

**Faculty of Law, Economics and
Finance of the University of
Luxembourg**

BOOK LAUNCH
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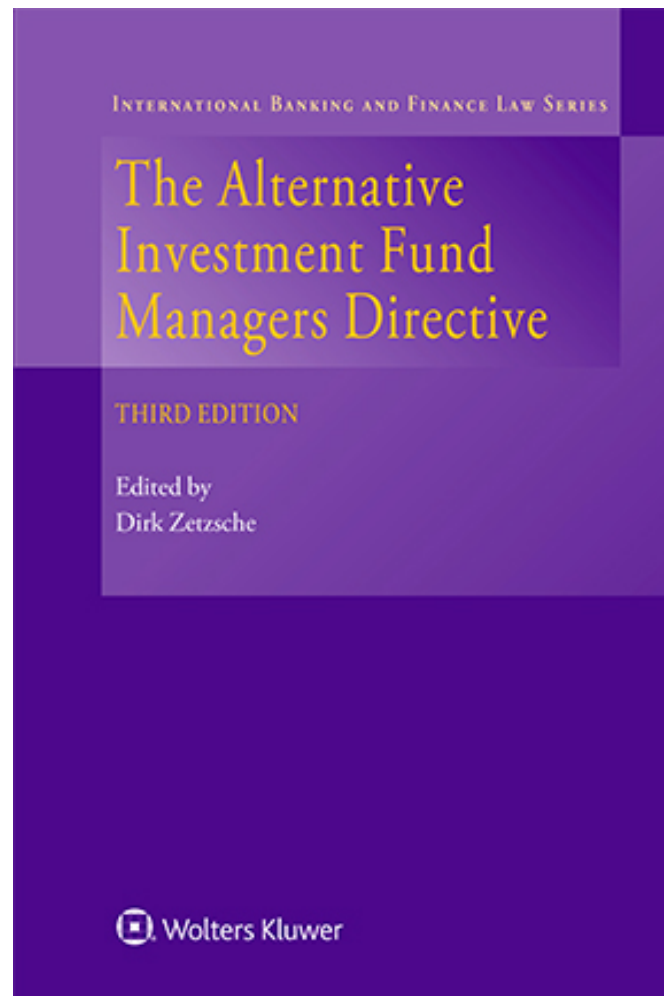

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Agenda

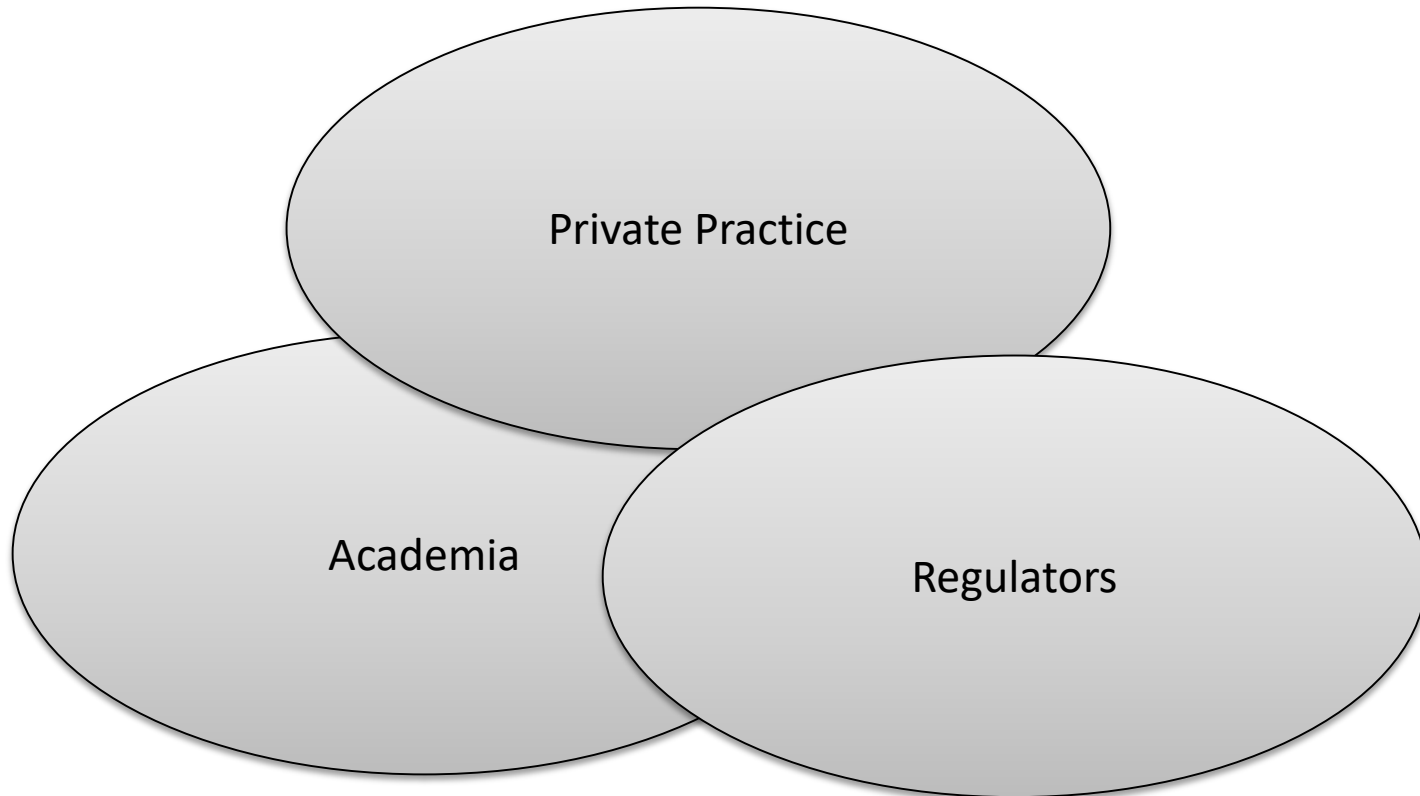
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- Overview of the book and the authors
- Author's view: the AIF definition and holding exemption (D. Zetzsche)
- Author's view: Delegaton (T. Partsch)
- Author's view: Subscription Credit Lines and Facilities (E. Havrenne)

