Alternative Investment Fund Managers

2009/0064(COD) - 30/04/2009 - Legislative proposal

PURPOSE: to establish a secure and harmonised EU framework for monitoring and supervising the risks that Alternative Investment Fund Managers (AIFM) pose to their investors, counterparties, other financial market participants and to financial stability and to permit, subject to compliance with strict requirements, AIFM to provide services and market their funds across the internal market.

PROPOSED ACT: Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/…/EC.

BACKGROUND: around €2 trillion in assets are currently managed by AIFM employing a variety of investment techniques, investing in different asset markets and catering to different investor populations. The sector includes hedge funds and private equity, as well as real estate funds, commodity funds, infrastructure funds and other types of institutional fund.

The financial crisis has exposed a series of vulnerabilities in the global financial system. It has highlighted how risks crystallising in one sector can be transmitted rapidly around the financial system, with serious repercussions for all financial market participants and for the stability of the underlying markets.

This proposal forms part of an ambitious Commission programme to extend appropriate regulation and oversight to all actors and activities that embed significant risks. The proposed legislation will introduce harmonised requirements for entities engaged in the management and administration of alternative investment funds (AIFM). The need for closer regulatory engagement with this sector has been highlighted by the European Parliament and by the High-Level Group on Financial Supervision chaired by Jacques de Larosière. It is also the subject of ongoing discussion at international level, for example through the work of the G20.

It is in recognition of these weaknesses and inefficiencies in the existing regulatory framework that the European Commission has committed to bring forward a proposal for a comprehensive legislative instrument establishing regulatory and supervisory standards for hedge funds, private equity and other systemically important market players.

IMPACT ASSESSMENT: the impact assessment covers five policy options:

Option 1: Do nothing;

Option 2: Self-regulation by AIFM industry;

Option 3: Member State action;

Option 4: EU-level action;

Option 5: International-level action.

The Commission concludes that, in comparison with industry and national action, EUlevel action has clear advantages, both in terms of effective risk monitoring and control and in providing a secure framework for pan-European AIF distribution. There is a risk that such an approach would not take adequate account of

the international dimension. However, international-level agreements would take considerable time to conclude and would likely be limited to broad principles. **EU-level action is therefore the preferred option**.

CONTENT: this proposal focuses on those activities that are specific or inherent to the AIFM sector and hence need to be addressed by targeted requirements. A number of the concerns that are commonly expressed about the activities of AIFM are linked to behaviours (e.g., short-selling, use of stock borrowing or other instruments to build a stake in company) which are not unique to this category of financial market participant. To be fully effective and coherent, these concerns must be addressed by comprehensive measures which apply to all market participants who engage in the relevant activities. This proposal is therefore designed to address matters that call for provisions specific to AIFM and their business.

Scope and definitions: in order to ensure that all AIFM operating in the European Union are subject to effective supervision and oversight, the proposed Directive introduces a legally binding authorisation and supervisory regime for all AIFM managing AIF in the European Union. The regime will apply irrespective of the legal domicile of the AIF managed.

Operating conditions and initial authorisation: to operate in the European Union, all AIFM will be required to obtain authorisation from the competent authority of their home Member State. All AIFM operating on European soil will be required to demonstrate that they are suitably qualified to provide AIF management services and will be required to provide detailed information on the planned activity of the AIFM, the identity and characteristics of the AIF managed, the governance of the AIFM, arrangements for the valuation and safe-keeping of assets and the systems of regulatory reporting, where required. The AIFM will also be required to hold and retain a minimum level of capital.

Treatment of investors: the proposed Directive requires AIFM to provide to their investors a clear description of the investment policy, including descriptions of the type of assets and the use of leverage; redemption policy in normal and exceptional circumstances; valuation, custody, administration and risk management procedures; and fees, charges and expenses associated with the investment.

Disclosure to regulators: to support the effective macro-prudential oversight of AIFM activities, the AIFM will also be required to report to the competent authority on a regular basis on the principal markets and instruments in which it trades, its principal exposures, performance data and concentrations of risk.

Specific requirements for AIFM managing leveraged AIF: the proposal: (i) empowers the Commission to set leverage limits through comitology procedures where this is required to ensure the stability and integrity of the financial system; (ii) grants additional emergency powers to the national authorities to restrict the use of leverage in respect of individual managers and funds in exceptional circumstances; (iii) foresees that AIFM employing leverage on a systematic basis above a defined threshold will be required to disclose aggregate leverage in all forms, and the main sources of leverage to the home authority of the AIFM.

Specific requirements for AIFM acquiring controlling stakes in companies: the proposal: (i) provides for disclosures of information to other shareholders and the representatives of employees of the portfolio company in which the AIFM acquired a controlling interest; (ii) foresees that the AIFM issues annual disclosure on the investment strategy and objectives of its fund when acquiring control of companies, and general disclosures about the performance of the portfolio company following acquisition of control.

Rights of AIFM under the Directive: in order to facilitate the development of the single market, an AIFM authorised in its home Member State will be entitled to market its funds to professional investors on the territory of any Member State. Member States will not be permitted to impose additional requirements on AIFM domiciled in another Member State insofar as marketing to professional investors is concerned.

Third country aspects: the proposed Directive permits AIFM to market AIF located in third country domiciles subject to strict controls on the performance of key functions by service providers in those jurisdictions. The rights granted under the Directive to market such AIF to professional investors will only become effective three years after the transposition period.

Supervisory cooperation information sharing and mediation: In order to ensure the secure functioning of the AIFM sector, competent authorities of the Member States will be required to cooperate whenever necessary so as to achieve the aims of the Directive. Given the cross-border nature of risks arising in the AIFM sector, a prerequisite for effective macro-prudential oversight will be the timely sharing of relevant macroprudential data at the European, or even global, level.

BUDGETARY IMPLICATION: the proposal has no implications for the Community budget.