The Alternative Investment Fund Managers Directive
European Regulation of Alternative Investment Funds

Dirk Zetzsche (ed.)

The Alternative Investment Fund Managers Directive (AIFMD) may be the most important European asset management regulation of the early 21st century. However, a preponderance of practitioners and academics in the field argue that, in its present form, the directive is seriously out of touch with both the system of European financial law and industry practice.

In this first in-depth analytical and critical discussion of the content and system of the directive, thirty-four contributing authors — academics, lawyers, consultants, fund supervisors, and fund industry experts — examine the AIFMD from every angle. They cover structure, regulatory history, scope, appointment and authorization of the manager, rules on delegation, reporting requirements, transitional provisions, and the objectives stipulated in the recitals and other official documents. The challenging implications and contexts they examine include the following:

- connection with systemic risk and the financial crisis;
- impact on money laundering and financial crime;
- nexus with insurance for negligent conduct;
- connection with corporate governance doctrine;
- risk management;
- transparency;
- the cross-border dimension;
- liability for lost assets; and
- impact on alternative investment strategies.

Ten country reports add a national perspective to the discussion of the European regulation. These chapters deal with the potential interactions among the AIFMD and the relevant laws and regulations of Italy, Switzerland, Luxembourg, The Netherlands, Austria, Liechtenstein, the United Kingdom, Germany, France, and Ireland. The former are Europe’s most vibrant financial centres and markets.

Designed to spur a critical attitude towards the emerging new European financial markets framework presaged by the AIFMD, this much-needed discussion not only elaborates on the inconsistencies and difficulties sure to be encountered when applying the directive, but also provides potential solutions to the problems it raises. The book will be warmly welcomed by investors and their counsel, fund managers, depositaries, asset managers, and administrators, as well as academics in the field.
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Dirk A. Zetzsche
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List of Contributors

Moritz Bassler is a Ph.D. student and research associate at the Chair of Prof. Rüdiger Wilhelmi for Private Law, Commercial, Company and Business Law as well as Comparative Law at the University of Konstanz, Germany. After he completed his studies in law at the University of Münster, Germany, and law and accountancy at the University of Dundee/Scotland he worked at the law firm White&Case LLP in Frankfurt in the departments for corporate law and mergers & acquisitions. Besides his research activities in company and capital market law he is holding seminars in contract law. In his dissertation he analyses the legal framework for collective investment schemes and certain trading activities that are employed by institutional investors.

Patrick Bont is the Head of the Legal & International Affairs team at the Financial Market Authority Liechtenstein where he has worked since 2009. Previously, he was a Director in the legal & compliance department of Swiss bank UBS in Switzerland and in Hong Kong. Patrick holds a master degree in law from the University of St. Gallen and a LL.M. in company, foundation and trust law from the University of Liechtenstein.

Prof. Dr. Paulo Câmara is an Invited Professor of the Faculty of Law at the Catholic University of Lisbon, of the Portuguese Securities Law Institute (IVM), of the Financial and Tax Law Institute (IDEFF), of the Novaforum /Universidade Nova de Lisboa (Portugal) and of the Universidade Agostinho Neto in Luanda (Angola). He is also a Partner at Sérulvo & Associados, where he co-heads the Financial Law, Capital Markets and Governance Department. Paulo stands as well as Vice-President of the Public Company Practice and Regulation Subcommitee at the International Bar Association. His former positions include: Director of the International Policy and Regulatory Department (2006-2008) and of the Corporate Finance Department (1998-2006) of the Portuguese Securities Commission (CMVM). Member of the Steering Committee of the National Council of Financial Supervisors (2006-2008). Member

Christophe Clerc is an M&A / CM partner at Marcus Partners in France since 2008. He practices corporate and securities law, with a focus on cross-border public and private mergers and acquisitions, joint ventures and group reorganizations. He also has extensive expertise in capital markets and corporate governance issues. He regularly advises major international groups, banks and other investors in a wide variety of transactions. Christophe was also closely involved in the implementation in France of the Takeover Directive. He advises the European Commission (Transparency Directive and Takeover Bid Directive) and the European Parliament (financial regulations and directives). He teaches corporate governance at the Institut d’Etudes Politiques (Paris) and securities regulations at Panthéon-Sorbonne University (Paris). He is a member of a permanent advisory committee of the Autorité des Marchés Financiers (AMF). Christophe graduated from Panthéon-Sorbonne University (Paris I) and Panthéon-Assas University (Paris II).

Jacques Deege is an M&A / CM counsel at Marcus Partners in Paris since 2011. Admitted to the Bar in Paris and New York, he has practised in both France and the United States. Jacques has an extensive experience in French and cross-border mergers & acquisitions and securities. He also practices corporate law and advises on corporate governance issues. He regularly advises major international groups, banks and other investors on a wide variety of transactions. Jacques graduated from Panthéon-Assas University (Paris II) and Columbia University School of Law.

