

# Luxembourg and the draft AIFM directive

By Olivier Sciales & Rémi Chevalier

On April 29, the European Commission submitted a draft Directive on Alternative Investment Fund Managers to the European Parliament and European Council in the first attempt to create a comprehensive regulatory framework for managers of non-Ucits funds in the European Union. Managers would benefit from a EU passport for cross-border distribution to professional investors.

The main innovations focus on the supervision, disclosure requirements and distribution of alternative funds. These proposals will only introduce a minimum threshold for member states, and countries such as France and Germany may well impose stricter requirements.

The directive would apply to all managers that manage and market non-Ucits funds in the EU with assets under management exceeding EUR100m, or EUR500m if the funds are not leveraged and are not redeemable for at least five years. Hedge, venture capital, infrastructure, private equity, real estate, commodity and non-EU retail funds are all concerned, irrespective of their type, legal structure or domicile.

The directive also regulates the marketing of non-EU funds and the authorisation of non-EU managers. A manager wishing to market a non-EU fund may only do so if the country of domicile has signed an agreement with the member state in which the manager is authorised agreeing to an effective exchange of information on tax matters as laid down by the OECD.

A non-EU manager wishing to market funds within the EU must apply for authorisation by a member state, which will only be granted if the manager's home country exercises prudential regulation and ongoing supervision equivalent to those laid down in the directive.

The directive would therefore impose significant hurdles on non-EU managers. However, if an authorisation is granted, it



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will be valid for all member states, allowing those managers to manage and market funds throughout the EU either directly or via a branch without having to comply with each country's particular legislative requirements.

An independent third party must value the fund assets at least yearly, as well as the shares or units. An independent depository, an EU credit institution, must be appointed to receive payments from investors, provide safekeeping for financial instruments and verify ownership of fund assets.

Managers must separate risk management from portfolio management functions, measure and monitor the risks associated with each strategy, and implement a due diligence process when investing on behalf of the fund.

The proposal introduces reporting requirements to the manager's home authorities. They must also report to investors on the valuation procedures, liquidity risk management, the existence of illiquid, hard-to-value or side-pocketed assets and each fund's risk profile.

Once authorised, the manager may provide management services to funds established elsewhere in the EU and market its funds to professional investors in other member states. The European passport to market non-European funds is scheduled to enter into force only three years after the transposition of the directive.

The directive could offer Luxembourg huge opportunities. As drafted, the distribution of offshore funds, such as those established in the Cayman Islands, may only be possible three years after the directive's ratification, which could accelerate the redomiciliation of offshore funds to Luxembourg.

The proposal will now be debated in the European Parliament. The directive has been criticised by the industry as disproportionate and discriminatory, but political agreement this year could see it become law in 2011. ■



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