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Third Country Treatment under AIFMD

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Background

- On 30 April 2009, the European Commission proposed a draft Directive on Alternative Investment Fund Managers (AIFM).

- As co-legislators, the European Parliament and Council also adopted their versions of the AIFM Directive:

  - On 17 May 2010, the European Parliament's Economic and Monetary Affairs Committee (ECON) approved proposed amendments to the European Commission's original draft AIFM Directive.

  - On 18 May 2010, the Council approved its version of the AIFM Directive.

- The Parliament and Council versions of the AIFM Directive differ in a number of respects, notably in their treatment of non-EU AIFs and AIFMs.

- The three European Institutions are now trying to come to an agreement. To that aim, the European Commission has started to circulate compromise proposals on a topic-by-topic basis. One of these compromises deals with the third country regime.

Third Countries – What is at stake?

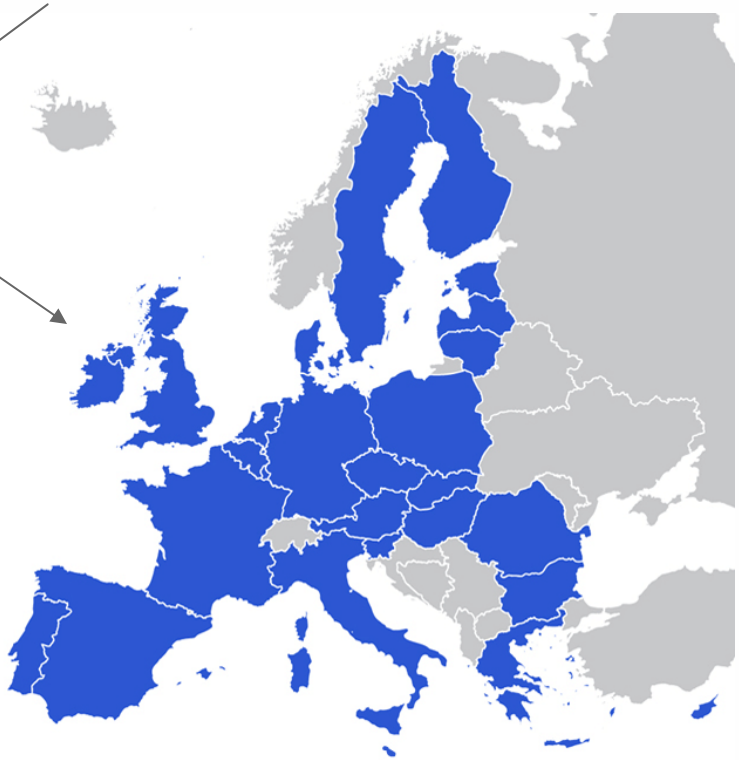
- As currently drafted, the third country regime would put severe constraints on fund marketing, capital raising, capital flow and investor's choice.
- There would be a 'guillotine effect' after three years for AIFMs and AIFs that don't meet the standards (or if the implementation mechanisms are not yet in place).
- After the transition period, EU investors can only buy (invest in) AIF which are domiciled in countries that comply with the conditions outlined before.
- It is not clear if the Directive would apply to non-EU AIFMs in respect of EU AIFs.

Third Countries – What is at stake?
Capital Flows, **by Investor Location**, from and to the EU (2007-2008)

AIFM Directive

Non-EU Investors invested €65bn in European funds investing in the European economy

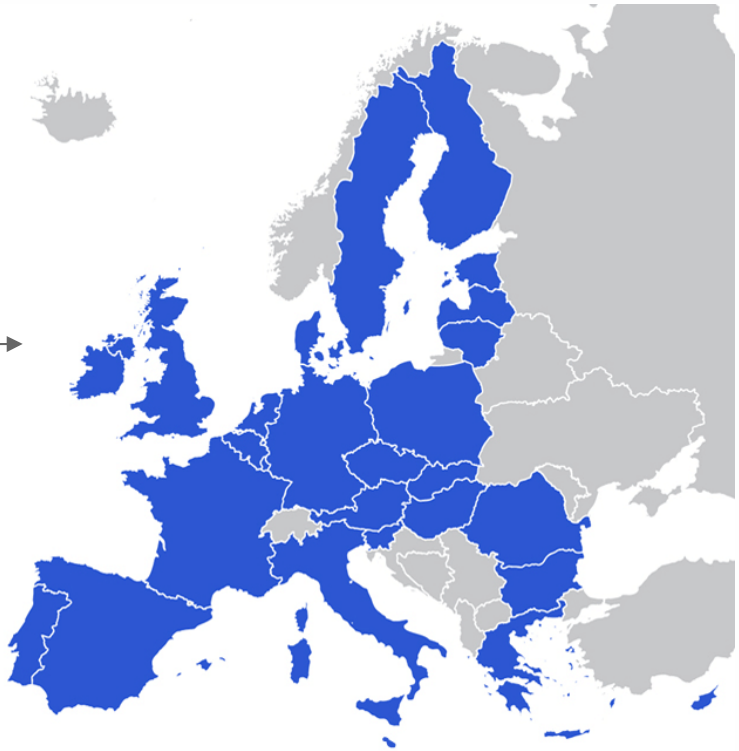
EU Investors invested €68bn in Non-EU Funds for investments outside the EU



