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Dear Sirs

Alternative Investment Fund Managers Directive

The City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Regulatory Committee. Members of the CLLS Regulatory Committee (the "**Committee**") advise a wide range of firms in the financial markets including banks, brokers, investment advisers, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

The members of the CLLS Regulatory Committee have particular experience in relation to the establishment and regulation of all types of domestic, EU and third country funds and represent firms with international fund establishment practices. Our comments are not therefore made solely from a U.K. perspective.

We are aware that various industry sectors will be commenting on the Directive from their own perspective. We are not making this submission in support of any particular industry sector and this letter does not address all the general issues generated by the current draft. Our purpose is solely to highlight certain core areas which we, as lawyers who regularly have to interpret legislation in relation to funds in a range of jurisdictions, consider create significant legal uncertainty. It is essential, if the Directive is to be successful, that there is no doubt as to its scope as otherwise there will be uneven implementation and the possibility of regulatory arbitrage across Member States. Legal uncertainty is also costly and produces a deeply unsatisfactory result for firms and investors.

We are not addressing all the ambiguities and uncertainties in the draft, since at this stage our purpose is to highlight the fundamental uncertainties arising out of the definition of "alternative investment fund", as to the activities that fall within the scope of the Directive and the position of third country managers and funds. We will be sending further comments on other issues that concern us.

"Collective investment undertaking"

It is extremely important that the Directive contains a proper definition of what is meant by a "collective investment undertaking" that is within its scope. At present, the concept is vague and uncertain; in the UK a similarly vague and broadly drafted concept led to the need for extensive exemptions, and we think this is an approach that should be avoided.

We suggest that the qualities of a collective investment undertaking as referred to in Recital 5 should appear in the definition in Article 3 so as to make it clear that for such an undertaking to exist (1) there must be capital raised from a number of investors with a threshold minimum number of participants in the undertaking, and (2) their investment should be made with a view to investing that capital in accordance with a defined investment policy on the principle of risk spreading for the benefit of those investors. Indeed, if this point is not recognised, there will need to be numerous exemptions to remove arrangements from the definition that would otherwise not be regarded in any normal sense as investment funds, for example to exempt large industrial companies with multiple subsidiaries, and single asset investment vehicles (because the concept extends to closed-ended entities).

There will still be a need for a few exemptions to put the position beyond doubt in certain areas and to remove from the ambit of the definition arrangements that ought not to be the subject of the substantive provisions of the Directive. In particular, we believe that there will need to be exemptions to deal with:

- investment arrangements involving only undertakings within the same group;

- employee participation schemes;

- joint venture arrangements; and

- legitimate arrangements established to facilitate corporate and financing transactions (including, but not limited to, vehicles which are used to facilitate investments, such as special purpose vehicles).

It is particularly important to eliminate the uncertainty because of the consequences of falling within the Directive, in particular in relation to marketing. It would create an absurdity to subject normal commercial, corporate and joint venture arrangements to pre-marketing notifications to regulators etc.

An enhanced definition accompanied by specific exemptions is therefore essential to avoid problems of legal uncertainty. We also consider that there should be powers to create further clarification in Level 2 legislation on the interpretation of "a number of investors" and "investing on the principle of risk spreading" and, in view of the likelihood that other difficulties will be identified later due to the lack of prior consultation on the Directive, possibly also to permit the creation of further exemptions in respect of other arrangements which are not considered to generate systemic risk concerns of the type the Directive addresses.

Activity being regulated

Whilst we understand that the intention of the Directive is to regulate the manager of the fund, it is not entirely clear what activities bring a person or an entity within the scope of the definition of "manager of alternative investment funds". In a meeting of lawyers from the different major law firms represented on the Committee, all active in the structuring of alternative investment funds, we had no common view of who would fall within this definition, in fact there were multiple views and no agreement between us as to the intention behind or the interpretation of the text.

Given that the Directive applies to funds of every kind and strategy, account needs to be taken of the fact that there are many possibilities at present for the structuring of the fund arrangements. It is not the case that in every fund there is a single entity which either carries out or which has overall responsibility for "management and administration services". It is very common in some types of fund/sectors for management to be separated from administration. In many common fund structures used throughout Europe there may be a fund vehicle with a board exercising overall supervisory functions and which sets or approves the investment policy and appoints one or more managers and, in some cases, separate administrators. The manager may appoint other managers. The legal powers and ability of these entities to influence the fund will be variable. Further, closed-ended funds in the form of bodies corporate will often have both a board of directors with overall responsibility for the entity's affairs as well as an external manager responsible for execution of the entity's investment policy and possibly, but not necessarily, also its affairs more generally. It is critical that there is clarity as to which entity is the AIFM. There must be a clear policy decision taken as to the characteristics which define the entity within the scope of the definition of "AIFM" and these must be clearly reflected in the Directive.

The confusion is increased by the definition of "management services". This is defined as the "activities of managing and administering one or more AIF on behalf of one or more investors". These are clearly recognised by the funds industry as wholly separate concepts. Is it therefore the intention that if a fund has a separate manager and administrator that neither of them falls within the scope of the Directive? This is a very common arrangement and in some types of fund is standard.

We also assume (although it is not stated) that if the day-to-day management of a fund is in fact the responsibility of the investors, then they are not the "manager", which would be the generally accepted view today. We believe it would be important to make this clear, particularly as the current definitions cover closed-ended entities and, unless amended as described above, will capture normal commercial, corporate and joint venture arrangements that would not ordinarily be regarded as investment funds.

In addition, the use of the term "AIFM" does not always appear to refer to a manager "*authorised under the Directive*", different terms must be used to refer to managers who are

not authorised under the Directive, otherwise confusion is increased. In addition, it should be clarified whether the term "authorised under the Directive" includes managers authorised for marketing purposes under Article 39.

Third country funds

We wish to raise the following points of legal uncertainty:

The Directive creates regimes which distinguish between funds "domiciled" or "established" in a third country and in a Member State. This concept has no settled meaning in the context of a fund, not least because of the multiple fund structures available, including pure contractual funds. We suggest that this uncertainty could be avoided by referring to "the law under which the fund is constituted".

The Directive imposes a three year period before the third country provisions apply. It needs to be clear that during that three year period a third country fund/manager can carry on marketing activity in accordance with the local private placement regime, and also that this will continue to be the case after the three years period has finished.

Position of firms authorised under other Directives

It is not clear whether credit institutions, insurance companies and pension funds are intended to be excluded from the whole of the Directive (including the provisions relating to managing and marketing AIF in which third parties invest) or only to be excluded in respect of management of their own account monies.

It is also not clear what the position is in relation to MiFID firms and what investment services may be provided by them to AIF or AIFM which are not subject to the Directive or to their other clients in relation to such AIF. This produces a further lack of clarity in relation to credit institutions which are subject to MiFID in relation to some services they provide. In our view there should be no restriction on the ability of MiFID firms to provide MiFID services and this must be made clear in the Directive.

We would be delighted to discuss the above concerns with you and to suggest drafting if required. You may contact me on 0207 295 3233 or by e-mail at margaret.chamberlain@traverssmith.com

Yours sincerely

Margaret Chamberlain

Margaret Chamberlain
Chair CLLS Regulatory Committee

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