with the AFM, to perform regular filings concerning their activities and to notify the AFM if they no longer meet the conditions for exemption.

10. Smaller Netherlands-based AIFMs may even rely on the ‘smaller AIFM’ exemption to market investment institutions to retail Dutch investors. In that case however, the participation rights must be offered to less than 150 Dutch retail investors or have a denomination or require a minimum investment of €100,000.

11. In principle, an AIFM may perform no other activities than the management of investment institutions and – subject to separate authorization under the UCITS Directive – that of UCITS funds. As a result, licensed banks and investment firms are not eligible to obtain an AIFM license. Under the current AFS rules, this combination is permitted. Therefore, these parties will need to reconsider the structure of their activities. In contrast, pursuant to the Act, licensed AIFMs may provide a limited number of “investment services”, including individual portfolio management, investment advice and receipt and transmission of orders.

Passporting

12. AFS-licensed managers of non-UCITS CISs do not currently have passporting rights. Therefore, they must rely on local (private placement) rules to offer their participation rights in other countries of the European Economic Area (“EEA”). The Act introduces a passport for licensed Dutch AIFMs. Subject to prior notification to the AFM, they may activate that ‘passport’ to market their investment institutions to professional investors in other EEA jurisdictions and/or to manage an AIF established in that jurisdiction, either cross-border or via a local branch. Licensed AIFMs established in

another EEA country have the same rights in relation to the Netherlands, subject to prior notification to their home country regulator.

Outsourcing by managers

13. Under the current AFS rules, licensed AIFMs are already subject to rules when outsourcing to other parties (part of) tasks they would normally perform themselves. As a result of the Act, licensed AIFMs (including those that currently rely on an exemption) will be required to meet different and more detailed outsourcing requirements, compelling them to review any existing arrangements. These requirements apply to outsourcing of any task listed in Annex I of the AIFMD (portfolio and risk management, but also valuation, register maintenance, record-keeping, marketing, etc.).

- a) Licensed AIFMs may only outsource “management” tasks (i.e. portfolio and risk management) to licensed asset managers, unless the AFM has given prior consent. Further restrictions apply if the outsourcing provider is established outside the EEA.
- b) Any task listed in Annex I of the AIFMD may only be outsourced subject to prior notification to the AFM (i.e. before the agreement enters into force). Similarly, any change in outsourcing arrangements must be notified to the AFM. There must be an objective reason for outsourcing.
- c) Before outsourcing a task listed in Annex I to the AIFMD, licensed AIFMs must perform due diligence to make sure the envisaged provider has the expertise and the operational capability to perform the task satisfactorily. There must be a written agreement giving the AIFM certain (such as instruction) powers. AIFMs must monitor the activities of the provider.
- d) AIFMs may not outsource tasks if there is a potential conflict of interest with the provider, unless “Chinese walls” and similar measures exist. In any event, an AIFM may not outsource portfolio or risk management functions to the depositary of the relevant investment institution.

- e) AIFMs must be careful as to the extent of delegation: an AIFM may not become a mere “letter box entity”. According to advice given by the European Securities Markets Authority (“ESMA”), this means that AIFMs must at all times be able to effectively supervise the delegated tasks and to manage the associated risks. Senior management must retain the power to take decisions in key areas falling under their responsibility.
- f) Pursuant to the AIFMD, an AIFM is strictly liable towards the investment institution it manages and its investors for the acts and omissions of outsourcing providers.

Depositary

14. Under the current AFS rules, the assets of non-UCITS regulated CISs must be legally owned by a separate bankruptcy-remote legal entity (*bewaarder*, usually referred to as the “custodian”). This does not apply if the CIS has legal personality and meets (higher) own funds requirements.

15. Pursuant to the Act, each investment fund must have a depositary within the meaning of the AIFMD (“**Depositary**”), regardless of whether the investment institution has legal personality or not. An AIFM may not act as Depositary. Only a limited type of entities (see below) may be appointed as “depositary”. Moreover, the role and responsibilities of a Depositary under the Act are very different from that of the “custodian” described above. The main implications of the Act in that regard for Dutch AIFMs are outlined below.

