

## The AIFM Directive and Investment Companies

### Member update, October 2009

#### 1. What is the Alternative Investment Fund Managers (AIFM) Directive?

The AIFM Directive will potentially regulate all investment companies regardless of their assets, domicile, size or venue for trading their shares. The legislation seeks to regulate managers of any non-UCITS fund. Those managers will be given various duties to ensure that those funds operate in a certain way.

#### 2. Couldn't giving the manager obligations of this type undermine and conflict with the obligations of investment company boards?

That is one of the risks. It will depend on the obligations set out in the final Directive but it is a real danger. The Directive should not be allowed to undermine the board or prevent directors and their shareholders from deciding critical issues themselves. For example, the current draft of the Directive envisages that there should be only one regulated manager. This could create problems where a company decides to appoint more than one portfolio manager or unbundle its administration functions.

An overview of the areas where the Directive creates requirements, and expects them to be overseen by the manager, as well as other problematic constraints on the operation of the sector (for example, in restricting the use of non-EU domiciles) is set out in **Annex 1**.

#### 3. How does the AIC intend these issues should be resolved?

Our starting point was that listed investment companies should not be covered by the Directive. Unfortunately, unrelenting political opposition to this option has forced us to revise our stance. Our current lobbying seeks to resolve problems created by the Directive through two routes:

- **Reducing potential compliance burdens:** This involves addressing each of the proposed requirements (see **Annex 1**) of the Directive to secure their removal or adjustment to make them more workable where they affect investment companies. This includes pointing out where there is overlap in the Directive with obligations created by other European rules and explaining where requirements are not relevant for closed-ended investment companies.
- **Amending the Directive to fit the investment company structure:** This involves calling for changes which would make investment companies directly responsible for complying with the Directive. If this outcome is not possible, other measures must be included to allow the Directive to operate without compromising the role of the Board.

#### 4. Doesn't that mean that you are arguing for increased regulation to be applied to the Board?

Yes. We have taken this approach in recognition of the changed regulatory climate. Political responses to the financial crisis make additional regulation

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inevitable. Our goal is to ensure that what is imposed to meet policymakers' concerns represents the lowest burden possible and allows our members to operate in their preferred way. Applying the Directive directly to the company is likely to be the best way to achieve this.

It will mean that the Directive does not create obligations for the manager which could conflict with the board's duties (arising from company law, the Listing rules and other European Directives etc). It will ensure that overall decision making power remains at board level and will ensure that the company is in control of its own regulatory compliance. This is what already happens with the Listing Rules, Disclosure and Transparency rules etc. Our solution maintains the status quo where the operation of the company is concerned but will also ensure that whatever regulation does apply is as manageable as possible.

### **5. There has been a lot of criticism of these measures, so, is there any chance that the AIFM Directive will simply be dropped?**

No. There is no doubt that regulation of one kind or another will be imposed: the political desire for action is overwhelming.

### **6. Will investment companies be able to avoid the AIFM Directive by moving offshore or outside the EU?**

As the Directive stands a company's domicile is not relevant to its application, it will affect our members wherever they are based.

### **7. Does your lobbying acknowledge different investment company types?**

Yes. Our lobbying approach allows us to recognise the different interests of specific types of investment companies. These include those domiciled outside the EU, self-managed trusts, those with different investment approaches (including private equity and hedge funds) and VCTs. An overview of the individual issues we are covering in our lobbying is covered in **Annex 1**.

### **8. When will the new rules come into force?**

The current timetable is for the rules to be finalised in July 2010 and introduced in the UK perhaps 18 months later. This suggests they could be in force by mid 2012. However, it is possible the timetable will change.

### **9. What can I do as a director to influence the process?**

A note exploring how your company can help is attached in **Annex 2**.

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**To discuss the issues raised in this note contact:**

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### Annex 1: Overview of key issues created by the AIFM Directive

ISSUE	AIC OBSERVATIONS
<b>Prevention of new share issues</b>	This is an unintended consequence of the Directive but it is a critical problem for the sector. It is therefore an AIC priority.
<b>Threat to role of the Board</b>	Maintaining the position of the board is likely to be resolved by enabling the Directive to be applied directly to the company.
<b>Regulatory overlap</b>	Overlap creates costs without benefit. Addressing this is a common theme of the AIC's representations.
<b>Risk management</b>	The Directive would give the external manager authority over risk management – an issue which should be determined by the board.
<b>Liquidity management</b>	These proposals are designed for open-ended funds and threaten to force closed-ended funds to offer redemption.
<b>Investment in securitised assets</b>	These restrictions on investment in securitised assets would be costly to comply with. They are discriminatory as they target funds rather than all investors who invest in these instruments.
<b>Capital requirements</b>	The proposed capital requirements should be reduced for investment companies as they are inappropriate for the structure.
<b>Independent valuation</b>	Valuation requirements are costly and create scope for conflict with the board. They should not be imposed on investment companies.
<b>Depositories</b>	These would create significant costs and are inappropriate for asset classes such as private equity and property. They also limit who can supply services and would prevent investment in certain jurisdictions.
<b>Delegation</b>	This is a critical issue as it threatens to prevent the appointment of managers or administrators outside the EU. It could also restrict domicile of funds outside the EU.
<b>Transparency requirements</b>	These provisions (relating to the annual report, investor disclosure etc) overlap with existing obligations and create unnecessary costs.
<b>Leverage caps</b>	The proposals limit commercial flexibility and are poorly thought out. They are difficult to comply with and create systemic risks.
<b>Private equity disclosures</b>	Disclosures are obliged in relation to portfolio companies over a certain size. These are onerous, inappropriate and discriminatory as they only apply to funds, not other buyers of European companies.
<b>Marketing shares to retail investors</b>	The Directive prevents retail investors buying shares except where individual states allow it. However this debate concludes, the UK will allow the continued sale of investment company shares in the UK.
<b>EU passport</b>	This allows funds within scope to be marketed across the EU. However, it discriminates against third country funds by denying the passport to non-EU funds for 3 years from Directive's introduction.
<b>Restrictions on third country suppliers and domicile</b>	Additional rules (e.g. on tax in place in non-EU jurisdictions) are imposed before marketing of non-EU funds is allowed. High hurdles mean non-EU AIFM are unlikely to secure authorisation. The Directive also stops investors purchasing non-EU funds. The proposals unacceptably discriminate against non-EU investment companies and the arrangements they adopt. All discriminatory third country proposals should be removed from the Directive.
<b>Commission rulemaking power</b>	The proposals give substantial powers to the Commission to change the rules, and create additional obligations, which is unacceptable.