Dr. Francesco Della Scala collaborates with the PwC Tax & Legal Service Milan’s Banking & Finance Department headed by Giovanni Stefanin. He is specialized in the assistance of credit institutions and financial intermediaries, with particular reference to regulatory aspects and prudential supervision of banks and other intermediaries. Moreover, he has acquired expertise on asset management topics, with respect to harmonized UCITS as well as hedge funds. Francesco graduated from the University of Milan, in which he also spoke on Basel III reform of bank’s regulatory capital. He cooperated with the drafting of some publications on specialized Italian legal journals.

Dr. Guenther Dobrauz-Saldapenna, MBA heads the Asset Management practice within PwC Zurich’s Regulatory & Compliance Services. Before this he held a similar position with Deloitte. Guenther has also served for a number of years as Legal Counsel and Managing Partner to a Swiss VC/PE firm and as Legal Counsel to an international hedge fund group. Earlier he has also practiced as an attorney with SCWP, a leading Austrian business law firm, as well as in court. Guenther holds a Masters and PhD degree in investment law from Johannes Kepler University (Linz, Austria), an MBA from the University of Strathclyde Graduate School Business (Glasgow, Scotland) and was elected for participation in the Venture Capital & Private Equity Executive Education Program at Harvard Business School.
List of Contributors

Guenther Guenther is the author of two books on investment selection and of 40+ articles mostly on investment vehicle structuring and VC/PE and hedge fund strategies in leading international expert journals. Guenther also is a guest lecturer on alternative investment law at a number of leading academic institutions, has spoken at more than 30 international conferences and is co-founder of the Swiss Strategies Group.

Charles Destrée is partner and the practice group head of the Finance & Projects group of the DLA Piper Amsterdam office (the Netherlands). He has significant experience in working as a senior finance and real estate M&A lawyer, and also as a manager for international law firms and real estate businesses in the Netherlands, Indonesia, and Australia. Over the years he has managed, as private practitioner as well as General Counsel of ING Real Estate Finance and ING Real Estate Investment Management, many major finance and M&A real estate transactions. Charles has been admitted as a lawyer in the Netherlands, as well as solicitor in England and Wales. In the area of real estate finance he has advised on complex structured and syndicated (property) finance transactions. He acts for financiers, fund managers and developers on all financing aspects of real estate investment and development. Charles also advised on real estate M&A transactions in the listed and unlisted real estate space. He has significant experience in acquiring and divesting real estate portfolios and real estate investment managers in many jurisdictions. In addition to his finance and M&A experience, Charles has extensive experience in financial services and regulatory projects, acting for banks, exchanges, and investment managers. In his role as General Counsel at ING Real Estate Investment Management and ING Real Estate Finance he was responsible for the implementation of regulatory projects and for obtaining the appropriate licenses for several business units.

Frank Dornseifer is Managing Director Legal and Policy Affairs of Bundesverband Alternative Investments e.V. (BAI), the German lobby organization for the Alternative Investment industry. He studied law at the universities of Bonn, Dublin (Trinity College) and Lausanne. After admission to the German bar in 2000 he practised various years as attorney in an international law firm in the field of corporate and securities law before joining the German Financial Regulator BaFin as deputy head of the policy unit within the investment management department. In this function he also represented BaFin in the Investment Management Committee of IOSCO, which elaborated in this time various reports on (fund of) hedge funds. Frank frequently publishes articles both on investment and corporate law and he is editor of the compendium ‘Corporate Business Forms in Europe’ and co-editor of a commentary to the German Investment Act. The finance committee of the German Bundestag, the EU commission and the European Parliament nominated him several times as expert on capital market law. Frank gives frequently speeches at national and international conferences on investment and regulatory topics.

David Eckner is executive manager of the Center for Business and Corporate Law and Lecturer in Securities Law and Regulation at the Heinrich-Heine-University of Düsseldorf (Germany) as well as Research Associate at the Propter Hominis Chair for Banking and Securities Law at the Institute for Financial Services of the University of Liechtenstein. David researches for a PhD in risk management of financial intermediaries and board member liability at the Chair for Civil Law, Commercial and Business Law (Prof. Dr. Ulrich
Noack) at the Heinrich-Heine-University of Düsseldorf. In these positions, David focuses on financial risk management, securitization, investor protection and general European as well as US financial market regulation. Prior to the commencement of his PhD research, David studied law at the Ruhr-University of Bochum and the Heinrich-Heine-University of Düsseldorf with a special emphasis on securities regulation. Moreover, he worked for the capital markets department of a German based law firm, the compliance division of a German savings bank and for the international trade group of a law firm based in Washington, D.C. During his studies, David published on legal education in the US and Germany as well as on German civil procedure law.

