

Asset Management

AIFMD News

Time for a second reading?

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But the most serious exclusion is that of women. In the 1990s, the number of illiterate women in the world increased from 300 million to 400 million. In many countries, women are still excluded from education, health care, and employment opportunities.

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Introduction

On 26 February 2010 by means of a 'State of play' document, the Spanish Presidency handed over the Alternative Investment Fund Manager (AIFM) dossier to COREPER (the Committee of Permanent Representatives of the EU) to thrash out a final compromise on the three remaining most contentious issues, in preparation for approval of the Council's 'general approach' by the EcoFIN Council on 16 March. This 'general approach' would have formed the basis on which the Council would then be negotiated with its co-legislator, the European Parliament. As we know, however, at the last minute the issue was dropped from the EcoFIN agenda on 16 March. Despite some reports to the contrary, the Spanish Presidency has indicated that it still wants to push for a resolution before the end of its term at the end of June, so this may not provide a hiatus in the debate in the Council working group.

So where did the debate in the Council working group stall? And how does this compare with the position in the European Parliament? The lead rapporteur, Jean-Paul Gauzès, has indicated that Parliamentary timetable will not be disrupted by the most recent developments. However, the unprecedented 1670 amendments tabled in the European Parliament suggest that the M. Gauzès has his work cut out to find a common path in Parliament. That said, many of the Parliamentary amendments already show strong convergence and pragmatism in terms of MEPs' views in key areas, and M. Gauzès' optimism in terms of finding a compromise may be well-founded.

There was considerable concern, particularly in the UK, about the direction that the Council had taken on the dossier prior to the EcoFIN meeting. In its 26 February 'state of play' document, the Spanish Presidency identified the following as key issues where consensus had not been reached in the Council working group:

- Scope/optional exemptions
- Depositories
- Third country issues.

In addition, it mentioned ongoing concerns in relation to remuneration, valuation and supervisory reporting.

Scope/optional exemptions

In its compromise position of 15 February 2010, the Spanish Presidency introduced an optional exemption whereby Member States could choose to exempt AIFM managing assets within the thresholds established by the Commission, in whole or part, on condition that they were registered and adhered to certain minimal reporting requirements. Exempted AIFM would not benefit from a European passport. The Presidency position, however, retained the initial Commission view that exempted AIFM should nonetheless be allowed to 'opt-in' to the regime in order to obtain a European passport, reflecting an approach taken in the Markets in Financial Instruments Directive (MiFD). Some Member States still firmly believe, however, that the Directive should apply to all AIFM (i.e. there should be no thresholds).

In Parliament, M. Gauzès' initial proposal was also to remove the Commission's *de minimis* thresholds and to rely on a realistic application of the proportionality principle in order not to overburden smaller AIFM. In their amendments, a number of MEPs from all parties supported the removal of the thresholds but for different reasons. Some emphasised the need to focus on systemically important firms and not overburdening smaller AIFMs; while others wanted to

ensure that all AIFM are caught by the Directive, thus removing any possibility for regulatory arbitrage by firms operating below the threshold levels. In terms of those MEPs who supported the retention of thresholds, the majority favoured increasing them to a greater or lesser extent. In the second exchange of views in the ECON Committee on 17 March, M. Gauzès indicated that he intends to retain an approach whereby all non-UCITS funds are covered by the directive but, in line with the proportionality principle, will introduce easing mechanisms based on the characteristics of different fund types, singling out private equity funds as a case in point. He is now suggesting retaining certain thresholds but only as one means of identifying certain funds to which a lighter regime might be applied.

Clearly, Parliament does not support the Spanish optional exemption based on volume of assets under management, as this would leave the way open to inconsistencies at the national level (and would be contrary to the drive towards legislative and supervisory convergence in the European Union).

M. Gauzès is clearly determined to introduce a proportional regulatory system for alternative investment funds. Although the proportionality principle applies to all EU financial

services legislation, there has been no comprehensive attempt, previously, to translate this principle into Level 1 legislation. The difficulties of adopting a proportionate regime surfaced during the Solvency II debate with the result that a *de minimus* threshold was retained.

In terms of other exemptions, MEPs generally support the exemptions identified by the Council working group. Other possible exemptions which appear frequently in the amendments include:

- Actively managed investments in the form of securities, such as certificates, managed futures, or index-linked bonds
- Closed-ended collective investment undertakings listed on a regulated market which are subject to regulation under the Listing, Prospectus, and Transparency Directives
- Holding companies which hold shares in their subsidiaries, given that such holding companies are not established for the main purpose of generating returns for their investors by means of, in particular, the divestment of their subsidiaries within a set timeframe, but which are aimed at carrying out a business strategy through their subsidiaries.

Depositaries

According to the ‘State of Play’ document, the debate in Council focussed on three key issues: the types of institution that can act as a depositary, the imposition on depositaries of high standards of liability toward investors (and the related issue of the possibility of discharging liability when delegating depositary tasks), and the requirement that a depositary is appointed in the home Member State of the AIFM.

The majority of Member States support allowing entities other than just EU credit institutions to act as depositaries, and also the possibility for depositaries to discharge their liability in certain well-defined situations. A significant minority of delegations are opposed to the concept of imposition of higher standards of liability: many are of the view that the UCITS standard should be applied and that there is no need for a higher one. The delegations of some Member States, where the alternative investment markets are not yet well-developed, would like to be able to use depositaries in other Member States and the Presidency has proposed a four-year transition period where this would be permitted. However, there are concerns about the implications of this approach, and the length of the proposed transition period, for prudential supervision.

