Ongoing Obligations Under AIFMD for Non-EEA Private Fund Managers – Regulatory Reporting, Annual Investor Report and Investor Disclosures

The Alternative Investment Fund Managers Directive (the "**AIFMD**") introduces new requirements for alternative investment fund managers ("**AIFMs**") established in the European Economic Area ("**EEA**") and non-EEA AIFMs that market their fund in an EEA state. See our Alert "AIFMD – What Actions Should Non-EEA Private Fund Managers Be Taking Now?".

In particular, non-EEA AIFMs will need to consider the obligations under AIFMD covering upfront investor disclosure, reporting to the regulators in the applicable Member States, ongoing reporting to investors and certain disclosure provisions triggered by acquisitions of stakes in EEA companies and anti-"asset stripping" provisions relating to EEA companies. This Alert focuses on the regulatory reporting, annual investor report and ongoing investor disclosures required under AIFMD. For a non-EEA AIFM, registering an intention to market in an EEA state triggers these requirements.

We are happy to deal with any questions on these obligations which clients may have, including parallels with equivalent US requirements.

Part 1 – Regulatory reporting

Managers must determine the first date when they will need to file regulatory reports in respect of the funds that they have marketed in an EEA state and consider the systems needed to generate the data for the reports. SEC-registered investment advisers to private funds have already committed considerable work to completing the SEC's Form PF, to which the AIFMD reporting form has many parallels, some of which are described below.

What is the AIFMD form?

ESMA, the pan-European regulator, has published two versions of the reporting template, v1.1 and v1.2 of XML files (the "**AIFMD consolidated reporting template**"). The UK Financial Conduct Authority ("**FCA**") has requested firms to report using v1.1, as the FCA has built its reporting infrastructure around v1.1. Other European regulators are likely to adopt v1.2. Managers must ensure completion and delivery of the correct version of the reporting form.

The file consists of:

- "AIFM file" containing the information relating to the AIFM to be reported under Articles 24(1) and 3(3)(d) of the AIFMD (first tab of the AIFMD consolidated reporting template); and
- "AIF file" containing information relating to the fund ("**AIF**") to be reported under Articles 24(1) and 3(3)(d), Article 24(2) and Article 24(4) of the AIFMD (second, third and fourth tabs of the AIFMD consolidated reporting template).

What regulatory guidance is available?

ESMA has published the following guidance on completing the form[1]:

- ESMA's reporting guidelines of 15 November 2013, which include guidance on the reporting fields and tables showing the values for some reporting fields;
- ESMA's technical guidance on the AIFM file and AIF file (last updated in March 2014) (referred to as the "IT schema");
- ESMA's opinion of October 2013 on the additional information to be collected under Article 24(5) of AIFMD; and
- ESMA's Q&As on AIFMD (last updated on 27 June 2014), which include guidance on a number of the reporting fields and which will be updated from time to time.

In addition, the FCA has made a number of statements in relation to reporting fields and EEA trade organisations are active in assisting members on understanding the requirements.

We continue to monitor relevant regulatory and trade organisation guidance and are assisting clients with completion of the reporting fields.

What information is required by the form?

The AIFMD consolidated reporting template comprises four main sections:

Relevant section	**Comments**
Tab 1 – AIFM file 24(1) **AIFM – specific information** This comprises information on (inter alia) the AIFM's principal markets and instruments and total assets under management ("**AuM**") of AIFs.	Each EEA AIFM and non-EEA AIFM (in respect of each fund it markets in the EEA) must complete this section. For a non-EEA AIFM, information at the level of the AIFM should only cover the funds marketed in an EEA state.
Tab 2 – AIF file 24(1) **AIF – specific information** This comprises information on (inter alia) the AIF's investment strategies, principal exposures and concentrations.	As above. A number of fields are asterisked, meaning that they need to be reported only to the extent required by the regulator in the relevant state.

[1] Each of these documents can be found on: http://www.esma.europa.eu/page/Investment-management-0

Tab 3 – AIF file 24(2) **Further AIF specific information** This includes more detailed information on exposures and risk profile.	As above. Various types of market risk measures are included in this section. As above, a number of these (such as value at risk ("**VAR**")) are asterisked, meaning that they need to be reported only to the extent required by the regulator in the relevant state. In this regard, the FCA has indicated that it will require VAR reporting from all funds pursuing a hedge fund strategy. This section also requires managers to report the results of risk and liquidity stress tests. An EEA AIFM is required to perform risk stress tests and liquidity stress tests under the AIFMD. A non-EEA AIFM is not subject to these requirements, so it should report information in these fields only to the extent it performs these tests.
Tab 4 – AIF file 24(4) **Leverage information** This includes information about: • the overall level of leverage employed by the fund; • a breakdown of leverage arising from borrowing of cash or securities and leverage embedded in derivatives; • the extent to which the fund's assets have been reused under leveraging arrangements; and • the identity of the five largest sources of borrowed cash or securities for the fund and the amounts of leverage received from each of those sources.	As above, each EEA AIFM and non-EEA AIFM (in respect of each fund it markets in the EEA) must complete this section, to the extent the relevant fund employs leverage on a "substantial basis". Leverage is employed on a substantial basis for this purpose when the fund's exposure (calculated according to the "commitment" method)[2] exceeds three times its net asset value.

