Alternative Investment Funds: **Gateway to EU Distribution**

FOLEY
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CAPITA Asset Services

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Agenda

- Introductions and AIFMD 101
- Alternative Irish Structures for AIFs
- The Role of AIFM
- The Role of the Depository
- Understanding Transparency and Reporting
- Focus on Remuneration
- Using AIFMD Passport to Publicly Market Funds in Europe
- Q&A

Speakers

- Michele Cottone
  - Managing Director, Global Product Management, BNY Mellon Alternative Investment Services
- Daniel Forbes
  - Solicitor, Dillon Eustace
- Stuart Fross
  - Partner, Foley & Lardner LLP
- Paul Nunan
  - Managing Director of Fund Solutions (Ireland), Capita Asset Services
- Antonella Puca
  - Senior Manager, Alternative Investments Practice, KPMG US

AIFMD 101

- Focus of panel - practical application of Directive
- From G-20, to Dodd Frank, to AIFMD
- Definition of Marketing
- The parameters for “reverse solicitation”
- Professional Investors
- Good news – EU is world’s largest public professional investor market for AIFs

Alternative Irish Structures for AIFs

- A fund for every occasion!
- New corporate AIF vehicle
- Irish AIFM application deadline

The Role of AIFM

- Practical challenges to US managers regarding applying and being the AIFM
  - AIFMD authorization is stages: EU firms first
  - Non-EU firms post July 2015
- AIFM: offering value added to investors and the investment manager
  - risk management
  - independence

The Role of the Depository

- Custody, safety and independence
- Who's eligible?

Understanding Transparency and Reporting

- Valuation – AUM, leverage
- Remuneration

Reporting Regimes

Directive	Regime	Marketing	Notes
Art 3.2	**Registration**	Private Placement	AUM below EUR 100 million (HF) / AUM below EUR 500 million (PE)
Art. 22, 23, 24	**Private Placement: Transparency Provisions**	Private Placement	US-based managers that manage EU-based funds or non-EU based funds marketed to EU investors
Full Directive	**Authorization Regime**	Passport	For US-based managers: only available after July 2015

Transparency Provisions: Directive Art . 22, 23, 24

Transparency Provisions	Requirement
Reporting ■ Annual report ■ Disclosure to investors ■ Reporting to competent authorities	■ Annual report for each AIF to investors and regulators, including: Audited financial statements Report on fund activities: Overview of investment activities during the year and an overview of the AIF's portfolio at year-end Overview of the funds' performance during the year Description of the principal risks and investment or economic uncertainties that the AIF might face Fund remuneration disclosures ■ Disclosures to investors ■ Annex IV – the EU equivalent of Form PF ■ More detailed reporting to regulators on highly-leveraged AIFs (3x)

AIFMD Transparency and Reporting

Function	Frequency
Scope of Assets	
1.Only AIF portfolios in scope; excludes non-EU funds that are not marketed in the EU for US-based managers, excludes UCITS 2.Eliminates double counting of AIF assets e.g., internal fund of funds 3.Excludes AIFs managed under delegation	N/A
Calculation Methodology	
1.Assets must be valued using the methodology set out in valuation provision, i.e., AIF domicile rules and/or governing docs 2.For non-derivatives, the asset side of balance sheet is used to define which assets are in scope of valuation 3.For derivatives must convert to the equivalent value of underlying asset, and use the absolute value of the underlying(see Annex II)	N/A

Note: at this point, AUM is materially different than RAUM (SEC's AUM).

