BENDURA FUND
MANAGEMENT BETA AG · LIECHTENSTEIN

European Union Harmonised Alternative Investment Funds as Corporate Structuring Vehicles

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With the Alternative Investment Fund Managers Directive (AIFMD), the European Parliament and the Council of the European Union (EU) have harmonised the regulatory framework for Alternative Investment Funds (AIF). The Principality of Liechtenstein as a member of the European Economic Area (EEA) participates in the EU's internal market and adopts most EU legislation concerning the single market. Liechtenstein's adoption of the AIFMD entered into force as from July 2, 2013 and the inclusion of the AIFMD in the EEA Agreement opened the EU for potential marketing of Liechtenstein AIFs on September 30, 2016.

1. Alternative Investment Funds

There generally are no limits regarding the types of assets an AIF could hold: certainly securities, as well as real estate, private equity, commodities, art, or intellectual property.

The resilient AIF structure
The AIFM regime is based on the regulation of the licenced Alternative Investment Fund Managers. The AIFM is responsible for portfolio management and risk management of the AIF as well as for the fund administration and other tasks with regards to the AIF. Although it is possible to delegate all these tasks to third parties, the AIFM is not allowed to delegate portfolio management and risk management of an AIF at the same time and cannot dispose of its overall responsibility.

Separation of powers regarding the AIF's assets is one of the measures taken to prevent misconduct and to preserve the interests of the investors. Therefore, the second most important actor in an AIF structure is the depositary, usually a bank. While it is the AIFM's duty to manage the assets of the AIF, the depositary has to take the bankable assets into custody and to make sure that the property of non-bankable assets of the AIF is not inadvertently encumbered with any rights of third parties. Regarding bankable assets the rule is: the AIFM manages the assets but must not possess them, the depositary has to keep the assets in custody but must not manage them. Furthermore, the depositary has the duty to check any transactions of the AIF regarding the adequacy of the according considerations and it is not allowed to hand over the bankable assets to the AIFM.

Every AIF has to appoint an external auditor and is subject to regulatory supervision by the regarding regulator, in Liechtenstein by the Financial Market Authority (FMA). Diagram 1 shows the basic structure of an AIF with its mandatory parties and the possible involvement of prime brokers and financing third parties.

