

Navigating a shifting regulatory landscape





Executive summary

Introduced in 2011, the Alternative Investment Fund Managers Directive (AIFMD) was developed with a primary objective of improving protection for alternative investors by insisting on greater transparency around areas such as conflicts of interest, valuations and liquidity profiles. The Directive was also intended to remove elements of the systemic risk that alternative funds can present to the European economy.

In January 2019, the EU Commission reported on the success of AIFMD in meeting these objectives. While it concluded that the Directive has satisfactorily created an internal market for AIFs and a harmonised regulatory and supervisory framework for managers, it also concluded that the AIFMD has generated its own set of "unintended consequences" and some challenges remain. Among other concerns, these include variances in implementation across member states and duplication with other regulation such as MiFID II and PRIIPs.

For Intertrust, few pieces of regulation have resulted in the heightened demand for client guidance as AIFMD. We've seen strong interest from clients for market insights, regulatory best-practice, comprehensive administrative support and, ultimately, solutions that mean they realise their strategic objectives within the AIFMD framework.

With discussions around AIFMD II now accelerating, we surveyed alternative investment managers in private equity, real estate, hedge and infrastructure about AIFMD, the issues they have faced and the concerns they have.

The findings were thought-provoking and painted a picture of a market embracing AIFMD but one that continues to need guidance and to rely on comprehensive, end-to-end advice and implementation.

For instance, the majority of respondents foresee the quantity of assets deployed by managers in AIFMD-compliant structures increasing over the next two years as well as many also saying that non-uniformity of AIFMD interpretation across different jurisdictions was a real challenge. It's in this sort of environment that third party service providers are able to provide the value-add service that managers need to succeed and thrive.

We have extensive experience of AIFMD and, we believe, an unparalleled team of experts in numerous jurisdictions focused on helping our clients navigate through and benefit from such regulation. We hope you find this report both interesting and insightful.



Ciara Smith
Head of Regulatory and
Compliance Services
Intertrust

The AIF landscape: a growing market

The Alternative Investment Fund (AIF) market has seen significant growth in recent years and investor appetite shows no sign of abating. Our research among alternative managers found a high level of understanding and broad acceptance that AIFMD has better formalised the market to the benefit of all stakeholders.

The main benefits of AIFMD include the fact that it has provided investors with full compliance and regulatory assurance (cited by 41%) and that it has driven up standards in transparency (30%). More than a quarter (27%) of respondents said it had also improved the quality of investor reporting.

"Irish ManCos have benefited from the massive growth in the AIF market over the last few year"
Intertrust Ireland

Most market participants have become very familiar with the legislation, and have first-hand experience of its requirements and implementation impact. Our survey found that, overall, 89% were familiar with AIFMD; of this, two thirds (66%) said they were either 'very' or 'extremely' familiar with it.

Looking ahead, 69% of respondents said they foresee the quantity of assets deployed by managers in AIFMD-compliant structures increasing over the next two years. A similar number (68%) said they foresee the value of assets increasing over the next two years. Only 16% said they think the value of assets will decrease.

"The best thing about AIFMD regulation is that it appeals to institutional investors"
Intertrust Luxembourg

In recent years, increasing numbers of US and Asian fund managers have started to market funds in Europe and this trend looks set to continue. Two thirds (66%) of our respondents said they expect to see an increase in US and Asian funds setting up AIFMD-compliant structures to attract domestic institutional investors over the same period.

Asked about the increase in the number of non-EU fund managers conducting European capital raising activities through AIFs in recent years, three quarters (73%) of said they expect this trend to continue over the next two years - with 12% saying it will grow 'significantly'. In terms of what will fuel this growth, more than half (55%) said it will be driven by market opportunities, with just under a quarter (22%) saying it will be down to increased regulatory pressures.

It's clear that AIFMD has resulted in a new landscape for alternative investors and that stakeholders are expecting the market to continue to grow, with strong opportunities not just in terms of capital deployment but also in terms of capital raising.

"There's a strong appetite from managers looking to launch into Europe which presents a huge opportunities for ManCos. The biggest opportunity for these ManCos lies in offering customisation of product solutions, such as management accounts"
Intertrust Americas

Our survey complements a large number of market studies showcasing the growth of the sector. According to the latest figures from Luxembourg's regulator, the CSSF, there are now more than 240 ManCos carrying full AIFM licences - and that number is expected to climb further as the market evolves and events such as Brexit catalyse demand.

