

AIMA Regulatory Update



An update from AIMA's Government and Regulatory Affairs Team

Dear AIMA member,

We have been extremely busy since the last Regulatory Update. ESMA came out with its final advice to the EU Commission on the AIFMD. Short selling regulation has been agreed in the EU and we are also extremely close to a final agreement on EMIR, the EU OTC derivatives clearing legislation. In the U.S., important Dodd Frank implementing detail was finalised by the SEC and the CFTC. The SEC published its final registration and reporting requirements while the CFTC has come out with long awaited position limits requirements. In the area of tax, the controversial EU financial transaction tax proposal has been unveiled by the Commission and we expect draft FATCA rules to be published before Christmas.

The AIMA Regulatory Update strives to provide a succinct update to members on the current state of play on the most important files in the Government and Regulatory Affairs space. It is a one-stop-shop for members seeking to gain a quick overview of the main points of interest to the hedge fund industry while also providing links to a number of internal and external documents for those interested in greater detail. The issues treated in the update do not provide an exhaustive list of AIMA's work in the area and we encourage members to enter into contact with AIMA's Government and Regulatory Affairs team if they wish to be informed on the progress of work on issues which are not covered.

ISSUES COVERED

- [AIFMD](#)
- [Short Selling](#)
- [EMIR](#)
- [FATCA](#)
- [Financial transaction taxes](#)
- [US swaps regulation](#)
- [SEC registration](#)
- [MiFID/MiFIR](#)

AIFMD: ESMA advice finalised

In the past several months the European Securities and Market Authority (ESMA) have consulted extensively on its technical advice which will form the substance of the secondary rulemaking to be adopted by the European Commission. These detailed rules will complement and render operational the higher level principles present in the AIFMD. ESMA delivered its Final Report to the Commission on 16 November 2011. The European Commission will now transform the policy advice into legislation. AIMA's AIFMD working group produced extensive comments on ESMA's draft advice and AIMA will engage with the Commission, the European Parliament and Member States in the finalization of the detailed rules of the AIFMD. Although the final ESMA report has improved from its initial draft in a great number of areas (third countries, depositaries' operational obligations, own funds, delegation, transparency and reporting), serious concerns remain as regards such issues as the depositary liability for lost assets, definition of leverage, powers of competent authorities to

limit leverage and the definition of the valuation function. AIMA continues to be engaged with the European Commission to ensure that ESMA advice is incorporated into legislation in a practical manner.

Links to relevant documents:

[CESR Call for Evidence - Implementing measures on AIFMD - 8 December 2010](#)
[AIMA's response to CESR's Call for Evidence - 14 January 2011](#)
[AIMA additional submission on depositaries - 18 March 2011](#)
[ESMA consultation on Article 3 \(thresholds\) - April 2011](#)
[AIMA Response to ESMA Article 3 discussion paper - 17 May 2011](#)
[AIMA 2nd additional submission on depositaries - 3 June 2011](#)
[AIFM Directive - 8 June 2011](#)
[ESMA's draft technical advice on AIFMD - 13 July 2011](#)
[ESMA's draft technical advice on third countries - 23 August 2011](#)
[AIMA response to ESMA's draft technical advice on AIFMD September 2011](#)
[AIMA response to ESMA's draft technical advice on third countries - 23 September 2011](#)
[ESMA Final Report - 16 November 2011](#)
[AIMA Analysis of ESMA advice - 18 November 2011](#)
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Short selling

The European Parliament (EP) and the Council of Ministers have now agreed a final text of the European Commission proposal to harmonise the regulation of short selling of shares and sovereign debt. This text has been ratified by the EP in plenary session and approved by COREPER ahead of formal ratification by ECOFIN. The agreement (i) introduces a ban on uncovered sovereign CDS but allows Member States to suspend the restriction in their own jurisdiction in given circumstances; (ii) imposes a requirement that, in order to be regarded as a covered short sale, the relevant share must have been located and the short seller must have reasonable expectation that settlement can be effected when due; (iii) introduces an EU-wide notification and reporting regime, whereby holders of net short positions must notify these privately to the regulator when they exceed 0.2% of the issued share capital of the issuer company and must publicly disclose these (on a named basis) when they exceed 0.5%. In each case, further notification or reporting is required at each 0.1% above the initial threshold; (iv) provides national competent authorities and ESMA with additional powers to intervene in the markets in times of stress and (v) excludes sales under a repo agreement or futures contracts from the definition of short sales in shares and debt instruments. A period for secondary rulemaking now follows, with a consultation paper expected in January 2012 with the implementation deadline now scheduled for 1 November 2012. AIMA has been asked to participate in ESMA expert panels which feed into the secondary rule making process.