The Authors: 37 leading AIFMD experts from all across Europe

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1) Introduce to legislation of relevance to AIFMD

- L1, L2, ESMA Guidance, ELTIFR; EuVECAR; EuSEFR; MMFR; STSR; new distribution directive and regulation; etc. + most important laws of EU member states (D, F, Ireland, Lux, NL)

2) Propose solutions

- Scope of the AIFMD, securitizations, depositary rules: safeguarding and monitoring duties re assets held in custody and other assets, depositary passports; venture capital financing and marketing

3) Accompany new developments

- Delegation, Subscription Credit Lines, Robo Advisors, Digital Asset Funds, RSI&Sustainable Finance Funds, Brexit, Infrastructure Investments

4) Systematic and also critical assessment

- Commenting on ESMA's and national authorities' view

- Introduction (see www.ssrn.com/abstract=3693776)

Part I: Scope

Part II: Regulation of the AIFM (pp. 179 – 438)

Part III: Regulation of the Depositary (pp. 439 – 594)

Part IV: Investment Strategies (pp. 595-772)

Part V: AIFMD's Cross-Border Dimension

Part VI: AIFMD's Transposition

Example: AIF definition, with focus on the holding exemption

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CHAPTER 2

Scope of the AIFMD

Dirk Zetsche & Christina D. Preiner

§2.01 INTRODUCTION

The central concept that determines the Directive's scope is the alternative investment fund (AIF).¹

Equivalent to hedge funds and private equity funds, the term 'alternative' investment fund is part of industry jargon. This understanding of the word 'alternative' refers to hedge funds and private equity funds as alternatives to the traditional investment funds that invest in securities. The success of traditional (investment) funds is measured by comparing the funds' performance with the overall development of a reference market (so-called beta strategies). Alternative funds seek to generate positive returns that are independent of the volatility of capital markets, or which at least do not correlate too strongly with them – the so-called alpha strategy.²

The AIFMD introduces a new definition of the AIF of, in essence, all investment funds other than those governed by the UCITS.³ However, this definition is not selective, because the term investment fund is itself not legally selective, rather a term

