

General comments

First of all it is a great achievement for the Icelandic financial industry to implement a new comprehensive legislation on the so-called Alternative Investment Fund Managers (« AIFMs »). This legislation will modernize the asset management regulatory framework establishing a clear distinction between the UCITS funds and Alternative Investment Funds (« AIFs ») or Specialized funds.

This legislation is the consequence of the EU politicians answer to the 2008-2009 financial crisis with the adoption of the Alternative Investment Fund Manager Directive (« AIFMD ») in 2011. The aim of the AIFMD is to bring a harmonised regulatory framework across the EEA for AIFMs and enhance the investors protection. Specifically, it seeks to ensure that all AIFMs are subject to appropriate authorisation and registration requirements; that there is proper monitoring of macro- and micro-prudential risks and a common approach to protecting professional investors; that there is greater accountability of AIFMs holding controlling stakes in non-listed companies; and the development of the Single Market in AIFs.

To this end, it covers a large number of areas including conduct of business, remuneration, delegation, valuation, reporting and transparency, risk, liquidity, depositary duties. It is worth to mention that it regulates the management company and not the fund itself.

EEA Member States have very little discretion as to how to implement Directive 2011/61/EU, as it is mostly what is known as a maximum harmonisation Directive. Nevertheless, this current draft of includes some national points such as the possibility to market AIFs to retail investors or the possibility to appoint professional custodians (e.g. lawyers or chartered accountants) upon conditions or to maintain a National Private Placement Regime (« NPPR »).

We could regret that the Level 2 Delegated Act on AIFMD provisions (« Level 2 ») has not been already integrated in the drafting of the bill to offer a consolidated regulation on AIFs. The industry will have to wait the regulation to be issued by the Ministry to properly implement the law and solve some points open for interpretation.

Given the deep trend regarding responsible investments and how the financial operators will answer to that new challenges, we could also consider that it is a missed opportunity to not have included minimum requirements on ESG integration or additional non-financial information disclosures in the reporting.

Finally, given the pressure to improve the transparency on all the fees and costs charged to the investors, this draft could have included provisions to facilitate the benchmarking amongst AIFs.

Five years post- implementation in EU, what are the lessons ?

Being mandatory since 2013 in EU, it is now possible to assess the first consequences of this piece of legislation on the various parties involved. Obviously, the fund managers have benefitted from the possibility of passporting for managing and distributing AIFs to professional investors across EEA. So we can expect that Icelandic fund managers would now be on the same playing field as other fund manager and would be able to attract more foreign capital.

The other lessons of the AIFMD implementation are the increased competition faced by the fund managers and the internal operational improvements. Indeed, AIFMs reviewed and in many cases adjusted their governance, policies and procedures to meet the requirements of AIFMD. Nevertheless, it led to higher cost mostly due to (i) the authorisation process, (ii) the marketing rules, (iii) the depositary requirements, and (iv) the minimum capital requirements. Furthermore, it will be interesting to see the FME decisions about the authorisation and on-going supervisory fees.

Regarding the investors, most LPs do not seem to have very strong views on the changes the AIFMD induced. They enjoy a relative increase of protection given the new organizational requirements especially around the reporting but are paying more fees (half of the costs have been passed onto LPs). The product range reduced also as smaller AIFMs are not anymore able to offer niche AIF products.

From a wider economy perspective, AIFMD has generally had a positive influence on the limitation of micro-prudential risks as regards conflicts of interests and risk management.

What are the key pitfalls we can anticipate ?

The previous implementation in EU countries gives Iceland valuable information on how to anticipate the main pitfalls. Firstly, the questions will be around the definition of an AIF and the interpretation of the criteria. Is it doing a fundraising if there are two investors ? What does it mean to have an investment policy ? Does a fund with one investment is not a AIF ? Some preliminary guidance provided to the industry will save time for the implementation.

Then at the level of the AIFM, it will be important to define precisely the periodicity of calculation of the threshold (annually ?) and to include some clauses dealing with the currency conversion of the threshold. We could questioned if it makes sense for an AIFM to be forced to request an authorization just because the krona appreciates significantly at year end for example.

Then the new batch of organizational requirements will raise questions especially for smaller AIFMs who could face staffing issues to setup a full functional and hierarchical separation of risk and portfolio management. Some incompatibilities will also have to be solved such as being portfolio manager and doing the valuation for example. In most cases, we can anticipate that the risk management function may be performed by a third party in certain instances applying the proportionality principle.

Another most debated point is the risk management provisions. As outlined by the Level 2, AIFMs will have to have in place a well-documented risk management policy covering all risks faced by the AIFs and the risk manager will need to set quantitative and/ or qualitative risk limits for each AIF covering market, credit, liquidity, counterparty and operational risks. That being said, it let a wide space for interpretation. FME, fund managers, service providers will have to agree on a common approach to ensure the proper implementation.

The next element to figure out is the delegation aspect of the AIFMD which will have to be closely monitored. Indeed, an AIFM may delegate part of its function but doesn't become a mere letter box. The AIFM should be able to justify any delegation, evaluate the delegates (skills, structure, staff...) and control. A particular attention will have to be made on the current intra-group arrangements and implement new processes to ensure a proper independence e.g. between parent/subsidiary.

The new requirements will also have wide reaching implications for the depositaries themselves, in terms of added costs and changes to their service offerings to name a few. Various elements are still discussed at European level such as the look-through principle for the safe-keeping obligations, the cash flow monitoring or the oversight duties. To which extent the depositaries have to look at the whole structure between the AIF and the underlying investments ? What would be the oversight frequency ? Do they have to do on-site visits for all AIFMs or with a risk-based approach ? What are the checks to perform for the oversight of a new investment ? This new law could be the right opportunity for the legislator to clarify or provide best practices to avoid heterogenous answers from the entities in-scope.

Conclusion

The current bill will have an extensive impact on the various parties involved in the alternative investment funds industry and to mitigate the increase of the operating costs, it is advisable that the points which have been largely discussed in EU are addressed directly through the regulations.

Finally, it is worth to mention that most of the provisions are consistent with the upcoming UCITS V regulations.

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