[2] The commitment method requires the AIFM to calculate the sum of the absolute values of all positions, with each derivative position converted into its equivalent position in the underlying assets using the conversion methodologies specified.

What are the reporting periods?

The reporting periods depend on the AIFM's strategy and total assets under management. Reporting periods are as follows:

Type of AIFM	Reporting frequency
1. AIFM managing portfolios of AIFs with total AIF assets under management ("**total AuM**")[3] above the €100 million or €500 million "small AIFM" threshold[4] but less than €1 billion, other than each AIF with total AuM in excess of €500 million (see 3 below) and private equity funds (see 4 below).	Half-yearly for all AIFs (1 January to 30 June; 1 July to 31 December).
2. AIFM managing portfolios of AIFs with total AuM in excess of €1 billion, other than private equity funds (see 4 below).	Quarterly for all AIFs (1 January to 31 March; 1 April to 30 June; 1 July to 30 September; 1 October to 31 December).
3. AIFM falling within 1 above, for each AIF with total AuM in excess of €500 million.	Quarterly for that AIF.
4. AIFM managing AIF that is unleveraged and that, in accordance with its core investment policy, invests in non-listed companies to acquire control (i.e., private equity funds).	Annual for that AIF (1 January to 31 December).

Closed-ended funds that are leveraged or that cannot demonstrate that their core investment policy is to invest in non-listed companies to acquire control – such as closed-ended real estate funds – will be subject to quarterly or half-yearly reporting.

When is the first report due?

The first report is due as from the first day of the quarter following the quarter in which the reporting obligation arises, until the end of the first reporting period. For a non-EEA AIFM, the reporting obligation will arise when it notifies or registers with an EEA regulator under the private placement regime for that state.

[3] For this purpose, total AuM comprises the gross value of assets under management and, for derivative positions, by converting each derivative position into its equivalent position in the underlying assets using the conversion methodologies specified.
[4] An AIFM will be below the €100 million threshold if it manages portfolios of funds whose assets under management, including any assets acquired through the use of leverage, do not exceed €100 million. An AIFM will be below the €500 million threshold if it manages portfolios of funds that are unleveraged (disregarding limited recourse leveraging at the portfolio level) and are closed-ended, and whose assets under management do not exceed €500 million.

For example, assuming:

- quarterly reporting;
- that the manager is marketing at today's date with transitional relief; and
- that the manager notifies or registers with a European authority for private placement in July 2014.

In this case, the manager will report for the period 1 October – 31 December 2014, with the report due by 1 February 2015. Thereafter, the manager will report every calendar quarter.

For example, assuming:

- annual reporting;
- that the manager is marketing at today's date with transitional relief; and
- that the manager notifies or registers with a European authority for private placement in July 2014.

In this case, the manager will report for the period 1 October – 31 December 2014, with the report due by 1 February 2015. Thereafter, the manager will report annually.

What is the reporting deadline?

The report must be provided no later than one month after the end of reporting period. The AIFM of a fund that is a fund of funds can extend this period by 15 days. Although this is not contemplated in the Directive, regulators may in practice allow the manager of a fund of funds to submit all its reports (including for funds that are not funds of funds) at the later date.

Where should the report be submitted?

An EEA AIFM will usually report to the competent authority in the member state of its registered office. A non-EEA AIFM will report to the competent authority in each member state where it markets the AIF. The FCA is developing a web interface (named Gabriel) for reporting that will be available in October 2014. Other EEA regulators may require delivery of the completed file by email.

If the AIFM has marketed the fund but the fund has not yet raised any capital (or has raised capital but has not yet invested), the AIFM should still submit the report, although the majority of fields will not need to be completed.

Where an AIFM markets one fund in one jurisdiction and another fund in another jurisdiction, the AIFM should report to the relevant regulator only in respect of the relevant fund marketed in its state.

If only a feeder fund is marketed into the EEA, is it necessary to report information on the master fund?