**Ezéchiel Havrenne** is a senior associate in the Investment Management practice of Loyens & Loeff in Luxembourg. Ezéchiel’s practice focuses mainly on advising international asset managers and financial groups with regard to the establishment and structuring of investment vehicles, with a particular emphasis on specialized investment funds and investment companies in risk capital. His experience includes namely the set-up of UCITS funds, regulated and unregulated private equity investment vehicles, real estate funds, fund of funds and master-feeder structures. Ezéchiel also has extensive experience in due diligence processes and take-over deals, as well as negotiations on behalf of and legal advice to institutional and retail investors in relation to investments in the abovementioned structures. Ezéchiel obtained his masters’ degree from the University of Pennsylvania Law School. Prior to joining Loyens & Loeff Luxembourg, he worked in Brussels and Luxembourg for other international law firms. Ezéchiel is the author of articles on regulatory aspects pertaining to alternative investment funds, especially in the real estate sphere.

**Hendrik Bennebroek Gravenhorst** is partner and civil-law notary in the corporate department of the DLA Piper Amsterdam office (the Netherlands). He specialises in the notarial aspects of reorganisations, M&A, de-mergers, corporate restructuring and corporate governance. He also advises on the setting up of regulated and non-regulated investment funds. He advises national and international (listed) enterprises. After graduating for his law studies at the Groningen University (1997) Hendrik passed the post graduate education from the Royal Dutch Organisation of civil-law Notaries (Koninklijke Notariële Beroepsorganisatie) in 2001. Thereafter, he completed a post graduate study in M&A in 2003. Hendrik has been advising clients with the setting up and converting of their investment funds and with all related regulatory aspects. He regularly advises on PMI projects, setting up of legal entities and structures, (tax driven) CV/Coop structures, corporate governance issues, pension funds, and private equity structures. He lectures on corporate law subjects, especially in the field of the new Dutch BV legislation (Flex-BV) and investment fund related subjects.

**James Greig** is a partner with PwC’s Financial Services Regulatory Group, specialising in financial services law and regulation with a particular focus on asset management and funds. Before joining PwC, he was a partner, based in New York, in US Law Firm Wilmer Hale’s Broker /Dealer and IM Group. He advises clients on a wide range of issues relating to UK financial services activities, including relationships with custodians, exchanges, clearing houses, prime brokers and investors. He has been involved in many international projects acting for US and UK based asset managers and broker dealers, including global reviews of clearing and settlement procedures, reviewing prime brokerage and custody, clearing
and settlement, investment administration and trading arrangements, and interpretation of the differences between US and UK regulation. In addition, James has a great deal of experience in relation to Regulatory enforcement matters, having advised several clients on FSA and LME enforcement related issues. James is also PwC’s UK lead on the Alternative Investment Fund Managers Directive.

Sebastiaan Hooghiemstra, LL.M. (Amsterdam/Tilburg) is a Research Associate at the Propter Homines Chair for Banking and Securities Law at the University of Liechtenstein. Sebastiaan holds Bachelor degrees in International & European law, Dutch law (both With Distinction) and Master degrees in International Business Law and Dutch Law (both With Honours) from Tilburg University. Sebastiaan also holds a Master degree in Tax Law (With Distinction) from VU University Amsterdam and successfully participated in the Summer School on European Business Law on the Heinrich-Heine-University Düsseldorf. Sebastiaan is conducting research and lectures in the field of Banking- and Securities law with a special focus on Depositary and Asset Management Law.

Shelley Horan B.C.L. (Hons), LL.M. (Corp. and Comm. Law Lond.) (Hons), B.L. (Hons) is a practicing barrister based in Dublin specialising in corporate and commercial law and regulatory enforcement. In addition, Shelley practices in tax law, competition law, intellectual property law, and financial markets and securities law. Shelley is an Adjunct Lecturer in Law in Trinity College Dublin and Course Director and principal lecturer on the Diploma in White-Collar, Corporate and Regulatory Crime in The Honorable Society of the King’s Inns. Shelley is the author of the legal textbook Corporate Crime (Bloomsbury Professional, 2011), is a member of the Disciplinary Committee of Certified Public Accountants, a member of the Expert Advisory Group for National Integrity Systems Study and a Director of Project Arts Centre. Shelley has published and presented widely in the realm of white-collar crime, engaged in a number of conferences and TV and radio discussions on the subject and she is also researching for a PhD in white-collar crime in Trinity College Dublin.

Dr. Ulf Klebeck is working as Senior Fund Lawyer for Bank Vontobel AG / Vontobel Asset Management in Zurich. He is in charge of all legal aspects of fund structuring, including UCITS and AIF structures. Ulf joined Vontobel from Capital Dynamics, a large sponsor of alternative investment funds-of-funds, including private equity, real estate, clean energy and infrastructure. At Capital Dynamics, he was in charge of inter alia dealing with all regulatory and tax issues of various fund structures. He started his career as an attorney-at-law in the Munich and Frankfurt office of Clifford Chance. While working on his doctoral thesis, he held the position of an assistant professor both at the University of Mannheim and Ludwig-Maximilians-University of Munich. Ulf regularly publishes in the areas of financial services regulation, investment law and corporate law. He is guest lecturer on investment law at a number of leading academic institutions. He regularly speaks at various international conferences on investment law topics.