But it's also clear that some challenges remain, and that the need for expertise and guidance remains as strong as ever.

Key findings



89%

89% are familiar with AIFMD; of this, two thirds (66%) are either 'very' or 'extremely' familiar with it



69%

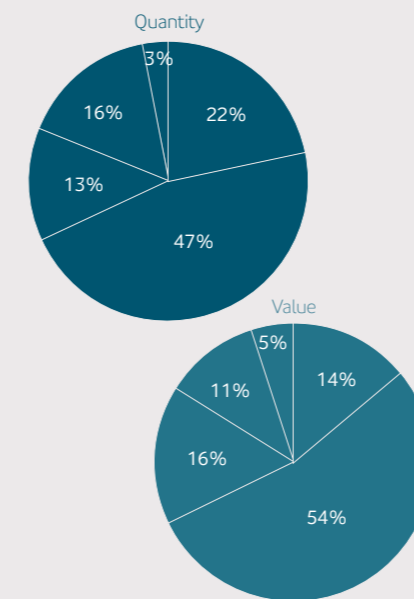
69% foresee the quantity of assets deployed by managers in AIFMD-compliant structures increasing over the next two years



66%

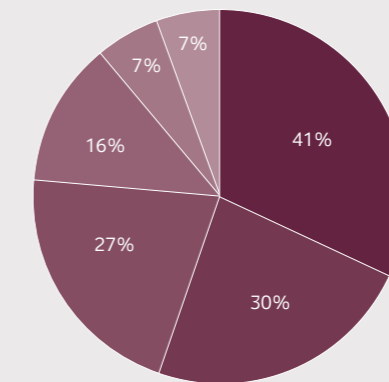
Two thirds expect to see an increase in US and Asian funds setting up AIFMD-compliant structures to attract domestic institutional investors over the same period

How do you foresee the quantity and value of assets deployed by managers in AIFMD-compliant structures changing over the coming two years? *



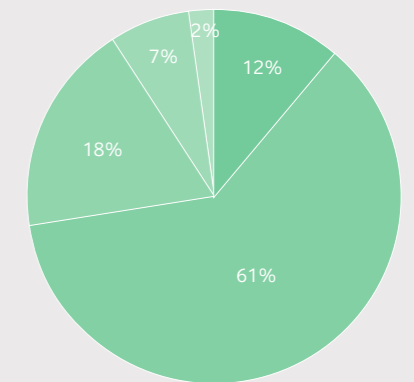
Quantity	Value	
22%	14%	It will increase significantly
47%	54%	It will increase slightly
13%	16%	It will stay the same as now
16%	11%	It will decrease slightly
3%	5%	It will decrease significantly

What do you see as being the key benefits arising from the introduction of AIFMD for AIFMs? (select all that apply)



- 41% Provided investors with full compliance and regulatory assurance
- 30% Driven up standards in transparency
- 27% Improved the quality of investor reporting
- 16% Establishment of the Luxembourg ManCo as a go-to solution for managers seeking an EU presence
- 7% Increased investment in new technology
- 7% Improved the stability of financial markets

There has been a gradual increase in the number of non-EU fund managers conducting European capital raising activities through AIFs in recent years. How do you expect this trend to continue over the next two years?



- 12% It will grow significantly
- 61% It will grow slightly
- 18% It will stay the same as it is now
- 7% It will decrease slightly
- 2% It will decrease significantly

* Please note some percentages will not add up to 100% due to rounding.

The AIF landscape: challenges remain

Eight years after it was rolled out across Europe, AIFMD may have largely become normalised and integrated into the mindset of investors and other stakeholders but it's clear that some challenges remain. Several of these are significant and require a dedicated approach and expert understanding to make sure processes and structures are fully optimised.

When asked which factors AIFs have found most challenging when marketing their funds across Europe, 91% cited regulation as the leading cause for concern; of which, over half (51%) said it was 'very challenging'. Some 87% highlighted applications and variations of permissions. Other obstacles included compliance, governance, risk management and fee transparency.

Regulatory arbitrage has muddied the waters for many investors and have led to a knowledge gap when it comes to practical application of the rules. 60% agreed that variances of AIFMD interpretation between different EU member states are responsible for widespread industry confusion about implementation.

