

Investment Management Group Newsletter

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Recent Developments

July 2009

This newsletter highlights the following recent developments:

Non-retail investment funds and private equity:

- Voluntary supervisory regime for investment institutions
- Proposed EU Directive on Alternative Investment Fund Managers
- Tax developments and private equity

Retail funds:

- Harmonised disclosure obligations

Asset managers and pension funds:

- Standard form Fiduciary Management Agreement available in English
- Outsourcing regulation pension funds amended

Voluntary supervisory regime for investment institutions

Voluntary supervision

According to a proposal to amend the Dutch Financial Markets Supervision Act (*Wet op het financieel toezicht*) as approved by the Dutch Cabinet, an investment institution or its manager

may opt for statutory supervision. This may be an option when participations in the investment institution are offered only to qualified investors. It will no longer apply that there is supervision only when participations are offered to the public. Voluntary supervision entails fewer requirements than mandatory supervision. This will result in the introduction in the Netherlands of a regime comparable, for example, to that of the Luxembourg Specialised Investment Fund (SIF).

Mitigated regime

Voluntary supervision entails fewer requirements than mandatory supervision, such as:

- no substantive requirements for annual and semi-annual accounts of the investment institution
- no requirement to publish the annual accounts of the investment institution
- no mandatory annual valuation of non-liquid assets by an independent expert
- no requirement of joint disposal of assets by manager and custodian
- no requirement to engage an independent custodian in case of risk of contagion.

Other requirements, which also apply to mandatory supervision, are applicable, such as:

- the testing of expertise and reliability of daily policymakers of (managers of) investment institutions
- a custodian must hold the assets of an investment fund which is not a legal entity
- minimum equity requirements for managers and custodians.

Voluntary supervision: when and why?

The mitigated regime may be advantageous because:

- many institutional investors which are only allowed to invest in supervised investment institutions may invest in investment institutions under the mitigated regime
- supervision costs are lower than for mandatory supervision
- the statutory arrangement for the separate capital of the custodian for each investment fund applies
- a Dutch public limited company (*naamloze vennootschap, N.V.*) may opt for the status of investment company with variable capital (*beleggingsmaatschappij met veranderlijk kapitaal, "bmvk"*); a bmvk is subject to fewer capital protection rules and in a bmvk more corporate powers are vested in the board instead of in the general meeting of shareholders.

The voluntary supervisory regime is to enter into force on 1 January 2010.

Proposed EU Directive for managers of alternative investment funds

On 30 April 2009, the European Commission submitted a draft directive for managers of alternative investment funds (the "**Draft Directive**") for preliminary review to the European Parliament and the Council. The European Commission intends to implement this directive in 2011. However, because of fierce opposition from the market as well as various EU member states, mainly because of the large reach and the 'one size fits all' approach, it is uncertain whether this will be feasible.

The Draft Directive will introduce a licence requirement as well as a European passport for alternative investment fund managers ("**AIFMs**"). Under certain conditions, licensed AIFMs may provide management services to alternative investment funds ("**AIFs**") and/or offer participations in AIFs to professional investors. The term 'alternative investment funds' is very broad and includes, save for some exceptions, all non-UCITS investment institutions. One of the exempted categories is the 'small' AIFM. Generally speaking, small AIFMs (including managers of most hedge funds) with less than EUR 100 million of assets under management, will be exempt from the directive. For most private equity funds managers a maximum of EUR 500 million of assets under management applies in order to qualify for the exemption.

A manager of licensed AIFs will be subject to certain ongoing obligations (see the **annex** for a summary). Some consequences of the directive for various types of investment institutions are set forth below.

ASF regime

Current Dutch supervisory law allows participations in an investment institution, having its seat in a country designated by the Minister of Finance and which is adequately supervised in this country of origin, to be distributed in the Netherlands without a licence (often referred to as 'adequate supervision funds' or "**ASFs**"). ASFs from outside the EU often are Guernsey, Jersey or US based investment funds, many of which are listed at Euronext Amsterdam.

