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EDITED BY: LENNAERT POSCH AND LLOYD WINANS

AUTHORED BY: DWIGHT SMITH, JOSEPH YESUTIS, LLOYD WINANS, CHRISTINA LAVERA, LENNAERT POSCH, MICHIEL COENRAADS, MATTIA COLONNELLI DE GASPERIS, FRANCESCA CANZANI, WALTER STUBER, AND ADRIANA MARIA GÖDEL STUBER

This year's review article addresses two of the most significant financial legislative developments in the United States and Europe in 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Directive on Alternative Investment Fund Managers, respectively. It furthermore gives insights into specific, material developments in the legislation of Italy and Brazil during 2010.

I. Developments in the United States*

A. THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

On July 21, 2010, the most sweeping banking legislation in a decade was signed into law as the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Act"). With a stroke of a pen, all types of financial institutions became subject to significant new conditions and limitations; nonfinancial, publicly traded companies received new obligations as well. As is always the case with landmark legislation, the consequences on day-to-day operations will emerge over time, as regulators begin their analysis and rulemaking.

The legislation is designed to advance several policies that had been observed, at best, in theory rather than practice, and is in some ways a reaction to the popular belief that the financial crisis of the last few years can be traced to regulatory failure. In broad terms, each policy is embodied in one or more specific titles:

- Identification of institutions and activities that pose systemic risk to the U.S. economy and the proper management of these risks—hence the creation of the Financial Services Oversight Council ("FSOC") (Title I).

* Editors: Lennaert Posch and Lloyd Winans, co-chairs of the International Financial Products and Services Committee.

* Contributed by Dwight Smith, Partner, Morrison & Foerster, LLP; Lloyd Winans, Partner, Alston & Bird LLP; and Joseph Yesutis and Christina LaVera, Counsel, Alston & Bird LLP.

- The end of the "too-big-to-fail" doctrine and the creation of a mechanism to handle the failure of systemically significant new institutions—thus new orderly liquidation authority for the Federal Deposit Insurance Corporation ("FDIC") (Title II) and changes to the emergency powers of the Federal Reserve Board ("FRB") and the FDIC (Title XI).
- Regulation of the shadow financial services industry, with respect both to institutions that take on or transfer risk—as a result, new regulation for private equity and hedge funds (Title IV) and participants in the structured finance market (Title IX).
- Transparency of complex financial instruments designed to transfer risk—accordingly, the restructuring of the derivatives market (Title VII).
- Effective protection of home loan borrowers and other consumers against abusive and deceptive practices—thus, the creation of the Bureau of Consumer Financial Protection ("BCFP") (Title X) and enhanced regulation of the residential mortgage industry (Title XIV), and the inclusion of the Durbin Amendment which requires interchange transaction fees on electronic debit transactions to be "reasonable and proportional" to the incremental costs to the issuer with respect to the transaction.
- Effective protection of retail investors—as a result, enhanced regulation of broker dealers and investment advisers (Title IX).
- Appropriate safety and soundness regulation of all institutions that control insured depository institutions—hence new substantive regulation (Title VI) and changes in supervisory authority (Title III).
- Other concerns—several other titles address financial institutions or activities whose links to the financial crisis are less clear, but that may pose great risks in the future: insurance companies (Title V) and payment, clearing, and settlement services (Title VIII).

The new rules and regulations, even though they may be a long time in coming in final form, require immediate attention by financial institutions for two reasons:

First, the impact of any new requirements will be dramatic and in many cases will result in material changes to how capital should be allocated across all business lines and how each business line should be managed.

Second, economic events could force action before the nominal deadlines in the Act. The economy remains fragile, and credit risk at the retail level is still significant. If there are adverse future developments, these will not wait for the Act to take full effect, and substantive regulation along the lines of the legislation could come into play sooner than expected. In some ways, the federal regulators already possess the power to implement the new obligations and duties contemplated by the Act.

As part of compliance planning, there are three overlapping perspectives to keep in mind:

- Regulatory Structure. The Act creates, among other things, two important agencies—the FSOC and the BCFP. Both are likely to make decisions that will affect institutions even outside of what is commonly perceived to be their jurisdiction. Additionally, the FRB will gain sweeping new supervisory authority. The powers of the other major federal financial services industry, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the FDIC and the Office of the Comptroller of the Currency (OCC) will expand in significant ways as

well. The one nominal regulatory reduction is the abolition of the Office of Thrift Supervision, although its powers and responsibilities will be folded into the OCC.

- Institutions. All but the smallest depository institutions will see changes in regulation that will depend in significant part on structure and charter. Substantial supervisory changes are in store for bank holding companies with nonbank subsidiaries; the FRB now has far greater authority over these subsidiaries. Of course, large nonbank financial companies should plan for the new relationship with the FSOC. With respect to charters, federal savings associations may need to re-think their charter choice (although the charter is not abolished), and companies with nonbank banks could (but are not certain to) face new regulation.
- Operations and Activities. The Act creates significant new restrictions for nearly all activities of financial institutions, both internal and external, and both wholesale and retail. While the vast majority of financial institutions will not themselves be deemed systemically significant, they may well engage in activities that the FSOC believes present systemic risk. Greatly enhanced regulation by the FRB could be the result. There are potentially critical changes for specific businesses as well. For example, all participants at any stage of the residential mortgage business will have new duties. The terms of certain mortgage loans are certain to change, which will have a ripple effect throughout the mortgage industry. As another example, the legislation, as is widely known and appreciated, effectively forces the reorganization of the market for over-the-counter derivatives; less publicized are new limits on the use of derivatives within a banking organization.