ESMA has advised member state regulators that they can require managers to report the information required under Articles 24(1) and 24(2) (tabs 2, 3 and 4 above) for the non-EU master AIF of the non-EU feeder AIF that is marketed in the EEA. The FCA has indicated that it will introduce this requirement into its AIFMD implementing rules. Managers will need to check the position taken by regulators in other member states.

What is the position with sub-funds?

ESMA's guidance is that a fund that takes the form of an "umbrella fund" will need to report information at the level of each sub-fund.

What do managers that are accustomed to Form PF need to be particularly aware of regarding the AIFMD form?

Only one third of the fields in the AIFMD form are identical to elements of Form PF. The rest requires data to be processed in a different way, or requires data that is not reported in Form PF. The AIFMD form has a common set of reporting requirements for all funds, regardless of fund type, with a few questions designed for private equity funds only. This means that the entire form must be completed for all funds, regardless of strategy. By contrast, Form PF imposes different reporting obligations depending on size of firm and type of strategy. We are advising clients on these issues, including the industry approaches for interpreting fields in the context of private equity or real estate strategies.

The methods for valuing an AIFM's derivative positions are set out in Annex II (Conversion methodologies for derivative instruments) of the AIFMD Level 2 Regulation. Under AIFMD, an AIFM must value derivative instruments by converting the position into the equivalent amount of underlying assets, according to the conversion methodologies in Annex II of the Level 2 Regulation (known as the "commitment" approach).

Can managers ask third parties to assist with AIFMD reporting?

As with Form PF, the challenge for AIFMD reporting is identifying all required data points, identifying the sources for those data, and processing the data according to AIFMD's aggregation and calculation rules.

Fund administrators and software platforms can play a role here. Fund administrators will have access to much of the required data and may assist in completing the form. Software platforms can hold and process the data required for AIFMD reporting, with the benefit of preserving an audit trail showing the sources used and any assumptions made. In practice, many managers will need to combine their own and third-party systems for capturing and processing various subsets of data, broadly comprising reference data (e.g. ISIN codes), position and transactions data, risk information, information drawn from prospectuses (such as redemption terms), investor information, financing information and fund performance.

Regulatory reporting reflects a taste of things to come. The regulators' message is clear: they expect investment in adequate systems and controls to fulfil reporting obligations promptly and comprehensively. Regulators are not yet forthcoming on the analyses that they will perform on the data collected or the level of regulatory engagement that managers can expect on the basis of the data they submit.

Part 2 - Annual investor report and investor disclosures

For a non-EEA AIFM, registering an intention to market in an EEA state triggers an obligation to prepare an annual investor report with contents required by AIFMD. Managers must determine the first date when they will need to issue this report in respect of the funds that they have marketed and consider any changes to the form of the report that they would normally produce. Managers should discuss the contents of the report required by AIFMD with their auditors as part of their next audit plan.

To whom is the report provided?

A manager is required to make available an annual report for the fund to investors. The manager may also need to provide the report to the competent authority in any state where it has marketed the fund.

What is the auditing requirement?

AIFMD does not prescribe any particular accounting standards. The accounting information in the annual report must be prepared in accordance with the accounting standards of the fund's home Member State (if an EEA fund) or in accordance with the fund's state of establishment (if a "third country" non-EEA fund). AIFMD does, however, require that the accounts be audited by an auditor empowered by law to audit accounts in accordance with the EU Statutory Audit Directive. As an exception to this rule, most Member States have permitted managers of non-EEA funds to apply an audit which meet international auditing standards in force in the country of the fund's registered office.

When is the report required and what is the deadline for producing the annual report?

The obligation will apply in respect of the financial year in which the obligation arises. The manager must make the annual report available no later than six months after the end of the financial year. A manager that makes its first marketing notification in July 2014 in respect of a fund whose financial year ends on 31 December 2014 will therefore need to prepare the report by 30 June 2015. Managers who are producing an annual report to an earlier deadline should consider whether they wish to include the information required by AIFMD in the same, or a different, version of the annual report.

What are the required contents of the annual report?

The report consists of:

- a balance sheet (or "statement of assets and liabilities");
- an income and expenditure account;
- a report on activities of the financial year;
- any "material changes" in the information that was originally disclosed to investors; and
- information on remuneration.

The AIFMD Level 2 Regulation contains the elements and line items of the balance sheet and income and expenditure account[5] and the requirements for the report on the activities of the financial year[6]. The layout

[5] Article 104 of Commission Delegated Regulation No 231/2013.

and terminology of line items should be consistent with the fund's accounting standards and comply with local law. Managers should check whether the Level 2 Regulation requires additional line items to the items currently included in the fund's report. One point to watch is that the AIFMD Level 2 Regulation requires separate income and expenditure line items for realized and unrealized gains on investments (under income) and realized and unrealized losses on investments (under expenses).