Daniel Litwin is a Research Associate at the Propter Homines Chair for Banking and Securities Law at the University of Liechtenstein. He holds a B.C.L./LL.B. degree from the McGill University Faculty of Law. His primary research interests include the influence of social norms on regulation, investment law, comparative law and the interaction of domestic
List of Contributors

Marcel Lötscher studied law at the University of St. Gallen and the University of Bern (lic. iur.). His initial professional training saw him complete a commercial banking apprenticeship at a major Swiss bank. He was admitted to the Lucerne bar in 2006 and continued to study, becoming a Swiss Fund Officer FA/IAF in 2010 and International Fund Officer FA in 2011. His appointments to various leading positions in the financial sphere include his role as a member of group executive management at a Swiss financial group. In addition to his professional commitments, Marcel is completing a doctoral degree in the field of collective investments. In 2012 he was appointed Head of Securities and Member of the Executive Board at the Financial Market Authority Liechtenstein (FMA). The Securities Unit oversees asset management companies, funds and their management companies.

Jérôme Mullmaier, attorney-at-law, is an associate in the Investment Management practice of Loyens & Loeff in Luxembourg where he specialises in fund structuring, with a special focus on private equity and real estate funds. He also spends significant time on corporate law aspects arising out of private equity transactions and the financing thereof. Prior to qualifying as an attorney, Jérôme interned with several international law firms in Paris (CMS Bureau Francis Lefebvre/White and Case LLP). Jérôme holds a Master degree in Economic Law from the Paris Institute of Political Studies (Sciences-Po) as well as a Masters degree in European Economic Law from the Robert Schuman University of Strasbourg. He has been member of the Paris Bar since January 2009 and is admitted to practice in Luxembourg under his home professional title. Jérôme is the author of articles on regulatory aspects pertaining to alternative investment funds, especially in the private equity sphere.

Julia Nicolussi is Research and Teaching Assistant at the Institute for Civil- and Company Law of the Vienna University of Economic and Business (Chair: Univ. Prof. Dr. Susanne Kalss, LL.M.). Her research is focused on Capital Market Law and Company Law. Before, she worked as a research associate at an Austrian business law firm. Julia holds a Master degree from the University of Vienna (Mag. iur., 2010), where she is doing her Ph.D. by now.

Diogo Pereira Nunes, LL.M. (Tilburg) is a Ph.D. Researcher and Lecturer in Business and Financial Law at the Department of Business Law of Tilburg University Law School, the Netherlands. In this position, Diogo is conducting his Doctoral research in the fields of Business and Financial Law, Venture Capital, Entrepreneurship and Innovation, as well as lecturing several courses on Business and Financial Law for the LL.M. in International Business Law program of Tilburg Law School. Besides his academic position, Diogo also exercises his practice in Law at the Associated Companies group of the Corporate Legal Department of Philips International B.V., in the Netherlands. Throughout his practice, he has had experience with providing legal counsel to the Philips group of companies in the areas of Corporate and Financial Law, in an international context; advising specifically in matters such as Venture Capital investments, spin-offs of new innovative ventures in the context of open innovation programs, disentanglement of legal entities in connection with strategic partnerships (such as International Joint Ventures), Mergers and Acquisitions and Private Equity investments. In his Ph.D. dissertation, Diogo will assess how can the European
corporate and financial legal frameworks be improved to provide an adequate innovation ecosystem for startup companies and a vibrant entrepreneurial finance market in Europe. As such, his current research interests cover subjects such as financial and venture capital markets, entrepreneurship and innovation, alternative investments and investment funds and alternative listing venues for equity/debt securities (private primary and secondary markets).

Thibaut Partsch is a Partner at the Investment Management practice of Loyens & Loeff – Avocats à la Cour in Luxembourg. He advises international clients on alternative fund structuring, with a focus on private equity, infrastructure and real estate funds. Thibaut is a member of the board of directors of the Luxembourg Private Equity and Venture Capital Association (LPEA) and is an active member of several working groups within the Association of the Luxembourg Fund Industry (ALFI). He regularly speaks at conferences and publishes on the subject of private equity funds. Thibaut obtained his masters’ degree from Harvard Law School. Prior to joining Loyens & Loeff Luxembourg, he practiced as an attorney in Brussels and New York. Thibaut co-authored “Le rachat d’actions propres” (Share buybacks), Brussels, Kluwer, 2001 and assisted Professor Hal Scott (Harvard Law School) in the writing of “International finance: Law and Regulation”, London, Sweet & Maxwell, 2004. Thibaut is admitted to the bar in New York and Brussels.