Reflecting the Council position, MEPs

in their amendments generally support both authorised credit institutions and investment firms being able to operate as depositaries. Some MEPs also strongly support extending this possibility to other authorised/supervised entities (such as central securities depositaries) in order to reduce concentration and the associated systemic risks. This would include any organisation authorised to provide such services at a national level, subject to prudential regulation and ongoing supervision, as well as the provision of appropriate financial and professional guarantees.

MEPs have recognised that it is not always necessary, depending on the nature of the fund, to appoint a depositary (for example, in relation to private equity funds) but stress the independence of depositary functions from the AIFM. Many have paid significant attention to clarifying the tasks of depositaries in order to ensure the possibility of delegating certain depositary tasks (generally to other depositaries) while retaining oversight responsibilities. Depositaries would remain fully liable when there is ‘unjustifiable failure’ (a concept which is not defined) but could be discharged of liability in cases of ‘force majeure’ or in the case of an appropriate contract under national law (the existence of which would be disclosed in advance to investors).

That said, MEPs would generally like to place the onus on the depositary for thorough due diligence prior to the appointment of third parties, and a default position of the depositary remaining responsible for any losses caused by the third party. A number of MEPs advocate the possibility for an AIFM to appoint a depositary in another Member State.

For non-EU AIF managed by EU AIFM, MEPs largely support M. Gauzès’ view that the depositary should be domiciled in the European Union, unless the third country concerned has signed cooperation and information exchange agreements and an agreement in relation to Article 26 of the OECD Model Tax Convention with the EU Member State concerned, meets certain international standards, and is has a prudential supervision regime equivalent to the EU.

Third country issues

Based on comments by Dan Waters of the FSA, this was the most contentious debate in Council. According to Mr Waters, the Spanish Presidency has put forward “a proposal that imposes burdensome, detailed requirements on funds that have no passport” which “will be seen as an attempt to protect European funds from competition from legitimate funds outside the EU”. Inter alia, this proposal would put “the Commission in the remarkable position of attempting to dictate to non-European regulators the terms of information-sharing arrangements they must enter into with European Member States”. Mr Waters believes that “in the fragile international economic environment in which we find ourselves, post one of the greatest financial crises in modern history, introducing these damaging constraints on international investment flows is surely the opposite of a sensible policy”.

Many of the amendments proposed in Parliament supported this view. Broadly speaking, a significant number of MEPs support permitting the marketing of non-EU funds to professional investors within the EU through national private placement regimes, provided there are suitable supervisory cooperation and information exchange regimes in place, along the lines advocated by IOSCO, and/or third country adherence to Article 26 of the OECD Model Tax Convention. This applied

both to non-EU funds managed by EU AIFM and non-EU AIFM.

Indeed, M. Gauzès has determined that the approach he will support going forward is similar to that proposed by the Commission in that there should be a transition period (he suggested five years) whereby 3rd country AIFM and AIF could market, or be marketed, in the EU under national private placement regimes, following which only an EU passport would be available based on clearly defined equivalence criteria. In order to ensure that the equivalence determination is a process with both teeth and consistency, MEPs suggested that the European Securities and Markets Authority (ESMA) should be required to support the Commission in this regard.

All over bar the shouting?

A delay in Council, with the AIFM Directive being dropped from the agenda of the EcoFIN Council on 16 March, does not mean that the whole process is stalled. The Spanish Presidency has indicated that it intends to continue the debate during the remainder of its term.

However, the focus of the debate will now shift to the European Parliament. The rapporteur, M. Gauzès, and other MEPs during the exchange of views on 17 March stressed that this was an opportunity for the Parliament to influence the direction of the debate positively and that their schedule should not be delayed. A vote in the Economic and Monetary Affairs Committee in April will therefore remain on track. Subsequent discussions with the Council may lead to some modifications in the ECON position prior to the vote in plenary: currently still scheduled in June or July this year.

However, looking at the divergences in Council and particularly the ongoing concerns in the UK, it appears increasingly unlikely that agreement will not be reached by the co-legislators before the summer. The ambitious, though laudable, intention of the ECON rapporteur to embed the proportionality principle into the Level 1 legislation introduces additional complexities to the debate which may be difficult to resolve, given the Council's current position on the issue.

Dan Waters wound up his comments on 25 February by saying *"We urge the Council, the Commission and the Parliament not to act in haste on these complex matters. Thoughtful and proportionate resolution of these issues is necessary to deliver a regulatory framework that enhances the stability of the financial system while encouraging sustainable economic growth and development across the EU"*.

Given the complexities of the debate, and the risk of views becoming entrenched, additional breathing space might be a good idea. It may now be time to reconsider the objective of adopting this Directive in one reading. A second reading would permit more careful deliberation to ensure that the many diverse views expressed by the Council, Parliament and the Commission are fully taken into consideration. A second reading would only add a few months onto the overall timetable but may ensure that the legislation that results is really fit for purpose.

If you would like to discuss any of the areas covered in this paper as well as the implications for your business, please speak with your local PricewaterhouseCoopers contact or one of our AIFMD specialists listed below:

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