February 2011

Newsletter No. 96

European Directive on Alternative Investment Fund Managers – Implications for Switzerland. The European Parliament recently passed the Alternative Investment Funds Directive («AIFMD»). The AIFMD is focused on managers rather than investment funds and will implement broad regulatory measures on both fund managers located within the European Union («EU») and those established outside of the EU that provide asset management services to European alternative investment funds. The Swiss fund industry will have to closely examine the details of the AIFMD.

walderwyss attorneys at law

European Directive on Alternative Investment Fund Managers – Implications for Switzerland

The European Parliament recently passed the Alternative Investment Funds Directive («AIFMD»). The AIFMD is focused on managers rather than investment funds and will implement broad regulatory measures on both fund managers located within the European Union («EU») and those established outside of the EU that provide asset management services to European alternative investment funds. The Swiss fund industry will have to closely examine the details of the AIFMD.

By **Enrico Friz**
lic. iur., Attorney at Law
Telephone +41 44 498 95 99
enrico.friz@walderwyss.com

and **Thomas S. Müller**
Dr. iur., LL.M., Attorney at Law
Telephone +41 44 498 95 60
thomas.mueller@walderwyss.com

Background

On 11 November 2010, the European Parliament passed the AIFMD in the form previously agreed on by both the Economic and Financial Affairs Council («ECOFIN») and the European Parliament in the previous month. Upon the text's formal approval by the ECOFIN, the final wording of the AIFMD will be published in early 2011 and will simultaneously enter into force. From that time, EU member states will be given two years to incorporate the AIFMD into their national laws. On the European level, the European Commission («EC») will adopt approximately one hundred delegated acts (known as «level two measures») within the same two-year time period to clarify various issues of the AIFMD. In addition, the EC will, based on the advice of the new European Securities and Markets Authority («ESMA»), also review the AIFMD's scope and application, which creates some uncertainty. Nevertheless, the finalized version of the AIFMD will implement detailed rules on fund managers, and will have a crucial impact on the fund industry in Europe and most likely Switzerland as well.

Scope and regulations of the AIFMD

The overarching objective of the AIFMD is to create a comprehensive and secure framework for the supervision and prudential oversight of managers of alternative investment funds in the EU and, inter alia, to increase the transparency of fund managers towards investors, supervisors and employees of the companies in which the funds invest.

The AIFMD's provisions will apply to all alternative investment fund managers («AIFMs») located in EU member states whose regular business is managing one or several alternative investment funds («AIF»). The AIFMD will apply regardless of whether the alternative investment fund is established inside or outside the EU and irrespective of whether the AIF is marketed within the EU. Also, AIFMs located outside the EU will be covered by the AIFMD if they either manage an AIF set up within the EU or any AIF that is marketed within the EU area. The AIFMD does not regulate AIFs, although such funds may continue to be regulated and supervised at the national level. An AIF is defined as any collective investment scheme that: (i) raises capital from a number of investors in order to invest based on a defined investment policy for the benefit of the investors; and (ii) is not subject to the UCITS regulation (undertakings for collective investment in transferable securities distributed to the public).

The AIFMD therefore applies to AIFMs of hedge funds, private equity funds, institutional funds, real estate funds and commodity funds. An authorized AIFM will benefit from a passport regime and may market its AIF to professional members in any EU member state. In a nutshell, the directive imposes rules on: how managers may conduct business (e.g. the remuneration, rules of conduct and conflict of interest), valuation, risk, and liquidity management, the depositary (generally an authorized financial institution with registered offices in the EU), and the delegation of management functions. The AIFMD also implements detailed rules regarding disclosures to investors and reporting requirements to regulators.

Consequences for a Swiss AIFM

An AIFM located in Switzerland may only provide asset management services to an EU AIF once it has received authorization from the EU member state of reference, which is the state where the AIFM carries out most of its management services. Full compliance with the AIFMD provisions will be required in order to obtain authorization. In addition, the following requirements will have to be met:

- The Swiss AIFM will have to appoint a legal representative located in the EU member state of reference. The legal representative shall, along with the AIFM itself, be the non-EU AIFM's contact for the relevant AIF's investors, ESMA, and the competent authorities regarding the activities which the AIFM is authorised to perform in the EU. The legal representative shall at a minimum be sufficiently equipped to perform compliance functions for the AIFM;
- A cooperation agreement must be put in place between the Swiss Financial Market Authority Finma («FINMA») and the corresponding authorities of the relevant EU member state in order to ensure an efficient exchange of information that will allow the competent authorities to carry out their duties regarding the supervision of the relevant AIFM;
- Switzerland shall not be listed as a non-cooperative country and territory by the Financial Action Task Force on anti-money laundering and terrorist financing;
- Switzerland shall have signed a double tax treaty with the member state of reference, which fully complies with the standards laid down in Article 26 of the OECD Model Tax Convention and ensures an effective exchange of information in tax matters;
- FINMA will have to supervise the AIFMs and the applicability of the AIFMD rules shall not be prevented by Swiss laws and regulations.

The aforementioned requirements apply to the marketing of an AIF established in Switzerland within the EU area as well. According to the last requirement listed above, Switzerland would essentially have to provide for adequate regulation and supervision of all AIFMs compared with the rules of the AIFMD, which is not yet the case. Further, the requirement of a cooperation agreement may turn out to be a Trojan horse: Since the minimum content of such a cooperation agreement will only be defined in the pending level two measures, one cannot exclude the possibility that the information demands may go beyond fund related issues and include certain investor data as well. As an alternative to the authorization proceedings mentioned above, the AIFMD permits EU member states to allow a Swiss AIFM to provide management services to the EU or market non-EU AIFs under a national private placement regime. The regulatory burden under this regime is rather light as the AIFM will only need to comply with the transparency requirements of the directive (e.g. an annual report, disclosure to investors, and reporting to competent authorities).

Conclusion

It will be difficult for the Swiss alternative fund industry to survive if Swiss law makers and regulators are not able to quickly bring Swiss legislation into compliance with the rules of the AIFMD once the level two measures have been published. At the same time, the new (costly) regulations in the EU provide a chance for the Swiss financial industry. Moderate Swiss regulation paired with an attractive tax regime may attract managers of alternative investment funds that are not currently being marketed to the EU area. Regardless, much effort will be required from the Swiss investment fund industry in order to handle these new regulations.

Walder Wyss Ltd.
Attorneys at Law

Seefeldstrasse 123
P.O. Box 1236
8034 Zurich
Switzerland

Phone + 41 44 498 98 98
Fax + 41 44 498 98 99
reception@walderwyss.com
www.walderwyss.com

Bubenbergplatz 8
P.O. Box 8750
3001 Berne
Switzerland

Phone + 41 44 498 98 98
Fax + 41 44 498 98 99
reception@walderwyss.com
www.walderwyss.com