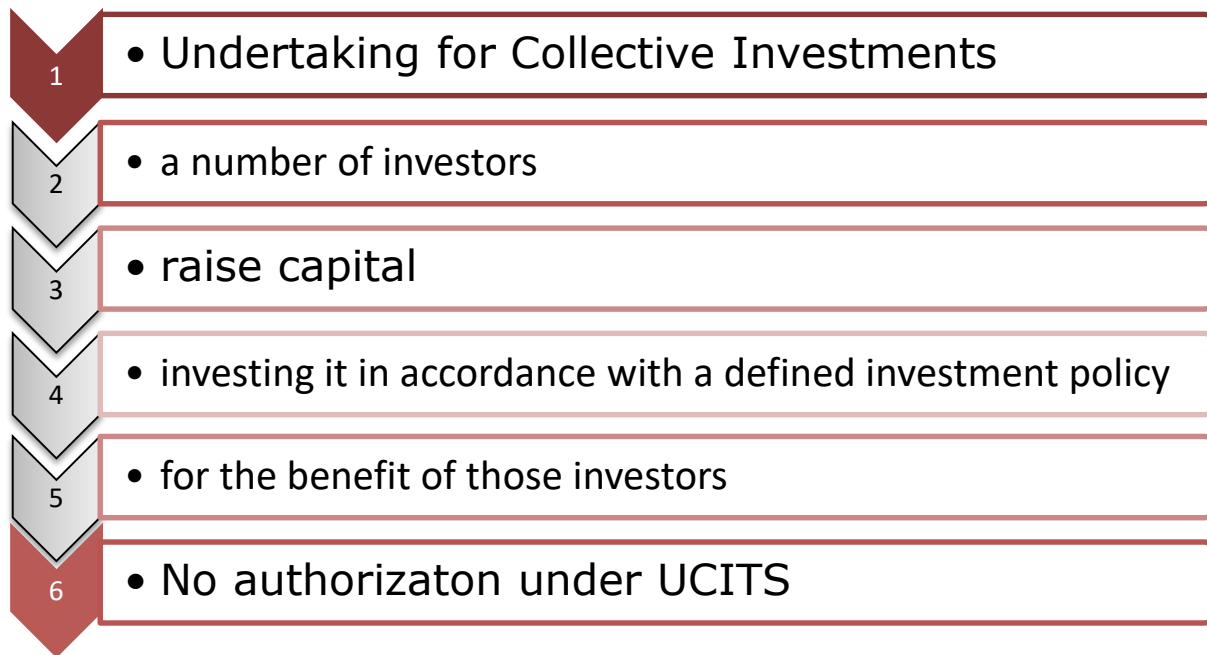
Article 4 (1)– **Definitions**

(a) **‘AIFs’** means **collective investment undertakings**, including investment compartments thereof, which:

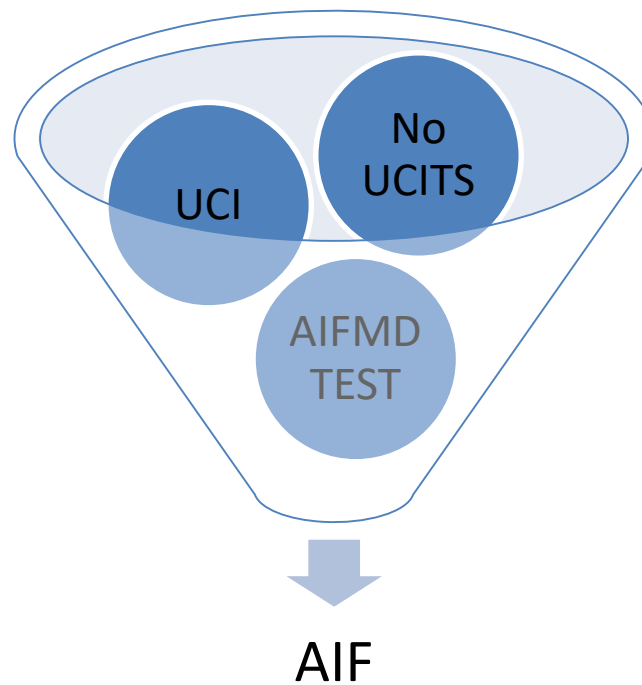
(i) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and

(ii) do not require authorisation pursuant to Article 5 of Directive 2009/65/EC;

