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 Émile de Girardin (1806–1881). It continues to hold even in the twenty-first 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. The considerable increase in the scope and complexity of regulation in the financial industry associated with reform and expansion of regulation 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 Émile de Girardin, but are all the more important.

2 EXPLORING THE SUPERVISORY CHALLENGE

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 authors want to thank Julia von der Osten, Dr Reinhold Schorer and Verena Schloemer – all FMA – Financial Market Authority Liechtenstein, Securities Division – for their contributions.

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 AIFM and UCITS. Moreover, transparency for investors and supervisors were 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.

---

a European Supervisory Authority (European Securities and Markets Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2008, 84; for instance, on EU/EAA Member State level, see for Liechtenstein Art. 4 FMA Act (Finanzmarktaufsichtsgesetz, LGBI. Nr. 175, 18. August 2004); for Germany, 4 BaFin Act (Finanzdienstleistungsaufsichtsgesetz, BGBl. I S. 1310, 22. April 2002); for the UK, see s. 2. of the Financial Services and Markets Act 2000.

2. A. Ogbamuchia, Das neue deutsche Gelddienstrecht, 51 (De Gruyter 2011).

3. Ibid., supra n. 2, at 52.


5. For further details, see D. Zetsche, Introduction, Ch. 1.


---

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 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 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 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 were unavoidable and had to be tackled early on. In particular, the following three areas were affected: organization and processes, expertise, and infrastructure.

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

Efficient supervision and short approval processes are only possible if the FMA staff have the necessary expertise. Hence, it was 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 had also a direct impact on infrastructure. Specifically, IT hardware and software, archiving systems and similar operating conditions had to be redesigned and supplemented.

This requires an early planning procedure, numerous internal projects, and the inclusion of an coordination with experts from the National Public Administration and external providers. In addition, on-going supervision had to be ensured. The efficient allocation of the limited human and financial resources in such a situation provided a special challenge for the FMA. At the same time, however, it was a precondition for being ready when the new provisions entered into force.
IMPLEMENTATION OF THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE (AIFMD) INTO THE EUROPEAN ECONOMIC AREA (EEA): ACQUIS

The parliament of Liechtenstein adopted the law on Alternative Investment Fund Managers (AIFMG) on 19 December 2012. It entered into force on 22 July 2013. Condition, therefore, was the timely implementation of the AIFMD into the EEA-Acquis. The AIFMD relates in several cases to the ESMA which was established by Ordinance (EU) No. 1095/2010 (ESMA-Ordinance) and took up its work on 1 January 2011. The AIFMD refers new duties and responsibilities to the ESMA, inter alia coordinating responsibilities, on-site visits in the Member States and mediation responsibilities in case of disputes between national supervisory authorities in relation to cross-border activities. In this respect the ESMA is authorized to issue binding decisions. In case the national authorities will not proceed accordingly, the ESMA may issue resolutions which are directly addressed to the market participants. The ESMA-Ordinance has not been implemented into the EEA-Acquis as to the time of writing (June 2015). For this reason the AIFMD and its accompanying legal instruments has not been implemented into the EEA-Acquis.

Following the delay of this implementation process of the AIFMD it was necessary to amend the AIFMG for purposes of maintenance of transparency and legal certainty on the one hand and for constitutional purposes on the other hand. These amendments were effected in such a way, that the provisions relating to the AIFMD, especially those relating to cross-border activities and provisions with respect to the coordination until the entry into force of the resolution of the Joint Committee of the EEA with respect to the implementation of the AIFMD were abolished. As a consequence, the AIFMG which was formally drawn up as transposing law and referred to all European legal instruments ceased temporarily (until the AIFMD's transposition in the EEA treaty) into a law based on national autonomy.

Insofar as the equal and unhindered market access of the Liechtenstein financial intermediaries is concerned, the transposing resolution is indispensable. Otherwise there will be no binding effect for the other EEA/EU Member States and the Liechtenstein financial intermediaries will have to apply for a licence according to the law of the relevant Member State. As a consequence, AIFMGs established in the three EEA states Norway, Iceland and Liechtenstein do not benefit from the European passport for cross-border marketing or management of alternative investment funds (AIF).

Despite the lack of transposition and as a sign for its EEA commitment, the FMA grants unhindered access of EEA-AIF to be marketed in Liechtenstein for accommodation purposes. The FMA will accept the marketing of EEA-AIF to professional and retail investors in Liechtenstein on the basis of authorization in accordance with Articles 42 and 43 of the AIFMD. The proceeding will be governed by Articles 150, 151 AIFMG and Article 200 AIFM. The application shall be submitted to the FMA. As a further consequence, the AIFM has to appoint a paying agent in Liechtenstein if the AIF will be marketed to retail investors. Moreover, until the transposition of the AIFMD in the EEA-Acquis the FMA cooperates in the relevant ESMA committees and initiatives for implementing the European Single Rule Book to the extent possible under Liechtenstein constitutional law.

