

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 Government submitted to the Dutch Lower House the legislative proposal (the “**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**”).

2. At a European level, certain provisions of the AIFMD will be further implemented through a regulation (the “**Regulation**”). The European Commission is currently drafting the Regulation on the basis of the “technical advice” of the European Securities and Markets Authority (“**ESMA**”). The European Commission intends to publish the Regulation in the summer of 2012. The Regulation will apply directly in the Member States.

3. This client memo briefly summarises the impact of the Proposal 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, and
- f) timing.

Given the fact that the AIFMD harmonised framework for non-European managers and funds will not enter into force before Q3 2015 (at the soonest), this newsletter does not deal with this particular aspect of the Proposal.

4. The Proposal will now be debated before the Dutch Parliament and is, therefore, subject to amendment. However, major amendments are not to be expected. Simultaneously, the Ministry of Finance will be working on the lower AFS regulations implementing the details of the Proposal.

2 The Proposal Scope

5. Under the current national (non-harmonised) 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 exemptions (e.g. 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 private placement exemptions. Institutional CISs and their managers remain largely 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.

6. The Proposal introduces a licensing requirement for all managers of “alternative investment funds” (“**AIFs**”), regardless of the type of investors targeted, the asset classes and the nature (closed-end or open-end) of the relevant AIFs. 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 so-called “UCITS Directive”) qualifies as an AIF [1]. Therefore, the Proposal has a very broad scope.

[1] UCITS (Undertakings for Collective Investment in Transferable Securities) are already subject to harmonised 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.

7. Under the Proposal, additional “Netherlands-specific” requirements (to be determined by lower AFS regulations at a later point) will apply to the marketing of AIFs to non-professional investors in the Netherlands, regardless of the country of establishment of the AIFs and that of the manager. According to the Proposal, these requirements will relate to additional investor disclosures (e.g. key investor information document) and further investor protection rules (e.g. affiliation to KiFiD, the Dutch dispute resolution institute).

8. Pursuant to the Proposal, AIFMs that are established in the Netherlands require a license from the Dutch Authority for the Financial Markets (“AFM”) in order to manage an AIF (in the Netherlands or abroad). The current exemptions will no longer apply (see however 10. below). Nevertheless, in accordance with the AIFMD, specific types of AIFMs are excluded from the scope of the Proposal. For instance, the Proposal does not apply to (managers of) pension funds, holding companies and securitisation special purpose entities.

9. According to the explanatory statements to the Proposal, pooling structures used by individual portfolio managers to pool the assets of different clients with parallel interests – such as pension funds – for (costs-) efficiency purposes may or may not qualify as AIFs, depending on the specific structure used. Pension funds and their managers will need to review their pooling arrangements to establish whether the Proposal 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 purely administrative purposes, shall not qualify as an AIF.

10. In the Proposal, the (optional) AIFMD exemption for smaller AIFMs has been implemented. 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 AIFs 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.

11. Smaller Netherlands-based AIFMs may even rely on the ‘smaller AIFM’ exemption to market AIFs 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. This “retail smaller AIFM” exemption was not included in the earlier (consultation) version of the Proposal.

12. In principle, an AIFM may perform no other activities than the management of AIFs and – subject to separate authorisation 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 Proposal, licensed AIFMs may provide a limited number of “investment services”, including individual portfolio management, investment advice and receipt and transmission of orders.

Passporting

13. AFS-licensed managers of non-UCITS collective investment schemes do not currently have any passporting rights. Therefore, they must rely on local (private placement) rules to offer their participation rights in other EER jurisdictions. The Proposal introduces a passport for licensed Dutch AIFMs. Subject to prior notification to the AFM, they may activate that ‘passport’ to market their AIFs to professional investors in another country of the European Economic Area (“EEA”) and/or to manage an AIF established in such country, 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’. Local rules may apply to retail AIF marketing in another EER country (for the Netherlands, see 7. above).

Outsourcing by managers

14. Under the current AFS rules, licensed AIFMs are already subject to rules when outsourcing to other parties (part of) the tasks they would normally perform themselves. As a result of the Proposal, 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.) and are summarised below.

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. These requirements are all a novelty.

