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# Council adopts EU rules for alternative investment fund managers

The Council today[1] adopted a directive introducing harmonised EU rules for entities engaged in the management of alternative investment funds, such as hedge funds and private equity firms (*60/10*).

Adoption of the text follows an agreement reached with the European Parliament at first reading. The directive will enter into force on the 20th day following its publication in the Official Journal; member states will have two years to transpose its provisions into national law.

The directive is aimed at:

– establishing common requirements for the authorisation and supervision of alternative investment fund managers (AIFM) in order to provide a coherent approach to the related risks and their impact on investors and markets in the EU;

– allowing AIFM to provide services and market EU funds throughout the EU single market, subject to compliance with strict requirements.

The directive is intended to fulfil commitments made by the EU at the G-20, in the wake of the global financial crisis, as well as the European Council's pledge to regulate all players in the market that might pose a risk to financial stability.

The activities of AIFM are currently regulated by a combination of national regulations and general provisions of EU law, supplemented in some areas by industry standards. The global financial crisis showed that uncoordinated national responses to the risks to which the funds were exposed made the efficient management of these risks difficult.

[1] The decision was taken at a meeting of Transport, Telecommunications and Energy Council



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Besides hedge funds and private equity, the directive also covers real estate funds, commodity funds and all other funds that are not covered by the directive on collective investment funds[1].

The main features of the directive are as follows:

– Authorisations. To operate in the EU, fund managers will be required under the directive to obtain authorisation from the competent authority of their home member state. Once authorised, an AIFM will be entitled to market funds established in the EU to professional investors in any member state. To obtain authorisation, AIFM will have to hold a minimum level of capital in the form of liquid or short-term assets.

– Depositary: AIFM will be required to ensure that the funds they manage appoint an independent depositary responsible for overseeing the fund's activities and ensuring that the fund's assets are appropriately protected. The depositary will be liable to the investor and the manager. It should be located in the same country as the fund if the fund is established in the EU. If the fund is established in a third country, the depositary should be located in the EU, unless a cooperation and information exchange agreement exists between the supervisors ensuring that regulations are equivalent and supervision can be carried out in accordance with requirements in the EU.

– Risk management and prudential oversight. AIFM will be required to satisfy the competent authority of the robustness of their internal arrangements with respect to risk management, including liquidity risks. To support macro-prudential oversight, they will be required to disclose on a regular basis the principal markets and instruments in which they trade, their principal exposures and concentrations of risk.

– Treatment of investors. In order to encourage diligence amongst their investors, AIFM will be required to provide a clear description of their investment policy, including descriptions of the types of assets and the use of leverage.

– Leveraged funds. The directive introduces specific requirements with regard to leverage, i.e. the use of debt to finance investment. Competent authorities will be empowered to set limits to leverage in order to ensure the stability of the financial system. AIFM employing leverage on a systematic basis will be required to disclose aggregate leverage and the main sources of leverage, and competent authorities will be required to share relevant information with other competent authorities.

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[1] Directive on undertakings for collective investment in transferable securities (UCITS)

– AIFM acquiring controlling stakes in companies. The directive introduces specific requirements for AIFM acquiring controlling stakes in companies, in particular the disclosure of information to other shareholders and to representatives of employees of the portfolio company. It however avoids extending such requirements to acquisitions of SMEs, so as to avoid hampering start-up or venture capital.

– Passport. The directive introduces a single market framework that will allow AIFM to "passport" their services in different member states on the basis of a single authorisation. Once an AIFM is authorised in one member state and complies with the rules of the directive, the fund manager will be entitled upon notification to manage or market funds to professional investors throughout the EU.

– Funds and managers located in third countries. Following a two-year transition period and subject to conditions set out in the directive, the "passport" will be extended to the marketing of non-EU funds, managed either by EU AIFM or by AIFM based outside the EU. In accordance with the principle of "same rights, same obligations", this approach will ensure a level playing field and a consistently high level of transparency and protection of European investors. The phased introduction of the third country passports will allow European supervisors to ensure that the appropriate controls and cooperation arrangements necessary for the effective supervision of non-EU AIFM are working effectively. Before the third country passport is introduced, and for a period of three years thereafter, national regimes will remain available subject to certain harmonised safeguards. Once this period has elapsed, and on the basis of conditions set out in the directive, a decision will be taken to eliminate the national regimes. At this point, all AIFM active in the EU will be subject to the same high standards and enjoy the same rights.

– Optional exemptions for smaller funds. The directive gives member states the option not to apply the directive to smaller AIFM, namely funds with managed assets below EUR 100 million if they use leverage, and with assets below EUR 500 million if they do not. Smaller funds will however be subject to minimum registration and reporting requirements.

The need for regulation and oversight of hedge funds is also the subject of ongoing discussion at international level within the G-20, the International Organisation of Securities Commissions and the Financial Stability Board.