

AIFMD Factsheet: Delegation

What is the AIFMD?

The Alternative Investment Fund Managers Directive (“AIFMD”) came into force on 21 July 2011 and was transposed into Irish national law in advance of the 22 July 2013 deadline. The AIFMD introduces new rules regarding the delegation of functions by alternative investment fund managers (“AIFMs”). In the Irish context, in many instances the self-managed qualifying investor alternative investment fund (“QIAIF”) will itself be the AIFM (in effect, a self-managed alternative investment fund).

Can an AIFM delegate its functions to third parties?

Subject to certain limitations and requirements, an AIFM is able to delegate the carrying out of some of its functions to third parties, who may be based outside of the European Union (“EU”); for example, a QIAIF will be able to delegate its portfolio management function to a US investment manager. The limitations and requirements vary depending on the type of function being delegated.

What limitations and requirements must be met?

AIFMs must notify the competent authorities of their home member state before the delegation arrangements become effective. In addition, the following conditions must be met:

- the AIFM must be able to justify its entire delegation structure on objective reasons;
- the delegate must have sufficient resources to perform the respective tasks and the persons who effectively conduct the business of the delegate must be of sufficiently good repute and sufficiently experienced;
- the delegation must not prevent the effectiveness of supervision of the AIFM and, in particular, must not prevent the AIFM from acting, or the alternative investment fund (“AIF”) from being managed, in the best interests of the AIF’s investors; and
- the AIFM may not delegate its functions to the extent that, in essence, it can no longer be considered to be the manager of the AIF and it becomes a letterbox entity.

Are there any additional requirements for the delegation of certain functions?

Yes. Where the delegation concerns portfolio management or risk management, the delegation will be subject to the following conditions:

- the delegate must be authorised or registered for the purpose of asset management and subject to supervision or, where that condition cannot be met, the delegation requires the prior approval of the competent authorities of the home member state of the AIFM; and
- where the delegate is a non-EU undertaking, cooperation between the competent authorities of the home member state of the AIFM and the supervisory authority of the undertaking must be ensured.

Are there any provisions concerning the selection and supervision of delegates?

Yes. The AIFM must be able to demonstrate that the delegate is: (a) qualified and capable of undertaking the functions in question; and (b) was selected with all due care.

In addition, the AIFM must be able to demonstrate that it is in a position to:

- monitor the delegated activity effectively at any time;
- give further instructions to the delegate at any time; and
- withdraw the delegation with immediate effect where this is in the interest of investors. The Level 2 Regulation provides that the delegation agreement should “confer flexible termination rights on the AIFM”.

The AIFM is also required to review the services provided by the delegate on an ongoing basis.

Can delegated functions be sub-delegated?

Yes. The delegate may sub-delegate any functions delegated to it, provided that the conditions described above are applied on the basis that references to “delegate” are read as references to “sub-delegate”. In addition, the AIFM must give its prior consent to the sub-delegation and must notify the competent authorities of its home member state before the delegation arrangements become effective.

Is the liability of the AIFM affected by the appointment of delegates?

No. The AIFM's liability towards the AIF and its investors is not affected by the fact that the AIFM has delegated functions to a third party (or by any further sub-delegation).

Are there any conflict of interests limitations?

Yes. The AIFM may not delegate portfolio management or risk management functions to the AIF's depositary or a delegate of the depositary. The AIFM may delegate such functions to other entities whose interests might conflict with those of the AIFM or the investors of the AIF, provided that each such entity has functionally and hierarchically separated the performance of its portfolio management or risk management tasks from its other potentially conflicting tasks and that the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors in the AIF.

Implementing measures on delegation

The AIFMD requires that the European Commission adopt “delegated acts” specifying the conditions for fulfilling the delegation requirements and the conditions under which the AIFM shall be deemed to have delegated its functions to the extent that it becomes a letterbox entity and can no longer be considered to be manager of the AIF. The delegated acts, known as the “**Level 2 Regulation**” set out:

- general principles to be complied with by the AIFM when delegating its functions;
- the criteria to be considered when assessing whether the entire delegation structure is based on objective reasons;
- features of the delegate;
- the conditions applying where portfolio or risk management are delegated. In particular, the Level 2 Regulation provides that, where a function is delegated to a non-EU undertaking, there must be a written cooperation arrangement between the competent authorities of the home member state of the AIFM and the supervisory authorities of the delegate. The Level 2 Regulation sets out certain provisions to be contained in such written agreements, including the ability of the competent authorities of the home member state of the AIFM to obtain information and documents from the third country supervisory authority;
- the conditions necessary to ensure effective supervision and to criteria to assess whether a delegation conflicts with the interests of the AIFM or the investor in the AIF; and
- the requirement that the AIFM consent in writing to any sub-delegation and details of the notification to be provided to the AIFM.

The Level 2 Regulation provides that the AIFM will be deemed a letterbox entity in any of the following circumstances:

- (a) the AIFM no longer retains the necessary expertise and resources to supervise the delegated tasks effectively and manage the risks associated with the delegation;
- (b) the AIFM no longer has the power to take decisions in key areas which fall under the responsibility of the senior management or no longer has the power to perform senior management functions;
- (c) where the AIFM loses its contractual rights to inquire, inspect, have access or give instructions to its delegates; or
- (d) where the AIFM delegates the performance of investment management functions to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself.

In relation to (d), the Level 2 Regulation provides that when assessing the extent of delegation, competent authorities shall consider the entire delegation structure taking into account not only the assets managed under delegation, but also a number of qualitative criteria. These include the types of assets invested in, and the importance of the assets under delegation for the risk and return profile and achievement of the investment goals of the AIF; the geographical and sectoral spread of the AIF's investments; the risk profile of the AIF and the types of investment strategies pursued; the types of task delegated in relation to those retained; and the configuration of the delegates and sub-delegates, their geographical sphere of operation and corporate structure.

Irish Implementation

The Central Bank of Ireland has published an AIF Rulebook, setting out the applicable rules for AIFMs, AIFs and their service providers. The AIF Rulebook provides that the board of the AIFM will be responsible for six key managerial functions:

- Regulatory compliance
- Fund risk management
- Operational risk management
- Investment management
- Capital and financial management
- Distribution

The AIF Rulebook provides that, where an AIFM delegates activities, the programme of activity (the document setting out the organisational structure of the AIFM, including how the AIFM intends to comply with its obligations under the AIFMD) must identify the designated person who will, on a day-to-day basis, monitor and control each of the individual managerial functions listed above. The board of the AIFM must formally adopt a statement of responsibility in relation to the functions and the procedures which apply in each case. The programme of activity must also provide for the types of report and frequency of reporting to the designated person and set out the circumstances in which action by a designated person is required.

Full details of the Asset Management and Investment Funds Group, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team can be accessed at www.matheson.com.

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