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 AIF.

e) AIFMs must be careful as to the extent of delegation: an AIFM may not become a mere “letter box entity”. According to the ESMA advice, 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 AIF managed and its investors for the acts and omissions of outsourcing providers. However, it seems that this strict liability is not properly reflected in the Proposal. Therefore, the Proposal might be amended in the course of the Parliamentary proceedings in that regard.

Depositary

15. 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 “custodian”) meeting minimum own funds requirements. This does not apply if the AIF has legal personality and meets (higher) own funds requirements. That entity has certain supervision duties, such as ensuring the AIFM acts in accordance with the articles of association of the AIF and approving acts of disposition of the AIFM. AFS-regulated custodians may outsource part of their duties subject to certain rules.

16. Pursuant to the Proposal, each AIF must have a depositary (“**Depositary**”), regardless of whether an AIF’s has legal personality or not. An AIFM may not act as Depositary. In principle, only a limited type of entities (see below) may be appointed as “depositary”. Moreover, the role and responsibilities of a Depositary under the Proposal are very different from that of the “custodian” described above. The main implications of the Proposal in that regard for Dutch AIFMs are outlined below.

a) For each AIF under management, a Dutch AIFM must appoint one single Depositary established in the same country as the AIF. Only EEA-licensed banks, certain EEA-licensed investment firms and specific Dutch “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 Proposal, AIFMs of closed-end (five year) AIFs that 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. The details concerning this – important – exception will be implemented through lower AFS regulations. Based on the explanatory

statements to the Proposal, licensed trust offices (*trustkantoren*) and civil-law notaries may qualify as “alternative” Depositary, although this is still uncertain at this point.

c) Pursuant to the Proposal, the Depositary fulfills two functions:

(i) safekeeping function: the Depositary must administer the AIF’s 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 of the AIF, 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 an AIF’s cash on segregated cash accounts held with the Depositary (if licensed as a bank) or one or more licensed banks. These safekeeping duties differ greatly 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 of the AIF and ensure cash is properly allocated. In addition, the Depositary must perform the same tasks as the “custodians” of AFS regulated funds currently do, e.g. ensure that the AIFM acts in accordance with the AIF’s articles of association, that external transactions, as well as sales and redemption of units, are performed in accordance with the applicable fund rules / investment policy and Dutch regulations, etc.

17. The Proposal acknowledges that the AIFMD does not specify which entity must be the legal owner of an AIF’s assets. Consequently, pursuant to the Proposal, it is no longer required (but still permitted) to use a bankruptcy-remote legal entity as legal owner of a Dutch AIF’s assets. Currently AFS-licensed AIFMs will need to review their current custody structure and assess how they can best deal with the new rules. In any event, they will need to appoint a Depositary themselves, as opposed to current practice, where the “*stichting bewaarder*” – rather than the AIFM – contracts with the “custody bank”.

18. Pursuant to the Proposal, the Depositary can only exclude its liability *vis-à-vis* an AIF 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 very strict liability on the Depositary in the event of loss of assets, which is not yet reflected in the Proposal. The remaining (extensive) 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

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

20. Not only will more AIFMs be 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 Proposal, Dutch-regulated AIFMs will be required to report and disclose information to investors concerning their actual level of leverage, their 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 redemption policy with 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. Here again, the specific content of this report will be determined through regulation by the European Commission, but based on the advice of ESMA, the current AFS regulations on yearly reporting by AIFMs will need to be amended to a large extent. AIFMs will need to amend their reporting systems timely in order to be able to generate the required information.

21. Pursuant to the Proposal, AIFMs of AIFs acquiring control (30% or more) 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 Proposal 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. This is all very new to the AIFMs affected.

Timing

22. Dutch AIFMs that currently hold an AFS-license or rely on an AFS exemption will need to comply with the new rules as of 22 July 2013 and to submit a license application by 22 July 2014. Dutch AIFMs becoming active after 22 July 2013 will need to obtain a license before performing any activities as AIFM. This means that managers need to think now about the practical implications of the Proposal for, *inter alia*, their custody and outsourcing arrangements in order to take timely action.

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

Hugo Oppelaar

Advocaat-partner

T: +31 (0)20 3485224

M: +31 (0)6 51829977

E: hugo.oppelaar@fmlawfirm.eu

www.fmlawfirm.eu