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AIFM Directive update:
Two steps forward, one step back...

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In May this year, both the European Parliament and the Council of the European Union voted to approve their respective draft texts for the Alternative Investment Fund Managers (AIFM) Directive. The good news is that this represents a significant milestone along the winding road towards a finalised Directive, which would mark the end of a period of significant regulatory uncertainty for the Alternative Investment Fund industry. The bad news is that the Parliament and Council texts contain substantial differences – and that a number of concerns held by the Private Equity, Hedge, Property and Venture Capital industries remain unresolved.

So what have the European Parliament and Council voted to approve? How do the two texts differ in their treatment of Private Equity and Property Funds? And what happens next in the European regulatory approval process?

Progress so far

The two different AIFM Directive texts were developed and approved by the European Parliament's Economic and Monetary Affairs Committee (ECON) and the European Economic and Financial Affairs Council (ECOFIN) on 17 and 18 May 2010 respectively. In some areas, the two texts share common ground. For example, both drafts prescribe the same approach to the application procedure for an Alternative Investment Fund (AIF) to receive authorisation for operating in the European Union. There is also a consensus with regards to the business conduct of AIFs, which covers areas such as the management of risks and conflicts of interest, and the fair treatment of all investors.

However, the texts approved by ECON and ECOFIN have significantly different approaches to a number of other key areas covered by the AIFM Directive:

The first area of contention is the Directive's treatment of AIF Managers based outside the EU. Under the draft text approved by the European Parliament, non-EU AIF Managers would be permitted to market funds to professional investors within the EU and provide fund management services inside the EU on a level playing field with EU AIF Managers. According to this draft, non-EU AIF Managers would need to comprehensively adhere to the AIFM Directive voluntarily, supervised by their home country's regulator (provided that the home country regulator has a cooperation agreement in place with the regulator in each EU Member State in which the AIF is marketed). At the same time, non-EU AIF Managers would indirectly fall under the supervision of a new EU financial services regulator. In this way, the Parliament's draft text offers a mechanism for non-EU AIF Managers to obtain a 'passport' for marketing Funds to professional investors across the EU.

In contrast, the Council's draft text permits EU Member States to retain private placement regimes covering AIF Managers from outside the EU. Under this version of the draft text, non-EU Fund Managers would be covered by national rules in this way, so long as the AIF Managers in question followed the AIFM Directive's transparency and disclosure rules.

'Asset stripping' is the second contentious area in which the two new approved draft

texts differ. In particular, the Parliament's draft contains new proposals regarding leverage limits on every Fund, to be monitored and enforced by a Fund's regulator. The Parliament's text also prescribes new restrictions on the use of portfolio company assets to finance an acquisition. These measures, which Socialist members of the European Parliament argue are designed to safeguard the longevity of companies on behalf of their employees, did not appear in the original draft text of the Directive published in 2009.

The Parliament and Council texts also diverge in their approach to disclosure. For example, the Parliament text's disclosure requirements would cover all portfolio companies with 50 or more members of staff and a Private Equity/Venture Capital shareholding of 10% or higher. In some instances the reporting requirements are more rigorous than the requirements for a listed company.

In contrast, the Council text's disclosure requirements would only cover portfolio companies with 250 or more members of staff, and only those that are majority owned by Private Equity/Venture Capital investors.

Criteria for exemptions to the AIFM Directive represent a further area in which the Parliament and Council texts part ways. Under the draft approved by Parliament, all AIF Managers would fall under the remit of the AIFM Directive, but Managers of certain types of Fund would be exempted from certain provisions of the Directive.

continued overleaf



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For example, a Manager of a 'real estate' AIF – a Fund focused on real estate or real estate-related assets – would enjoy partial exemptions to the Directive. Partial exemptions would also be granted to Private Equity AIF Managers, including exemptions to depositary requirements and compulsory periodic valuation requirements.

In contrast, under the draft text approved by the Council, AIF Managers with Assets Under Management (AUM) that fall below specific thresholds would be exempt from the Directive (though such exemptions would be at the discretion of EU Member States). For instance, Private Equity Fund Managers would be exempted if their AUM was less than €500 million, so long as their Fund was not leveraged and did not feature redemption rights during the first five years (among other criteria), while Hedge Fund Managers would be exempt if their AUM was below €100 million.

Lingering concerns

The conflicting proposals under the two draft AIFM Directive texts present a number of concerns for the members of the Alternative Investment Fund Management industry across Europe and beyond. Specific issues include:

- *Treatment of AIF Managers from outside the EU.* The European Venture Capital Association (EVCA) favours the pan-European approach to treatment of non-EU AIFs and their Managers as prescribed by both the original draft of the Directive and the draft text approved by the European Parliament, rather than the national

approach prescribed under the Council's text. The EVCA argues that a pan-European approach, and a 'level playing field' for all AIF Managers both inside and outside the EU, are important factors in ensuring the future prosperity of both the investment industry and the companies that it supports.

- *Portfolio company disclosure.* The EVCA is also particularly concerned about the low threshold for portfolio company disclosure prescribed under the Parliament's draft text (companies with 50 or more members of staff and a 10% or higher Private Equity/Venture Capital shareholding). The industry body argues that the Council text's higher thresholds for portfolio company disclosure are significantly favourable, though still too low. In addition, the AIF industry is also concerned that the disclosure requirements under the Parliament's draft text are too detailed, covering profits on the sale of a company and management team remuneration packages, for example.

The final Directive is likely to be approved in late July or early Autumn 2010

- *'Asset stripping' measures.* Members of the AIF industry, including the EVCA, are also concerned about the measures within the Parliament's approved text that call for the setting of leverage limits for Funds. Only Leveraged Funds should be obliged to adhere to leverage limits, the EVCA argues.

Next steps

Now that both the European Parliament and the Council of the European Union have voted to approve their respective draft texts for the AIFM, the next stage is final 'trilogue' negotiations between the European Parliament, the European Commission and the Council of the European Union. These negotiations are designed to resolve differences between the Council and Parliament texts in order to create a final agreed Directive. It is hoped that the European Parliament will be able to vote on the finalised text in July 2010.

MORE INFO

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