

Proposed Directive on Alternative Investment Fund Managers

(KPMG organised a conference on 15 June 2009 on the proposal. Comments on the Directive by the panelists are included in italics.)

As part of its response to the financial crisis, the European Commission has proposed on 29 April 2009, a Directive on Alternative Investment Fund Managers (“AIFM”) with the aim to create a comprehensive and effective supervisory and regulatory framework for AIFM in the European Union (“EU”).

«The industry welcomes the idea of an EU-wide regulatory framework for AIFM and the follow up of the systemic risk »

Scope of the Directive

The proposed Directive applies to all managers that manage and market non-UCITS funds in the EU, unless their assets under management do not exceed EUR 100 million or EUR 500 million when the Alternative Investment Funds (“AIF”) managed are not leveraged and have no redemption rights exercisable during a period of 5 years following the date of constitution of the AIF.

“The possibility to manage and market funds across the 27 European countries is the reward for compliance with enhanced transparency, reporting and organisation.”

The managers in scope must request an authorization from their Supervisory Authority in relation to the management of AIF. This authorization will be valid

for all Member States, giving the possibility to those managers to manage and market AIF within the EU either directly or via a branch.

The marketing of each AIF to professional investors (as defined in Annex II of MIFID) in the AIFM Home Member State is subject to submission of a notification to the Supervisory Authority that will grant authorisation within 10 working days.

The marketing of an AIF to professional investors in another Member State is only subject to notification to the Home Member State that will transmit the complete file to the Host Member State authorities. The AIF may be marketed in the Host Member State as from the date of the notification to the Host Member State.

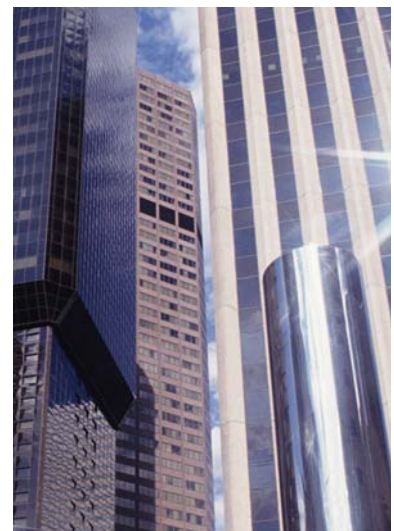
“It is not the right time to create a single market for the distribution of AIF to retail investors.”

The proposed Directive intends to restrict the marketing of Alternative products to professional investors as it considers that these products entail a relatively high level of risk and have features that render them unsuitable for retail investors. However, some products covered by the Directive such as funds of hedge funds and real estate funds are currently accessible to retail investors in some Member States. The

proposed Directive recognises this and gives the possibility to Member States to allow the marketing of AIF to retail investors in their territory and to apply additional regulatory safeguards for this purpose, meaning that there is no cross border management company passport for AIF for retail investors.

Requirements concerning conduct of business

In general, the AIFM must act fairly, honestly, with due skill, care and diligence. It must also act in the best interests of the AIF managed, the investors of those AIF and the integrity of the market.



AIFM must also take all reasonable steps to identify conflicts of interests and maintain and operate effective organizational and administrative arrangements to manage those conflicts of interest. In that respect, AIFM are required to segregate tasks and responsibilities which may be regarded as incompatible with each other.

The Directive further requires AIFM to implement an independent risk management function and risk management systems in order to measure and monitor appropriately all risks to which the AIF is exposed. When engaging in short selling the AIFM must operate procedures which ensure that he will be able to deliver the securities and that the risks associated with the delivery of short sold securities are captured in the risk management system.

In addition the AIFM must employ an appropriate liquidity management system and ensure that the liquidity profile of the AIF complies with its underlying obligations, i.e. the redemption policy.

Capital requirements

The AIFM must have own funds of EUR 125 000. Where the value of the portfolios managed (AIF managed directly or by delegation) exceeds EUR 250 million, additional own funds of 0.02% of the amount in excess of EUR 250 million must be provided.