Under the Draft Directive these funds will be subject to a third country regime. Deviating from the current Dutch ASF regime, the European Community will then designate countries with adequate supervision. Where there is also an OESO Model tax treaty between the Netherlands and the third country where the manager of the ASF and/or the ASF itself is based, such managers may offer participations from the third country to professional investors in the Netherlands.

If the Draft Directive is adopted, the Dutch ASF regime cannot be continued. It is important that there will then be sound transitional arrangements for ASFs which have been admitted to the market in the Netherlands under the ASF regime. A possibility for this need yet be included in the Draft Directive.

Private equity

Private equity funds, including buyout and venture capital funds, usually do not fall within the scope of present Dutch supervisory law because (i) they make use of an exemption, or (ii) their activities do not qualify as investment but as entrepreneurial activities. Although the Draft Directive does not make a clear distinction between private equity funds and 'ordinary' business enterprises (or e.g., a conglomerate of enterprises), the European Commission obviously intends to include private equity funds in the Draft Directive. In addition, present exemptions will most likely be revoked.

Cumbersome obligations for private equity funds will most likely be:

- the mandatory appointment of an independent valuation expert for the valuation of assets of and the participations rights in the private equity fund, and
- the mandatory appointment of a licensed EU credit institution as custodian (*bewaarder*) of the assets of the fund and for which separate liability provisions are included in the Draft Directive.

The Draft Directive also includes specific disclosure obligations which will be especially important for buyout funds. As soon as the fund has an interest in a company of 30 percent or more, the AIFM must provide information to the company (including its shareholders and representatives of employees) on the acquisition of control, the investment strategy and the investment objectives. This includes information on internal and external communications and the policy on avoiding and managing conflicts of interest. Where listed companies are concerned, the manager must also provide information as required in the event of a public takeover bid. A

party acquiring 30% control in a listed company will generally speaking have to make a compulsory takeover bid, which requires such information to be made public for that reason already.

The disclosure obligations do not apply to participations in small or medium-sized companies where fewer than 250 people are employed and/or whose annual turnover does not exceed EUR 50 million and the balance sheet total does not exceed EUR 44 million.

Hedge funds

AIFMs systematically applying leverage must – in addition to other new requirements – provide additional information to investors and the relevant authorities (in the Netherlands: the AFM), including the maximum leverage which they may use for the AIF as well as the total leverage used. These requirements will be especially relevant for hedge fund managers. Under exceptional circumstances the supervisor may impose limitations on the leverage to safeguard the stability and the integrity of the financial system.

Retail investment funds (non-UCITS)

The Draft Directive is aimed at managers of non-UCITS investment institutions, including AIFs aimed at retail investors. The national legislator may introduce additional rules for retail investment institutions. Although it is still unclear how the national legislators will amend the current supervisory law for retail investment institutions, standards from the Draft Directive (when adopted) will be seen as minimum standards. This may *inter alia* result in the requirement that retail investment funds must engage a licensed EU credit institution as custodian, including the corresponding liability provisions for custodians.

UCITS

The Draft Directive does not relate to UCITS. It is, however, likely that, as a consequential effect of the Draft Directive, certain requirements will be copied in the UCITS directives. In any event, it seems illogical to subject managers offering participations to professional investors to provisions (in the case of AIFs) that are stricter than those applicable to managers offering

participations to retail investors (in the case of UCITS). The European Commission has recently adopted a similar view in respect of the mandatory custodian (being a licensed EU credit institution) and the corresponding liability provisions for custodians.

European passport

The Draft Directive also includes a European passport. Upon completing a notification process, a licensed AIFM may provide management services to professional investors in another EU member state. This means that for these activities there will not be different rules and resulting selling restrictions for each member state.

Tax developments and private equity

On 15 June 2009, the Dutch Ministry of Finance released a discussion paper with proposals for changes in the taxation of group interest, the deductibility of 'excessive' interest and the participation exemption. The discussion paper contemplates that the proposals will become effective as of 1 January 2010.