AIFMD Transparency and Reporting

Timing, Monitoring and Breaches of thresholds	
1. AUM must be recalculated at least annually (more frequently for open-ended and liquid AIFs) and AIFM must define a threshold calculation date (and frequency) to their home member state regulator and notify the regulator of plans to change this date. 2. At a minimum, all asset valuations must have been done within the prior 12 months, e.g., PE, RE, etc., but more frequently for liquid assets 3. Policies and procedures must support calculation and procedures for monitoring based on investor capital contributions/distributions/subscription/redemptions, and portfolio asset value changes. 4. If an AUM threshold is passed at a recalculation: ▪ If AIFM believe this is temporary (less then three months in duration) then notify regulator, explain rationale, recalculate in three months, notify regulators of result and take any necessary action ▪ If AIFM believes breach is not temporary then must notify regulators and take any necessary action ▪ If breaching the authorization threshold and not temporary then must apply for authorization within 30 days	On investor inflow/out flow, change is asset value (at minimum annually)

Reporting Provisions: Timeline

AIFMD has extensive reporting obligations, high commonality with Form PF in underlying data and data reported but more aggressive deadlines, a different approach to scoping, unique calculations for AIFMD- concepts e.g., leverage and marked differences for private equity.

Reporting	Frequency	First report date*	Reporting deadline
Annual AIF report (to regulator in home member state of AIFM and AIF and to investors on request):			
1. Audited balance sheet and income statement (with auditors report) 2. Activities and material changes 3. Remuneration disclosure 4. Side-pockets and changes in liquidity arrangements 5. Risk profile and systems	**Annual**	**FYE 2014**	**Within 6 months of FYE**
Annex IV - AIFM-specific (Periodic to Regulator):			
1. AUM (assets under management) 2. Main instruments and markets traded 3. List of AIFs (ID, launch date, type, NAV) – on request of regulator	**Quarterly**	**Q4 2014** (Authorized/ non-EU AIFM)	**30 days after FQE** (45 days for fund of funds)

Notes: Frequency of reporting shown is for AIFM with EUR 1 billion or more in leveraged AIF AUM. The report dates above assume that the AIFM takes advantage of the transition period through July 2014.

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<table>
<tr><td colspan="5">Annex IV - AIF-specific (Periodic to Regulator):</td></tr>
<tr>
<td rowspan="2">1. AUM, investment strategy and performance
2. Main instruments and markets traded
3. Geographic and sector concentration
4. Leverage and borrowing (including synthetic)
5. Risk management systems
6. Market risk
7. Counterparty risk
8. Portfolio liquidity and concentration</td>
<td rowspan="2">9. Investor liquidity and concentration
10. Financing liquidity
11. Exposure by asset class,
12. Turnover
13. PE deal size and dominant influence
14. Side-pockets/change in liquid. arrangement
15. Position and liquidity stress tests</td>
<td>Quarterly
For leveraged AIFs</td>
<td>Q4 2014
For leveraged AIFs</td>
<td rowspan="5">30 days after FQE
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</tr>
<tr>
<td>Annual
For unleveraged private equity AIFs</td>
<td>FYE 2014
For unleveraged private equity AIFs</td>
</tr>
<tr><td colspan="4">Annex IV - Periodic Reports for Highly-leveraged AIF (to be made available to Regulator):</td></tr>
<tr>
<td>1. % of collateral re-hypothecated
2. Aggregate size of short positions</td>
<td>3. Leverage and borrowing
4. Gross exposure of controlled financial/legal structures</td>
<td>Quarterly</td>
<td>Q4 2014
(Authorized 2013/non-EU AIFM)</td>
</tr>
</table>

Reporting Provisions Comparison with Form PF

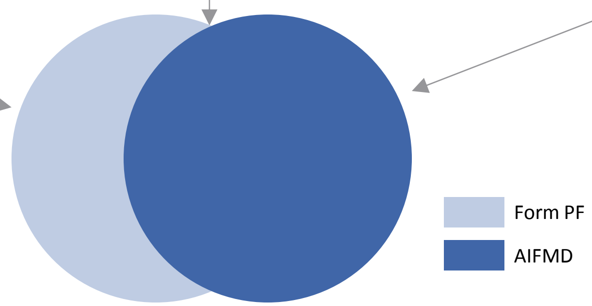
Analysis of data overlap between Form PF and AIFMD reporting

Common underlying data and common questions. Some areas of difference in calculations and different scope of applicability:

- Fund strategies (Scoping conclusions may be quite different)
- Turnover
- Geographic focus (Scope different)
- Investor concentration (Top five is same but classifications are unique)
- Counterparty risk
- Portfolio liquidity