Christina-Delia Preiner is a Research Associate at the Propter Homines Chair for Banking- and Securities Law, Institute for Financial Services, at the University of Liechtenstein, Vaduz. Prior to joining the chair, her interests were centered on tax law and intellectual property law. She also worked as a research associate at Austrian business law firms. Christina graduated in 2011 at the University of Vienna (Mag.iur.) and is currently PhD student at the University of Salzburg. Her current interests focus on issues related to the field of banking- and securities law. She is particularly researching on asset management law and the AIFMD implementation in Liechtenstein.

Verena Schlömer is employed as a lawyer for the Financial Market Authority Liechtenstein, in the department Securities Division, Legal section. Before this she was working as a lawyer for two Luxemburgish Master KAG where she was responsible for all legal devices related to funds. Verena graduated with the first and second state examination as fully qualified lawyer (Ass. iur.) at the University of Trier. Additionally she completed a course relating to lawyers called FFA (Fachspezifische Fremdsprachenausbildung Englisch) at the University of Trier which is an additional apprenticeship in a foreign language relating to the US American and British legal system. The emphasis of her education was put on studies in commercial law.

John Siena, based in London, heads BNY Mellon’s Office of External and Regulatory Affairs for the EMEA region. He provides legal advice on all matters relating to BNY Mellon’s activities throughout the region, serves as the primary legal advisor to BNY Mellon’s EMEA executive management on regulatory and legislative matters and oversees and advises on strategy for engaging with regulatory reform matters. John also currently lectures at King’s College, London, on Financial Law and Institutional Investment. He formerly was Assistant General Counsel, EMEA, at Brown Brothers Harriman (August 2005–November 2011) and Senior legal Counsel and Senior Attorney at The Northern Trust Company (May 1988 – July
2005). From 1993 through 1999, he taught as an Adjunct Professor of Law at Chicago Kent College of Law, teaching Commercial Banking Law 801, an LL.M. course covering U.S. banking law and regulation. John has authored or co-authored articles in various publications relating to investment fund structures, EU legislation and related topics. In addition to participating in various industry associations as well as governmental and legal bodies, John serves as Vice Chair of the European Focus Group, Association of Global Custodians (AGC), on the Prudential Regulation Board of the Association of Financial Markets in Europe (AFME) and is a country representative in the European Trustee and Depositary Forum (ETDF). John is admitted to the Illinois Bar (1988).

Sascha Staat is a banker and lawyer. He focuses on banking and banking regulatory and investment law and on banking and securities litigation. Sascha has been an associate with CMS Hasche Sigle in the banking team of the Frankfurt office since 2010. Sascha regularly advises small and large banks, financial service providers and other parties in a wide range of banking and banking regulatory law issues. A further focus of his work relates to applications and licences and the topic of compliance. Prior to joining CMS, Sascha was in-house lawyer in the compliance office of a major foreign bank where he assisted with the development of the national and international compliance organisation of the bank and advised the bank on many different restructuring measures and projects and on all compliance legal issues and the topic of conflict of interest management. In the area of compliance Sascha was one of the central contacts of the bank for contact and cooperation with the regulatory authorities (BaFin and the Federal Bank).

Dr. Giovanni Stefanin, attorney at law since 1998, is the leader of the Milan’s Italian financial services legal team of PwC Tax & Legal Services, of which he is associate partner. Before collaborating with the law firm PwC Tax & Legal Services, he has accrued a significant expertise within primary Italian bank company and law firm. Giovanni prides himself on more than 10 years of experience in the management of all the matters related to the banking and financial services, with particular reference to the corporate banking, regulatory, investment services and asset management. Particularly, he assisted clients in the set-up banking assurance joint venture and company insurance. He has worked on various international reorganization projects carried out through mergers, de-mergers, acquisitions, contributions of businesses and sales of businesses. Giovanni spoke in many conferences organized by Italian professional associations, with particular respect, recently, to the UCITS IV implementation in Italy and the AIFMD. He is also author of publications on legal journals specialized in banking and capital markets. In particular, he is member of the editorial board of the journal “Strumenti finanziari e fiscalità”, directed by Victor Uckmar and Luigi Guatri.

