I

(Resolutions, recommendations and opinions)

OPINIONS

EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 16 October 2009

on a proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/…/EC

(CON/2009/81)

(2009/C 272/01)

Introduction and legal basis

1. On 3 June 2009 the European Central Bank (ECB) received a request from the Council of the European Union for an opinion on a proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/…/EC ([1]) (hereinafter the 'proposed directive').

2. The ECB's competence to deliver an opinion is based on the first indent of Article 105(4) of the Treaty establishing the European Community. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

General observations

3. The ECB supports the intention to provide a harmonised regulatory and supervisory framework for the activities of alternative investment fund managers (AIFMs) in the European Union. The proposed provisions on reporting to the competent authorities should, in principle, contribute significantly to enhancing financial stability monitoring and thus to better informed assessments of the risks to financial stability connected with the activities of AIFMs and the Alternative Investment Funds (AIFs) that they manage. The harmonisation of rules and the resulting passport should benefit financial integration by improving the level playing field in the EU.

4. The ECB urges the Commission of the European Communities to continue the dialogue with its international partners, in particular the United States, to ensure a globally coherent regulatory and supervisory framework. As noted by the Eurosystem in its contribution to the Commission's consultation on hedge funds, an internationally coordinated response is necessary given the highly international nature of the industry and the consequent risks of regulatory arbitrage and evasion ([2]). This might help to ensure that the requirements in third countries for AIFMs are equivalent to those to be put in place in the EU and that non-EU domiciled AIFMs could benefit from access to the EU markets on a reciprocity basis.

([1]) COM(2009) 207 final.

([2]) Eurosystem contribution to the European Commission's consultation on hedge funds, 25 February 2009, p. 3, available on the ECB's website at http://www.ecb.europa.eu

5. Recital 3 of the proposed directive identifies, as one of its central objectives, the establishment of a framework capable of addressing the risks 'to investors, other market participants and markets' posed by AIFs by 'taking into account the diverse range of investment strategies and techniques employed by AIFM'. In this respect, it is noted that the proposed directive would concern all types of funds not covered by Directive 2009/…/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) ([1]) such as hedge funds, commodity funds, open-ended real estate funds, listed closed-ended funds, private equity funds and venture capital funds. Such funds form a heterogeneous group of investment pools, organised under various legal forms in different jurisdictions, both within and outside the EU. In this respect, the provisions of the proposed directive could be tailored in a way that better reflects fundamental differences between AIFs.

6. All central banks should be expressly excluded from the scope of the proposed directive.

7. More generally, the ECB sees a potential risk of regulatory arbitrage between AIFMs, insurance companies and credit institutions, among which the proposed directive does not create a level playing field. Except for the AIFM's management of its own assets, requirements under the proposed directive should be coherently applied to AIFMs, credit institutions and insurance companies. In the same vein, the proposed directive does not specify 'fit and proper' criteria and minimum experience requirements for an AIFM's senior managers and executives. For level playing field reasons, the ECB therefore suggests inserting provisions to this effect in the proposed directive in line with similar provisions in other areas of the EU financial acquis.

8. The ECB notes that certain provisions in the proposed directive (for example, those related to short selling, securitisation and the acquisition of a controlling influence in companies) are intended to regulate horizontal issues that concern all market participants, and not just AIFMs. While the ECB understands the rationale for certain of those provisions, the ECB would suggest considering instead introducing such provisions only by means of legislation that maintains the level playing field among various market participants, for instance by inserting such provisions in existing EU legislation applicable across sectors.

9. The ECB welcomes, in principle, the provisions relating to the reporting obligations of AIFMs (who would be required to provide high-quality information to the competent authorities) and the mechanisms for the exchange of information between supervisory authorities. The ECB however suggests that an in-depth analysis should be undertaken in order to focus reporting obligations on data that can reasonably be expected to be relevant for monitoring financial stability, to ensure the consistency of data reporting obligations with the legal framework that will establish the European Systemic Risk Board (ESRB) and the European System of Financial Supervisors (ESFS), and to enable these bodies to obtain supervisory information necessary and appropriate to fulfil their respective tasks ([2]). While the focused reporting obligations that result from this analysis should be reflected in the proposed directive, further specification would also be possible through comitology. The ECB stands ready to assist in the analysis.