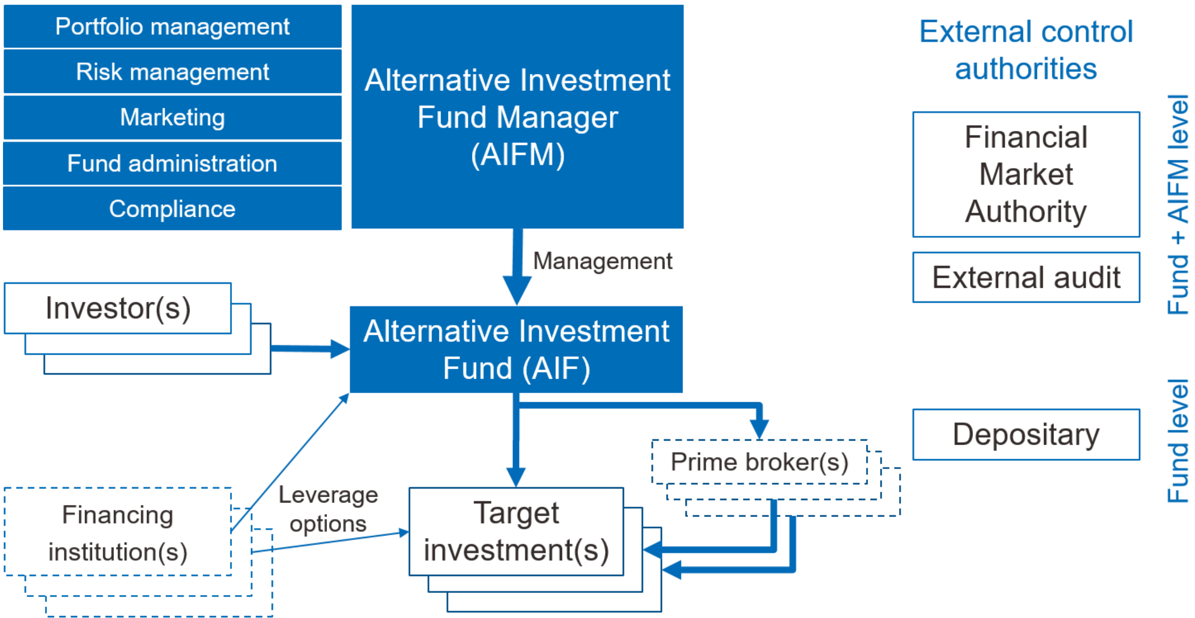

Diagram 1: Basic AIF structure

AIF fund unit transactions via clearing systems using central counterparties (CCP)
Other than with hedge funds in most Anglo-American jurisdictions, Central European AIF fund units usually are not registered with the AIF. In fact, the settlement of subscriptions and redemptions of AIF units is conducted via the clearing systems (e.g. Clearstream, Euroclear, SIX SIS) by using a CCP as counterparty for both parties of the transaction.

Therefore, the AIF units generally are created as uncertificated clearable securities. To subscribe for the AIF units, the custodian bank of the investor files a subscription form for the regarding AIF units and submits it to the depositary of the AIF which acts as transfer agent for the AIF. In the subscription form, the investor's custodian subscribes the AIF units in its own name but on behalf of its customer without disclosing him, and covenants that its customer, the investor, is eligible for the AIF units pursuant to the AIF's fund documents. After the subscription has been accepted, the transaction is settled via the clearing systems as delivery versus payment (DVP) transaction. After having received the AIF units in his security account at his custodian bank, the investor has the AIF units at his disposal and, for example, would be free to sell them in an over the counter transaction to any discretionary third party. As a result, neither the AIF nor the AIFM or the depositary usually do know who the investors are.

2. Governance framework and internal monitoring system of AIFs

AIFs are heavily regulated regarding the functioning of their internal control systems and their external control bodies. There is a variety of dimensions of the governance framework and the monitoring instances which can be listed as

- functional (rule adherence = compliance; risk avoidance; damage repair),
- hierarchical (lines of defence: operations, internal control system, internal audit), and
- perspective (internal control system; external control authorities).

Diagram 2 gives an overview of the implementation of these three dimensions. The AIFM has the duty to establish the internal control system. External control bodies are the depositary bank, the external auditor and the governmental regulator.

