

USING CLUB DEALS: WHAT ARE THE REGULATORY CHALLENGES?

In the last few years there has been a significant increase in the number of transactions completed through "Club Deals". Club Deals are often created by high net worth individuals or families that make one or more investments together. They can also be the result of a temporary partnership between two or more investment funds that pool their resources together and make the acquisition collectively. Banks also set up their "club deal" corporate vehicle in which they take a minority participation and hire managers to monitor investment opportunities, opening the remaining corporate capital to wealthy families in search of good investment opportunities. The instrument is not industry specific, in the sense that it is being used in real estate deals but also for industry and financial investments.

Investors participating in club deals are usually seeking greater control over the investment strategy and want greater involvement in the decision-making of the vehicle, with the possibility to share the knowledge and the contacts they have in their field of expertise. In many club deals, investors have the choice to opt in or opt out from any investment, cherry picking the opportunities they find most interesting.

Club deal organizers, managers and investors should consider some requirements and constraints deriving from the rules on investment advisory under MIFID II and MIFIR as well as under the European Directive on Alternative Investment Fund Managers (AIFMD). The AIFMD requirements are detailed and far reaching.

A European manager of an AIF (Alternative Investment Fund) needs to be licensed and subject to regulatory supervision under the AIFMD.

The AIFM Directive also imposes capital requirements, sets out detailed standards that managers must adhere to in their day-to-day business, contains reporting rules and places leverage limits.

One of the most notable provisions is the asset stripping prohibition providing that when a fund acquires control over a company, the manager of that fund is not allowed, for a period of two years following the acquisition of control, to facilitate, support, instruct or vote in favour of certain distributions, capital reductions, share redemptions and/or acquisitions of own shares by the relevant company, and must in fact use its best efforts to prevent any such transaction from taking place.

The AIFMD also provides for certain exemptions for managers in charge of smaller funds. An exemption is granted to any manager managing one or several AIF, which are not leveraged and without redemption rights for a period of five years and with assets under management below €500m. Also exempted are managers managing one or several AIF whose assets under management are below €100m.

The intentionally broad definition of what is an Alternative Investment Fund contained in the Directive (article 2) means that club deals cannot be excluded a priori from the AIFMD regime. They are in a grey area: for example, the French authority, Autorité des Marchés Financiers, has considered an AIF subject to the AIFMD a club deal in which investors had delegated to managers also the decisions to invest and divest the single stakes.

The decision on whether a club deal is AIFMD exempt depends on how it is practically structured. Each situation should be assessed on its own merits, in order to determine whether the criteria of the AIF definition are fulfilled. Drafting documentation correctly is crucial in this respect.