Claudio Tettamanti, is director and Market Leader Liechtenstein at PwC Switzerland. He is a Swiss certified public accountant with a licence to conduct the profession also in Liechtenstein. At PwC he is responsible for the audit practice in Liechtenstein. His client base consists of various banks, investment fund companies and other financial intermediaries in Liechtenstein. He started his career at PwC in the year 2000. Earlier he was working as an internal auditor for Verwaltungs- und Privatbank, Vaduz, most recent as deputy Head of Internal Audit.
Mark van Dam, attorney-at-law, is a partner in the Investment Manage practice of Loyens Loeff N.V. in Amsterdam where he specialises in private equity fund formation, pension fund pooling arrangements and fund investments for institutional investors. Mark is a member of the Amsterdam bar and the New York bar. Mark has worked as a New York lawyer for a leading New York law firm in New York and London on private equity fund formation and investments as well as private equity transactions. Prior to working as an attorney, Mark worked as an aide to the leader of a political party in parliament in the Netherlands and as a policy aide to the same political party in the Dutch parliament. Mark holds master degrees in Law from Utrecht University (1995) and Harvard Law School (1996) and in History from Utrecht University (1992). Mark was a Fulbright scholar (1995-1996) and was awarded a German Academic Exchange Service scholarship in history in 1991-1992.

Prof. Dr. Erik P.M. Vermeulen is Professor of Business and Financial Law at Tilburg University Law School and Tilburg Law and Economics Center (TILEC). He is Chairman of the Department of Business Law. In addition to having held visiting positions at Ghent University in Belgium, Pontificia Universidad Javeriana in Colombia and Interdisciplinary Center (IDC) Herzliya in Israel, he lectures regularly at the TIASNimbas Business School, the Brabant Center for Entrepreneurship, the Duisenberg School of Finance in the Netherlands, and Kyushu University Faculty of Law in Japan. Erik is also Senior Counsel Corporate/Vice President at the Corporate Legal Department of Philips International B.V. in the Netherlands. In this function, he advises on corporate governance matters, including the corporate structure of the Philips group of companies, corporate venturing and international mergers and acquisitions. He has worked on national and international projects for organizations such as the OECD, the European Commission and the Dutch Development Finance Institution concerning financial and venture capital markets, corporate law, and corporate governance of listed and non-listed companies. He has written extensively in the area of corporate law, partnership law, corporate governance, joint ventures, venture capital and innovation. His current research looks at trends and developments in the financial and venture capital markets, corporate governance and value-creation, disclosure regimes, dispute resolution and enforcement, business law/lawyers, innovation and entrepreneurship, and listings on alternative stock markets. He is a founding member of the International Venture Club Council, a member of the Board of the Foundation for Education of Inhouse Lawyers in the Netherlands and a member of the Legal Committee of EuropeanIssuers.

Markus Wagner works for the Financial Market Authority Liechtenstein, as head of the Supervision Section in the Securities Division. Before he worked for the Financial Market Authority Austria as an onsite inspector in the department rules of conduct and compliance, which supervised the MiFID implementation of Austrian credit institutes. Markus graduated in law at the University of Innsbruck (Mag. iur.), before he worked for a law firm and an insurance company in Innsbruck. Markus is guest lecturer at the Fund Officer seminar and the CAS Fund Business Expert seminar in Zürich, which both are organised by the Fund Academy AG, Zürich.

Gregory Walker, Dip CII® is the founder of Walker Risk Solution Ltd., a specialised risk advisory and insurance broker with a focus on the legal liability exposures of fund and asset managers. Before this, Gregory served on AIG Europe’s executive board and held
senior management positions in Frankfurt and Zurich, which included the underwriting of financial institutions’ professional liability risks. He also was a management consultant at Credit Suisse owned Fides Group and subsequently at KPMG Fides, where he led a team of the insurance practice. Gregory started his professional career at Winterthur Insurance in the IT-department and later served as executive associate at Winterthur’s Asia-Pacific division in Hong Kong and in Sydney. Gregory, a Swiss and British citizen, is a member of the U.K. Chartered Insurance Institute (CII) and a senior associate of the Australian and New Zealand Institute of Insurance and Finance (ANZIIF). He is the author of several articles on executive risk and special liability insurance. He also is a lecturer on corporate governance of the Associate in Risk Management-program at the Insurance Institute of Switzerland.

**Prof. Dr. Rüdiger Wilhelmi** is professor of law and holds the Chair for Private Law, Commercial, Company and Business Law as well as Comparative Law at the Faculty of Law at University of Konstanz, Germany. After his legal education at the University of Tübingen Germany, the University of Leiden, the Netherlands, and the Court of Appeal in Berlin, Germany, he worked as Counsel in the legal department of BMW before returning university. His main areas of research comprise company law, corporate finance and capital market law, competition law and comparative law. He has published numerous articles in these fields. His current research in the field of capital market law looks at the present financial crisis and its repercussions on law, the history and the system of capital market law, securitisation and mergers and acquisitions.