Links to relevant documents:

[EC proposal - 15 September 2010](#)
[Final text - 21 Nov 2011](#)
[AIMA Position Paper - December 2010](#)
[Oliver Wyman Report - The effects of short selling public disclosure of individual positions on equity markets - February 2011](#)
[AIMA Research Note - The European Sovereign CDS Market - April 2011](#)
[AIMA Note on SSR Trialogue Texts - May 2011](#)
[AIMA SSR Update Note - 6 July 2011](#)
[AIMA Update Note October 2011](#)
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EMIR

In July 2011, the European Parliament adopted amendments to the European Commission's draft proposal to establish a regulatory regime for central counterparties (CCPs) and requirements for the clearing and reporting of OTC derivatives. On 4 October 2011, the Council of Ministers also reached agreement on its own amendments to the draft proposal. There appear to be a number of differences between the EP's and Council's views on certain issues, including: **scope** (there are significant differences between the wording of the EP and the Council provisions on pension scheme and intragroup trade exemptions); **third country provisions** (the Council has introduced a International Coordination article and has extended the clearing obligation to trades between two

non-EU parties); **corporate governance** (EP wants extensive representation of buy-side interests on CCP boards and committees); and **segregation of clients' collateral** (EP wants 'full segregation' for clients to be the default choice for CCPs while Council wants this as an option to client omnibus accounts). As of 10 October 2011, parties entered into trilogue negotiations to try to reach agreement on a compromise set of amendments by the end of the year.

Links to relevant documents:

[European Commission Proposal for a Regulation on OTC derivatives, central counterparties and trade repositories - 15 September 2010](#)

[AIMA Position paper - 7 December 2010](#)

[European Parliament Report on the proposal for a regulation on OTC derivatives, central counterparties and trade repositories - 7 June 2011](#)

[AIMA EMIR Update Note - 4 July 2011](#)

[AIMA EMIR Update Note - 6 July 2011](#)

[Polish Presidency proposed amendments to the proposal for a regulation on OTC derivatives, central counterparties and trade repositories - 23 September 2011](#)

[AIMA EMIR Update Note - 28 October 2011](#)

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FATCA (Foreign Account Tax Compliance Act)

The purpose of FATCA is to detect US taxpayers who evade tax through offshore holdings. FATCA will require Foreign Financial Institutions (FFIs) to obtain and report information regarding US customers and beneficial owners to the Internal Revenue Service (IRS) or suffer 30% withholding tax on US sourced income. The IRS issued preliminary guidance on priority implementation issues and, following comments from stakeholders, guidance on some priority issues. Further guidance July 11 introduced phased implementation: reporting 30 Jun 2013; withholding 1 Jan 2014 (on FDAP); and 1 Jan 2015 on all 'withholdable payments' (start date for Passthru Payment rules). AIMA has made three written submissions to date, met US Treasury and the IRS in June 2011 and followed up with them in July and September, providing detail on issues facing hedge fund managers and proposals for practical approaches to implementation. It appears that draft implementing rules will be issued for consultation in mid December 2011.

Links to relevant documents:

[HIRE Act - Chapter IV is FATCA](#)

[AIMA submission - 29 June 2010](#)

[IRS Notice 2010-60 - 27 August 2010](#)

[AIMA submission - 1 November 2010](#)

[IRS Notice 2011-35 - 8 April 2011](#)

[AIMA submission - 6 June 2011](#)

[Notice 2011-53 \(as revised - July 2011\)](#)

[AIMA submission on implementation issues & proposals - 16 September 2011](#)

[AIMA's FATCA Q&A](#)

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Financial Transaction Tax / Financial Activities Taxes (FTT/FATs)

The European Commission's proposal for a FTT Directive was issued on 28 September. The proposed Directive sets a minimum FTT at 0.1% for bonds and equities and 0.01% for derivatives (levied on the notional value).

The proposed FTT has a wide scope, to capture a broad range of financial transactions where at least one party is established in an EU Member State and either that party or another is a financial institution (very broadly defined, however; the European Financial Stability Facility and central counterparties are among few entities excluded from the definition). Financial transactions include the purchase and sale of any 'financial instrument' (shares, bonds, notes, units and including repos, stock lending, etc) and concluding or modifying derivatives. It also covers the purchase and transfer of structured products (e.g., tradable securities or other instruments offered by way of a securitisation). The tax will be calculated on the higher of consideration for the transaction or market price (for everything except derivatives) and on the notional value of derivatives and the tax will be on gross transactions before netting off and be cumulative. This means that each 'leg' of a transaction (e.g. vendor to broker to clearing member, and so on) could

attract the tax, leading to severe cascade effects and much higher effective rates of tax than the headline rates.