5 EFFECTS TO THE MARKET

Based on Article 189 AIFMG, applications for recognition of an AIFM or authorization respectively registration of an AIF managed by the AIFM could be filed since 1 April 2013, i.e., more than three months prior to the transposition deadline for EU Member States. The licencing or authorization was effective at the earliest with the EEA-Acquis’s entry into force (22 July 2013). Following to this early possibility to file an application, Liechtenstein was in focus of international market participants. The FMA had many conversations with financial intermediaries which were interested in being licenced in Liechtenstein. Due to the delays in the AIFMD’s transposition into the EEA-Acquis yet notwithstanding Liechtenstein’s intensive efforts, the international requests decreased slowly. However, nationally the Liechtenstein fund management companies managing non-UCITS funds submitted themselves to the AIFMD-Regime.

This seems to be based on the situation that the fund managers want to be prepared by the time the AIFMD will be implemented in the EWR-Acquis. Up-to-date (June 2015) eight so-called big AIFM were licenced. Furthermore, the FMA granted a license to a risk manager based on the AIFMG’s authorization scheme for risk managers. The first AIF was authorized by the end of March 2014.

A special challenge was the introduction and transposition of the provisions of the AIFMD as manager regulation. First, this implied a rethinking that as from thereon the fund manager will be regulated rather than the product. Second, new duties were accrued such as, but not limited to the responsibility to implement a remuneration-policy with respect to all employees which is to prevent to take too high risks, the functional and hierarchical separation of the risk- and portfolio management as well as the obligation of the AIFM to do at least the risk- or portfolio management itself, the distinguished requirements with regard to risk management and further substance requirements for the AIFM, the reporting requirements and the independent calculation. All those requirements implied new challenges for the AIFM. Therefore, the FMA as well must live up to the challenge to assess in each case if the applying AIFM is sufficient qualified and organized to manage the future AIF with its personnel and duly fulfill the imposed responsibilities. As such, each filed application is to be assessed on a case-by-case basis which requires an administrative discretionary decision. To conduct the licensing process best, the FMA assists each applicant proactively. Accordingly, conversations between the intermediary and the FMA may take place ahead of and during the authorization process. Finally and before issuing the licence, there will be an onsite visit. This way it can be ensured, that the licence can be issued based on a sufficient general picture.
Figure 4.1 Licences pursuant to the IUG, UCITSG and the AIFMG

- VerwG; 14
- OGAW; 205
- QA; 189
- IIFaW; 77
- AIFM gross; 9
- Risikomanager; 1
- AIF; 5
- VerwG; 12
- IIGaWmeR; 39

Data as of 9 June 2015; source: FMA

Figure 4.1 reflects the licenced intermediaries and related products according to the IUG, UCITSG and AIFMG. This includes: management companies (VerwG), pursuant to IUG and UCITSG, distributors (VertrB) according to the IUG, IIG, qualified funds (QA), investment undertakings for other assets (IIFaW), investment undertakings for other assets with higher risk (IIFaWmeR), undertakings for collective investments in transferable securities (UCITS), AIFM, AIF and risk managers.

Figure 4.2 illustrates this by showing the related volumes concerning the IUG, UCITSG and AIFMG.

6 OUTLOOK

The transposition of the AIFMD did not lead to a one-size-fits-all solution, neither for the fund business nor for the supervisory authorities. The envisaged uniform European distribution passport lead to substantial changes in business models as well as the supervisory practice.

From a Liechtenstein perspective, it will be interesting to see, in which direction the funds that are currently licensed under the IUG will be directed. While we first observed a trend towards the stricter UCITSG regulation (which was likely due to the yet-lacking AIFMD passport), we estimate that of the remaining funds approximately two-thirds belong in their current form to the AIF domain. Furthermore, the Liechtenstein legislator contemplates to implement a third fund regime for collective investment schemes that neither meets the UCITSG nor the AIF definition. Finally, the next generation of European financial regulation, including MiFID II, the PRIIPSR and the ELTIFR signal further changes on the side of the industry and regulators.

All in all, we will be able to draw conclusions as to the attraction and effects of the AIFMD, as well as the true challenges for supervisors only after a certain time after effective implementation of the AIFMD and aforementioned legislation that impact on AIFMs into the EEA-Acquis.

Regardless of the rapid change in the regulatory environment and the complexities of European multi-level legislation, the FMA is committed to maintain a pragmatic (but not a tailored to suit the market need) approach with proportionality within the limits of the legal and regulatory environment provided by the AIFMD and European financial law to ensure the stability of the financial market, investor protection, to prevent market abuses as well as to ensure the transposition and implementation of the acknowledged international standards.
International Banking and Finance Law Series

VOLUME 20

Series Editors
Professor Joseph Norton, Professor Ross Buckley and Professor Douglas Arner.

Subjects
Topical issues in international banking and financial services law, such as regulatory responses to the global financial crisis or regulation of alternative investment funds.

Objective & Readership
To provide authoritative analysis of trends and complex subjects for academics, regulators and practitioners involved in international banking and financial services law.

The Alternative Investment Fund Managers Directive
Second Edition
Edited by
Dirk A. Zetzsche

The titles in this series are listed at the back of this volume.