- a) For each investment institution under management, a Dutch AIFM must appoint one single Depositary established in the same country. Only EEA-licensed banks, certain EEA-licensed investment firms and “custody foundations” (*stichtingen bewaarder*) may act as Depositary. For non-EEA AIFs, Dutch AIFMs may use a local Depositary, subject to certain minimum requirements.
- b) Pursuant to the Act, AIFMs of closed-ended (five year) investment institutions, which do not invest in financial instruments or only invest in non-listed companies, may appoint another type of entity than described above, subject to certain minimum conditions. Based on the explanatory statements

to the Act, licensed trust offices (*trustkantoren*) and civil-law notaries may qualify as ‘alternative’ Depositary.

- c) Pursuant to the Act, the Depositary fulfills two functions:
 - (i) safekeeping function: the Depositary must administer the entitlements to financial instruments in segregated financial instruments accounts held with the Depositary itself. Where possible, financial instruments that are fit for that purpose must be physically delivered to the Depositary. For other assets the Depositary must verify ownership of the assets and record the same in its books on the basis of documentary evidence. The Depositary must maintain cash on segregated cash accounts held with the Depositary (if licensed as a bank) or one or more licensed banks. These safekeeping duties differ significantly from the current AFS rules for custodians, on the basis of which the custodian is a passive legal owner typically using a “custody bank” (generally a member of a regulated market) for account-keeping and transaction purposes; and
 - (ii) oversight function: the Depositary must monitor the cash flows and ensure cash is properly allocated and ensure that the AIFM acts in accordance with the articles of association, that external transactions, as well as sales and redemption of units, are performed in accordance with the applicable internal rules, investment policy and Dutch regulations, etc.

16. The Act acknowledges that the AIFMD does not specify which entity must be the legal owner of the assets. Consequently, pursuant to the Act, it is no longer required (but still permitted) to use a bankruptcy-remote legal entity as legal owner of the investment institution’s assets. AFS-licensed AIFMs will therefore need to review their current custody structure and assess how they can best deal with the new rules.

17. The Depositary can only exclude its liability *vis-à-vis* the investment institution and its investors in the event of loss of assets by a sub-custodian if very strict

conditions are met. Regardless of delegation, the AIFMD imposes a strict liability on the Depositary in the event of loss of assets.

The remaining requirements will be implemented through lower AFS regulations, to the effect that:

- (a) the Depositary may only delegate its safekeeping if there is an objective reason to do so;
- (b) before entering into delegation arrangements, the Depositary must establish that the envisaged provider is a regulated entity that is subject to prudential supervision, and has the expertise and operational capability to perform the task satisfactorily; and
- (c) the Depositary must monitor the sub-custodian on an ongoing basis.

The new delegation requirements are much stricter and more detailed than the current AFS outsourcing rules for “custodians”. They will affect both new and existing sub-custody arrangements, prompting AIFMs to review, terminate, restructure or re-negotiate these arrangements.

Disclosure and reporting

18. Under current Dutch regulations, Dutch-regulated AIFMs are already required to disclose extensive information to both (potential) investors and the AFM: a prospectus, a “Key Investor Information Document” and (half-) yearly reports. Furthermore, certain (intended) changes affecting an AIFM and/or investment institution may trigger incidental notification requirements. As mentioned above, these requirements currently apply to (briefly put) retail CISs. As a result of the Act, similar yet further-reaching disclosure requirements will become applicable to all AIFMs, including those that currently rely on an AFS exemption.

19. Not only will more AIFMs become subject to the new rules, but the nature of the disclosure and reporting requirements will also change. For instance, under (lower AFS regulations pursuant to) the Act, Dutch-regulated AIFMs will be required to report and disclose information to investors concerning their level of leverage, level of exposure per geographical area and sector, existing ‘special rights’ / side-letters,

extensive staff remuneration-related information, information on arrangements with prime-brokers (including re-hypothecation), risk-management systems, liquidity profile and arrangements (e.g. consistency of the redemption policy with the investment policy, based on stress tests). Once a year, AIFMs will be required to submit to the AFM a yearly report containing financial and other information. The content of this report will be determined through regulation by the European Commission, but based on the advice of ESMA. AIFMs will need to amend their reporting systems timely in order to be able to generate the required information.