**Prof. Dr. Dirk A. Zetzsche, LL.M. (Toronto)** is professor of law and holds the Propter Homines Chair for Banking and Securities Law at the University of Liechtenstein. He is also one of the directors of the Center for Business and Corporate Law at Heinrich Heine University in Düsseldorf (Germany) where he took his Ph.D. with a thesis on shareholder information in public corporations in 2004 and his habilitation (Dr. iur. habil.) on principles of collective investments in 2012. Dirk has published extensively in the field of banking, securities, company law and corporate governance. His advisory work includes participation in working groups commissioned by the European Commission, the European Parliament, the German Federal Ministry of Justice, the German Federal Ministry of Finance, the Government of Liechtenstein and the Finanzmarktaufsicht Liechtenstein, Liechtenstein’s financial markets authority.
Chapter 4
Challenges from the Supervisor’s Perspective

Marcel Lötscher & Patrick Bont

1. INTRODUCTION

The dictum ‘Gouverner, c’est prévoir’ is attributed to the French politician Emile de Girardin (1806–1881). It continues to hold even in the 21st century. The financial markets are undergoing an unprecedented upheaval. The globalization and internationalization of markets and businesses is being accompanied by a fundamental reform and expansion of supervision and regulation across national borders. This is associated with a considerable increase in the scope and complexity of regulation in the financial industry. This also entails considerable risks, as the world has painfully experienced over the past few years. The desire for more control and protection is understandable, but influencing this complex system may also have undesirable effects. These effects should be avoided and the right balance of rules and freedom should be found. Looking ahead and acting prudently have not become easier since Emile de Girardin, but are all the more important.

2. EXPLORING THE SUPERVISORY CHALLENGES

The predominant role of supervisory authorities is to safeguard the stability of financial markets, to protect investors and customers, prevent market abuse, as well as to implement and comply with recognized international and European standards.¹


The government as legislator and, for instance, the Finanzmarktaufsicht Liechtenstein (hereinafter referred to as ‘FMA’) as the supervisory authority must deal with a conflict of goals. ‘On the one hand, there is the [intermediary] with an understandable need for clearly and easily implementable regulatory requirements. On the other hand, any attempt to offer the [intermediary] and other practitioners schematic instructions on how to supplement indeterminate legal terms or make use of leeway in interpreting the law necessarily runs counter to the legislative goal of replacing the formalistic approaches taken by [intermediaries] with an autonomous, flexible, and risk-based assessment of individual cases.’

Resolving this conflict of goals is not, however, a precondition for risk-based supervision as such. Rather, the dialogue necessitated by this conflict should help ensure coherent implementation of the supervisory requirements. The suggestions made by supervisors should furthermore enable application and implementation of the relevant laws and regulations to be legally secure. The conflict of goals inherent in the system is supplemented by the information asymmetry prevalent especially in the fund industry.

From July 2009 onwards, the regulatory landscape of collective investment undertakings was subject to significant change. One of the core rationales was to create harmonized regulatory standards for management companies and the funds they manage, such as AIF and UCITS. Moreover, transparency vis-à-vis investors and supervisors was about to be improved. In any of these cases, the subject matter to be governed was and will be mostly interdisciplinary, i.e. the regulation of banking and financial markets is to be legitimated and shaped by an economic understanding. This rising importance of economic rationales influencing financial regulation bears predominantly a twofold challenge for supervisors.

On the one hand, the challenge for the supervisor is now the conflict between the legislative goal of a formalistic approach and the goal of an autonomous, flexible, and risk-based assessment of the individual case. This will be particularly aligned with the transparency required to dissolve the information asymmetry and not lead to information overload. The principle of investor protection inherent in both points must be ensured.
Another focal point in the supervisory challenge will be to preserve and strengthen the accountability of the respective financial centre as such. On the other hand, the quality burden on supervisory authorities will be raised significantly. As economic approaches become more important and are, most notably, subject to frequent change, supervision will become more costly due to a higher demand for education and training.

3. RESOLVING THE SUPERVISORY CHALLENGES

Given that financial market regulations increase and become more complex for national supervisory authorities as well as the European System of Financial Supervisory (hereinafter referred to ‘ESFS’), appropriate resolutions have to be found. Aligned with international and European rulemaking, these resolutions encompass a variety of different settings. A brief overview of certain aspects is given in the following by specifically highlighting the AIFMD transposition process in the perspective of the FMA.

3.1. MARKET ANALYSIS

The FMA follows a dualistic system of supervision in Liechtenstein. This means that, in addition to the work of the supervisory authority as such, certified auditors act as the extended arm thereof. The supervisory authority and the auditors, thus, constitute a two-stage approach to safeguarding financial market stability and reputation.

A market analysis forms the basis for the supervisor’s contributions to the legislative process and its active exchange of views with intermediaries and the relevant business associations. The market analysis also forms the basis for transforming intermediaries and products under the new legislation. On the basis of the auditors’ reports, the FMA initiates official proceedings where necessary. Moreover, it also selects the financial institutions for detailed on-site inspection. Instead of the common ‘know your customer’ philosophy, the approach applicable to the persons and entities supervised by the FMA is referred to as ‘know your supervisor’.