We've seen a significant increase in client engagement and planning over the past two or so years since the UK voted to leave the European bloc

More than half (59%) of respondents predict that the prospect of 'regulatory arbitrage' between European Union member states seeking to attract business

One of the most striking findings from the research was that more than half (59%) of respondents predict that the prospect of 'regulatory arbitrage' between European Union member states seeking to attract business - from, say, the UK due to Brexit or globally - is likely to grow over the next two years.

This shows that while regulation is seen largely as a positive it remains a challenge for fund promoters to follow, with non-uniformity of AIFMD application by country seen as the biggest difficulty. While National Private Placement Regimes (NPPRs) by definition are likely to be different in each country the marketing and pre-marketing under passporting - and by extension the passporting of AIFM itself - should be more consistent across the EU. The challenge, perhaps surprisingly, is that this isn't the case.

Brexit and the AIFM landscape

The UK's departure from the European Union - whether through a soft or hard Brexit - is seen as a major upheaval but also an opportunity and a source of business for alternative investors.

Brexit presents a significant issue as UK fund promoters, which are likely to lose the option to use the AIFMD or UCITS route for EU fund marketing and will need to seek alternative solutions. Over half (54%) of the respondents to our survey believe that UK fund managers are most likely to establish a presence in the EU until the AIFMD third-country regime is switched on either through an EU subsidiary or by appointing an EU authorised 'host' AIFM.

We've seen a significant increase in client engagement and planning over the past two or so years since the UK voted to leave the European bloc. The protracted, drawn-out and difficult exit process has not helped calm the sector and added to investor fears.

Notwithstanding, a large minority (44%) of those responding to our research have made progress with their contingency plans in relation to Brexit (or, indeed, European country fragmentation) for marketing AIFs into the EU. In the event of a hard Brexit, contingency plans will need to be escalated.

Key findings



91%

91% cited regulation as the leading cause for concern; of which, over half (51%) said it was 'very challenging'



59%

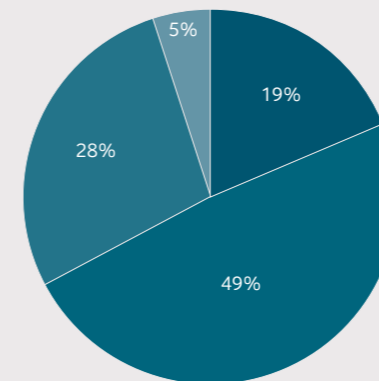
59% predict that the prospect of 'regulatory arbitrage' between European Union member states seeking to attract business is likely to grow over the next two years



60%

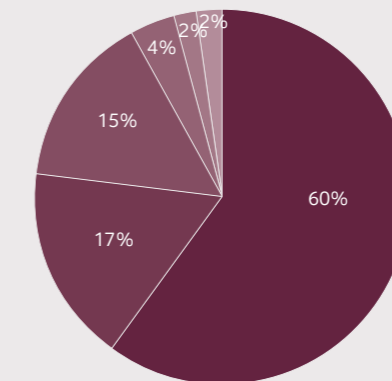
60% agree that variances of AIFMD interpretation between different EU member states are responsible for widespread industry confusion about implementation

Do you think that the prospect of 'regulatory arbitrage' between EU member states seeking to attract business is likely to grow over the next two years?*



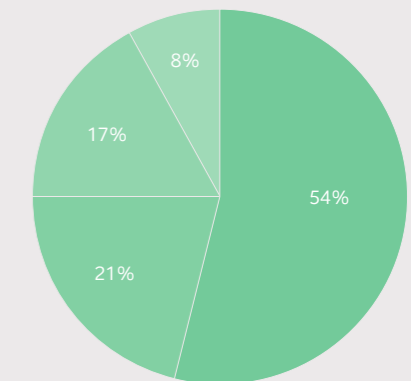
- 19% Yes - it will grow significantly
- 49% Yes - it will grow modestly
- 28% No - it will stay the same
- 5% No - it will fail

In which areas do you believe the knowledge gap is the biggest among non-EU AIFMs regarding AIFMD?



- 60% Variances of AIFMD interpretation between different EU member states
- 17% Set up
- 15% Governance and oversight
- 4% Depositary services
- 2% Remuneration policy
- 2% Capital requirements

Which of the following routes do you think UK fund managers are most likely to deploy in marketing their AIFs into the EU?