20. AIFMs holding shares in listed or non-listed companies will need to notify to the AFM – and to the relevant company and its shareholders – the level of their interest when exceeding or falling under certain thresholds. These requirements are similar to those under the Transparency Directive 2004/109/EC, but have a wider scope. Other extensive information requirements will apply if the relevant ‘target company’ is not listed on a securities exchange. Furthermore, the Act introduces a two-year prohibition on distribution, capital reduction, own share purchase, etc. following the acquisition of control in a non-listed company, including a prohibition to vote on other shareholders’ proposals to that effect.

Member state options

21. The Netherlands has made use of the following member state options:

- (i) introduction of a lighter depositary regime for closed-ended funds with long (at least 5 years) lock-in (no redemption rights) to be held in custody (particularly relevant for the real estate and private equity industries);
- (ii) introduction of an amended Dutch private placement regime;
- (iii) introduction of a “retail regime” for marketing investment institutions to retail investors;
- (iv) introduction of certain additional (investment advisory) activities an AIFM is allowed to perform;
- (v) absence of stricter Dutch rules with respect to the acquisition of holdings in issuers and non-listed companies in the Netherlands than prescribed by the AIFMD;

- (vi) allowing a six month period for making the annual accounts available (i.e. no shorter period); and
- (vii) disallowing the possibility to provide up to 50% of the additional amount of own funds in the form of a guarantee given by a credit institution or an insurance undertaking.

Changes in the private placement regime for non-European managers

22. As previously mentioned, the draft of the Exemption Regulation is at this stage (mid-June 2013) in consultation form. The most important change is that Section 4 of the current Exemption Regulation will be entirely deleted. Section 4 includes the following exemptions:

- (i) participations are offered exclusively to qualified investors;
- (ii) participations are offered to fewer than 100 persons other than qualified investors;
- (iii) participations on offer can only be acquired for an equivalent value of at least €100,000;
- (iv) the denomination per participation is at least €100,000; and
- (v) the CIS is established in and subject to full supervision in a “designated state”.

The fact that exemption 1 above will be deleted in the Exemption Regulation will in practice not have a material effect. The reason is that the Act introduces a new section 1:13b in the AFS. Under this section virtually all rules relating to AIFMs (including the license obligation) do not apply to AIFMs (a) established (and regulated) in a designated state or, (b) in case the AIFM is not established in a designated state, if the participations will solely be offered to qualified investors.

This means that the private placement regime for offerings to solely qualified investors will essentially remain unchanged. The only other exception that will remain is the “designated states”-exemption. However, this only applies to AIFMs established in Guernsey, Jersey or the United States (if regulated).

European Regulation

23. Certain provisions of the AIFMD are implemented through a regulation (the “**Regulation**”). The key operational requirements of the AIFMD are stated in

the final Level 2 Regulation of 19 December 2012 on the basis of ESMA’s “technical advice”. The Regulation was published in the Official Journal of the European Union on 22 March 2013 and entered into force on 11 April 2013. The Regulation will be applicable as from 22 July 2013. The Regulation will apply directly in the Netherlands. Furthermore, the European Commission published a Q&A section on the application of the AIFMD on its website.

In addition, ESMA published its final report on the guidelines for key concepts of the AIFMD on 24 May 2013 and at the same time launched a consultation on guidelines for AIFMD reporting obligations under articles 3 and 24 of the AIFMD.

Next steps

24. As said The AIFMD will be implemented in Dutch law by 22 July 2013. Newly registered AIFMs will need to obtain a license by that date. Currently licensed AIFMs will need to comply with the Act by the same date and obtain a new license from the AFM within the transitional period. The managers must take steps in order to implement the changes into their business.

If you have any questions on the above, please contact Hugo Oppelaar:

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