10. Due consideration could also be given to aligning certain requirements to report to the competent authorities (as specified in draft Articles 21 and 24) with those of Regulation ECB/2007/8 of 27 July 2007 concerning statistics on the assets and liabilities of investment funds ([3]). This Regulation, which currently applies to euro area-domiciled investment funds, enables harmonised balance sheet statistics to be collected. Alignment with these reporting requirements and the use of a standardised reporting template for all AIFs covered by the proposed directive would contribute to EU-wide systemic risk assessment. It would also minimise the additional reporting burden for those AIFs that are already reporting such information. While the proposed directive should specify the fundamental rules that apply to the business models implemented by AIFMs, the ECB would also support resorting to comitology procedures to devise certain of the more technical and detailed provisions aimed at the EU-wide standardisation of the information mentioned in draft Articles 21 and 24. The items covered

([1]) Not yet published in the Official Journal.
([2]) Communication from the Commission, European Financial Supervision, 27.5.2009, COM(2009) 252 final, available on the Europa website at http://www.eur-lex.europa.eu
([3]) OJ L 211, 11.8.2007, p. 8.

by the reporting requirements could thus include, for instance, the AIF's balance sheet information based on Regulation ECB/2007/8, income statements, cash flow statements and projections (including primary sources of funding, list of prime brokers and contingency liquidity arrangements in different scenarios), investor redemption restrictions, assets held using a mark to model valuation, leverage, positions in derivatives (including notional amounts and collateral posted), illiquid assets and non-investment grade assets, and the use of short-selling. The ECB expects that the ESRB will be consulted on implementing measures to be adopted in this area.

11. The concept of leverage is fundamental to the business model implemented by many AIFMs. The definition of 'leverage' under the proposed directive does not, however, include specific leverage ratio concepts. The ECB is concerned that, without additional clarifications inserted into the text of the proposed directive, it may be difficult to implement the proposed definition. Implementing measures in this area should benefit from the technical contributions of central banks and non-central bank supervisors. Thus, the ECB expects that the ESRB and the ESFS will be consulted on implementing measures to be adopted in this area, including as proposed in Amendment 7 in the Annex, on possible measures refining the concept of 'leverage', and on specifying when an AIF is employing high levels of leverage on a systematic basis.

12. Article 25(3) of the proposed directive provides that the Commission shall adopt implementing measures setting limits on the level of leverage that AIFMs can employ, taking into account, inter alia, the type of AIF, its investment strategy and the sources of leverage. The ECB acknowledges that leverage can create important risks for financial stability. Owing to their investment flexibility, AIFMs can play an important role in supporting financial market liquidity, thereby contributing to effective financial market functioning and price discovery. Maintaining this role calls for balanced and appropriately risk-adjusted leverage limits applicable to AIFs that take their full risk profile into account while not excessively hindering their investment flexibility.

13. The ECB stands ready, if warranted, to offer further views on any revised draft that becomes available. Where the ECB recommends amending the proposed directive, specific drafting proposals are set out in the Annex accompanied by an explanation. The majority of these proposals do not address the more general observations made above.

Done at Frankfurt am Main, 16 October 2009.

