

## AIFMD: EU HEDGE FUND REGULATION

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The EU's Alternative Investment Fund Managers Directive (AIFMD), which became effective at the state level in July 2013, has had a significant impact on the management of Alternative Investment Funds (AIFs)—hedge funds, private equity funds and REITs—marketed in Europe. AIFMD's rules for the operation and transparency of AIFs have created a new regulatory regime largely based on Europe's existing Undertakings for Collective Investment in Transferable Securities (UCITS) directives, which regulate European mutual funds. However, unlike other regulatory frameworks that address the authorization and operation of the fund itself, AIFMD is directed toward the fund managers who are now held to account for compliance, hence the wording "Managers Directive."

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### Defining AIFs

AIFMD broadly defines an AIF as basically any investment fund that does not fall under the UCITS mutual fund classification. More specifically, the definition includes any collective investment undertaking which raises "capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors." The fund may be open-ended or closed-ended and structured in the form of any legal entity. Notably exempted from the AIF definition are holding companies, joint ventures, securitization special purpose entities, pension funds, certain other funds related to one's employment, and family funds.

### Identifying an AIFM

The AIF Manager (AIFM) is identified in the directive according to the core functions he or she—or it— carries out. Those core activities are comprised of portfolio management and risk management. Depending upon legal format, if an AIF is internally managed then the entity may be considered the authorized AIFM. Alternatively, an external AIFM can be appointed by the fund. In addition to the core activities, an external AIFM may be licensed by a member state to provide additional investment services such as discretionary portfolio management, the rendering of investment advice, and administration of fund units.

### Cross-Border Marketing

While the restrictive measures of AIFMD require leverage limits, risk profiles, and liquidity ratios, the flip side of the regulatory framework is that member states will be allowed to market and manage a state-authorized fund anywhere in the EU. What is important for U.S.-based hedge fund managers to be mindful of is that fund managers based outside the EU who manage and/or market funds in the EU are also subject to the impact of AIFMD and will need to adapt their overseas marketing and operational activities accordingly.

As of 2015, AIFMD allows for the licensing of non-EU AIFMDs pursuant to the Management and Marketing Passports. The applicant must submit an application to an EU "Member State of Reference" (MSR) and, once approved, will enjoy the same AIFM benefits—and regulation—as an EU-based AIFM.

## CONTACT US!

**DAVID KINNEAR**  
O: 212.913.0500 x565  
M: 917.886.3222  
E: DAVID.KINNEAR@GREENPOINTGLOBAL.COM

**WILLIAM H. ANDERSON, ESQ**  
O: 212.913.0500 x586  
M: 914.672.4975  
E: WILLIAM.ANDERSON@GREENPOINTGLOBAL.COM