

Executive Summary

9 October 2009

- AIMA supports the authorisation of all AIFMs without any threshold;
- AIMA supports enhancing the safety of European markets by the provision to national regulators of the data necessary to monitor financial stability within their capital markets;
- AIMA calls for an increased limit of €1 billion for disclosure of systemically relevant data;
- AIMA concludes that, without significant revision, the Directive will lead to less choice and greater costs for investors within the EU - without achieving the stated objectives of the Directive.

The Alternative Investment Management Association (AIMA) is the not-for-profit trade association which represents the hedge fund industry globally. Its membership comprises 1,100 firms in over 40 countries across Europe and internationally and is drawn from all parts of the hedge fund industry - including hedge fund managers, fund of hedge funds managers, prime brokers, administrators, accountants and lawyers.

The European hedge fund industry presently has more than €250 billion of assets under management within the EU, employs about 50,000 people in Europe, and generates tax revenues of an estimated €4 billion a year. The great majority of the money invested with hedge funds comes not from wealthy individuals but from institutional investors, including pension and insurance funds investing on behalf of EU citizens.

AIMA welcomes a Directive which would see appropriate and proportionate regulation of alternative investment fund managers (AIFMs) and which would provide national regulators with the information they need to monitor financial stability effectively within their markets, while allowing Europe to maintain its position as an attractive place in which to do business and increasing investor protection.

AIMA is among those who doubt that the current draft would deliver this - and we welcome moves to improve the present text. We also note that many policy-makers - including among those most active in calling for regulation of the industry - now agree on the need for a proper impact assessment to be undertaken.

AIMA looks forward to engaging constructively with all stakeholders and makes the following observations:

- **Proportionate regulation** - the purpose of the Directive is to address 'systemic risk' yet all significant analysis, including the de Larosière Report to the Commission, has found that the hedge fund industry neither caused the recent financial crisis nor played a significant role in it; good regulation needs to be introduced proportionately, supported by evidence, rather than on the basis of myths and misconceptions.
- **Conflict with existing EU financial services legislation** - hedge fund managers are already subject to regulation under a number of existing EU financial services legislative measures, including MiFID, the Capital Requirements Directive, the Market Abuse Directive, and the Transparency and Prospectus Directives. The current text of the AIFM Directive overlaps with, or conflicts with, much of this, requiring the deletion and revision of large parts of the present text and/or revision of the above Directives.
- **Policy co-ordination** - there should be more co-ordination with the G-20 Global Plan for Recovery and Reform, as an EU-only solution risks being detrimental to investors in the EU.
- **Registration of AIFMs** - all AIFMs operating within the EU should be regulated, regardless of their legal form or the amount of assets under management. Under the current proposed threshold, some AIFMs would not be subject to any regulatory oversight.
- **Disclosure of systemically relevant information** - the current drafting, and a threshold of €100 million, would swamp regulators with a mass of data of little or no systemic relevance. Whilst we would support regulation of all AIFMs (with no set thresholds), requiring comprehensive data only from AIFMs managing in excess of €1 billion would be a more proportionate and effective means of meeting the Commission's purpose.

- **Third country marketing provisions are protectionist and unworkable** - the current draft would prevent non-EU funds from being marketed to EU professional investors by non-EU managers by the imposition of conditions which non-EU managers would find difficult or prohibitive to comply with (and so making it impossible to obtain authorisation); such a protectionist measure runs obvious risks of retaliatory measures being taken against EU managers wishing to market outside the EU.
- **Reduction of choice and diminishing returns for EU investors** - the current proposals would mean EU based investors - including institutional investors, pension funds, endowments and insurance companies who invest on behalf of millions of EU savers - would not be able to access funds domiciled in, or managed from, outside the EU. This would deny EU investors access to 90 to 95% of the eligible universe of funds in which they currently invest. This reduction of investor choice would have a detrimental effect on consumers as it would seriously impact portfolio diversification and hence, potentially, the returns on pensions, savings and other financial products. AIMA estimates that the absence of non-UCITS assets as part of a European pension portfolio and the implicit cost related to the draft Directive could cost the industry €25 billion per annum in lost investment performance.
- **Delegation** - the provisions on delegation by AIFM should be removed as they are likely to prevent investors within the EU from benefiting from the expertise of non-EU fund managers. They are also unnecessary and the conditions established by the MiFID Directive on delegation of portfolio management services should continue to apply.
- **Leverage** - the level of leverage in the hedge fund industry currently averages 1 x assets (source: ECB) as opposed to the levels of 50 x assets reached by the banking sector; the draft fails to appreciate the number of different purposes for which leverage is used by different types of alternative investment funds. To seek to impose a single limit, intended to cover all types of investment strategy and asset classes, is simplistic and would damage the industry and its investors. A more effective way for regulators in Member States to monitor developing leverage trends within their markets would be to require prime brokers to provide relevant lending data in accordance with an agreed and preferably harmonised disclosure template, as indeed is already the norm in the UK (which is home to 87% of EU hedge fund assets under management).
- **Depositaries** - by insisting on EU credit institutions only, the Directive would severely limit the number of prime brokers and custodians which an AIFM might use, thereby concentrating counterparty risk. It also fails to take into account existing practice in respect of sub-custodians. By imposing strict liability on depositaries, the Directive will raise costs or restrict investment choices - ultimately for investors - as prime brokers will either assume such increased risk of liability by substantially raising their fees or refuse to take on risk in respect of certain markets and/or strategies.
- **Master/ Feeders** - whereas master/feeder structures have been assessed under UCITS IV as being suitable for being marketed to retail investors, it is unclear whether the Directive would permit them to be marketed to professional investors. Such funds are widely used by hedge funds, which would have to choose between costly restructuring or remaining outside scope and thus unavailable to EU investors.

AIMA fully recognises the impetus for greater regulation and supervision for all aspects of the asset management industry, including the hedge fund sector. As mentioned above, we support appropriate and proportionate moves to achieve this. As the voice of the global hedge fund industry, we seek to play a positive and constructive part in the work of reshaping those areas of the Directive where we consider the current provisions require either clarification or revision. AIMA, therefore, looks forward to working constructively with the Commission, the Parliament and the Council to help produce a revised Directive along the lines indicated above, resulting in legislation which:

- introduces appropriate and proportionate levels of protection for professional investors;
- achieves a sensible and efficient means of regulating and supervising AIFMs;
- ensures regulators are provided with the data which they require to monitor financial stability effectively within their markets without overwhelming them with additional but irrelevant, information; and
- safeguards the interests of the EU's existing investor base while ensuring that the EU remains an attractive market and centre for new investment, thereby ensuring that the alternative investment fund management industry continues to provide enhanced returns for ordinary EU citizens and pensioners.