The President of the ECB

Jean-Claude TRICHET

ANNEX

Drafting proposals

Text proposed by the Commission	Amendments proposed by the ECB [1]
Amendment 1	
Article 2(2) (new point (h))	
'2. This Directive shall not apply to any of the following: […].'	'2. This Directive shall not apply to any of the following: […] **(h) national central banks of the Member States.**'
Explanation:	
Article 2(2)(g) of the proposed directive excludes, inter alia, the ECB from the scope of the proposed directive. The national central banks in the European System of Central Banks should also be expressly excluded from the scope of the proposed directive as these central banks, in view of their objectives and tasks, do not represent sources of risk justifying their inclusion within the proposed directive.	
Amendment 2	
End of Article 3	
	'The Commission shall adopt implementing measures further specifying the definition of "Leverage" in paragraph 1 **Those measures designed to amend non-essential elements of this Directive by supplementing it shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 49(3).'**
Explanation:	
The definition of 'Leverage' could be usefully clarified.	
Amendment 3	
Article 8	
'Article 8 *Withdrawal of the authorisation* The competent authorities may withdraw the authorisation issued to an AIFM where that AIFM: 1. has obtained the authorisation by making false statements or by any other irregular means; 2. no longer fulfils the conditions under which authorisation was granted; 3. has seriously or systematically infringed the provisions transposing this Directive.'	*'Article 8* *Withdrawal of the authorisation* The competent authorities may withdraw the authorisation issued to an AIFM where that AIFM: 1. has obtained the authorisation by making false statements or by any other irregular means; 2. no longer fulfils the conditions under which authorisation was granted; 3. has seriously **and**/or systematically infringed the provisions transposing this Directive. **Any withdrawal of authorisation shall be effective immediately and promptly announced**. **The Commission shall adopt implementing measures further specifying the timing and the addressees of an announcement on the withdrawal of an authorisation in paragraph 1**. **Those measures designed to amend non-essential elements of this Directive by supplementing it shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 49(3).**'

Text proposed by the Commission	Amendments proposed by the ECB [1]

Explanation:

Many credit and master agreements specify 'events of default' that entitle a counterparty to terminate a contract or a transaction entered into under the master agreement. Withdrawal of authorisation is a standard type of 'event of default'. To ensure that any withdrawal of an AIFM's authorisation does not result in a disorderly termination process — that may well otherwise have different effects in different Member States — it would be desirable to specify that the practical implications of a withdrawal are the same throughout the EU, in particular with respect to when and to whom a withdrawal of authorisation is announced, and when the withdrawal produces effects. The ECB suggests that the Commission could adopt implementing measures via a comitology procedure to specify when and to whom a withdrawal of authorisation should be announced.

The ECB would express similar concerns if breaches by an AIFM of the 'operating conditions for AIFM' set out in Chapter III of the proposed directive were also to result in an event of default, or trigger other contractual or legal rights of termination.

Amendment 4

Article 16(3)

'3. The rules applicable to the valuation of assets and the calculation of the net asset value per unit or share of the AIF shall be laid down in the law of the country where the AIF is domiciled or in the AIF rules or instruments of incorporation.'	'3. The rules applicable to the valuation of assets and the calculation of the net asset value per unit or share of the AIF shall be ~~laid down in~~ **those applicable in accordance with** the law of the country where the AIF is domiciled or the AIF rules or instruments of incorporation.'

Explanation:

US Generally Accepted Accounting Principles or 'GAAP' are not 'laid down in the law' of the United States, and a similar factual background may well apply in other countries. Article 16(3) of the proposed directive, as drafted, may therefore be impossible to implement.

Amendment 5

Article 17(3)

'The depository shall be a credit institution having its registered office in the Community and be authorised in accordance with Directive 2006/48/EC of the European Parliament and Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast).'	'The depository shall be a credit institution having its registered office in the Community and be authorised in accordance with **national law or** Directive 2006/48/EC of the European Parliament and Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast).'

Explanation:

The amendment would broaden the definition of depository at least to include credit institutions that are allowed under national law, rather than just credit institutions authorised by Directive 2006/48/EC.

Amendment 6

Article 18(1)(d)

'(d) the AIFM must demonstrate that the third party is qualified and capable of undertaking the functions in question, that it was selected with due care and that the AIFM is in a position to monitor effectively at any time the delegated activity, to give at any time further instructions to the third party and to withdraw the delegation with immediate effect when this is in the interest of investors.'	'(d) the AIFM must demonstrate that the third party is qualified and capable of undertaking the functions in question, that it was selected with due care and that the AIFM is in a position to monitor effectively at any time the delegated activity, to give at any time further instructions to the third party and to withdraw the delegation with immediate effect when this is in the interest of investors **and simultaneously substituting different delegation arrangements that are consistent with Article 6(3)**.'

Explanation:

To ensure consistency with Article 6(3) of the proposed directive, which requires the authorisation of any AIFM to 'cover any delegation arrangements made by the AIFM', the proposed change is intended to require that alternative delegation arrangements are in place should it ever become necessary for the AIFM to withdraw a delegation 'with immediate effect'.

