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*“... The definition of an alternative investment fund is a wide one...”*

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## DRAFT EU DIRECTIVE ON ALTERNATIVE INVESTMENT FUND MANAGERS

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### Overview

**On 30 April the European Commission published a draft directive on Alternative Investment Fund Managers (“AIFMs”). This note sets out details of the current proposals and the main areas of contention.**

### Background

Whilst the recent financial crisis is not specifically the reason for the current proposals, market participants would be forgiven for concluding that it was, based on a reading of the explanatory memorandum that accompanies the draft directive and on the timing. Rather, the proposals form part of a Commission programme to “extend appropriate regulation and oversight to all actors and activities that embed significant risk”.

### The central proposal

The central proposal, which seems reasonable enough, is that managers of alternative investment funds must be authorised. However, this broad requirement is subject to a size threshold; the directive does not apply to managers whose assets under management do not exceed 100 million Euros, or 500 million Euros in the case of funds that are not leveraged and where the minimum investment time horizon is five years. Managers of AIFs that do not meet these size requirements will have the ability to opt in to the directive if they so wish.

Whilst the requirement for authorisation is not new for UK based asset managers this is not necessarily the case across the EU and the directive will therefore have the beneficial effect of levelling the playing field as far as UK based managers are concerned. Those likely to be hardest hit are those European managers that will require authorisation for the first time.

The definition of an alternative investment fund is a wide one being “any collective investment undertaking ...whose object is the collective investment in assets and which does not require authorisation pursuant to the [UCITS Directive]”. Potentially caught are hedge funds, private equity funds, real estate funds, commodity funds, infrastructure funds and other types of institutional fund. Specifically the directive will not apply to the management of pension funds or managers of non-pooled investments such as endowments, sovereign wealth funds or assets held on own account by credit institutions or insurance undertakings.

### Marketing

The proposed directive makes real progress on the knotty issue of pan European marketing of non-UCITS funds. The current position is that managers of AIFs wishing to market their funds across Europe face the prospect of investigating local requirements in

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each member state in which the funds are to be marketed and complying with local requirements on a state by state basis. AIFMs authorised under the directive will be entitled to market shares or units in the AIFs that they manage to professional investors (MiFID definition) throughout the EU. It seems likely that the marketing benefits will be the main drivers for firms wishing to opt in to the directive.

The proposed directive permits AIFMs to market AIFs located in third countries subject to strict controls on the performance of key functions by service providers in those jurisdictions. However, because of the time needed to provide for additional requirements in implementing measures these rights will only become effective three years after the directive takes effect.

### **Contentious issues**

The current proposals are unsatisfactory in a number of areas and one hopes that between now and implementation progress can be made in making them more palatable. In particular:

- the requirement for independent asset valuations and custodians is likely to lead to increased costs for some funds and may undermine the combined operator / manager role which is common in relation to UK domiciled funds;
- the current proposals relating to delegation are unsatisfactory in their present form as they would appear to prohibit the established practice of the provision of advice by a UK regulated firm to an offshore asset manager which has a direct relationship with the fund concerned;
- the draft directive's proposals relating to disclosure of leverage to investors and regulators are in many ways sensible but arguably go too far in terms of detail, which would be better left to local regulators;
- the proposals relating to the acquisition of a controlling interest in listed or unlisted vehicles will impose additional requirements on private equity firms but, despite having a somewhat socialist flavour, do not appear to be overly onerous.

### **Conclusion**

The directive has a long way to go before it can be adopted and no doubt a number of changes will be made to it. However, a number of the proposals are sensible and as draft directives go it could be a great deal worse.

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