Form PF Specific data e.g.,:

- Regulatory AUM
- Portfolio stress tests
- Section 4: Private equity data
- Section 3: Liquidity fund data



AIFMD-specific data e.g.,:

- Leverage and AUM calculations
- Net equity delta, DV01, CS01
- Market and liquidity stress tests
- Private equity data, e.g., dominant Influence
- Borrowing embedded in financial instruments
- Gross exposure of underlying SPVs
- Preferential treatment of investors
- Currency exposure
- Principal markets and instruments
- Prime brokers
- Domiciles

Given the common underlying data used to address reporting, the major overlaps in fund scope and need to replicate this for Form PF, and multiple EU member states, a common framework for systemic risk reporting is the most logical, efficient and robust approach:

- Consistent identification and sourcing of underlying data
- Support for multiple computations rules from the same combinations of data sources to address “similar” questions
- Supports for multiple output formats for filing the same funds to different regulators on different schedules in a consistent manner

Note: Form CPO-PQR has similar degree of overlap with AIFMD and higher overlap with Form PF. AIFMD will have multiple implementations with difference in format and some differences in content as implemented in member states.

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Form PF Compared to AIFMD

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Valuation Provisions

Article	Requirement
Valuation	■ Detailed valuation policy and procedures required ■ Personnel must be independent of portfolio management ■ Subject to independent annual review ■ Model based valuation: Models subject to independent review and senior management approval ■ NAV frequency to match investor sub/reds or minimally annual: Calculation and methodology subject to regular AIFM verification ■ If used, external valuation agents need to provide professional guarantees

Notes: (1) AIFMD also applies to any EU-domiciled AIF whether marketed or not in the EU. Member states may allow marketing to retail investors under local regulation, subject to the same or higher levels of regulation.

Leverage Provisions

Function	Frequency
Overall	
1. Must define the maximum leverage for AIF, demonstrate compliance with this level and notify regulator if exceeded at any time 2. Leverage is defined as the ratio between exposure and NAV, under each of two Exposure methods – gross and commitment 3. Must have documented procedures for doing both calculations 4. Look through entities controlled by the AIF where goal is to create leverage for the AIF but not through portfolio companies for private equity 5. Can exclude short-term bridge financing if covered by contractual capital commitments from investors	As required
Gross Method for Exposure	
1. Sum of the absolute values of all positions 2. Exclude cash and cash equivalents (with return no more than high grade three month government bond) both long and short 3. Convert derivatives to absolute equivalent value of underlying (as per AUM) 4. Include exposure from borrowed cash reinvestment at greater of asset value vs. borrowed cash amount 5. Include repo/reverse, stock borrow/loan and convert borrowing according to highly prescriptive rules	N/A

Commitment Method for Exposure	
1. As for gross method except for extensive netting and hedging and other exceptions that reduce or eliminate derivatives in calculations	N/A
Hedging arrangements	
1. Defined as a combination of trades that may refer to different underlying assets but in place to offset risk 2. Positions must not aim to generate return must offset general and specific risks and derivative risks (if any) must be offset 3. Must be verifiable reduction in market risk at AIF level, must relate to same asset class and must be efficient in stressed market conditions	N/A
Netting arrangements	
1. Defined as trades with same underlying assets (irrespective of maturity date) with sole aim of eliminating risks of other positions 2. AIFs which primarily invest in interest rate derivatives must use specific duration netting rules, that net within maturity buckets. This can be done alongside hedging rules, but this is subject to limitations if results misrepresent the AIF risk profile	N/A
Other arrangements in which derivatives can be eliminated	
1. If they are a perfect swap 2. Are equivalent to a long position when combined with a cash equivalent position and do not create any additional exposure/leverage/risk 3. Are FX derivatives used solely for currency hedging and do not add exposure/leverage/risk	N/A