Text proposed by the Commission	Amendments proposed by the ECB [1]
Amendment 7	
End of Article 22	
'For the purposes of the second subparagraph, an AIF shall be deemed to employ high levels of leverage on a systematic basis where the combined leverage from all sources exceeds the value of the equity capital of the AIF in two out of the past four quarters.'	'~~For the purposes of the second subparagraph, an AIF shall be deemed to employ high levels of leverage on a systematic basis where the combined leverage from all sources exceeds the value of the equity capital of the AIF in two out of the past four quarters~~. **The Commission shall adopt implementing measures further specifying the circumstances in which an AIF shall be deemed to employ high levels of leverage on a systematic basis**. **Those measures designed to amend non-essential elements of this Directive by supplementing it shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 49(3).**'
Explanation:	
Article 22 of the proposed directive would have the practical effect that the vast majority of AIFs would be deemed to employ high levels of leverage on a systematic basis because their combined leverage would frequently exceed their net assets (rather than their 'equity capital'), which might not provide the appropriate point of reference in a fund context. The ECB suggests that this technical issue would be best resolved by the Commission adopting implementing measures via a comitology process, with the appropriate involvement of supervisors and other competent authorities.	
Amendment 8	
Article 33(8)	
'8. AIFM may only market shares or units of an AIF domiciled in a third country to professional investors domiciled in another Member State than the home Member State of the AIFM as from the date referred to in the second subparagraph of Article 54(1).'	'8. AIFM may only market shares or units of an AIF domiciled in a third country to professional investors domiciled in another Member State than the home Member State of the AIFM as from the date referred to in the second subparagraph of Article 54(1). **Shares or units of an AIF domiciled in a third country that have been purchased by an investor domiciled in a Member State prior to that date may continue to be held by the investor or sold to the AIFM.**'
Explanation:	
As of now, investors (including private, retail investors) may legitimately own shares or units of third-country domiciled AIFs. Our proposed addition is designed to ensure that there are legal rules for handling such investments after the transition to the new regime set out in the proposed directive (i.e., a regime under which an AIFM from a third country would need authorisation in order to continue its current activities within the EU), and in particular to ensure that the value of those shares or units is not adversely affected merely as a result of the third-country AIFM either not seeking, or not obtaining, authorisation to continue its current activities within the EU. Alternatively, the transitional rules could be amended.	
Amendment 9	
Article 46(1)	
'1. The competent authorities responsible for the authorisation and supervision of AIFM under this Directive shall communicate information to the competent authorities of other Member States where this is relevant for monitoring and responding to the potential implications of the activities of individual AIFM or AIFM collectively for the stability of systemically relevant financial institutions and the orderly functioning of markets on which AIFM are active. The Committee of European Securities Regulators (CESR) established by Commission Decision 2009/77/EC of 23 January 2009 [2] shall also be informed and shall forward this information to the competent authorities of the other Member States.'	'1. The competent authorities responsible for the authorisation and supervision of AIFM under this Directive shall communicate information to the competent authorities of other Member States, ~~where this is relevant for monitoring and responding to the potential implications of the activities of individual AIFM or AIFM collectively for the stability of systemically relevant financial institutions and the orderly functioning of markets on which AIFM are active~~ **to the central banks, including the European Central Bank and to the European Systemic Risk Board, for the exercise of their functions**. ~~The Committee of European Securities Regulators (CESR) established by Commission Decision 2009/77/EC of 23 January 2009 [2] shall also be informed and shall forward this information to the competent authorities of the other Member States.~~'

Text proposed by the Commission	Amendments proposed by the ECB [1]

Explanation:

The addition would ensure that central banks, including the ECB (also on behalf of the ESRB) are appropriately informed of information relevant to the exercise of their functions by use of terminology applied in other areas of the EU financial acquis.

[1] Strikethrough in the body of the text indicates where the ECB proposes deleting text. Bold in the body of the text indicates where the ECB proposes inserting new text.
[2] OJ L 25, 29.1.2009, p. 18.