- 54% Establishing a presence in the EU until the AIFMD third-country regime is switched on either through an EU subsidiary or by appointing an EU authorised 'host' AIFM
- 21% National private placement regime (NPPR) for each target EU member states
- 17% Not applicable
- 8% Other (please specify)

* Please note some percentages will not add up to 100% due to rounding.

Solutions

How best, then, to navigate through the AIFMD landscape, particularly if the noise around AIFMD II is becoming louder and we draw closer to its eventual implementation? For instance, it has been mooted that AIFMD II might create third country AIFMs or AIFs passporting rights, broadening out the market even further, but also necessitating an even greater need for oversight and control.

Interestingly, some of the desired outcomes of AIFMD II mirror the perceived weaknesses of the first version. When asked what outcomes they would most like to see emerge from the AIFMD II, some 60% of respondents said they wanted better harmonisation to reduce variances of AIFMD interpretation between different EU member states.

69% of respondents said they foresee the quantity of assets deployed by managers in AIFMD-compliant structures increasing over the next two years

Spotlight on: Ireland real estate

Intertrust in Ireland have built a leading brand in providing global corporate services to the real estate market, an asset class we've seen significant growth in. We provide AIFM and fiduciary services to a number of real estate funds and they range from a diverse portfolios with multiple properties, multiple lease arrangements and many investors to single property funds of one. Real estate remains to be an attractive asset class for alternative managers and the structures and robust regulatory framework within Ireland allows managers to access European investors and large pools of capital across the globe. As well as real estate the Irish office has also seen significant growth in private capital funds across equity and debt.

Some of the desired outcomes of AIFMD II mirror the perceived weaknesses of the first version

As previously noted, while more than two thirds (69%) of respondents said they foresee the quantity of assets deployed by managers in AIFMD-compliant structures increasing over the next two years, almost two thirds (62%) said that non-uniformity of AIFMD interpretation across different jurisdictions was a real challenge as of today.

79% of respondents said they expect the take up of third-party turnkey solutions for managers looking to remove the burden of setting up their own AIFM to increase over the next two years, highlighting the opportunities and challenges the directive has generated in the market.

Spotlight on: Luxembourg client case study

Intertrust provides AIFM, central administration and depositary services to a private equity firm, managing approximately \$1.3 billion since it was established in 2007. The firm's focus is on making primarily control investments in SMEs with attractive business models in the industrial and service sectors, which may expand internationally.

As part of this project, our Luxembourg team provide an end-to-end solution for the Fund, GP and intermediate acquisition companies. Total deal size is estimated at €500,000 (annual basis with one SPV).

The fund is expecting to raise up to €500 million in commitments from investors throughout Europe and North America. The fund is expecting to make 10-12 investments over the course of a five to seven years investment period.

The client has been serviced by our team in Luxembourg since 2007 when they launched their first fund. The client has valued the existing relationship, the global coordination between the different offices and being able to offer a holistic solution for the management of the fund.

The client and its advisers were impressed by our responsiveness, experience and attention to detail. In addition, the strong network we can offer allows us to support the client in Luxembourg and various other countries.

Key findings



60%

60% want better harmonisation to reduce variances of AIFMD interpretation between different EU member states



62%

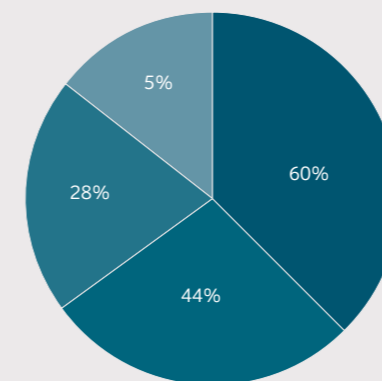
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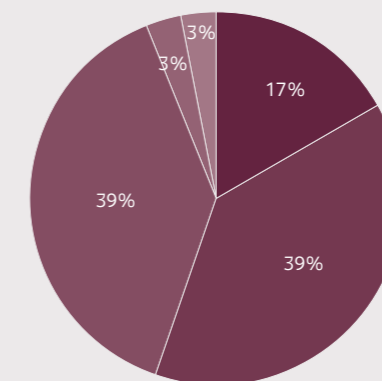
79% expect the take up of third-party turnkey solutions for managers looking to remove the burden of setting up their own AIFM to increase over the next two years

