ALLEN & OVERY

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How the implementation of AIFMD in Belgian law will affect private equity transactions

On 10 March 2014, the draft law implementing the alternative investment funds management directive 2011/61/EU (**AIFMD**) was submitted to Belgian parliament (the **AIFMD Law**). We expect the final AIFMD Law to become effective in the second quarter of this year. The legislative process is unlikely to result in any significant changes to the draft AIFMD Law.

This briefing paper describes and analyses the requirements that the AIFMD Law will impose on an alternative investment fund manager (**AIFM**) managing an alternative investment fund (**AIF**) that acquires a controlling shareholding in a (listed or non-listed) company, and the related restrictions on asset stripping. We also highlight the notification obligations on acquisition (or loss) of a major holding in non-listed companies.

Speed Read

Articles 76 to 83 of the AIFMD Law will impose obligations on large AIFMs managing one or more AIFs that acquire major holdings in or control of certain types of portfolio companies.

The obligations arising from these articles include:

- the requirement to notify the acquisition of major holdings and control of non-listed companies;
- disclosure requirements on the acquisition of control of (listed or non-listed) companies;
- some specific annual reporting requirements in the event of an AIF exercising control of non-listed companies; and
- certain restrictions on asset stripping for AIF that acquire control over a (listed or non-listed) company.

These obligations do not apply if the portfolio company is a 'small' company or a special purpose vehicle whose purpose is the purchasing, holding or administering real estate.

Contents

Introduction

Articles 76 to 83 of the AIFMD Law will introduce the following provisions (the **Transaction Provisions**):

- A requirement to notify the acquisition by an AIF of a major holding or control of non-listed companies (article 79).
- Disclosure requirements in the event of the acquisition by an AIF of control of a (listed or non-listed) company (article 80).
- Specific provisions regarding the annual report of the AIF exercising control of non-listed companies (article 81).
- Asset stripping restrictions in the event of the acquisition by an AIF of control of a (listed or non-listed) company (articles 82 and 83).

Articles 76 and 77 determine the scope of application of these provisions.

Scope

AIFs and AIFMs covered

The Transaction Provisions apply:

- to an AIFM managing one or more AIFs which, either individually or jointly on the basis of a control agreement, acquires control of a non-listed company; and
- if two or more AIFMs co-operate on the basis of an agreement pursuant to which the AIFs managed by those AIFMs jointly acquire control of a non-listed company (in which case each of the AIFMs must make the required notifications and disclosures).

The provisions requiring notification of acquiring (or losing) major holdings also apply where the holding is less than a controlling interest.

The AIFM managing the AIF must comply with the Transaction Provisions. If an undertaking does not qualify as an AIF falling within the scope of the AIFMD Law, the Transaction Provisions will not apply. If an undertaking qualifies as an AIF and falls within the scope of the AIFMD Law, the Transaction Provisions will also not apply if the AIFM managing the AIF qualifies as a small AIFM.

(a) What is an AIF?

The AIFMD Law defines an AIF as:

"a collective investment undertaking, including investment compartments thereof, which:

(a) raises 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

(b) is not a UCITS."

To qualify as an AIF, in addition to not qualifying as a UCITS, an undertaking must satisfy each of the following conditions:

(i) The undertaking must qualify as a **collective investment undertaking**.

Based on the final report of ESMA containing guidelines on key concept of the AIFMD (the **ESMA Key Concepts Guidelines**), an undertaking qualifies as a collective investment undertaking if each of the following conditions is met:

- The undertaking's capital must be pooled to generate a pooled return to investors by acquiring, holding or selling investment assets (as opposed to an entity whose purpose is to manage the underlying assets as part of a general commercial or industrial purpose).
- Investors do not have day-to-day discretion and control of the undertaking.
- The undertaking has no commercial or industrial purpose (ie the pursuit of a business strategy such as running a predominantly commercial activity involving the purchase, sale and/or exchange of goods or commodities and/or the supply of non-financial services or an industrial activity involving the production of goods or construction of properties or a combination of both).

(ii) The undertaking must have a **number of investors**.

An undertaking will be deemed to only have one investor if, by operation of law, its articles or any other binding arrangement, no capital may be raised from other investors.

(iii) The undertaking must have a **defined investment policy**, ie a policy about how the pooled capital must be managed to generate a pooled return for investors.

(iv) The undertaking must **raise capital** with a view to investing it for the benefit of its investors in accordance with the defined investment policy.

The ESMA Key Concepts Guidelines define "raising capital" as:

"the commercial activity of taking direct or indirect steps to procure the transfer or commitment of capital by one or more investors for the purpose of investing it in accordance with a defined investment policy."

In principle, investment by a family member in its family office does not qualify as raising capital. The ESMA Key Concept Guidelines under pinning the definition of the family office exemption are narrow so that many vehicles currently considered to be a 'family office' may not meet this definition. The ESMA Key Concept Guidelines state that when capital is invested in an undertaking by a member of a family, for the investment of whose private wealth the undertaking has been **exclusively** established, that is not likely to be within the scope of raising capital.

