SECTOR SPOTLIGHT:
The Impact of the Alternative Investment Fund Manager's Directive

Fergus McNally is an Asset Management Partner at EY.

"With many asset managers and global service providers impacted by the directive, being in a position as EY are, to mobilise multi-jurisdictional teams with the requisite local legislative and industry knowledge has been a big advantage," said Mr McNally. *"We have been able to mobilise these cross border teams at short notice to deliver meaningful solutions to our clients as they navigate the challenges of the directive."*

Mr McNally stated that the breadth and reach of AIFMD make it a truly transformational piece of legislation. He noted that, following the financial crisis in 2008, legislators have sought to impose a comprehensive set of rules on investment managers, in the hope that crises of the future will be averted.

"From an AIFM's perspective, the directive places numerous responsibilities on the manager vis-à-vis authorisation, operations and supervision of the manager," he observed. *"For smaller asset managers, there is no doubt that the directive will add cost and complexity to the running of these businesses, as they either look to add staff numbers or delegate out certain functions in order to comply with the requirements of the directive."*

Mr McNally explained that the directive does not stop at investment managers. In his view, arguably one of the most contentious aspects of the directive concerns the role of the depositary and in particular depositary liability. Under the directive, a depositary will be, as a general rule, liable to an AIF or its investors for the loss of financial instruments in its custody. The depositary will not however be liable where it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable.

"As you can imagine, this has been the subject of intense debate within the industry over the past few years as organisations seek to understand their new found responsibilities under the directive and develop new operating frameworks and pricing structures to manage this challenge in an AIFMD ready world," he elaborated.

For EY's clients, the directive raises the regulatory/compliance bar. Mr McNally noted that over the past 18 months, the firm's clients, both managers and service providers alike, have been conducting a gap analysis of existing operating models, policies and practices with the requirements of the directive.

"At EY, we have a long history of working with start-up managers in the alternatives sector," he continued. *"With the additional cost barriers to entry of AIFMD, I believe we will see a further drop off in start-ups in this space than we have seen in the past."*

According to Mr McNally, the obvious pros of the directive are the ability for authorised AIFM's to avail of the European marketing passport as they seek to distribute their products across the EU. From an investor perspective, he believes that the *"Brand AIFMD"* could be seen as a mark of quality, with *"base line"* operational standards for investment managers. This could in turn speed up investor operational due diligence and decision making when it comes to investing in an AIFM's fund products.

On the other hand, Mr McNally highlighted the increased costs associated with compliance as a major con.

"There are many compliance challenges associated with the directive," he commented. *"Right now, a key area of focus for managers is to understand the remuneration provisions of the directive with certain jurisdictions, including the FCA, having just recently published specific guidance on this. In addition, managers have been:*

- *working through how they are organised internally and what gaps need to be remedied to comply with the directive;*
- *determining how they will seek to manage the delegation of functions and establishing; and*
- *documenting robust policies and procedures, in order to be able to demonstrate to regulators on inspection their compliance with the directive.*

"Depositaries have been grappling with the risk that AIFMD poses to their business and how to develop sophisticated pricing policies to ensure that they are remunerated for this. They have also been carefully redesigning their internal operating frameworks, to enable themselves to carry out their responsibilities under the directive, including developing new solutions to capture their responsibilities for cash flow monitoring."

Mr McNally believes that the most positive impact of the directive will be felt by firms who look to avail of the marketing passport sooner rather than later. He stated that the benefits of having such a passport will enable firms to navigate and distribute in a homogenous manner across the EU, which compares favourably with the complexity and differing requirements of currently navigating differing private placement regimes on a country by country basis.

"Additionally, and admittedly it's too early to say yet, but AIFMD has the potential to be to alternatives what UCITS is for mutual funds and in the future might serve as a positive marketing banner for firms looking to gather assets," he added.

As a jurisdiction, Ireland administers more than 40% of all global hedge fund assets. Mr McNally sees AIFMD as an opportunity for Irish service providers to offer clients AIFMD ready solutions in fields such as reporting, valuation and possibly through "Depository Lite" offerings.

"As a location which has heavily invested in servicing the alternatives sector, Ireland may well be ideally placed as a domicile, for investment managers as they look to either re-domicile existing fund products to a European centre of create new European based AIF's, that fully comply with the directive and mirror their successful offshore investment strategies," he explained.

"I suspect new fund/manager launches will drop off as firms utilise the transitional provisions of the directive, adopting a wait and see approach for a form of precedence or standardisation to emerge," concluded Mr McNally.

EY
Building a better working world

Company: EY
Name: Fergus McNally
Email: fergus.mcnally@ie.ey.com
Web: www.ey.com/ie
Address: Harcourt Centre, Harcourt Street, Dublin 2
Telephone: +353 1 221 2599