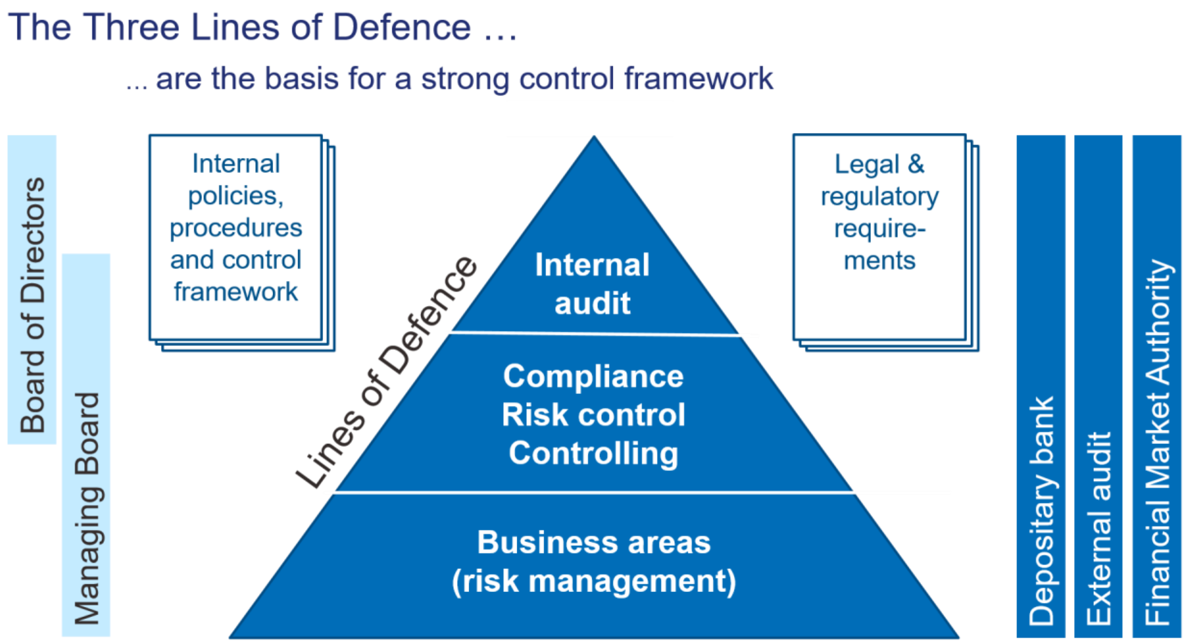

Diagram 2: The three lines of defence

Whereby for conventional security funds the quantitative risk controlling approach is prevailing, AIFs often comprise of a small number of assets, or even only one single asset, as, for example, in a closed-club or single-investor AIF with private equity or real estate assets. Hence operational risk management plays a more important role.

With respect to crime prevention, in the day-to-day business of an AIFM for private-equity and real-estate AIFs, anti money laundering (AML) measures are the main focus. This affects on the one hand the subscription of AIF units by investors, on the other hand the AIF's asset transactions. Fortunately, the Central European custom of delivering fund units via the clearing systems as DVP transactions reliefs the AIFM of much of the workload with the investor's side regarding AML prevention: it is the

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duty of the subscribing bank on the other side of the transaction to check the source of funds of the subscribing investor. Since only banks with sufficient AML measures are allowed to participate in the clearing systems, them generally can be trusted.

3. Structuring with AIFs

Since AIFs virtually have no limits regarding the assets they hold, they are ideal for

- private equity, start-ups, spin-off investments, or
- financial leverage of non-regulated asset managers who are restricted regarding the number of investors they could incorporate into an investment project.

But furthermore as with many other types of financial instruments, there are more application possibilities for investment funds than only their primary purpose of pooling capital belonging to numerous investors used to collectively purchase securities. Very important secondary purposes are to use an investment fund for

- asset structuring within more or less complex corporate structures,
- succession and tax planning,
- anonymising of strategic or activistic investments,
- protection against hostile takeovers, or
- as wrapper for any types of assets.

Variety of corporate structures for AIFs
Liechtenstein AIFs come in five different corporate structures to satisfy the promoter's and the investor's needs regarding structuring, control and taxes. The most important corporate structures are the

- investment company as limited company with variable capital (SICAV), whereby the investors are the holders of the investor shares and the AIFM is the managing director;
- collective trusteeship, whereby the investors are the beneficiaries and the AIFM is the trustee; and
- limited partnership, whereby the investors are the limited partners and the AIFM is the managing director of the general partner.

Balancing the interests of the promoters and the AIFM
Most important for the AIFM in such cases is the balancing of the interests of his customer as AIF promoter with the own interests of the AIFM as regulated fund manager. Since the AIFM is not allowed to leave the portfolio management to the promoter, it is imperative to clearly define the promoter's goals and targets beforehand. These goals and targets then can be incorporated into the AIF's constituent documents in order to give the AIFM a clear guidance how this AIF has to be managed and to give the promoter the certainty that in "his" AIF exactly will happen what was economically intended. For closed-club or single-investor AIFs there is no need to publish the AIF documents in case some privacy might be needed. Furthermore, procedures can be put in place by which the promoter has the possibility to replace the AIFM by another licensed AIFM in case of irreconcilable differences.

Structuring example A: AIF as equity and leverage provider for a business incubator
The successful XY Business Incubator Limited Company has more private equity opportunities than monies to invest. It is seeking additional equity as well as external finance and knows already some potential investors. In its jurisdiction, XY Ltd. as a financial investor into target companies must not onboard more than only a few investors as shareholders of the XY Ltd. itself since otherwise it would be considered an investment fund without the regarding regulatory licence.

The founding shareholders of the incubator company as promoters to the AIF want to secure a particular portion of the profits of XY Ltd. as a reward for their lifetime achievement by successfully having setup the business. They also want to stay in control of XY Ltd. and to be provided with the maximum possible external control of the AIF.