Article 7 of the draft AIFMD Law specifies that certain entities are excluded from the application of the AIFMD Law. These include employment participation schemes, securitisation vehicles and holding companies. A company qualifies as a holding company if:

(a) the commercial purpose of holding its participation(s) is to carry out one or more business strategies through its participations to contribute to their long term value; and

(b) it is:

(i) operating for its own account and is listed on a regulated market in the European Economic Area (**EEA**); or

(ii) not established for the main purpose of generating returns to its investors by means of divestment of its participations, as evidenced in its annual report or other official document.

Recital (8) of the AIFMD indicates that joint ventures are not covered by the directive, but neither the directive itself nor the draft AIFMD Law define what a joint venture is or provide a specific exemption. It is therefore necessary to turn to the key elements of the definition of an AIF to determine whether a joint venture will qualify as an AIF and therefore be caught by the AIFMD Law.

(b) AIFMs covered

Based on Article 10 of the draft AIFMD Law, the following AIFMs will be bound by the Transaction Provisions:

(i) A Belgian AIFM managing one or more EU or non-EU AIFs.

(ii) A non-EU AIFM managing one or more EU AIF or marketing one or more EU or non-EU AIFs in the EEA, in each case where Belgium is that AIFM's reference member state.

The Transaction Provisions will not apply if the AIFM is a small AIFM that has not opted for a full application of the AIFMD Law. An AIFM is deemed a small AIF if it (directly or indirectly):

- has assets under management (including assets acquired through the use of leverage) that in total do not exceed EUR 100 million; or
- has assets under management that in total do not exceed EUR 500 million and its portfolio of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF.

Leverage is any method by which the AIFM increases the exposure of an AIF whether through borrowing of cash or securities, leverage embedded in derivative positions or by any other means.

Portfolio companies covered

The Transaction Provisions apply:

- in full, in the event of an acquisition of control in a non-listed company; and
- in part, in the event of an acquisition of a controlling participation in a listed company.

For non-listed companies, "control" means holding (directly or indirectly) more than 50% of the voting rights of the non-listed company.

For listed companies, "control" is the level of voting control at which a mandatory offer is required under the rules of the member state in which the company has its registered office (as required by the EU Takeover Directive 2004/25/EC – often 30%, but this varies between member states).

Notification requirements will also apply in the event of an acquisition of a major holding in a non-listed company.

The Transaction Provisions will not apply if the company in which the participation is acquired is:

- a small company, ie a company employing fewer than 250 persons and which has an annual turnover not exceeding EUR 50 million and/or a balance sheet total not exceeding EUR 43 million; or
- a special purpose vehicle with the purpose of purchasing, holding or administrating real estate.

In addition to these exceptions, it is important to remember that the portfolio company must have its registered office in an EEA member state for the Transaction Provisions to apply.

Notification and disclosure requirements

Notification requirements in the event of an acquisition of a major holding

When an AIF acquires, disposes or holds shares of a non-listed company, the AIFM managing that AIF must notify the FSMA when the proportion of voting rights held, reaches, exceeds or falls below the thresholds of 10%, 20%, 30%, 50% and 75%.

This obligation applies whether or not control is acquired and will catch minority investors.

Notification and disclosure requirements in the event of an acquisition of control

The table below gives an overview of the notification and disclosure requirements that apply to an AIFM managing

an AIF that acquires control in a listed or non-listed company.

Where the disclosures are expressed to be addressed to the employee representatives, it must be noted that the AIFMD Law does not provide a direct disclosure requirement from the AIFM to the employee representatives. The AIFMD Law simply provides that the AIFM must request that the board of directors of the 'acquired' company discloses the information notified to it to the employee representatives (or, if none, the employees themselves) and the AIFM is subject to a best efforts obligation to ensure that this happens.

	Non-listed	Listed	Addresses
Resulting situation in terms of voting rights	✓	X	– Target – Known shareholers – FSMA – Employee representatives
Conditions subject to which control was acquired	✓	X	
Date on which control was acquired	✓	X	
Identity of the AIFM managing the AIF acquiring control	✓	✓	
Policy for preventing and managing conflicts of interest, in particular between the AIF, AIFM and the 'acquired' company	✓	✓	
Policy for external and internal communication relating to the portfolio company in particular as regards employees	✓	✓	
Intentions regarding future business of the 'acquired' company	✓	X	– Target – Known shareholders – Employee representatives
Disclosure of the likely repercussions on employment within the 'acquired' company, including any material change in the conditions of employment	✓	X	
Information on the financing of the acquisition and the acquisition itself	✓	X	– FSMA – AIF investors

Exceptions

The notification and disclosure requirements to the target company's employee representatives or employees are subject to the confidentiality provisions in the Information and Consultation of Employees Directive (2002/14/EC), on the basis of which:

– employee representatives (and experts who assist them, including advisors) must not reveal to employees or third parties any information which, in the legitimate interests of the undertaking or establishment, has expressly been provided in confidence; and
– there is no obligation to communicate information if the nature of the information provided is such that, according to objective criteria, doing so would seriously harm the functioning of the company or would be prejudicial to it.

