Industry impact

The details of the Directive, and how it affects Luxembourg

This proposed Directive on Alternative Investment Fund Managers (AIFM) marks the first attempt to create a comprehensive and effective supervisory and regulatory framework for AIFM in the EU by imposing on European investment managers of non-Ucits investment funds a common set of rules in terms of licensing and supervision. In return, AIFM benefit from a European passport for cross-border distribution to EU professional investors.

Produced in record time, the proposal is now in the hands of the European Parliament, where it is expected to be subject to stormy political negotiations. From a Luxembourg perspective, this Directive creates big opportunities, and, if ratified, could have a big effect on the alternative investment industry. Indeed, the distribution of offshore funds to professional investors (as defined by Mifid) will only be possible after three years following the Directive's ratification. This could, by accelerating the re-domiciliation of offshore funds to the Grand Duchy, strengthen Luxembourg's position as a major hub for investment funds.

However, across Europe, the project is widely criticised as disproportionate and discretionary, and it still divides countries such as the UK and France. Amendments or delay in its enforcement should therefore be expected. Should a political approval be reached by the end of 2009, the Directive could come into force in 2011.

The main innovations focus on the regulatory supervision, the disclosure requirements and the distribution of Alternative Investment Funds (AIF). However, it should be pointed out that these proposals will only introduce a minimum threshold for member states, and countries such as France and Germany will probably pass harsher requirements.

Scope of the Proposed Directive

The proposed Directive would apply to all managers that manage and market non-Ucits funds in the EU, unless their assets under management do not exceed €100 million, or €500 million when the Alternative Investment Funds (AIF) managed are not leveraged and have no redemption rights exercisable during a period of five years following the date of constitution of the AIF. This constitutes a major innovation since AIF have so far been immune from any harmonised regulatory regime within the EU.

All non-Ucits funds are concerned (hedge funds, venture capital funds, infrastructure funds, private equity funds, real estate funds, commodity funds, non-EU retail funds), irrespective of their type, their legal structure or their country of domicile (even outside the EU). Indeed, the Directive also regulates the marketing of non-EU funds and the authorisation of non-EU AIFMs. Consequently, an AIFM wishing to market a non-EU fund may only do so if the country of origin has signed an agreement with the relevant EU member state agreeing to an effective exchange of information on tax matters complying with the standards laid down in Article 26 of the OECD Model Tax Convention. In addition, a non-EU AIFM wishing to market within the EU must apply for authorisation by a member state, which will only be granted if the AIFM's own country has prudential regulation and ongoing supervision equivalent to those of the Directive.

The Directive would therefore impose hurdles on non-EU fund managers, triggering calls to avoid protectionism. However, if granted, the authorisation will be valid for all member states, allowing those managers to manage and market AIF within the EU either directly or via a branch without having to comply with each country's particular legislative requirements.

Operating conditions

Organisational requirements: AIFM shall only delegate activities following prior authorisation of the home member state regulator, which will look at the quality of the service provider. Delegation does not affect liability. AIFM must entrust a legally and functionally independent valuator with the valuation of the assets under management, at least yearly, as well as the valuation of shares or units. The AIFM must also make sure that each AIF has a depositary to receive payments made by investors and book them in a segregated account, safe-keep the financial instruments and verify ownership. The depositary must be independent and an authorised credit institution with its registered office in a member state.

Minimum capital requirements: AIFM should have initial capital of at least €125,000. However, when the value of the portfolio exceeds €250 million, additional own funds of 0.02% must be provided.

Risk management: AIFM must separate risk management and portfolio management, and monitor all risks associated with each AIF strategy. In particular, the AIFM must implement appropriate, documented and regularly updated due diligence, according to the investment strategy, objectives and risk profile of the AIF. Lastly, the risk profile of the AIF must correspond to the size, portfolio structure and investment strategies of the AIF as laid down in its rules or instruments of incorporation.

Reporting obligation: The AIFM must provide information on its principal instruments and the principal exposure of each AIF. At the end of each quarter, it must provide a list of the AIFs. The AIFM must also provide investors with specific procedure information, including valuation procedures and liquidity risk management. The percentage of illiquid, hard-to-value or side-pocketed assets, as well as the updated risk profile will also have to be periodically disclosed.

European passport: Once approved by its home regulator, the AIFM is free to provide management services to an AIF in any other member state. It can also market the AIF it manages in another state. However, this is only for professional investors, and retail cross-border marketing of units or shares of AIF should not be authorised by the European regulator. The passport to market non-European AIF is scheduled to enter into force only three years after the Directive.

Leveraged AIF: Particular reporting obligations apply when the combined leverage from all sources exceeds equity capital in two out of the previous four quarters. Then the AIFM must disclose to investors the maximum level of leverage of each AIF, as well as any right of re-use of collateral, guarantees under the leveraging agreement and on a quarterly basis, the actual leverage in the previous quarter. It will also have to disclose to its home authorities the leverage employed by each AIF.

Controlling influences in companies: AIFM in a position to exercise 30% or more of the voting rights of an issuer or of a non-listed company must notify the company and shareholders. This does not apply when the company employs fewer than 250 persons, has turnover less than €50 million or an annual balance sheet less than €43 million.

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