A structure as shown in Diagram 3 addresses all requirements of the promoters. A new class of preferred shares in XY Ltd. secures the voting majority and a special dividend right for them. Via the voting founder shares of the AIF in the corporate form of an investment company or “SICAV”, the promoters are in charge of appointing the Board of Directors of the AIF and could take seats in the Board themselves. While not allowed to take over the portfolio management of the AIF from the AIFM, the Board of Directors has the power to replace the AIFM as corporate managing director of the SICAV-AIF by any other licensed AIFM. With the non-voting investor shares in the SICAV-AIF, new investors have the opportunity to get exposure to XY’s business returns. In the general assembly of XY Ltd. on the other hand, only the AIFM as manager of the SICAV-AIF would appear on grounds of the AIF’s ordinary shares, eliminating any risk of being exposed to aggressive activistic shareholders. Besides subscribing shares of XY Ltd., the AIF could also agree with XY Ltd. on other instruments of

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financing, e.g. performance linked loans with regards to the performance of XY Ltd. itself or with regards to single investment targets of XY Ltd.

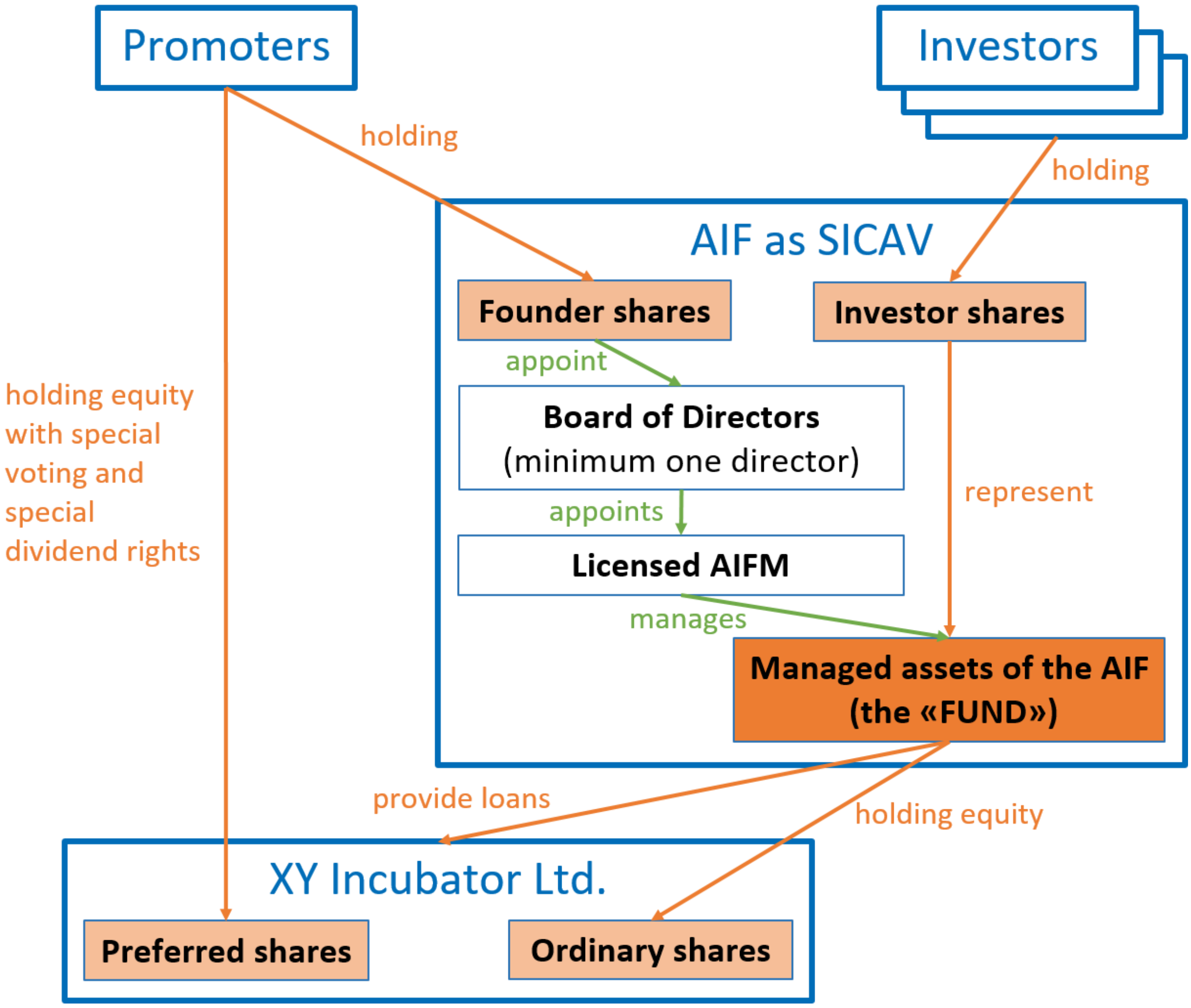

Diagram 3: AIF as equity and leverage provider for an unregulated financial business