The proposed changes, in particular those limiting the deductibility of financing expenses, are particularly relevant for private equity funds that make use of Dutch holding companies for leveraged investments.

Mandatory group interest box

A mandatory group interest box is proposed, taxable at an effective rate of 5%. The group interest box will include the balance of all interest income and expenses of the group as well as certain other types of income or gains related to financing activities of the group. The implementation of this regime is subject to approval by the European Commission.

Restrictions on the deductibility of financing expenses – two alternative approaches

In response to recent turmoil about 'excessive' interest deductions, the discussion paper further puts forward two alternatives for the legislator to limit the deductibility of interest. Both alternatives

apply to related and unrelated party financing, have in common that they only apply if and to the extent interest expenses exceed EUR 250,000, and are to replace existing thin cap rules.

The first alternative introduces two specific rules:

- limitation of the deductibility of interest paid on (i) loans which are attributable to participations that qualify for the participation exemption, and (ii) group receivables that fall within the scope of the group interest box, and
- limitation of the deductibility of 'excessive' interest offset by a Dutch holding company against the profits of subsidiaries that is part of the same consolidated tax group ("fiscal unity"). Interest is considered 'excessive' if and to the extent the taxpayer's debt-to-equity ratio exceeds 3:1.

The second alternative comprises *generic* earnings-stripping rules which focus on a taxpayer's P&L to determine whether interest expenses are excessive. In this proposal, interest will only be deductible up to 30% of the taxpayer's EBITDA. Exceptions apply if the taxpayer is not part of a group or if the group's debt-to-equity ratio is higher than the debt-to-equity ratio of the taxpayer.

Participation exemption

The discussion paper proposes to relax the requirements for the participation exemption. The current objective criteria, although introduced as recently as 2007, have proven highly impractical. The paper proposes to reinstate the pre-2007 non-portfolio investment test but with some improvements. In short, the participation exemption will apply to any participation of at least 5% that is not held as a passive portfolio investment. The proposed change contains an escape for subsidiaries held as passive portfolio investment if:

- the subsidiary is subject to a 10% or higher corporate income tax rate, or
- the assets of the subsidiary consist for less than 50% of passive investments.

Harmonised disclosure obligations for packaged retail investment products

The European Commission has communicated that harmonised disclosure obligations and conduct of business rules for distribution must apply to all 'packaged retail investment products'. This must render packaged retail investment products better comparable.

Such packaged retail investment products include:

- participations in investment institutions – both UCITS and non-UCITS
- unit linked products such as a life insurance featuring an investment component
- structured securities
- structured term deposits such as an interest cap (an option limiting interest rate risk).

Offerors of packaged retail investment products (such as the fund manager of an investment institution) and distributors (intermediaries and advisors) must – in addition to the prospectus for the product – make available a uniform document containing 'key investor information'. This document will be comparable to the 1 or 2 page Key Investor Information document of UCITS IV, which will replace the elaborate Simplified Prospectus of UCITS III. This document discloses:

- the key features of the product
- its final costs
- the product risks
- expected risk-reward (returns)
- the conditions attached to capital guarantees.

The information must be made available to investors in a timely fashion, in order to be of actual influence on the decision to purchase the packaged product. It is to be expected that for packaged retail investment products the uniform information document will replace the financial leaflet (*financiële bijsluiter*) which is currently required in the Netherlands.

For the distribution of participations in investment institutions in the Netherlands there will be no difference whether the participations are offered via an investment firm or by the fund manager.

In addition, all conflicts of interest in connection with the sale of or advice on a product must be avoided, managed and disclosed.

The European Commission aims to submit a more detailed draft of this regulation for consultation by the end of 2009.

Standard form Fiduciary Management Agreement available in English

Based on the DUFAS Principles of Fiduciary Management, De Brauw has drafted:

- a Fiduciary Management Agreement template, and
- Explanatory Notes.

De Brauw Blackstone Westbroek has also prepared **English-language versions** of these documents, which are currently available on our website (www.debrauw.com) and may be used by market parties as a basis for their individual fiduciary management arrangements.