Third Countries – What is at stake?
Capital Flows, **by Fund Location**, to the EU (2007-2008)

AIFM Directive

47%* of the total funds raised from European PE/VC houses is raised through managers based outside the EU



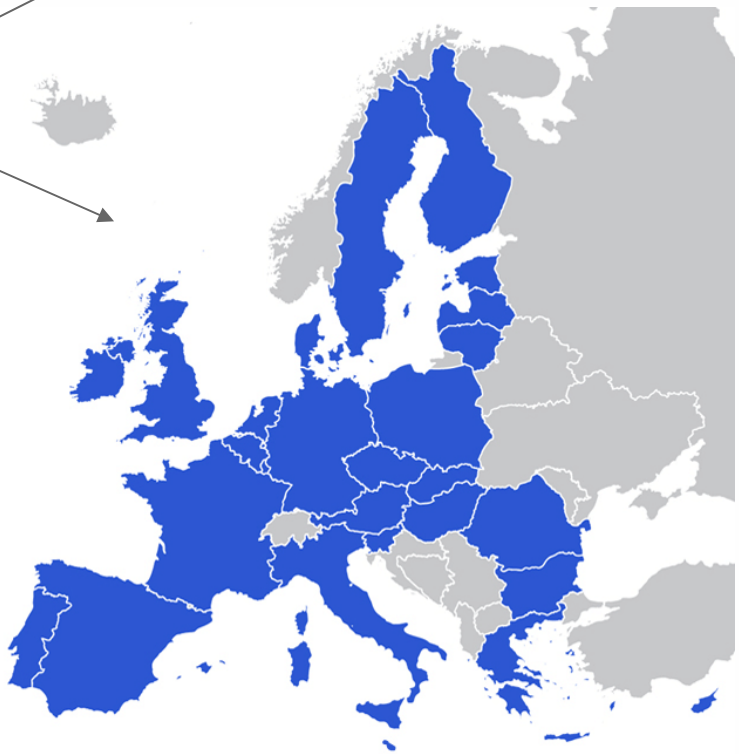
*This represents €73bn raised by European PE/VC houses through legal structures based outside the EU, for investment in the EU economy

Third Countries – What is at stake? Capital Flows, **by Investments in the Real Economy**, from and to the EU (2007-2008)

AIFM Directive

Funds located outside the EU invested €57bn in the EU economy

Funds located in Europe invested €4bn in Non-EU economies



AIFMD Status

- The following analysis is based on the latest European Commission's proposed third country compromise.

- The core element of this compromise is a transitional period where national regimes and EU level provisions coexist.

  Until 3 years after entry into force of the Directive, national regimes can continue to exist without passport, while the EU regime is being established.

- It should be borne in mind that the AIFM Directive remains a moving target and is still under discussion. Therefore, please note that this presentation is not a summary of what the ultimate legislation will look like.

- EVCA's aims:

  - No disruption to the everyday business for non-EU Fund Managers.
  - Access to the European market based on an operational system and with no competitive disadvantages for non-EU players compared to their EU counterparts.

AIFMD Status – Commission Compromise Proposal

DURING transition period of 3 years

National regimes continue to exist without passport but WITH minimum requirements:

EU AIF		THIRD-COUNTRY AIF	
EU AIFM	Third-country AIFM	EU AIFM	Third-country AIFM
Full passport	Conditions for marketing	Minimum requirements for national regimes for third country AIFs	
	• AIFM compliance with the disclosure and reporting requirements of the AIFMD + • A cooperation agreement regarding systemic risk oversight between the competent authority (CA) of the Member State (MS) where the AIF is marketed and the CA of the country where the AIFM is established.	• AIFM compliance with the Directive except for the Depositary requirements + • A cooperation agreement between the CA of the AIF's domicile and the CA of the MS where the AIFM is established.	• AIFM compliance with the disclosure and reporting requirements of the AIFMD + • A cooperation agreement regarding systemic risk oversight between the CA of the MS where the AIF is marketed and the CA of the country where the AIFM is established.

AIFMD Status – Commission Compromise Proposal

DURING transition period of 3 years

WHILE EU regime is being established:

<table>
<tr><th colspan="2">THIRD-COUNTRY AIF</th><th>THIRD-COUNTRY AIFM</th></tr>
<tr><td>EU AIFM</td><td>Third-country AIFM
registered by ESMA + marketing notification</td><td rowspan="2">AIFM from third countries or their domiciles, respectively, have to comply with the following conditions:

• the AIFM and its domicile, respectively, have to comply with the four third-country AIF requirements:
  • appropriate cooperation agreement between its home jurisdiction and ESMA;
  • its home jurisdiction meets standards on money-laundering and terrorist financing;
  • tax agreements between its home jurisdiction and each Member State where it plans to market AIF interests;
  • the Commission has determined that its home jurisdiction grants comparable market access to EU AIFMs.
• AIFM has to register with ESMA
• AIFM has to agree, through a contract with ESMA, to comply with the AIFMD on a voluntary basis
• A cooperation agreement between CA of AIFM domicile and ESMA on how to carry out the oversight of the AIFM (assist in investigations, exchange of information) to be in place
• AIFM has to submit itself to the jurisdiction of courts in the Union</td></tr>
<tr><td colspan="2">3rd country AIF can only be marketed to professional investors in the EU with passport IF:

