

BVI Investment Funds AIFMD Update

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Since the release of the AIFMD Level 2 regulations, we have been closely monitoring developments on AIFMD.

This update looks at:

- How BVI funds can be marketed in the EU after 22 July 2013
- Letter box entity risk
- Transitional provisions
- Marketing

1. AIFMs in BVI

1.1 From 22 July 2013 onwards, managers of EU funds will need to comply fully with the Directive in order to market to investors in the EU. The Directive will bring with it significant and costly additional regulatory obligations in relation to depository requirements, capital adequacy, leverage restrictions, valuations and manager remuneration restrictions.

1.2 However, fund managers based in eligible "Third Countries" (such as the BVI) are expected to be able to continue to market funds based in such Third Countries (Third Country Funds) to investors in EU Member States by using the existing private placement rules, subject to the following conditions:

(a) A supervisory co-operation agreement must be in place between the regulator of the EU Member State in which the Third Country Fund is to be marketed and the British Virgin Islands Financial Services Commission (FSC). The FSC and the European Securities and Markets Authority (ESMA) on 22 May 2013 entered into a co-operation agreement with the regulators of the EEA

Member States co-ordinated by ESMA, which will enable BVI funds to be marketed in the EU from July 2013.

(b) The BVI fund complying with certain transparency and reporting requirements set out in the Directive. Significantly, managers privately placing their funds will be required to comply only with those elements of the Directive necessary for private placement and not the more detailed provisions relating to full passporting.

(c) The BVI remaining off the Financial Action Task Force blacklist.

2. Letter-box entities

2.1 The Level 2 regulations explain what could lead to a fund manager being deemed a "letterbox entity". Where a fund manager no longer retains the necessary expertise and resources to supervise a delegated task, or no longer has the power to take decisions in key areas or delegates the performance of more investment management functions than it retains, then the fund manager may be deemed to be a letterbox entity.

2.2 The Financial Conduct Authority (previously the FSA), in a recent consultation paper, confirmed that it will take account of the criteria set out in the Level 2 regulations and will also undertake a qualitative assessment as to whether any proposed delegation arrangement would lead to a "letter box entity".

2.3 There are a number of steps that fund managers can take to avoid characterisation as a letterbox entity, including:

(a) Including in the fund documents an undertaking from the fund manager that it will continue to oversee and control any adviser and an acknowledgement from the adviser as to the limits of its role.

(b) Ensuring the fund manager's operational policies and procedures are sufficiently robust, for example by including a requirement for frequent oversight meetings by the fund manager of all decisions made by any delegates.

(c) Considering whether the fund manager needs its own permanent establishment in the BVI, with its own employees and premises from which to carry out operations. This is an effective method of demonstrating sufficient expertise and resources for the fund manager to perform senior management functions in relation to the implementation of a Third Country Fund's investment policy and investment strategy.

3. Transitional provisions

3.1 On 29 April, HM Treasury published a Q&A on the transposition of the Directive into UK law confirming its intention to extend the one year transitional arrangements to Third Country Fund manager's marketing their funds into Europe after July 2013.

3.2 This means that BVI fund managers who have been managing a fund before 22 July 2013 will be able to continue to market their funds in the UK from 22 July 2013 for up to 12 months without having to comply with the transparency and reporting requirements set out in the Directive.

3.3 This is welcome news given the UK's importance as a market for BVI fund managers, although fund managers should be aware that member states other than the UK may choose to implement the transitional provision more restrictively.

4. Marketing

4.1 Passive marketing (or reverse solicitation as it is also known) is expressly excluded from the scope of the Directive. If a fund is not actively marketed, then its manager is not required to take any further action in connection with Directive.

4.2 The Directive defines marketing as the 'direct or indirect offering or placement at the initiative of the AIFM (ie the fund manager), or on behalf of the AIFM, of units or shares of an AIF (ie Third Country Funds) it manages to or with investors domiciled or with a registered office in the Union'.

4.3 It appears from recent draft guidance that the term "passive marketing" will be narrowly construed by the FCA and will only apply to communications specifically solicited by investors, although Treasury's Q&A paper may indicate a less narrow approach. Indications are that UK regulations will be amended so that the marketing restrictions will apply only to offering or placement at the initiative, or on behalf of, the fund manager.

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