The Directive on Alternative Investment Funds Managers (AIFM) and its impact on Gibraltar – current position.

On April 29 2009, the European Commission submitted a draft directive on Alternative Investment Fund Managers to the European Parliament and European Council. The directive would impose significant hurdles on non-EU managers. However, if an authorisation is granted to a fund, it will be valid for all member states, allowing the managers to manage and market funds throughout the EU either directly or via a branch without having to comply with each country's particular legislative requirements. The directive states in its opening paragraphs that the funds in question are defined as all funds that are not regulated under the UCITS.

The draft directive produced significant concern by fund managers and by individual states. The UK confirmed that it was strongly in support of the ability of funds domiciled outside the European Union to market within Europe on the principle that investors and the industry in Europe and the UK benefitted from third-country funds. It was felt that provisions restricting the ability of investors to invest through non-EU vehicles were "a very significant restriction on investor choice" and "protectionist" with an estimated 40% drop in funds available to investors. It was also widely felt that the Commission had underestimated the compliance costs of the AIFM directive, estimated as euros1.4 billion according to a study completed by the UK Financial Services Authority.

Although some aspects of the directive are recognized as being welcomed by investors, such as the necessity for greater transparency and information to investors, opposition to the directive as it stands has gathered considerable momentum. The economic and monetary affairs committee in the European Parliament has expressed the view that a principles-based rather than a product-specific directive should emerge from the EU, and the attempt by the present directive to cover the entire spectrum of funds under a single heading of “alternative” is impractical. The head of the committee, Sharon Bowles is quoted as saying “it is not well written. It was put together too quickly. It needs a complete overhaul.” Such overhaul is the responsibility of the committee.

Looking at the original draft it requires that managers must separate risk management from portfolio management functions, measure and monitor the risks associated with each strategy, and implement a due diligence process when investing on behalf of the fund. The draft also introduces regular reporting requirements to the authorities of the manager's home member state. The manager must also report to investors on the valuation procedures, liquidity risk management, the existence of illiquid, hard-to-value or side-pocketed assets and each fund's risk profile. These proposals will only introduce a minimum threshold for member states, and it is felt that countries such as France and Germany may well impose stricter requirements.

Once authorised, the manager may provide management services to funds established elsewhere in the EU and market its funds to professional investors in other member states. As drafted, the distribution of offshore funds, such as those established in the Cayman Islands, may only be possible three years after the directive's ratification, which could accelerate the redomiciliation of offshore funds to

EU jurisdictions and hence the directive could offer opportunities to jurisdictions such as Gibraltar. However recent proposals as outlined below may bring changes to these provisions.

The directive as drafted would apply to all managers that manage and market non-Ucits funds in the EU with assets under management exceeding EUR100m, or EUR500m if the funds are not leveraged and are not redeemable for at least five years. Hedge, venture capital, infrastructure, private equity, real estate, commodity and non-EU retail funds are all concerned, irrespective of their type, legal structure or domicile. This maybe a higher figure than HFA's average fund value, but undoubtedly not outside of the aspirations of our fund managers.

On November 12, 2009, the Swedish presidency issued a compromise proposal to the directive, which aims to address the criticisms received and to deliver a text on which Member States can agree. Below is considered the significant elements of these proposals and their impact on the directive. (The original directive is attached for comparison).

Remuneration Policies. There is a completely new provision on remuneration policies.
AUM Threshold. The exemption for AIFMs managing AIFs totalling €100 million or less (€500 million for unleveraged AIFs with a five-year or greater lock-in) remains, but the blanket exemption for credit institutions has been removed.
Marketing. Article 3(1)(e) has been amended to define marketing as offerings or placements at the initiative of the AIFM. This is a major change, which is well received as it means that approaches by potential investors to AIFMs will not be classed as marketing, as they were under the previous definition.
Valuation. The requirement to appoint an independent valuator has been removed from Article 16. Instead, there is a general requirement to ensure that appropriate and consistent procedures are in place to provide proper valuation of the assets, and a requirement, where appropriate, to ensure the functional independence of the valuation and portfolio management function.
Depositary. The depositary provisions in Article 17 have also been significantly relaxed.
Delegation. The power to delegate in Article 18 is wider than before. No longer do AIFMs need prior authorization from regulators in order to delegate, notification only is required and the text implies that this can be on a one-off' general basis, though this needs to be clarified.
Leverage. The provisions that apply to AIFMs managing leveraged AIFs, which previously required disclosure of leverage levels both to investors and to regulators, have largely been deleted.
Third Countries. The third-country provisions in Chapter VII (Articles 35–39) have all been deleted. Instead, there is a provision providing that AIFMs can only manage non-EEA AIFs if the legislation of the country of the AIF is in line with the standards set by international organisations, and an appropriate co-operation agreement exists between the regulator of the AIFM and the supervisory authorities in the country of the AIF
Passport. Article 33 of the Directive makes it clear that the marketing passport only applies in respect of AIFs that are established in the EEA. The proposals state that the Commission will assess, three years after the AIFM Directive comes into force,

whether, and if so, under what terms, the passport is to be extended. This is an interesting change from the previous draft, as Article 35 of that draft provided for such a passport, albeit with a three-year delay and subject to conditions. What we now have is more uncertain as the Commission could set more onerous conditions, less onerous conditions, or decide not to extend the passport at all. It is doubtful whether this uncertainty will appeal to firms.

Are the proposals an improvement on the original directive? General opinion is that this is an improvement and that it is the sort of considered draft the Commission should have released in the first place. It also looks more professional, as the Swedish presidency has corrected various minor slips and omissions in the previous version. The new provisions regarding delegation, depositaries and valuation will be generally welcomed. However the position of third-country AIFMs managing AIFs needs to be clarified. It looks as though the proposals leave the current position unchanged, that is, marketing of the AIF to investors in an EEA state will continue to be possible, provided that local law allows it. However, it would be helpful if that were clarified.

Although the Swedish presidency proposals mark for many a definite improvement, it is generally expected to be subject to further changes before an agreed text is reached. The lobbying efforts by firms and their trade associations will therefore continue. One other point to note is that the proposals still leaves various difficult issues that the Commission must resolve in further provisions at a later stage which is not helpful for firms or their advisers.

It would therefore be wise at the present to consider the directive as work in progress with the final details yet to emerge. The uncertainty over the directive has put European fund managers in a difficult position. The collective wisdom says that the final directive will be significantly redrafted but whether this will happen, and the resultant details leaves much uncertainty.

Although the original plan was to implement the directive in 2010 it is now felt that the eventual directive will not come into effect until 2011 or even 2012. Dependent on the final wording the directive could offer considerable opportunity to Gibraltar and hence to HFA both in the establishment of new funds and the possibilities of redomiciliation of funds from BVI and Cayman specifically. Without a doubt, Cayman Islands has become the world's most important hedge fund domicile but also Gibraltar provide the services, infrastructure and operational flexibility which the international investor demands, within the framework of enforced legal guidelines, that are in tune with the requirements of the modern hedge funds industry.

Hedge funds are able to move into Gibraltar by continuation of their legal form without liquidation and fresh registration is a relative simple procedure, if redomiciliation is provided for in the constitution documents and if permitted to do so by the foreign jurisdiction. For successful redomiciliation just a few formalities and the presentation of a few evidences are necessary. Redomiciliation into Gibraltar also enables hedge funds to convert into a PCC.