• Domicile of the AIF complies with:
  • an appropriate cooperation agreement is in place between its home jurisdiction and ESMA;
  • its home jurisdiction meets standards on money-laundering and terrorist financing;
  • tax agreements are in place between its home jurisdiction and each Member State where it plans to market AIF interests;
  • the Commission has determined that its home jurisdiction grants comparable market access to EU AIFMs.
• The depositary of the AIF is established in the Union, but can delegate tasks to entities in third countries</td></tr>
</table>

AIFMD Status – Commission Compromise Proposal

AFTER transition period of 3 years

- EU/Member State access only possible via EU regime under AIFMD

  AIF from third countries regardless of where the AIFM is established can only be marketed in the EU on the basis of the AIFM Directive, i.e. national regimes will be 'disapplied'.

  As a result, if any of the conditions are NOT met, it would mean a FULL BAN of third country AIF/AIFMs from marketing in the EU ('guillotine effect').

AIFMD Status – Commission Compromise Proposal

Passive marketing

During transition

EU investors can invest on their own initiative ('passive marketing') into third country funds without any requirements in the Directive (but national rules might apply).

After transition

Passive marketing (fund sales on the initiative of the investor) would have to comply with the four 'fund conditions' (cooperation agreement, anti-money laundering, agreement on exchange of information on tax issues (OECD Model), reciprocal market access).

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The Way Forward

The Way Forward

- The AIFMD legislative process is in the trialogue stage.
- After several trialogue meetings, it remains unclear what the final AIFM Directive will look like.
- On none of the topics discussed so far, the Council, European Parliament and European Commission have reached an agreement.
- The AIFM Directive remains a moving target and is still under discussion.

The Way Forward

PE/VC Industry proposal to reach a compromise

- We need a European solution (passport) inspired by the European Parliament text, but improved to make it fly.

- National regimes are to be kept at least as long as an EU solution has not been implemented successfully.

- Passive marketing should be allowed, and if needed, regulated preferably at national level.

THEREFORE, the industry has proposed:

- to conciliate the solution proposed by the Council with the passport proposed by the Parliament and to transform the guillotine effect into a real 3-year transition period, plus a strong review clause.

  Otherwise, if the conditions for a passport are not met, the proposal of the Parliament will work as a guillotine and cut all capital flows from outside the EU if the conditions to receive a passport are not met after 3 years.

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Annex I: Overview of the PE/VC Industry's Key Concerns and Messages

Third countries – Key points from the PE/VC Industry's point of view

- Private equity is about raising money worldwide to invest locally.

  Around 60% of European venture capital funds and 40% of buyout funds come from outside the EU. These sources of finance should not be put at risk by having our trading partners feel they are being treated unfairly.

- There also continues to be a major risk for European institutional investor returns, if undue restrictions are imposed regarding their ability to invest in funds outside the EU.

- Access of and to non-EU funds is important for the continuous supply of European companies with capital from outside Europe and for European investors and their asset allocation strategy.

- The European economy cannot afford depriving its funds and companies of resources coming from cooperative third countries, nor preventing its investors from diversifying their risks by taking stakes in other regions of the world.

- To provide legal certainty to investors, it is critical that the national private placement regimes remain in place at least as long as it takes to make the EU passport system operational.

Third countries – Key points from the PE/VC Industry's point of view

- Professional investors should be free to place their funds as they so choose as long as they are in compliance with their own regulation and any such investment guidelines which their Board may have decided upon.

- Protection of investors at EU level would be more efficient by applying rules to the marketing of funds rather than to the investment in a fund. This is the approach taken worldwide to investor protection – not penalising the investors themselves.

- Institutional investors (pension funds, insurance companies, banks) are protected and regulated through specific and harmonized EU legislative instruments.

- From a legal and public policy point of view, any restriction to the right to invest of investors should not be addressed through an EU directive which regulates the behaviour of other market actors, in casu the fund managers, but through a review of the harmonized EU legislation applicable to these investors or for other, country specific, professional investors, for which there exists no harmonized EU legislation, through a review of applicable national legislation.

Third countries – Key points from the PE/VC Industry's point of view

EU innovative companies need capital to grow and long-term shareholders which can commit themselves to their daily management with the determination to develop an effective corporate strategy.

Therefore:

- It is key that the third country regime does not alienate Europe's major trading partners to take a defensive and protectionist stance on bilateral investment with Europe, at a time when such investments are badly needed in the wake of the financial crisis, as this would lead to inward investment into Europe's economies and SMEs being inhibited or slowed down.

- It is important that the third country rules do not damage the returns of Europe's pension funds and institutional investors, and do not restrict the freedom of European investors to invest in AIFs outside the EU, as that would threaten the competitiveness of the European private equity and venture capital industry vis-à-vis its North-American and Asian equivalents.