Organisational requirements

The AIFM shall have the necessary and appropriate resources to perform their management activities. They shall have updated systems and documented internal control procedures.

Delegation of the activities of the AIFM is permitted under certain conditions: prior authorization of the regulator, quality of the service provider, delegation of portfolio management only to authorized AIFM. No delegation is permitted to the depositary or to the valuator. Delegation does not affect the liability of the AIFM.

The AIFM must ensure that for each AIF it manages, a valuator is appointed to establish the value of the assets acquired by the AIF and the value the shares/units of the AIF. The valuator must be independent from the AIFM. The AIFM must ensure that the valuator has appropriate and consistent procedures to value the assets in



accordance with applicable valuation standards and rules.

«The requirements regarding the independent valuator and the depositary bank may significantly increase the costs. The industry claims for a more tailored approach.»

The AIFM must ensure that for each AIF it manages, a depositary is appointed to receive payments made by investors and book them on behalf of the AIFM in a segregated account, safe-keep the financial instruments of the AIF and verify ownership over all the assets of the AIF. The AIFM shall not act as the depositary. The depositary shall be a credit institution with registered office in the EU. The depositary shall be liable to the AIFM and the investors of the AIF for losses suffered as a result of its failure to perform its obligations. To the contrary of the current requirements for UCITS, the onus of the proof lies with the depositary. Depositaries may delegate their tasks to other depositaries but remain fully responsible.

Reporting obligations

To support the oversight of the AIFM activities, the proposal introduces regular reporting requirements towards the authorities of their Home Member State.

The AIFM shall provide aggregate information on the principal instruments in which it trades, markets of which it is a member or where it actively trades and on the principal exposures and most important concentrations of each of the AIF it manages. At the end of each quarter, the AIFM shall provide a list of the AIF it manages.

For each AIF it manages the AIFM will report on the liquidity management, the risk profile and the risk monitoring, the asset categories and the short selling activities. The AIFM shall also submit an annual report within four months after the year-end of the AIF.

«The proposed Directive is not a 'one size fits all' approach and there are also certainly more fine tuning required.»

Specific obligations for AIFM managing leveraged AIF

Specific reporting obligations apply to AIF where the combined leverage from all sources exceeds the value of the equity capital in two out of the previous four quarters.

In respect of each AIF, the AIFM will disclose to investors the maximum level of leverage that he may employ, any right of re-use of collateral, guarantees granted under the leveraging agreement and on a quarterly basis, the actual amount of leverage in the previous quarter.

The AIFM will also disclose to the competent authorities of its home Member State the overall level of leverage employed by each AIF it manages with a breakdown between leverage from borrowing of cash or securities and leverage embedded in financial derivatives. The identity of the five largest sources of borrowed cash or securities must be disclosed with the level of leverage created by each.

Specific obligations for AIFM managing AIF which acquire controlling influence in companies

Specific reporting obligations apply to AIFM managing one or more AIF which either individually or in aggregation acquire 30% or more of the voting rights of an issuer or of a non-listed company domiciled in the EU except if such issuer or non-listed entity may be classified as a small and medium enterprise (employs fewer than 250 persons, turnover does not exceed EUR 50 million and/or total balance sheet does not exceed EUR 43 million).

No later than four trading days from the day the AIFM is in the position to exercise 30% or more of the voting rights of a non-listed company, the AIFM must notify



non-listed companies of this situation.

The proposed Directive also provides for differing disclosure requirements depending whether the AIFM has acquired controlling interest in an issuer or in a non-listed company.

Where an AIFM acquires 30% or more of the voting rights of an issuer the following information must be provided to the issuer, its shareholders and its employees:

- Information required in Article 6(3) of Directive 2004/25/EC on takeover bids i.e. details on the conditions of the transaction, the parties involved, the intention as regards the future of the business;
- The policy for preventing and managing conflicts of interests, in particular between the AIFM and the issuer;
- The policy for external and internal communication of the issuer, in particular as regards the employees.