What outcomes would you most like to see emerge from the AIFMD II? (select all that apply)



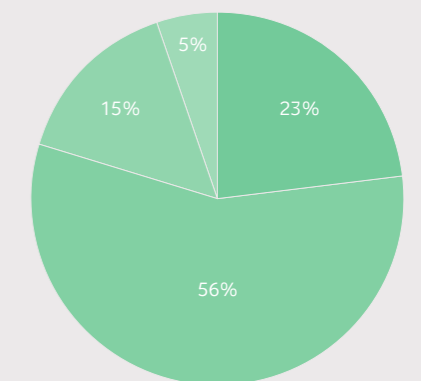
- 60% Better harmonisation to reduce variances of AIFMD interpretation between different EU member states
- 44% Consistent approach to what is pre-marketing and marketing
- 33% Extension of marketing passport to non-EU AIFMs
- 23% Extension of marketing passport to non-EU AIFs

Over the next 12 months how do you anticipate the popularity of the use of passports for qualifying AIFs to change in relation to National Private Placement Regimes for capital raising?*



- 17% They will be much more popular
- 39% They will be slightly more popular
- 39% They will be as popular
- 3% They will be slightly less popular
- 3% They will be much less popular

How do you expect the take-up of third party turnkey solutions for managers looking to remove the burden of setting up their own AIFM to change over the coming two years?*



- 23% It will increase significantly
- 56% It will increase slightly
- 15% It will stay the same as now
- 5% It will decrease

* Please note some percentages will not add up to 100% due to rounding.

Conclusion

Our snapshot survey on AIFMD shows the need for a continued assessment on the Directive and its implementation across member states. It highlights the scale of knowledge and expertise required to meet compliance and maximise the benefits for managers, and to also understand the options open to them.

Our point of difference when handling AIFMD compliance is our bespoke approach

With a majority of respondents to our survey predicting a rise in 'regulatory arbitrage' between EU member states over the next two years, the emphasis remains on managers to understand where and how to set up qualifying funds and which partners to work with.

Many AIFMs may not realise it's possible to benefit from a tailor-made solution. Our point of difference when handling AIFMD compliance is our bespoke approach. Unlike many of peers, our experts benefit from in depth local knowledge, which is essential to make sense of the many different (and at times conflicting) interpretations of the directive.

Methodology

Research was carried out in February 2019 by Pollright, the research division of Citigate Dewe Rogerson, on behalf of Intertrust.

A total of 115 responses were gathered of alternative investment managers from across Europe, North America and Asia via an online survey sent to a global database of professionals provided by Preqin and Intertrust.

About Intertrust

www.intertrustgroup.com

Intertrust is a global leader in providing expert administrative services to clients operating and investing in the international business environment. The Company has more than 2,500 employees across 41 offices and 29 jurisdictions in Europe, the Americas, Asia Pacific and the Middle East. Intertrust had leading market positions in selected key financial markets, including the Netherlands, Luxembourg, Jersey and the Americas. Intertrust delivers high quality, tailored corporate, fund, capital market and private wealth services to its clients, with a view of building long-term relationships.

The company works with global law firms and accountancy firms, multinational corporations, financial institutions, fund managers, high net worth individuals and family offices.



2,500+
employees



41
offices



29
jurisdictions

AIFM ManCo services

As an authorised Alternative Investment Fund Manager (AIFM), we provide regulatory compliant solutions to managers (EU and non-EU) that enable them to market their fund across Europe. Licensed by the Central Bank of Ireland (CBI) in Ireland and the Commission de Surveillance de Secteur Financier (CSSF) in Luxembourg, we provide AIFM services for AIFs and other open and closed-ended alternative funds that meet the criteria of qualified AIFs.

As an outsourced AIFM, we're uniquely positioned to provide a range of AIFM-related risk and regulatory compliance solutions to EU, US and Asian based investment managers. Our AIFM-related services provide the requisite substance, infrastructure, employees, resources, systems, reporting disclosure, and supervision of service providers and delegated activities to comply with AIFMD.

We have expertise in risk management, portfolio management, legal matters and compliance, offering fully integrated fund services, covering AIFM, central administration and depositary services, either as a holistic solution or on a standalone basis.

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