## **Annex 2: Options for Member representations**

### **What can I do to help?**

If you wish to support the AIC's own representations there are various options you might consider. These include:

- Contacting MEPs and other European policymakers to raise your concerns.
- Encouraging your major investors to engage in the debate over the Directive.

### **Which policymakers should we seek to influence?**

Key targets will be MEPs. Individual director's may wish to contact their local MEP(s) as voters to ask them to get involved and ensure the interests of the investment company sector are taken account of. Alternatively the Chairman could write on behalf of the company to its own local MEP (identified according to the location of its registered office).

To identify your local MEP you may wish to use the link below.

<http://www.europarl.org.uk/section/your-meps/your-meps>

Members could also contact key members of the ECON, the Parliamentary Committee which is taking the lead on scrutinising this issue on behalf of MEPs.

The Chairman of the Committee is Sharon Bowles MEP. She can be contacted at: Parlement européen, Bât. Altiero Spinelli 10G201 60, rue Wiertz, B-1047 Bruxelles.

You might also contact Jean-Paul Gauzès MEP, who is leading the work of ECON on the Directive and will be very influential in preparing amendments to the proposals. He can be contacted at Parlement européen Bât. Altiero Spinelli. 13E258 60, rue Wiertz B-1047, Bruxelles. (As he is a French MEP you may want to translate your comments into French, but this is not essential.)

Members may also wish to feed their views into the European Commission. One option for this would be to write to: Charlie McCreevy, Commissioner for Internal Market and Services, Internal Market and Services, European Commission, Brussels 1049, Belgium. These letters should also be copied to Ugo Bassi, Head of Unit, at the same address.

### **What should the message be?**

The basic message we would like to get across is that the AIFM Directive creates real and unique problems for the investment company sector.

This is because investment companies have a legal and governance structure which was not properly considered when the proposals were drafted.

The problems are not simply a case of increased cost and inconvenience, they are fundamental. For example, they compromise the benefits provided by the

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existing governance structure by undermining the board; they threaten the ability of any investment company (established or yet to be launched) to issue shares; and require them to offer redemption (which is nonsensical for closed-ended funds). These consequences are a fundamental threat to the sector.

Any regulatory measures introduced must address the unique problems the Directive creates for investment companies. With this in mind, you may wish to support our proposal that the obligations should be applied directly to the company itself and not an external supplier. This will support the investment company structure and ensure its commercial flexibility. You might also make reference to the AIC's own representations and your support for them. This should increase the traction of our own, more detailed, arguments.

In addition, you might want to pick one or two of the specific problems created by the Directive (see **Annex 1**) and highlight the problems this raises for your own company.

### **Any other tips?**

Your message should reflect your own circumstances and concerns. However, there are some general points you should bear in mind.

- A personalised message will have more impact than making a standard response. In this context, you should single out one or two key concerns and provide a short explanation of how the proposals will affect your company.
- Don't forget to include a short description of what your company does and who its shareholders are.
- Some critics of the proposals have suggested that the Directive is an 'attack on London/the City'. Whether or not you feel that there is truth in this accusation, this is not the most productive message to put forward. While arguments of this nature may be well received by those who are already sympathetic to our position, they are unlikely to attract those who are less favourably disposed – and it is these individuals who we need to bring onside.
- Suggesting that elements of the industry will go 'offshore' should also be resisted. The Directive will affect investment companies regardless of their domicile. Suggesting that such moves can be used to avoid problems will make it more difficult for the AIC to secure understanding about the problems the Directive will create for the offshore community.

### **How long should this letter be?**

An effective letter need not be long – perhaps only a couple of pages. The ambition is to grab policymakers' attention and demonstrate that a proper debate needs to be had about the direction and shape of regulation.

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### **What should we do to encourage investors to get involved?**

Arguably, third party endorsement for changing the Directive to take account of our needs will be even more helpful than direct representations by members. They can provide a 'consumer' voice which may have more resonance with European policymakers.

With this in mind, Members might identify their top 5 – 10 largest institutional shareholders and send them a copy of any letter sent to MEPs and ask if they could also support the arguments you have raised. You might suggest that they get in touch with: Charlie McCreevy and key members of the Economic and Monetary Committee.

If shareholders are based in other EU Member State they might also contact their own national authorities (Treasury department and financial regulator) and MEPs to urge them to ensure the Directive is workable and proportionate. Contact details will depend on the country involved.

You might also suggest that they contact the AIC if they want more detail on how the proposals will affect the investment company sector.

### **Can I get any help with this?**

If Members would like advice on making representations we would be pleased to discuss these issues with them. Please contact me if this would be helpful. Guy Rainbird, Public Affairs Director. [guy.rainbird@theaic.co.uk](mailto:guy.rainbird@theaic.co.uk)