The AIFMD contains a list of information that must be disclosed to investors before they invest in the fund. The annual report must contain details of any "material changes" to this information during the financial year. "Material changes" means where there is a substantial likelihood that a reasonable investor, becoming aware of such information, would reconsider its investment in the fund. A description of any potential or anticipated impact on the fund or its investors is also required.

What does the remuneration disclosure comprise?

An AIFM must disclose the total amount of remuneration paid to its staff and a break-down of this information in relation to the relevant fund.

More specifically, an AIFM must disclose the following:

- the total amount of remuneration for the financial year, split into fixed and variable remuneration paid by the AIFM to its staff, including, where relevant, any carried interest paid by the AIF; and
- the number of beneficiaries.

Having made this disclosure, the AIFM must then disclose an allocation or breakdown of this information in relation to this fund. Many AIFMs will take the view that allocating a proportion of the total remuneration to a given fund or allocating a certain number of staff (and their total remuneration) to a given fund is not appropriate. In that case, the AIFM should state that the total remuneration paid to the staff of the AIFM relates to this fund and disclose the number of its funds under management and its total fund assets under management.

An AIFM must also disclose the total amount of remuneration paid to:

- senior management; and
- members of the staff of the AIFM (other than senior management) whose actions have a material impact on the risk profile of the AIF. This category of staff comprises "risk takers" (including portfolio managers, traders and sales persons) and staff responsible for financial control, risk management, legal, HR and compliance.

An AIFM must also provide an overview of its remuneration policy.

Is there anything else that must be included in the annual report?

When a fund with a private equity strategy acquires control of an EU non-listed company (which will be subject to the AIFMD anti-"asset stripping" rules), the AIFM must include in the fund's annual report certain information on the company. This includes, *inter alia*, a fair review of the company's business, any

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[6] Article 105 of Commission Delegated Regulation No 231/2013.

important events that have occurred since the end of the financial year and the company's likely future developments. This obligation does not arise if the annual report of the non-listed company already contains this information. If this information is included in the non-listed company's annual report, the AIFM must make this information available to the fund's investors within six months following the end of the fund's financial year and in any event no later than the date on which the non-listed company's annual report must be drawn up.

Ongoing disclosures to investors

The AIFMD contains a list of information that must be disclosed to investors before they invest in the fund. The AIFMD also requires an AIFM to make certain periodic disclosures to investors. These principally relate to hedge funds and arise from regulatory concern as to the use by managers of gates, side pockets and excessive leverage. The majority of these disclosures can be included in the fund's annual report or in an updated version of the prospectus.

The following is a checklist:

- An AIFM must periodically disclose to investors the percentage of the fund's assets that are subject to special arrangements arising from their illiquid nature. The AIFM must provide an overview of any special arrangements in place, including whether they relate to side pockets, gates or other similar arrangements, the valuation methodology applied to assets that are subject to such arrangements and how management and performance fees apply to these assets. This information can be provided at the same time as the AIF's annual report is made available.
- An AIFM must periodically disclose to investors any new arrangements for managing the fund's liquidity. The AIFM must:
    - for each fund that is not an unleveraged closed-ended fund, notify investors when it makes "material" changes to their liquidity management systems and procedures;
    - immediately notify investors when it activates gates, side pockets or similar special arrangements or decides to suspend redemptions; and
    - provide an overview of the changes to arrangements concerning liquidity, regardless of whether these are "special" arrangements.

    This liquidity information cannot be provided as part of the fund's periodic reporting – so it must be provided on an *ad hoc* basis. An AIFM must immediately notify investors when it activates gates, side pockets or similar special arrangements.

- An AIFM must periodically disclose to investors the fund's current risk profile and the risk management systems employed by the AIFM to manage those risks. The AIFM must outline the measures it uses to assess the sensitivity of the fund's portfolio to the most relevant risks to which the fund is exposed; and, if risk limits set by the AIFM have been (or are likely to be) exceeded, must provide a description of the circumstances and the remedial measures taken. This information can be provided at the same time as the fund's annual report is made available. The starting point for these disclosures will be the current disclosure requirements under IFRS7/FRS29. The AIFMD also provides some standard metrics for measuring risk, such as Value at Risk (VaR).

- An AIFM must, for each AIF that employs leverage, disclose on a regular basis any changes to the maximum level of leverage that the AIFM may employ on behalf of the AIF and any changes to the right of reuse of collateral or any guarantee granted under any leveraging arrangement; and the total amount of leverage employed by that AIF. As above, this information can be provided at the same time as the fund's annual report is made available.

In addition, when an AIFM acquires control of a non-listed company, the AIFM must provide the AIF's investors with information on the financing of the acquisition.