



On behalf of the Public Affairs Executive (PAE) of the  
*EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY*

## **AIFM Directive – Optional Procedure for Small Alternative Investment Fund Managers**

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### **Background**

The proposed AIFM<sup>1</sup> Directive in its current form provides for an exemption for AIFMs where the cumulative AIFs<sup>2</sup> under management fall below a threshold of €100 million. For AIFMs which only manage unleveraged AIFs and do not grant investors redemption rights during a period of five years following the date of constitution of each AIF, a specific threshold of €500 million applies.

It is important to note that AIFMs that are unleveraged and do not grant redemption rights do not create systemic risks and small AIFM of this kind have no significant impact on the Internal Market. They are usually specialized in the financing of small and medium sized firms at local, regional or national level, according to national practices and rules or they are highly specialised in promising high-technology projects. As a matter of example, private equity firms invested around €3.8bn in 327 European clean-tech companies in 2008.<sup>3</sup>

Unfortunately, the de minimis exemptions in the proposed AIFM Directive do not provide a real safe harbour to these smaller entities because:

- Small AIFM operating in the EU and raising funds in the EU should be able to benefit from the European passport stipulated by the AIFM directive.
- Regulated institutional investors may be pushed to invest only in regulated GPs, regardless of their size.
- Small AIFM operating in markets with no national regulation will have no choice but to comply with the AIFM Directive.
- Under Article 4 of the proposed AIFM Directive, Member States having no national law on AIFMs will have to implement a framework for the smaller end of the market. It is still unclear to which extent the AIFM Directive will influence such incoming regulation.

As a result, venture and small private equity firms may become subject to the rules regardless of the threshold. Unfortunately, the detailed requirements will entail serious shortcomings for all companies independently of their size, which are even more harmful for those entities at the smaller end of the market, in particular with regard to their operating conditions. Among others, the provisions on capital requirements, valuation, depositary, delegation (including to an entity established in a third country) and marketing are inappropriate. Also the disclosure requirements, in particular at the level of the portfolio company in which the fund has acquired a controlling or dominant influence, is disproportionate for venture and small private equity firms.

As a matter of example, it is estimated that establishing a fund in the United Kingdom of around €110 million dedicated to financing start-up companies in technology requires from the owners an initial investment of around €675,000. The AIFM Directive capital requirements

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<sup>1</sup> AIFM stands for Alternative Investment Fund Manager.

<sup>2</sup> AIF stands for Alternative Investment Fund.

<sup>3</sup> Source: PEREP\_Analytics

would increase the initial cost of setting up such a fund by almost 50% to around €1 million. Higher rates of increase (almost 60%) have been calculated for setting up a German venture capital fund of €50 million. Consequently, these increased capital costs will have a clear impact on the supply side of capital for young and innovative companies as they potentially stop funds from being created due to the financial challenges in meeting these requirements or as they might be transferred to the investors and thus make the investments less attractive.

EVCA believes that, while regulation for AIFMs above the thresholds should be mandatory, smaller entities falling below the thresholds should be entitled to decide on an individual basis and based on specific criteria to be regulated under the opt-in procedure foreseen in the Directive. However, any regulation imposed on those AIFMs willing to opt-in, should be very carefully tailored to the limited risks they present. They should be subject to specific and appropriate requirements.

Below you find an orientation of what the European private equity and venture capital industry believes should be included in this optional procedure. While most of the issues addressed below represent a concern for all AIFM that are unleveraged and do not grant redemption rights the consequences are particularly disproportionate for small AIFM below the threshold. EVCA is ready to suggest exact wordings for each of the items mentioned below.