Breaking it down



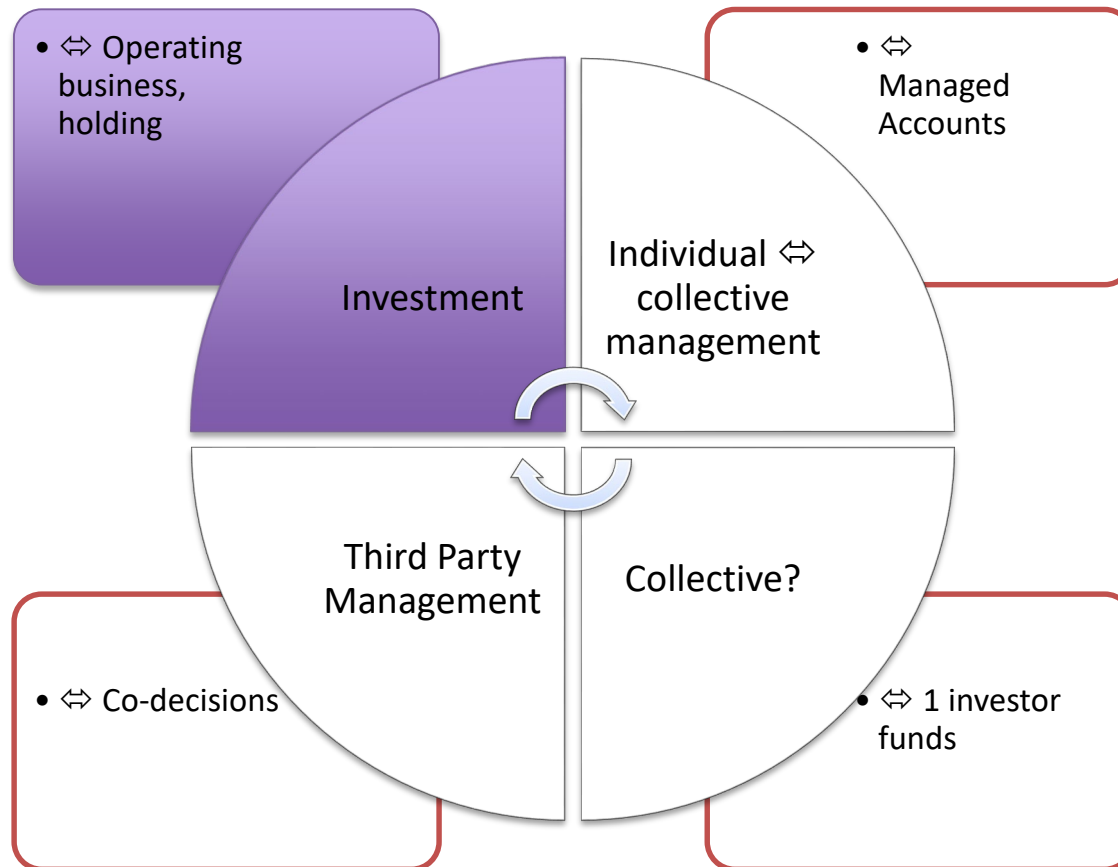
Three building blocks of the AIF definition



What are Undertakings for Collective Investments? (UCI)

- First Part of AIF Definition

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- Holding companies (Art. 2 (3) lit. a) AIFMD
- Sole investor related parties within a group
 - Treasury Offices
- [Group-sponsored pension vehicles]
- [Employee participation schemes]

§2.03[A]

Dirk Zetsche & Christina D. Preiner

detailed manner. However, it only refers to conflicts between the AIF and the investors of this AIF, and another AIF or the investors therein.⁸⁴ On the basis of the aforementioned, conflicts regarding *several* investors of one AIF with other investors of the same AIF must be subject to the same rules, based on the requirement to treat conflicts between ‘two clients of the AIFM’ appropriately (Article 14(1)(e) AIFMD).⁸⁵

§2.03 **SAFE HARBOUR BASED ON BUSINESS ACTIVITY (ARTICLE 2(3) AIFMD)**

[A] **Four Rationales for Excluding Activities**

A catalogue of exclusions, relating to activity, can be extracted from Article 2(3) AIFMD. These exclusions are based on at least one of four policy rationales.

[1] *Holding Companies: Regulated Versus Non-regulated Business*

First, the Directive segregates the private and the regulated fields by drawing a line along the term ‘holding companies’. Without being clearly delineated, the holding exemption hints at a basic distinction between operating businesses activity and investment activity.