3.2. REGULATORY PROJECT MANAGEMENT: THE AIFMD IN LIECHTENSTEIN

As an EEA member, Liechtenstein is required to implement and apply a body of European directives and regulations. The government and authorities are, therefore, constantly planning and executing relevant projects in a wide range of areas. The resources of a small state like Liechtenstein are, of course, limited. Hence, it is of the utmost importance to define priorities and to target the use of the available specialists.

Liechtenstein followed the discussions and preparations at the European level with regard to the introduction of a comprehensive and harmonized regulation of AIFMs. Shortly after adoption of the AIFMD, the government commissioned experts from its own staff and the FMA to plan the implementation of the AIFMD and to assess the consequences, opportunities, and risks for the financial centre. It was recognized that the implementation of the AIFMD is of extraordinary importance to the financial centre. The fund business, both UCITS and AIFs, but in particular AIFs, have traditionally been a very significant pillar of the Liechtenstein financial centre. Implementing the AIFMD should, therefore, on the one hand be consistent with the government’s financial centre strategy, and at the same time ensure that the European requirements are implemented correctly and completely. The government was therefore requested to approve a project to that effect.

The AIFM project was headed by the Office for International Financial Affairs. The FMA served as the project office and made experts available for project management. The project team included representatives of the National Public Administration, the FMA, the Fiscal Authority, the University of Liechtenstein, and the business associations of the financial centre.

The project was divided into four streams, each of which was the responsibility of one project group. These streams were coordinated as follows:

1. The first stream dealt with implementation of the AIFMD in national law. This included preparing the draft law and ordinance as well as accompanying and initiating the entire political legislative process.
2. The second stream considered market orientation, marketing and communication. A particular issue was which business models would be possible and desirable within the framework of the AIFMD and how changes should be communicated.
3. The third stream considered taxation-related topics of AIFMs. The question of the fiscal impact of the AIFMD’s provisions was examined in particular by experts from the Fiscal Authority.
4. The fourth stream dealt with qualification and training. As previously mentioned, this stream was and still is of importance as the AIFMD imposes new and, should adequate training fail, costly measures on AIFMs. Accordingly, the professional qualifications of AIFMs were particularly stressed. The working group developed concepts to ensure that the necessary opportunities for basic

8. The Principality of Liechtenstein, the Kingdom of Norway and Iceland are EEA Member States, see Agreement on the European Economic Area (EEA), OJ L 1, 3 January 1994, p. 3 (hereinafter ‘Treaty of Porto’).
9. See particularly Art. 7 of the Treaty of Porto and its annexes IX (financial services), XII (free movement of capital) as well as XXII (company law).
and continued training are available and that the requirements on managers are specified in detail.

In conclusion, the basis for a proper transposition was a structured and well-organized project with an interdisciplinary project team that brings experts and stakeholders to the same table. By pooling these interests, competencies and ideas, acceptance was created on the part of both, the authorities and the market.

3.3. IMPLEMENTATION WITHIN THE FMA

As a supervisory authority, the FMA’s actions must be guided by the principle of legality. Therefore, every new regulation and every new law affecting the financial market also have an impact on the work of the FMA. In general, the density of regulation is steadily increasing, both nationally and internationally, and the European financial market regulations expanding in terms of scope and complexity. For a comprehensive change of law as triggered by the AIFMD, major adjustments within financial market supervision are unavoidable and must be tackled early on. In particular, the following three areas are affected: organization and processes, expertise, and infrastructure.

The implementation of the AIFMD in national law has an impact on approval processes and on-going supervision. The internal organization of the national supervisory authority must be adjusted in a range of aspects. Competences, workflows, deadlines and so on, must be redefined. Furthermore, responsibilities must be assigned and communicated externally.

Efficient supervision and short approval processes are only possible if the FMA staff have the necessary expertise. Hence, it is of the utmost importance to train FMA staff intensively and/or to cooperate with external professional service providers.

The adjustment of processes and organizational structures has also a direct impact on infrastructure. Specifically, IT hardware and software, archiving systems and similar operating conditions must be redesigned and supplemented.

This requires an early planning procedure, numerous internal projects, and the inclusion of and coordination with experts from the National Public Administration and external providers. In addition, ongoing supervision must be ensured. The efficient allocation of the limited human and financial resources in such a situation is therefore a special challenge for the FMA. At the same time, however, it is a precondition for being ready when the new provisions enter into force.

4. OUTLOOK

The implementation of the AIFMD in national law is only the first, albeit the most important step in an extended process. The FMA will have to incorporate these measures into its internal processes. This will entail additional work and again have an impact on internal

organization and resources. The same is true of the numerous technical guidelines expected to be issued by ESMA. A review of the AIFMD regime by the EC is planned for 2017. Depending on the experiences of ESMA at the European level and by the supervisory authorities in the individual states, this may entail another major revision of the AIFMD.