Remuneration Provisions

Article	Requirement
Remuneration	■ Requirement for a remuneration policy covering senior management, risk taking functions, control functions and any other similarly compensated employee. ■ AIFMs that are "significant" in size or in terms of the size of the funds they manage should establish a remuneration committee to oversee the remuneration policy. ■ Fixed and variable components should be appropriately balanced ■ At least 50% of variable remuneration should consist of units or shares of the AIF or equivalent ownership interests, share-linked instruments or non-cash instruments with at least 40% of variable remuneration deferred over an period appropriate to the lifecycle and redemption policy of the AIF ■ Payment & vesting of variable remuneration should be subject to the overall financial performance/downward adjustment ■ Guaranteed variable remuneration should be exceptional and limited to new hires in their first year ■ Disclosure, in the annual report to investors, of the total amount of remuneration for the financial year, split into fixed and variable remuneration and, in relation to carried interest, the amount and number of beneficiaries. The aggregate amount of remuneration broken down by senior management and members of staff of the AIFM who have a material impact on the risk profile of the AIF.

Focus on Remuneration

- Feedback on these requirements from US managers
- Proportionality

EU Approach to Remuneration

	Trading Partners (banks, investment banks)	Portfolio managers	AIFMs and Their Delegates
Legislative status	▪ CRD III until 31 Dec 13 ▪ CRD IV from 1 Jan 14	▪ CRD III until 31 Dec 13 ▪ CRD IV from 1 Jan 14	▪ AIFMD from date of authorisation
Identified staff	▪ Material risk-takers of balance sheet: senior managers, traders, senior employees in control functions ▪ Employees at similar level as above	▪ Material risk-takers of balance sheet: senior managers, senior employees in risk functions ▪ Employees at similar level as above	▪ Employees whose professional activities have a material impact on the risk profile of the AIFM or AIF ▪ Employees in same bracket as above ▪ Delegates whose professional activities have a material impact on the risk profile of the AIFM or AIF
Governance	▪ Supporting business strategy ▪ Conflicts of interest ▪ Governance + Remuneration Committee ▪ Risk + Compliance oversight	▪ Supporting business strategy ▪ Conflicts of interest ▪ Governance + Remuneration Committee ▪ Risk + Compliance oversight	▪ Supporting business strategy ▪ Conflicts of interest ▪ Governance + Remuneration Committee ▪ Risk + Compliance oversight
Risk Adjustment	▪ Risk management + tolerance ▪ Performance measurement + risk adjustment	▪ Risk management + tolerance ▪ Performance measurement + risk adjustment	▪ Risk management + tolerance ▪ Performance measurement + risk adjustment

Where the Shoe Pinches

	Trading Partners (banks, investment banks)	Portfolio managers	AIF Managers and Delegates
Design + Structure	▪ 1:1 fixed variable mix ▪ 40/60% deferral ▪ 50% variable in non-cash instruments ▪ Retention – malus + clawback ▪ Performance adjustment	▪ 1:1 fixed variable mix ▪ 40/60% deferral ▪ 50% variable in non-cash instruments ▪ Retention – malus + clawback ▪ Performance adjustment	▪ 1:1 fixed variable mix ▪ 40/60% deferral ▪ 50% variable in non-cash instruments ▪ Retention – malus + clawback ▪ Performance adjustment
Disclosure	▪ Disclosure on staff category basis ▪ Aggregate disclosure ▪ website	▪ Disclosure on staff category basis ▪ Aggregate disclosure ▪ website	▪ Disclosure on staff category basis ▪ Aggregate disclosure ▪ Annual Report
Proportionate Disapplication	▪ Only for non-significant, non-complex and limited activity banks + investment banks	▪ general disapplication' for limited activity portfolio managers	▪ justifiable disapplication' for non-significant, non-complex + limited strategy AIFMs

Making “Proportionality” Work

- Inventory identified staff
- Inventory how you pay your people
- Recognize the difference between remuneration and “profits interests” of founders
- Map out the alignment between pay and the best interests of the fund
- Adopt a policy based on your current policies

Using AIFMD Passport to Publicly Market Funds in Europe

- Better than Jobs Act/Reg D Rule 502(c)
- AIFM per se pan-EU placement agent
- Opportunity to passport/navigating AIFMD

vs. letting investors find you

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