In order to make the exception meaningful, activities which are typically allocated to a holding company such as those of the treasury department (‘firm-internal AIFM’), joint ventures and employee participation schemes or employee savings plans are excluded from the scope. The delineation is along the lines of *commercial/business versus investment activity*. Details are discussed *infra*, at §2.03[A][2].

HOLDING DEFINITION (ART. 4 (1) o) AIFMD)

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... company with shareholdings in one or more other companies, the commercial purpose of which is to carry out a **business strategy** or strategies through its subsidiaries, associated companies or participations in order to **contribute to their long-term value**, and which is either a company:

(i) operating on its own account and whose shares are admitted to trading on a regulated market in the Union; or

(ii) **not established** for the main purpose of **generating returns for its investors** by means of divestment of its subsidiaries or associated companies, **as evidenced in its annual report or other official documents**;

Holding Definition – 4 Feature Test

(1) the holding of participations

(2) business strategies or commercial activity

(3) stimulation of long-term value in participations.

(4) The company must ...

– either act on its own behalf *and* have shares admitted to trading on a regulated EU market (positive formulation),

– or not have been founded for the primary purpose of obtaining an economic return for the investors through the disposal of subsidiaries, or related companies, as denoted by the annual report, or the constituting documents (negative formulation).

„ESMA considers that the explicit exclusion of holdings companies should not be used as a means to circumvent the provisions of the Directive“ (ESMA/2012/117, No. 16)

⇒ When do actors circumvent the AIFMD? –
Depends on clear definition

1. „Business Strategy“ as core criterion
2. Operating holdings - Learning from the ECJ
3. Non-controlling holdings – a typology

1. BUSINESS STRATEGY AS CORE CRITERION

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- Systematic Perspective (tax, accounting, comparative law)
- „business strategy“ / commercial / economic activity ⇔ investment
- Highly contentious issue in all jurisdictions

2. OPERATING HOLDING – LEARNING FROM THE ECJ

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'the mere fact of holding shares, even controlling shareholdings, is insufficient to characterise as economic an activity of the entity holding those shares, when it gives rise only to the exercise of the rights attached to the status of shareholder or member, as well as, if appropriate, the receipt of dividends, which are merely the fruits of the ownership of an asset. ...

On the other hand, an entity which, owning controlling shareholdings in a company, actually exercises that control by **involving itself directly or indirectly in the management** thereof must be regarded as taking part in the economic activity carried on by the controlled undertaking.'
(ECJ, 10 January 2006, Case C-222/04, *Finanze v. Cassa di Risparmio di Firenze*, paragraphs 111 et seq.)

2. OPERATING HOLDING – LEARNING FROM THE ECJ

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(1) exercising control over a business

⇒ control based on elements of company law, e.g.
special rights granted to the shareholder, control
contract

(2) involving itself directly or indirectly in the management.

Examples: coordinate sales, pricing, production of goods & services sold by group companies on entity level, joint marketing, staff decision below CEO / board level, joint HR development for staff of group companies etc.

3. NON-CONTROLLING HOLDING – A TYPOLOGY

(pp. 52-54)

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⇒ No easy solutions

⇒ Typology rather than definition

§2.03[B]

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[4] Non-controlling Holdings

The aforesaid criteria work for operating holdings. However, which criteria apply in order to segregate holdings that do not hold controlling stakes in their participations or holdings that have controlling stakes but do not exercise control? The problem is well known in various legal systems. For example, there are several cases on this issue in the US.¹⁰¹ The same issue arises in other legal areas such as tax law. It cannot be assumed that regulators applying the AIFMD will succeed in finding a simple and appropriate solution. It is rather a classification that is case-specific. A few basic principles can be highlighted here.

3. NON-CONTROLLING HOLDING – A TYPOLOGY

(PP. 52-54)

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AIF/AIFM

“– holds fractional units of blue-chip companies and occasionally trades with them in order to optimize its portfolio; or
– holds individual, large shares with the aim of selling these at a profit post re-structuring or stabilization. ...

Indicators are, for example:

- the investment strategy, as given in the constituting documents;
- a limitation period for the company that forces management to wind-up the company after a certain period of time (in the AIF sector, periods between five and ten years are common);
- a carried-interest arrangement which assigns profits to management for the sale of assets;
- a very long lock-up period for investors of three to five years with a redemption right after the lock-up period expires.”