Structuring example B: protection against hostile takeover

The Board of Directors of a listed company holding multiple business companies has been made aware that a hostile takeover shall take place. The attacker intents to rip the company's holdings apart and to sell them in pieces. After consultation with the company's lawyers, the Board of Directors decides to take measures making the company unalluring for the attacker.

Diagram 4 shows a possible final structure as result of these measures. A new holding company is being established. The holdings of the old holding company are put into the new holding company. The old holding company puts the new holding company as subscription in kind into an AIF set up for this purpose and gets AIF fund units in return. The AIF has a lock-in period of ten years and is open for third-party investors. In case of a hostile takeover, the attacker would get a company with AIF fund

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units in it and no possibility to redeem them or to lay hands on the original holdings of the old holding company.

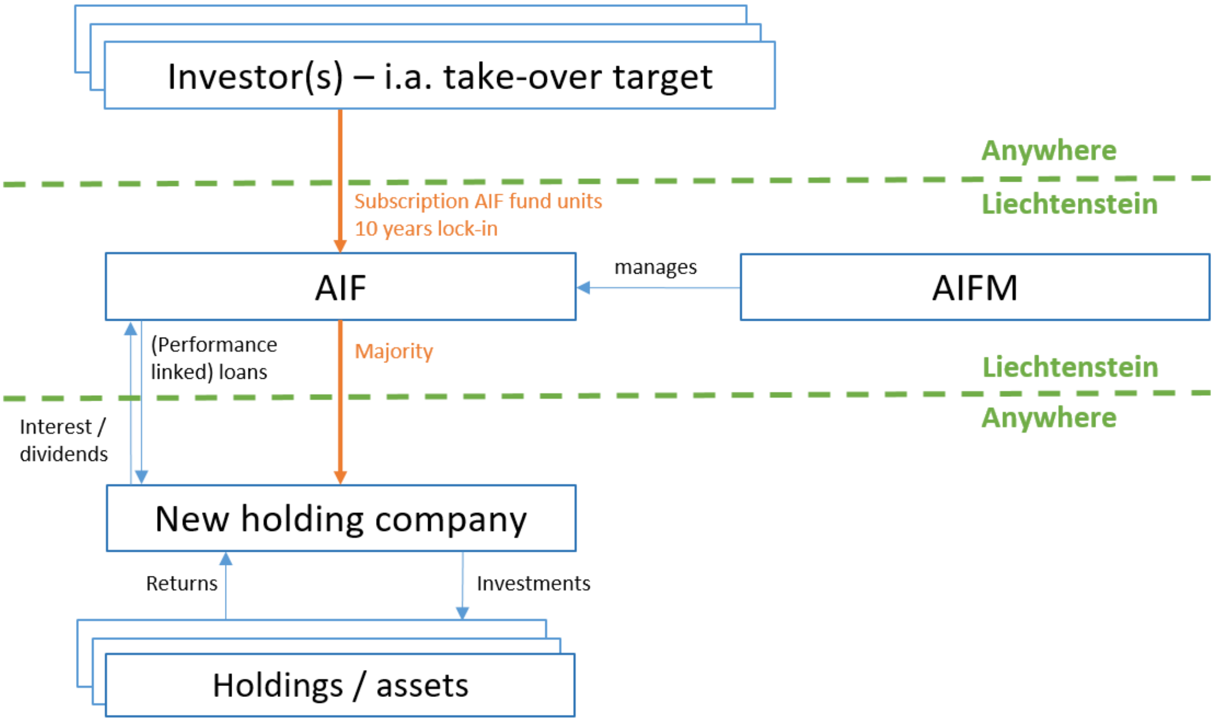

Diagram 4: AIF for protection against hostile takeover

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