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The EU Alternative Investment Fund Managers Directive: Where are we now?

With the AIFMD settled nearly a year ago, the European Commission looks to advance to "Level 2" which will move towards implementing the regime into each country's national law.

The EU Alternative Investment Fund Managers Directive (the "AIFMD") is back in the news, as the European Commission, a key law-making arm of the European Union, is expected to publish at the end of April supplemental legislation dealing with central issues such as regulatory capital, risk management and depositary requirements.

The AIFMD itself was settled in July last year and cannot now be changed, but this year will see a raft of implementing legislation and regulations from EU legislators, national governments and regulatory authorities in advance of implementation on 22 July 2013.

We are currently almost a year into a two-year period of consultation, negotiation and drafting at EU and individual member state level. During this time, EU legislation setting out additional detailed requirements on certain aspects of the AIFMD (known as "Level 2") is being developed for adoption by the European Commission, and national laws and regulatory rules are being created in individual member states (including the UK) to implement the AIFMD regime into each country's national law.

The EU process

Early-stage development of the Level 2 measures is in the hands of the relevant EU supervisory authority, the European Securities and Markets Authority ("ESMA"). ESMA conducted a consultation exercise in summer 2011 and delivered its report to the European Commission in November 2011.

Having taken account of ESMA's report, the European Commission is expected to publish its proposed legislation at the end of this month. The European Parliament and Council of the EU will then have a chance to comment before the European Commission finally adopts the legislation as an EU regulation, currently scheduled for July 2012. It will become effective alongside the AIFMD in July 2013.

Meanwhile, ESMA is expected to publish further consultation papers during the course of this year on supplementary guidelines for certain AIFMD technical standards (including remuneration, calculation of leverage, and co-operation among regulators).

The UK process

In the UK, laws and regulatory rules to implement the AIFMD regime are being consulted on and prepared by the UK regulator – the Financial Services Authority ("FSA") – and the UK finance ministry – HM Treasury – who are working closely together:

- A high-level FSA consultation on implementing the AIFMD ran from January to March 2012, inviting comment on possible approaches to implementation. Detailed proposals, including drafts of FSA rules, are expected to be published for consultation in autumn 2012, and finalised in late 2012 or early 2013.
- HM Treasury, which is responsible for implementing the AIFMD into UK law, is currently undertaking an informal high-level consultation on policy options for implementing legislation. A formal consultation is expected in the summer.

Next steps

As the implementation deadline approaches, many firms are setting up an implementation workstream to assess the likely impact of the AIFMD on their business after 22 July 2013, and the measures that will need to be put in place to ensure full compliance with applicable requirements. The position will become clearer over the summer, but firms which are currently fundraising should now evaluate the likely impact of the AIFMD to ensure that the proposed fund structure achieves the regulatory objectives of both the firm and prospective investors.

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CRC Energy Efficiency Scheme: Steps Towards Simplification

Criticisms of the UK CRC Energy Efficiency Scheme have been taken into consideration and simplification proposals have been published, which, if adopted, could simplify administration for private equity-backed portfolio companies.

The UK CRC Energy Efficiency Scheme ("CRC"), designed to encourage businesses to reduce their energy consumption, has been an administrative headache for many private equity firms. The rules on qualification and registration are overly complex, and the approach to participation by members of corporate groups has, in some cases, resulted in portfolio companies being required to participate on a joint basis, even where there is no commercial connection between them.

It now appears that criticism of the new regulations has not fallen on deaf ears. In his recent Budget speech, the Chancellor of the Exchequer described the CRC as cumbersome, bureaucratic and imposing unnecessary cost on business. He announced that the Government is seeking major savings in the administrative cost of the CRC for businesses, failing which HM Treasury may replace CRC revenues with an alternative environmental tax.

The Government has published detailed simplification proposals which, if adopted, will be implemented for phase two of the CRC (beginning in April 2013). The qualification and registration process will still be time-consuming for organisations with complex group structures, including private equity firms, but the proposals do appear to resolve administrative issues regarding joint participation by unrelated portfolio companies.

As now, firms will be required to identify their CRC group(s) by applying the "parent and subsidiary undertaking" tests set out in the Companies Act 2006. Despite numerous representations about the operational independence of portfolio companies and the technical difficulties in applying these tests to limited partnership structures, it seems this approach will not be modified for investment funds, which will continue to be treated like conglomerates. Consequently, private equity firms will still need to analyse their group structure, and portfolio companies with low energy usage will still be pulled into the CRC net if the portfolio as a whole exceeds the qualification threshold.

On the positive side, the proposed 'disaggregation' rules will be much more flexible. Under the current rules, a private equity firm may 'disaggregate' a portfolio company, enabling it to participate in the CRC on a standalone basis, but only if the electricity consumption for that portfolio company and the firm's residual 'group' (i.e., remaining portfolio companies and any related fund or management company vehicles) exceeds the CRC registration threshold. As a result, a portfolio company with low electricity usage cannot be disaggregated and must participate jointly with others.

Under the simplified proposals, any entity or group of entities, regardless of electricity consumption, would be permitted to disaggregate, allowing each portfolio company within a qualifying CRC group to register as a separate CRC participant and be independently responsible for its own data collection and reporting obligations. In addition, instead of being a 'one-time only' election at the start of each CRC phase, the proposed rules would allow a private equity firm to disaggregate entities within its group annually in respect of subsequent compliance years.

While not a perfect solution, the proposals may at least simplify administration for private equity-backed portfolio companies whose ownership changes from time to time. It is anticipated that the Government will announce its final decision later this year.

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