The AIFMD changes the rules of the game – AIFMs have to re-evaluate licensing options, fund domiciles and distribution strategies. Liechtenstein has shaped up for this new reality. An extensive vehicle catalogue, coupled with efficient onshoring possibilities and a licensing regime tailored to industry needs, make it the Continental European alternative for hedge fund managers

Liechtenstein – An onshore alternative for AIFMs and AIFs

Caution, disruptive innovation ahead

It is now a widely shared belief that the EU Alternative Investment Fund Managers Directive (AIFMD) will have a similar effect at the manager level as the introduction of the Ucits standard did at the European retail investment funds level. It may swiftly become not only a standard, but a dominant design and, as such, will segment the industry. Alternative investment fund managers (AIFMs) targeting European institutional investors will soon find that AIFMD compliance features prominently in due-diligence questionnaires and potentially becomes an additional key selection criterion. In order to be considered AIFMD-compliant, managers will have to be licensed in an approved jurisdiction. This qualification must be obtained at the given manager's effective place of management, as this typically requires proof of substance and competence with regard to the fulfilment of the two defining tasks: portfolio management and risk management.

As always, when disruptive innovation occurs – regardless of whether it is triggered by a revolutionary technological change or the introduction of a new set of rules – the typically observed break-up of previously consolidated markets offers opportunities for innovative players, fast movers and those with offerings that anticipate the changed needs of the market and deliver quality and value. The Principality of Liechtenstein has positioned itself well to benefit from the expected changes in the European AIFM and alternative investment fund (AIF) markets. In particular, AIFMs currently based in neighbouring Switzerland have been identified as a source of new business.

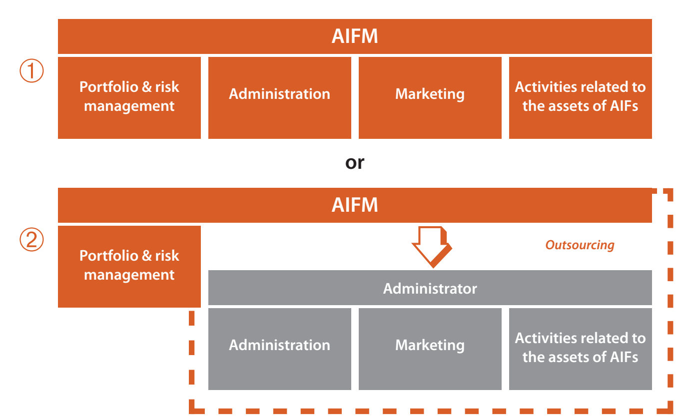
An alternative for Swiss managers

Currently, most Swiss-based hedge fund initiators and their products are structured as follows: the fund is typically domiciled in an offshore jurisdiction to ensure tax neutrality at the vehicle level and to allow for maximum flexibility with regard to investment policy. Since licensing in Switzerland thus far has not been available for managers of foreign AIFs, the asset management entity is usually also set up offshore. The initiators of the fund then usually act as advisers. The advantages of this structure are of course the reduced liability of the adviser and the potential for tax optimisation, inasmuch as typically only part of the management fee is passed on as an advisory fee, while the performance fee is usually received and retained offshore, free of taxes. Normally, the latter is received by the principals via their respective holding vehicles, which in turn afford options for tax optimisation. This situation will most likely change rapidly, given that the Swiss Collective Investment Schemes Act is currently being amended and, in future, will extend the licensing regime to also include Swiss AIFMs of AIFs. But, since Switzerland is not an EU member state and will thus only be able to grant its managers access to the new EU AIFM passport regime once the framework is also extended to third countries, this may come too late for managers who rely on fast time-to-market and branding for their positioning. In particular – and again as a result of the AIFMD – once national private placement schemes are phased out, not only AIFMs but also AIFs intended for placement with EU-qualified investors will come under pressure and it can be expected that the already identifiable onshoring trend for AIFs will also accelerate.

The Liechtenstein advantage

Unlike Switzerland, the Principality of Liechtenstein is a member of the European Economic Area and has for a number of years successfully ensured its full integration into the harmonised European market for collective investment schemes. Also, when it comes to the transposition of AIFMD, this tiny country has great hopes. As the first country in Europe to do so, Liechtenstein has produced its draft AIFM Law (AIFML), which is currently making its way through parliament and is expected to enter into force in early 2013. Not only is the AIFML a prime example of a new law that is fully in line with the original directive, it is also a textbook example of linking theory with practice, an exercise that results in differentiation and potentially creates added value.