3. NON-CONTROLLING HOLDING – A TYPOLOGY

(PP. 52-54)

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Holding

- “– holds, generally speaking, larger stakes in the controlled companies;
- implements a common strategy and a uniform management across these companies due to control agreements, sales relationships, etc.;
- was founded in order to control a company on a long-term basis while ‘control’ implies the responsibility for the overall strategy of the subsidiaries, or
- is required to hold shares for a very long time for tax reasons in order to fulfil its purpose.”

3. NON-CONTROLLING HOLDING – A TYPOLOGY

(PP. 52-54)

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Rather AIF
than
holding
...

“if

- it merely holds the property with a view to taking advantage of changing market prices;
- it pursues business by investing in businesses carried out by others without having control;
- it pursues both investment and commercial activity to a substantial extent;
- activities meeting the AIF criteria constitute the greater part of the entity’s operations.”

3. NON-CONTROLLING HOLDING – A TYPOLOGY

(pp. 52-54)

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Rather
Holding
than AIF

...

“if

- the undertaking requires a substantial number of personnel;
- the undertaking’s main business is the provision of services and production and not investment capital;
- the parent company benefits from the holding exemption;
- activities meeting the holding criteria constitute the greater part of the entity’s operations.”

3. NON-CONTROLLING HOLDING – A TYPOLOGY

(PP. 52-54)

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Content of Constituting Documents, Publications
etc. important, but

„Substance over Form“ (anti-circumvention)

Conduct matters! FSAs to apply ex post view.

In particular: crowdfunding platforms?

- Crowdfunding platform as Holding? See Ch. 2, p. 32 (based on the ESMA opinion from 2014)

The holding exemption will regularly not be applicable to crowdfunding models, as the goal to generate returns from disinvestment is given rather than the will to use the investment in the context of a long-term strategy.³²

- Yet, what is crowdfunding?
 - (+) Funding of multiple projects based on investors' choice (rather than managers choice) with a view to selling it later
 - (-) Funding of a long-term group strategy through issuance of shares or units (choice made by group management)
 - ⇒ Terminology used by entrepreneurs misleading if not a legal expert (« appeal » of crowdfunding); needs reconsideration in light of new CFReg and various laws of memberships where CF, CL etc are protected terms.

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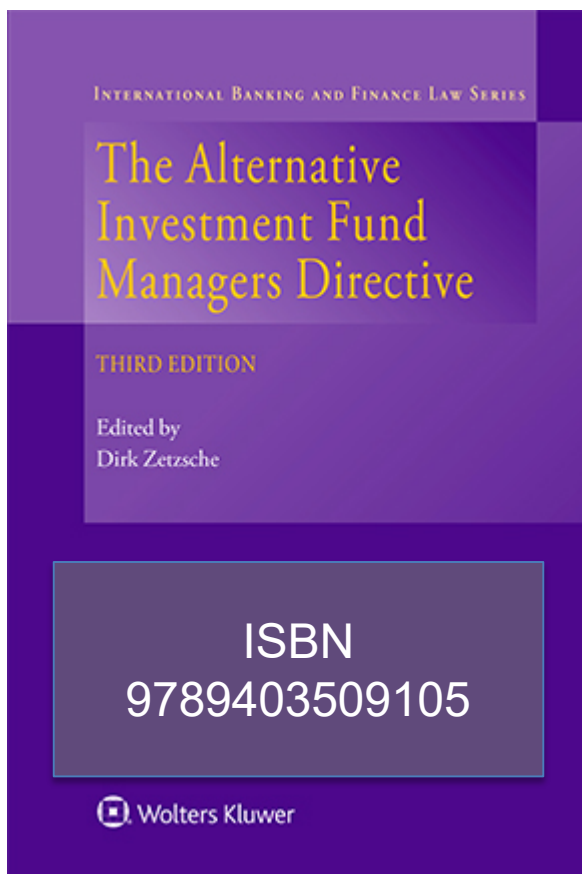
[The Alternative Investment Fund Managers Directive, Third Edition |
Wolters Kluwer Legal & Regulatory](#)

A sample chapter introducing to basics of the
AIFMD can be downloaded free of charge at:

www.ssrn.com/abstract=3693776

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downloaded paper) for copyright reasons!

Thank you!



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