Annual reporting

Article 29 of the AIFMD provides that when an AIF acquires control of a non-listed company, the AIFM managing that AIF must either:

(a) request and use its best efforts to ensure that the annual report of the company includes certain additional information (see below) and that this

report is made available by the board of directors of the company to the employee representatives (or, where there are no employee representatives, to the employees directly); or

(b) include the required information relating to the company in the annual report that it must make available for that AIF in accordance with article 22 of the AIFMD.

If the AIFM elects the first option, there is an obligation to make the required information available to the investors of the AIF. If the AIFM elects the second option, there is an obligation to use its best efforts to ensure that the information is disclosed by the board of directors of the company to the employee representatives (or, where there are no employee representatives, to the employees directly).

Article 81 of the draft AIFMD Law is less clear on whether an AIFM has these options. Paragraph 1 of that article reflects the obligation under paragraph (a) above, without the alternative option under paragraph (b) above. This suggests that the required additional information must in any case be included in the annual report of a non-listed company.

The additional information to be included in the annual report must include at least a fair review of the development of the company's business representing the situation at the end of the period covered by the annual report. The report must also give an indication of:

- any important events that have occurred since the end of the financial year;
- the company's likely future development; and
- certain prescribed information concerning acquisitions of own shares.

Asset stripping

The asset stripping provisions of the AIFMD Law go further than the current Belgian financial assistance restrictions. These new provisions will be particularly relevant for debt-push down structures and leveraged recapitalisation transactions.

If an AIF acquires control of a (listed or non-listed) company, during the 24 months following the acquisition of control the AIFM:

- is not allowed to facilitate, support or instruct any distribution, capital contribution, share redemption and/or acquisition of own shares by the company as described below;
- must not vote in favour of a distribution, capital reduction, share redemption and/or acquisition of own shares by the company as described below; and
- must, in any event, use its best efforts to prevent distributions, capital reductions, share redemptions and/or the acquisition of own shares by the company as described below.

The obligations imposed on the AIFM relate to the following:

(a) Any distribution to shareholders made when on the **closing date of the last financial year** the net assets as set out in the company's annual accounts are, or following such distribution would become, lower than the amount of the subscribed share capital plus those reserves which may not be distributed by operation of law or the company's articles. If the uncalled part of the subscribed capital is not included in the assets shown in the balance sheet, that amount must be deducted from the amount of the subscribed capital (the **Net Assets Test**). This restriction is substantially in line with existing Belgian requirements for dividend distributions.

(b) Any distribution to shareholders where the amount of which would exceed the amount of the profits **at the end of the last financial year** plus any profits brought forward and sums drawn from reserves available for this purpose, less any losses brought forward and sums placed in reserves in accordance

with applicable law or the company's articles (the **Profit Test**).

(c) If, to the extent that acquisitions of own shares are permitted, the acquisition by the company, including shares previously acquired and held by it, and shares acquired by a person acting in its own name but on the company's behalf, would have the effect of reducing the net assets below the amount mentioned in paragraph (a) above.

The term "distribution" in paragraphs (a) and (b) above must be widely construed and includes the payment of dividends or interest relating to shares.

One may question whether the term "distribution" in paragraphs (a) and (b) above also includes share capital reductions. Although there are good arguments to defend the view that the reference to distributions in these paragraphs should not extend to share capital reductions, the European Commission has stated in the Q&A in relation to AIFMD that paragraphs (a) and (b) also apply to share capital reductions. This means that even if the company has a share capital that substantially exceeds the required minimum share capital, it will not be able to reduce its share capital if to do so would result in a breach of the Profit Test.

The restrictions on share capital reductions do not apply to any reduction of the subscribed capital where the purpose of which is to offset losses incurred or to include sums of money in a non-distributable reserve provided that, following such operation, the amount of such reserve is not more than 10% of the reduced subscribed capital.

Considering the debt push down techniques that are commonly used in Belgian transactions, and given the Net Asset Test, the Profit Test and the broad concept of 'distribution', the new asset stripping restrictions will have the following impact during the 24-month period after acquisition of control:

- It will no longer be possible to make a distribution of current year profits by way of interim dividends; this will primarily affect the timing of effecting a debt push down.
- As a share capital reduction will become subject to the same limits as a dividend distribution, the reduction of share capital will no longer be a common means to effect a debt push down; this will primarily affect the amount of debt that can be pushed down.

As the AIFM has an on-going obligation to comply with the asset stripping conditions during the 24-month period after the acquisition of control by the AIF managed by it, it will be important to make the necessary arrangements with any buyer that will acquire control of the company during that 24-month period.

Sanction Regime

In addition to the administrative sanctions that can be imposed by the FSMA, the draft AIFMD Law also contains a criminal sanctions regime that will apply in the event of a breach of the AIFMD Law.

Article 370 of the draft AIFMD Law provides for a criminal sanction ranging from eight days to three months imprisonment and/or a EUR 50 to EUR 10,000 penalty for those persons who intentionally do not comply with the Transaction Provisions.

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