Outsourcing regulation pension funds amended

The rules for outsourcing by pension funds have changed. These changes empower supervisors to request information directly from and to conduct an immediate investigation with the third party to whom the activities have been outsourced. Notwithstanding this, the pension fund remains fully responsible for the performance of these activities.

The changes may imply that existing arrangements (such as investment management agreements) entered into between pension funds and third parties need to be revised. These changes have entered into force on 1 July 2009.

Recent developments

Contact

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Annex – Summary of ongoing AIFM obligations

Conduct of business	
1	The AIFM shall: (a) act honestly, with due skill, care and diligence and fairly in conducting its activities; (b) act in the best interests of the AIF it manages, the investors of those AIF and the integrity of the market; and (c) ensure that all AIF investors are treated fairly.
2	The AIFM must have a policy regarding conflicts of interest.
3	The AIFM must ensure that the functions of risk management and portfolio management are separated and implement risk management systems.
4	For each AIF it manages, the AIFM must employ an appropriate liquidity management system and a redemption policy. It must also adopt procedures which ensure that the liquidity profile of the investments of the AIF complies with its underlying obligations.
Capital requirements	
5	The AIFM shall have own funds of at least EUR 125,000. Where the value of the portfolios of AIF managed by the AIFM exceeds EUR 250 million, the AIFM shall provide an additional amount of own funds which must be equal to 0.02 % of the amount by which the value of the portfolios of the AIFM is in excess of EUR 250 million.
Organisational requirements	
6	The AIFM shall, at all times, use adequate and appropriate resources that are necessary for the proper performance of their management activities. The AIFM shall have updated systems, documented internal procedures and regular internal controls of their conduct of business, in order to mitigate and manage the risks associated with their activity.
7	For each AIF it manages, the AIFM must appoint an independent valuator to establish the value of assets acquired by the AIF and the value of the shares and units of the AIF (at least once a year).
8	For each AIF it manages, the AIFM shall ensure that a depositary is appointed which is a credit institution having its registered office in the EU and be authorised in accordance with the Banking Directive (recast) (2006/48/EC).
Delegation of AIFM functions	
9	Each delegation to third parties of tasks by an AIFM requires prior authorisation (subject to certain conditions) from the competent authorities of its home EU Member State.
Transparency requirements	
10	For each of the AIF it manages, the AIFM shall make available to investors and competent authorities an annual report for each financial year (including audited accounts).
11	AIFM shall ensure that AIF investors receive certain information before they invest in the AIF, as well as any changes thereof, including (but not limited to) a description of (i) the investment strategy and objectives, (ii) the procedures to change the investment strategy or policy, (iii) legal implications of the contractual relationship entered into for the purpose of the investment, (iv) valuation procedure, (v) delegated functions, (vi) liquidity risk management, (vii) all fees, charges and expenses, and (viii) preferential treatment of (an) investor(s). Furthermore, for each AIF managed by an AIFM, the AIFM shall periodically disclose to investors certain information, including (i) the percentage of the AIF's assets, (ii) any new arrangements for managing the liquidity of the AIF, and (iii) the current risk profile of the AIF and the risk management systems employed by the AIFM to manage these risks.
12	AIFM shall regularly report to the competent authorities of its home EU Member State on the principal markets and instruments in which it trades on behalf of the AIF it manages. It must also disclose to these competent authorities similar information as must be disclosed to investors and also information on (i) the main categories of assets in which the AIF invested, and (ii) where relevant, the use of short selling during the reporting period. Furthermore, for each of the AIFs it manages, the AIFM shall submit an annual report and (quarterly) a detailed list of all AIFs managed by the AIFM to the competent authorities of its home EU Member State.
Obligations regarding an AIFM managing specific types of AIF	
13	As described in the Legal Alert, the Proposal also includes specific obligations for AIFMs managing leveraged AIFs (mostly hedge funds) and for an AIFM managing AIFs which acquire controlling influence in companies (mostly buyout funds).