### **Optional procedure for small AIFMs: Recommendations**

EVCA would propose that AIFMs which manage funds below the indicated threshold and are willing to opt-in be asked to comply only with the following requirements:

- They should be authorised as required by Article 4 of the European Commission's proposal dated 30.4.2009.
- The procedure for granting the authorisation as currently presented in Article 5 should be amended for small entities. They should provide the competent authorities with information only on the obligations that they should fulfil as presented below.
- The conditions for granting the authorisation should require competent authorities to be satisfied with smaller entities meeting only the obligations that apply to them under the opt-in regime and not the full requirements of the Directive. Therefore, Article 6 of the proposal needs to be amended accordingly.
- Small AIFMs should not be subject to detailed regulatory notification requirements prior to any changes in the features of the AIFs they manage, unless these changes are in contradiction with the restrictions placed on the AIFM's scope of permission by the competent authorities. The competent authorities should only receive the documents after the negotiations between the manager and the professional fund investors have been closed. Consequently, Article 7 of the AIFM proposal should be amended.
- Article 8 foresees the possibility of withdrawal of the authorisation. This Article should also apply to small AIFMs. However, this clause should require that before withdrawing the authorisation the competent authorities should consider the interests of the investors in the AIF and seek to make or facilitate appropriate arrangements for the subsequent management of the AIF in accordance with its terms.
- Interests of investors should be considered on a collective basis and small AIFMs should be subject to the normal requirements relating to market integrity in the same way as other market participants. The specificities of how competent authorities should assess whether the small AIFMs comply with such requirements should be tailored taking into consideration their small size and their limited resources. Consequently, Article 9 should be amended accordingly

- Whereas small AIFMs should be required to comply with the provisions under Article 10 relating conflict of interest, these requirements should take into account the nature, scale and complexity of their business. In addition, any relevant conflict of interest and appropriate ways to address them should be addressed on an individual basis. Therefore, Article 10 should be amended accordingly.
- Small AIFMs should not be subject to capital requirements beyond own funds of €50,000. In addition, no variable amount based on capital under management or annual expenses should be required for these entities. Consequently, Article 14 should be amended accordingly.
- Small AIFMs should comply with the transparency requirements as stipulated in Article 19. However, the mandatory period for reporting needs to be extended to six months in circumstances where information is required from third parties (such as the audit of any underlying investments of the AIF). In addition, specificities regarding the content and format of the annual report should be tailored taking into consideration their small size and their limited resources. Article 19 should therefore be amended accordingly.
- Whereas small AIFMs should be obliged to disclose specific information to investors, they should not be subject to special disclosures relating to illiquid assets or liquidity when they manage funds with no leverage and no redemptions rights exercisable five years after their inception date. In addition, the specificities of the disclosure obligations and the frequency of disclosure should be tailored taking into account their small size and their limited resources. Small AIFMs should disclose that they are authorised under the optional procedure. Article 20 should be amended accordingly.
- Whereas small AIFMs should be subject to reporting obligations to competent authorities, they should not be obliged to have special reports relating to illiquid assets or liquidity, or to trading in securities when they manage closed-ended funds with no leverage. In addition, they should be protected from disclosing confidential and commercially sensitive information. Also, the specificities of the reporting obligations should be tailored taking into account their small size and their limited resources. Article 21 should be amended accordingly.
- Small AIFMs should not be subject to requirements in relation to reporting on portfolio companies which are inconsistent with and go beyond those stipulated in existing company law, violate the rights of other shareholders and do not protect confidential information. Therefore, Chapter IV should be amended accordingly.
- Small AIFMs should not be subject to preclearance obligations in respect of marketing to professional investors. Information should be filed at conclusion of marketing so that competent authorities have information about the AIFs in the form they are actually established, together with information on the restricted marketing conducted. Article 31 should be amended accordingly.
- Article 32 should be amended so as to ensure that small AIFMs from any EU Member State are allowed to market to retail clients in a Member State on the same basis and subject to the same requirements as a national AIFM.
- Small AIFMs should be allowed to market shares or units of AIFs to professional investors in another Member State. In addition, they should only be obliged to file information at conclusion of marketing. Moreover, the host Member State should not impose any additional requirements on the small AIFMs in respect of matters covered by the AIFM Directive, and there should be no delay on marketing rights. Article 33 should be amended accordingly.
- Whereas small AIFMs should apply the provisions of the Directive to their firm and to new funds they will establish after the transition period, there should be an exemption for already existing funds ('grandfathering' clause).

## Notes to the Editor

### About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

### About EVCA

The European Private Equity and Venture Capital Association is the voice of European private equity and venture capital, representing more than 1,300 members. In addition to promoting the industry among key stakeholders, such as institutional investors, entrepreneurs and employee representatives, EVCA develops professional standards, research reports and holds professional training and networking events.

