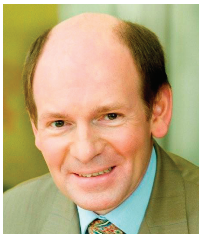
Alternative Investment Fund Managers Directive – another regulatory overkill?



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The financial and economic crisis which has peaked for the time being in the collapse of Lehmann Brothers in the fall of 2008, has led to numerous cries, mostly by politicians within the European Union, to subject the sector of international finance to a stricter regulatory scheme.

The area of finance where stricter regulations were considered necessary to replace the laissez-faire is the management of Alternative Investment Funds (AIF). Thus, two years ago a first draft of an Alternative Investment Fund Managers Directive (AIFM Directive) was presented to the Commission of the European Union. Having received approval from the European Parliament at the end of last year, the draft was approved by the Economic and Financial Affairs Council of the European Commission in June 2011.

Therefore, the member states of the European Union will have to transpose the AIFM Directive into national law within the next two years. This means that one has to be prepared for national regulation, in compliance with the AIFM Directive, by July 2013.

The content of the AIFM Directive shall be briefly summarized in the following:

- The AIFM Directive does not address Alternative Investment Funds as such but their management (Alternative Investment Fund Managers – AIFM), be it a natural person or a legal entity. An AIFM must henceforth obtain a concession for the management of such funds and the sale of participations in such funds from the national financial markets supervisory authority, which in Austria is the *Finanzmarktaufsicht* (FMA). It must be counted as an advantage that a concession, obtained in one member state of the European Union, entitles to conduct the same business activities in all other member states (the so called Passport Regulation).

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- The AIFM Directive applies to all AIFM with an official seat in the European Union which provide services to one or more Alternative Investment Funds. This applies irrespective of whether the AIF has its seat within the European Union, if the services are performed directly or through a third party, whether the AIF is an open-ended or close-ended fund and which structure the AIF and the AIFM have. This means that the management of funds which so far were not subject to regulatory oversight, like close-ended funds, will in future be supervised. This includes funds which have been regulated in Austria and in other member states by specific laws; for example the Austrian Investment Fund Act or the Austrian Real Estate Investment Fund Act, subjecting them to double the amount of regulations in future.

- Exempt from the AIFM Directive are funds which fall under the Directive governing Undertakings for Collective Investment in Transferable Securities (UCITS). Interestingly enough the AIFM also does not cover national, regional and local governments and bodies or other institutions which manage funds supporting social security and pension systems. Small AIFM on the other hand will be subject to less regulatory requirements according to the AIFM Directive.

- In order to be allowed to manage an AIF, one will have to fulfil certain qualifications. The AIFM Directive poses requirements with regard to the minimum capital, the reputation and experience of the directors, proof of appropriate risk and liquidity management, proof of adequate and legal prevention methods and the arrangement with a depositary bank.

- Special rules apply to Private Equity Funds which are the core of the AIFM Directive. They are subject to special transparency regulations and reporting requirements. The reasoning behind this is that companies where Private Equity Funds hold a share shall be protected from so called "asset stripping". Hence there is a duty to notify the authorities once the voting rights in a company, where a private Equity Fund holds participations, reaches or sinks below a certain threshold.

- Inspired by the political discussion regarding the remuneration of bankers, in particular their bonuses, the AIFM Directive contains regulations with regard to the remuneration of management and employees. For instance 40% of the to be paid bonuses have to be deferred between three and five years until it is clear whether a bonus would really be justified.

- The new European agency for the supervision of the financial markets, the European Securities and Markets Authority (ESMA) in Paris, has received special powers under the AIFM Directive, including the power to pass additional regulations with regard to the AIFM Directive.

Two years have passed since the idea of passing such a directive first came up. Now it seems clear that the real problem for the financial markets are the household debts of the public. It must therefore be doubted, or at least questioned, whether the real aim of the directive, to stabilize the financial markets, will be achieved. Any activities by private equity funds have nothing to do with the extreme budget deficits in almost all western countries. It must be feared that the directive will only lead to an increase in cost and more bureaucracy for the financial industry, which will in the end disadvantage European financial markets in competition for new investments. ■

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