AIFMD – Through the Haze

The Alternative Investment Fund Management Directive ('AIFMD' or the 'Directive') has come into effect as of 22 July 2013, with a one year transition period. It is vital that concerned parties use this transition period to bring their operations in line with the Directive during this time.

The Malta Financial Services Authority (MFSA), through the publication of revised Investment Services Rulebooks in June 2013, placed Malta as one of the first jurisdictions to accept applications for licences of new Alternative Investment Funds (AIFs) or Alternative Investment Fund Managers (AIFMs), in terms of the Directive.

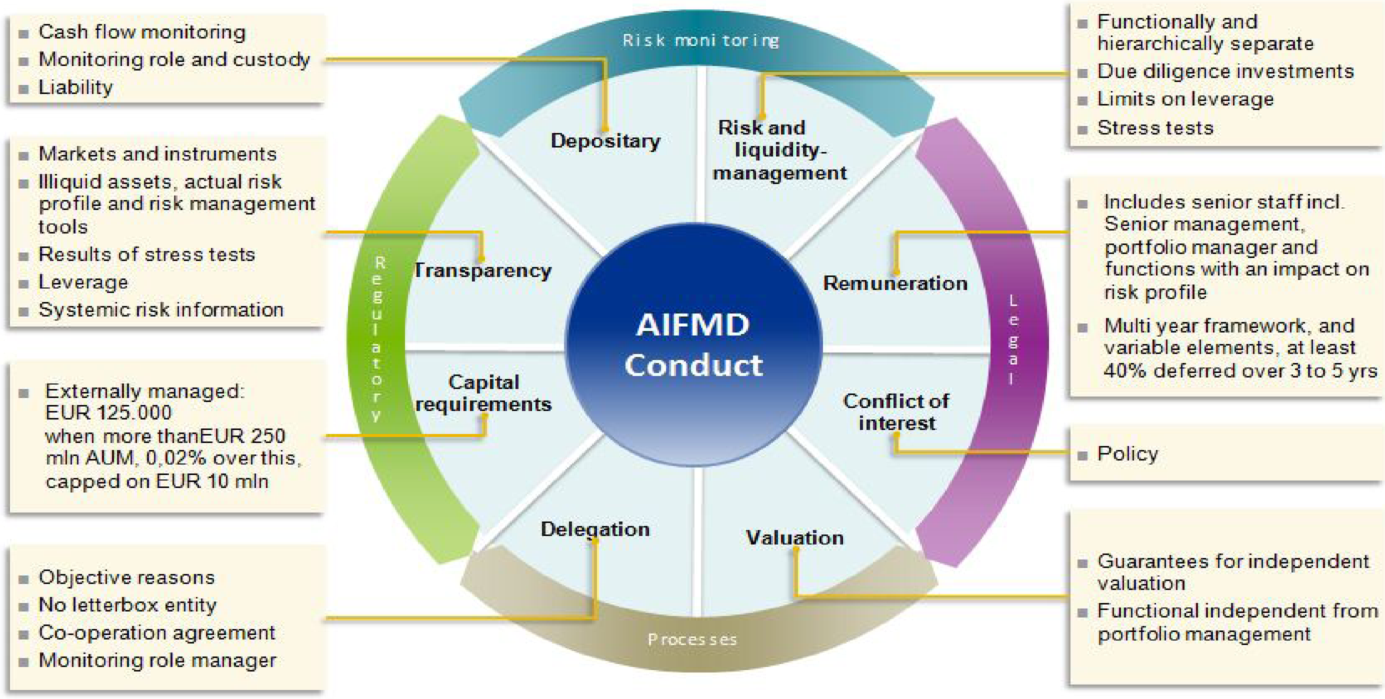


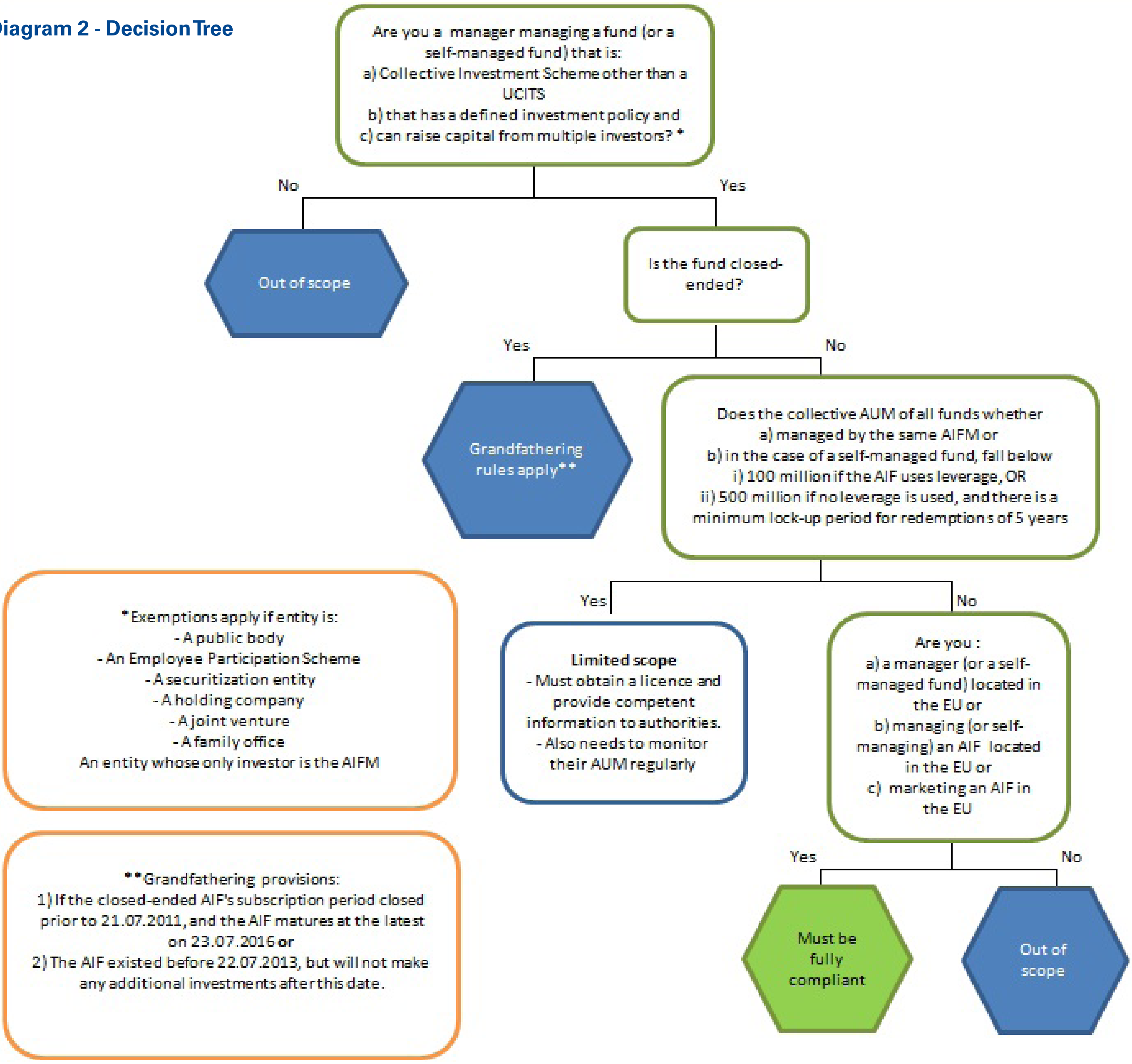
Diagram 1 - The impact of the AIFMD

Its aim is that of increasing regulation to EU AIFMs managing Alternative Investment Funds (AIFs), both within the EU and outside, to create a level playing field, and increase investor protection. It also seeks to regulate the marketing of AIFs within the EU, even when managed by a non-EU AIFM, and creates a Passport that will permit managing and/or marketing on a cross-border basis. Therefore, although the AIFMD originally set out to regulate the European hedge fund industry, the final draft encompasses most managers of Alternative Investment Funds within, and also outside, the EU.

The Directive will at times also filter down into the AIFs themselves in the case of self-managed funds. This gives way to the AIF also being treated as the AIFM, and this will be particularly widespread in Malta, given the attractiveness of the jurisdiction for self-managed funds.

The table on the next page will help to identify whether a fund or a manager will fall within the scope of the Directive. However, funds or managers that do not fall within the scope of the Directive might still want to make use of the opt-in clause, to avail themselves of the possibility to passport services and market throughout Europe.

Diagram 2 - Decision Tree



Assets under management (AUM)

The calculation of the AUM differs from the NAV, in that it aggregates all assets managed by the AIFM without deducting liabilities.