Where an AIFM acquires 30% or more of the voting rights of a non-listed company, the following information must be provided to the non-listed company, its shareholders and its employees:

- Its identity;
- The development plan for the non-listed company;
- The policy for preventing and managing conflicts of interests, in particular between the AIFM and the company;
- The policy for external and internal communication of the non-listed company, in particular as regards the employees.

The proposed Directive further requires additional disclosures in the annual reports of the AIF in relation to each issuer and non-listed company:

- Details on the future operational and financial developments of the company;
- The financial risks associated with the capital structure;
- Information regarding employee matters such as turnover, terminations of contracts and recruitment;
- Statement on significant divestment of assets;



- Information required under point (f) of Article 46a(1) of Fourth Council Directive 78/660/EEC i.e. the composition and operation of the administrative, management and supervisory bodies and their committees (specific to issuers);

- Overview of the capital structure (specific to issuers);
- Overview of management arrangements (specific to non-listed companies);
- Information required under point (b), (c) and (e) to (h) of Article 3 of Second Council Directive 77/91/EEC i.e. information on the nominal value, type and class of the shares subscribed, the amount of the paid up subscribed capital.

Rules in relation to third countries (effective only 3 years after the transposition period)

« One should not prevent access in the EU to both AIFM and AIF but should make sure that the level of supervision of third countries become more and more equivalent to the one applicable within the EU »

Marketing of third country AIF

An AIFM may only market shares of an AIF domiciled in a third country to professional investors in a Member State if such third country has signed an agreement with this Member State which complies with the standards laid down in Article 26 of the OECD Model Tax Convention and ensures an effective exchange of information in tax matters.

Delegation of tasks

The AIFM may delegate administrative tasks to an entity established in a third country provided that the entity is authorised and subject to prudential supervision in the country of establishment and there is an appropriate cooperation agreement between the two countries.

Appointment of third country valuator

A valuator established in a third country may be appointed provided that the third country has equivalent valuation standards and rules to those applicable in the EU.

Depositary for third country AIF

In respect of AIF domiciled in third countries, Member States shall allow the depositary to delegate the performance of one or more functions to a sub-depositary in the domicile of the AIF provided that:

- The legislation of the third country is equivalent to the provisions of the AIFM Directive.
- A decision confirms that sub-depositaries in this country are subject to effective prudential regulation and supervision equivalent to the provisions laid down in Community law.
- Cooperation between the Member State and the third country is sufficiently ensured.

AIFM established in third countries

Member States may authorise AIFM established in third countries to market AIF to professional investors in the EU provided that:

- The legislation of the third country regarding prudential regulation and ongoing supervision is equivalent to the provisions of the AIFM Directive.
- The third country grants EU AIFM effective market access comparable to that granted by the EU to such AIFM.
- A cooperation agreement between the two countries ensures an efficient exchange of information on matters relevant for the monitoring the potential implications of the activities of the AIFM for the stability of systematically relevant financial institutions and the orderly functioning of the markets in which the AIFM is active.

- Such third country has signed an agreement with this Member State which complies with the standards laid down in Article 26 of the OECD Model Tax Convention and ensures an effective exchange of information in tax matter.

« The requirement to sign up to tax transparency is a good objective but it should be part of a separate initiative. »

The above provisions will only apply three years after the final date for transposition of the Directive. The rights granted under the proposed Directive to market third country AIF to professional investors will therefore only become effective three years after the transposition period. In the meantime, Member States may allow or continue to allow AIFM to market third country AIF to professional investors on their territory subject to national law.

**Timeline**

«In the coming months, there will be an ongoing thinking and dialogue to make the implementation of this text workable and well balanced »

The proposal was deposited with the European Parliament where it is expected to be the object of intense political discussions and negotiations. If political approval is reached by the end of 2009, the Directive could come into force in 2011 and the provisions regarding the treatment of third countries will become applicable in 2014.

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