Links to relevant documents:

[EC consultation paper - February 2011](#)

[AIMA submission - 19 April 2011](#)

[EC Communication - 29 June 2011](#)

[EC Proposal for own resources- 29 June 2011](#)

[Commission Proposal for Directive - 28 September 2011](#)

[Joint Associations' letter to the UK Chancellor of the Exchequer - 24 October 2011](#)

[Response to House of Lords' Call for Evidence - 7 November 2011](#)

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US swaps regulation - Position limits

The US Dodd-Frank Act required the Commodity Futures Trading Commission (CFTC) to establish rules on **position limits** for futures and options contracts traded on a designated contract market and swaps that are economically equivalent to such futures and options. On 18 October 2011, the CFTC Commissioners approved a Final Rule on Position Limits for Futures and Swaps, which was subsequently published in the Federal Register on 18 November 2011. The Final Rule introduces position limits for **28 physical commodity futures and options contracts and their economic equivalents**, including separately calculated limits for contracts in the "spot-month" and "non-spot-months". The CFTC has retained the existing CFTC Rule Part 150 disaggregation rules and independent account controller exemption, which AIMA advocated for in our response to the CFTC's January 2011 request for comments. The Final Rule also contains a position visibility regime for five metal contracts and four energy contracts. The Final Rule will come into force on 17 January 2012; however, the position limits and position visibility regimes will not be applicable to traders until 60 days after the CFTC has published a final rule in the Federal Register which defines the term "swap". This is expected in the first quarter of 2012, with the position visibility regime, spot-month limits and legacy non-spot-month limits, therefore, becoming effective in quarter two, 2012. Non-legacy non-spot-month limits will become applicable from approximately quarter three, 2013.

Links to relevant documents:

[CFTC request for comments on Position Limits for Derivatives - 26 January 2011](#)

[AIMA response to the CFTC request for comments on Position Limits for Derivatives - 28 March 2011](#)

[CFTC Final Rule - Position Limits for Futures and Swaps - 18 November 2011](#)

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SEC/CFTC reporting agreed

The Securities and Exchange Commission (SEC) voted on 26 October to adopt the new Form PF. Under these rules investment advisers to private funds will be required to report certain information to the SEC and this information is intended to enable the Financial Stability Oversight Council to monitor financial risk in the US financial system. According to the rules, advisers with less than \$150 million in private fund assets under management need not file Form PF. Advisers above this threshold are divided into large advisers and smaller advisers and the amount of information and frequency of reporting required is linked to this categorization. Large hedge fund advisers are those managing funds in excess of \$1.5 bn. Form PF is a joint rulemaking effort by the SEC and the Commodity Futures Trading Commission (CFTC) and the CFTC has also adopted Form PF (although only section 1 and 2). Private fund advisers required to file Form PF and also subject to registration requirements as CTA/CPO may file Form PF to satisfy certain CFTC reporting requirement. Additionally, CPOs and CTAs who are otherwise required to file Form PF will have the option to submit Form PF in relation to commodity pools that are not private funds. This will allow advisers to consolidate their reporting to some extent. Filing Form PF through the Form PF filing system would be considered a filing with both the SEC and CFTC.

Links to relevant documents:

[SEC proposed rules - 26 Jan 2011](#)

[AIMA response to SEC and CFTC Form PF consultation 12 April 2011](#)

[Securities and Exchange Commission - AIMA submission on private fund systemic risk reporting 12 July 2011](#)

[SEC Final rules on Form PF 31 Oct 2011](#)

[AIMA Summary of registration and reporting requirements - 30 Nov 2011](#)

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MiFID 2 and MiFIR

Following a prolonged consultation process during the course of 2010, on 18 October 2011, the European Commission published two documents, a proposal for a recast Directive (MiFID 2) and a proposal for a Regulation (MiFIR), which revise the existing MiFID regime and take into account lessons learned from the recent financial crisis. Whereas a Directive, when finalised, must be implemented into each Member State's legislation, a Regulation has direct and immediate effect. Among the key issues contained within MiFID 2 and MiFIR are provisions which would (i) extend the existing regime both in terms of instruments and firms covered, so that, for example, certain commodity firms will fall within scope of the regime; (ii) impose regulatory requirements on firms undertaking algorithmic trading (including HFT); (iii) impose position limits on the trading of commodity derivatives; (iv) impose restrictions on the provision of services in the EU by third country firms, whose home jurisdiction(s) would have to be seen as 'equivalent' before being able to provide services in Europe; and (v) introduce enhanced pre- and post-trade transparency provisions in respect of both equities and non-equities. The European Parliament, through its ECON Committee, and the Council will now review the proposals and put forward their own amendments.

Links to relevant documents:

[MiFID2 text](#)

[MiFIR text](#)

[EC consultation - 8 December 2010](#)

[AIMA response to EC consultation - Review of MiFID - 9 February 2011](#)

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