1. AIFM structuring options in Liechtenstein



Source: Guenther Dobrauz-Saldapenna

The most important element is the replacement of the Fund Management Company Model, which was originally adopted from Switzerland, by the Administrator Model, which is more closely oriented towards international standards and the expectations of AIFMs. Not only can the administrators act as service providers to AIFs, they can also become an enabling factor for AIFMs that wish to obtain a licence. According to AIFMD, the two core functions of an AIFM are portfolio management and risk management. In addition, an AIFM may perform administrative, marketing and other activities related to the assets of AIFs. If an AIFM wishes to focus solely on its two core functions, it is possible under AIFML to outsource the other activities to an administrator who has to be licensed by the Financial Market Authority Liechtenstein and still obtain an AIFM licence (see figure 1). Depending on the final outcome of AIFMD Level 2 measures, it may very well even be possible to outsource risk management.

Fast track to AIFM status

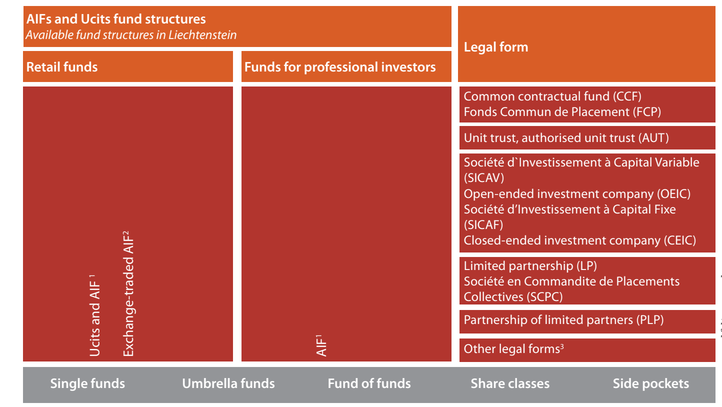
For managers wishing not only to become AIFMD-compliant but also to benefit from first-mover advantage, an additional interesting option exists in Liechtenstein. Generally, the domestic transposition of the AIFMD-related legislation is required to be enacted by July 2013. Liechtenstein is attempting to have its new law and accompanying ordinance already in place by the end of the year, and having it all enter into force early next year. Rather than wait for this, managers willing to relocate to Liechtenstein can already apply for the currently existing asset manager licence. Once obtained, it should be relatively easy and, above all, fast to then upgrade to AIFM status.

AIF options

AIFMD is primarily focused on manager regulation. Certain additional requirements, such as the increased responsibility of custodians and certain restrictions with regard to brokers, are aimed at enhancing system stability through the incorporation of proven concepts from the Ucits realm into AIF structures. Otherwise, the directive is not too focused on products for the time being. Nevertheless, we see a number of managers who are also already modifying their fund setup to gain maximum benefit from the AIFMD regime, its passport and the anticipated more restrictive placement rules across Europe as private placement schemes are gradually phased out. In particular, we see a number of managers migrating their existing offshore funds onshore, using transfer-by-continuation to ensure track-record preservation. Others are creating onshore clones of their existing offshore funds and, going forward, will use dual structures for different investors. In some cases, we also see managers repackaging their strategies as 'NewCits', often by means of swaps, and thereby elegantly sidestepping the entire AIFMD issue.

Here again, Liechtenstein has positioned itself well in terms of AIFs. Not only will it be possible to migrate pre-existing AIFs by way of continuation, which ensures preservation of the valuable historic track record, but also the already extensive catalogue of available fund vehicles (see figure 2) will be extended to include limited partnerships. Within Liechtenstein AIF structures, AIFMs will effectively control the funds they set up and, as such, nominate the necessary professional service providers (for example, an administrator) and may also delegate other tasks to third parties. In addition, the depository/custodian bank and auditors are also nominated by the AIFM on behalf of the fund. If required, the AIFM can also establish direct relationships with prime brokers, thereby making the AIF a direct business partner of the prime broker.

2. Structuring options in Liechtenstein



Source: Wolfdieter Schnee

[1] From July 23, 2013 onwards

[2] Prospectus must be submitted according to the EU Prospectus Directive

[3] If necessary, other legal forms can be implemented through the Liechtenstein AIFM Ordinance if they are in accordance with AIFMD

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