Each derivative position, including any derivative embedded in transferable securities, will need to be converted into its equivalent position in the underlying assets of that derivative, and added to the AUM. Methodologies for the valuation of derivatives are detailed in Article 10 and Annex II of the Directive.

Cross holdings in other AIFs, as well as any UCITS managed by the AIFM may be excluded from the calculation.

AUM needs to be calculated for each AIF at least annually, at the same time each year and requires auditor confirmation for those falling below the threshold. As soon as the AUM exceeds the threshold, then the regulator should be informed.

If the excess is considered to be temporary, reasons should be given as to why this is deemed so, and what actions will be taken to lower the level to below the threshold within 3 months.

At the end of the 3 month period, the AUM calculation will need to be resubmitted, and if it is still above the threshold,then an application will need to be submitted for authorisation under AIFMD to the regulator within 30 days.

Capital Requirements

Self-managed AIFs must have an initial capital of at least €300,000, while externally managed AIFs require an initial capital of €125,000. If the AUM of the AIF exceeds €250m, then additional own funds of 0.02% of the amount over €250 million will need to be added to the initial capital, up to a combined limit of €10 million.

Professional Indemnity insurance or additional own funds will also be required to cover potential liability risks.

Delegation

Core functions of the AIFM are considered to be Portfolio and Risk Management. Delegation of either core function, or also partial delegation, is permitted, provided that the AIFM retains the resources to properly supervise the delegation.

Delegation is subject to certain policies and procedures set out by the Directive and the MFSA, and must be justified and notified to the regulator. Any change in the delegated party, or any sub-delegation will also need to be notified .

Remuneration

AIFMs are required to implement a remuneration policy for staff that may be classified as Senior Management, risk takers and those in control functions. The policy should discourage risk-taking which is inconsistent with the risk profile or fund rules of the AIFs being managed. Fixed and variable components of remuneration should be appropriately balanced and at least 50% of any variable remuneration should consist of units in the AIF being managed.

Malta has applied the remuneration policy to the AIFMD, without applying a look-through approach in case of delegation.

Annual Reporting Obligations

The Directive mentions the following list of mandatory information required at the level of the AIF.

- Statement of assets and liabilities
- Income and expenditure account
- Report on the activities during the financial year
- Any material changes to information disclosed to investors
- The total amount of remuneration, split between fixed and variable, paid to staff members of the AIFM, and broken down between risk takers, control functions and senior management.

The annual report will need to be audited, and must be made available to the regulator within **6 months** of the fund's financial year-end. The **4 month** deadline will apply in case the AIFs securities are admitted for trading on a regulated market.

Additional Reporting

AIFMs are required to provide certain information regularly (depending on their AUM) to the MFSA with regards to each AIF managed. Information must also be provided to investors.

Leverage needs to be reported in detail to the Authority as below:

- The main markets and instruments traded
- Main categories of assets held by each AIF, including geographical and sector investment focus
- Percentage of assets subject to special arrangements due to illiquidity, and any new liquidity arrangements
- Risk profile of the AIF, risk management systems employed
- Periodic stress test results, undertaken under normal and exceptional circumstances
- The level of leverage in each AIF should be reported, and should include the sources of leverage

'De minimis' AIF

AIFs classified as 'de minimis' benefit from a lighter regime, unless they would like to opt in to the AIFMD. These AIFs are required to provide the MFSA with the following information.

- Details of investment strategy
- Regular reporting of the main instruments being traded, principal exposures and concentrations
- Regular reporting of the AUM
- A management letter prepared by the auditor of the AIF, and confirmation from the auditor that the AUM calculation complies with the AIFMD requirements.

In addition to the AIFMD Regime, Malta has also retained the Professional Investor Fund (PIF) Regime.

How KPMG can help

Rather than viewing the Directive as purely a compliance burden, KPMG has identified ways that the Directive can increase business opportunities. These include, among others, regaining investors' trust, accessing European markets and reaching out to new ones.

KPMG can help to implement the Directive by:

1. Calculation/ review of AUM to determine whether a fund/ fund manager falls above/ below the Directive threshold.
2. Understanding your strategy, and your clients needs
3. Assessing the impact, gap analysis, and suggestions for an improvement plan
4. Assistance in Implementation, prioritising actions based on costs, benefits and timing. Inclusion of experts in relation to depositary, reporting and other relevant areas.
5. Ongoing support, suggestions for efficiency optimisation, and assistance for your teams and client service offerings

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