Until the regulations for each title are drafted and implemented, which is expected during the course of 2011, some uncertainty will remain as to the extent of changes to product offerings, processes, disclosures, and risk management practices. The history of banking law in the United States is dynamic and has been so since the country's inception. The Act is yet another sweeping revision that attempts to ensure the safety of the economic lifeblood of America.

II. Developments in the European Union (E.U.)*

A. European Directive on Alternative Investment Fund Managers

1. *Introduction*

On November 11, 2010,[1] the European Parliament adopted the Directive on Alternative Investment Fund Managers ("AIFM"s), setting forth rules regulating the activities of AIFMs.[2] This Directive is certain to have a serious impact on the way E.U. funds are

* Contributed by Lennaert Posch and Michiel Coenraads of Stibbe (Amsterdam, the Netherlands), following up on and updating their article in the International Financial Products and Services Committee newsletter of August 2009.

1. Press Release, European Commission Statement at the occasion of the European Parliament vote on the directive on hedge funds and private equity (Nov. 11, 2010), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/573&format=HTML&aged=0&language=EN&guiLanguage=en.

2. Commission Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and Amending Directives 2003/41/EC and 2009/65/EC, COM (2009) 207 final (Oct. 27, 2010) [hereinafter *Directive of the European Parliament and of the Council*], *available at* http://www.

managed, and on the management and marketing of non-E.U. funds in the E.U. Consequently, prior to its adoption, the Directive has, from the first draft of April 2009, encountered severe concerns from various interest groups.

According to the European Commission, which initially proposed the Directive, the global financial crisis has exposed a series of vulnerabilities in the global financial system and revealed that AIFMs, as significant actors in the financial system, can cause significant risks. These risks exist not only for investors in AIFM-managed funds, but also for investors' creditors, for the companies that form part of the funds' investment portfolios, and even for the financial system at large.

The Directive regulates the managers of alternative investment funds (hereinafter also "AIF"s), rather than directly managing the funds themselves. Under the Directive, a comprehensive, harmonized E.U. framework for prudential oversight and the supervision of AIFMs is created. In addition, the new European Securities Market Authority ("ESMA") will be granted certain powers to intervene in the management of AIFs. On the other hand, granting AIFMs passport rights, thereby enabling them to provide their services and market the funds across the internal market of the E.U., creates a level playing field.

2. *Scope: Not Only European, But Global Impact*

The Directive applies to all AIFMs located in the E.U. and to AIFMs located outside the E.U. that manage E.U. AIFs or that market AIFs into the E.U. Generally, the following exemptions apply: AIFMs that manage funds with an aggregate asset portfolio of less than €100 million are exempted from the authorization requirement. AIFMs with assets under management of less than €500 million are exempted as well, but only if those AIFs are not leveraged (there can exist leverage at the portfolio company level though) and if they do not offer redemption rights for the investors during five years after the inception of the fund. To these smaller managers, a lighter "registration only"-regime applies. They are however given the opportunity to 'opt-in' so as to avail themselves of passporting rights, in which case these smaller funds must also fully comply with the Directive.

Certain specific entities, such as holding companies, central banks, pension funds investing their own money or securitization special purpose entities, do not fall within the scope of the Directive.

It is remarkable that the scope is so broad that the Directive catches not only hedge funds and private equity firms, but also other types of collective investment vehicles, such as commodity funds or closed end listed investment companies. On the other hand, vehicles that are not structured as a fund (but for example as managed accounts, such as Bernard Madoff's investment company) are not covered by the Directive.[3]

3. *Authorization*

a. Authorization Process

A starting point of the Directive is that each member state of the E.U. must ensure that no AIFM acts as a manager or promotes any fund without prior authorization in accor-

evca.eu/uploadedFiles/Home/Public_And_Regulatory_Affairs/AIFM_Directive/AIFMD_Proposal_Text_27 1010.pdf.

3. *Id.* arts. 2 ¶¶ 1-2, 3 ¶ 1.

dance with the Directive.[4] The procedure for obtaining authorization includes providing a wide range of information to the member state's authority, including (i) details on the shareholders/members of the AIFM and its structure; (ii) details on its remuneration policies; (iii) the terms (or rules) and the instruments of incorporation of each fund that the AIFM intends to manage; as well as (iv) the information that the AIFM is required to give to the fund's prospective investors.[5] The authority must decide within three months (extendable on a case-by-case basis to six months) after the application has been submitted and can approve, approve with restrictions, or reject the application. ESMA will maintain a central public register of all AIFMs and all AIFs that may be marketed in the E.U.

b. Initial Capital and Own Funds

There is a minimum own funds requirement for AIFMs of €125,000 (€300,000 for self-managed funds), but additional capital (subject to a cap) will be required if the assets of the fund under management exceed €250 million. This aims to ensure the continuity and regularity of the AIFMs' work.

AIFMs must also have adequate funds to cover professional liability risks or have adequate insurance for these risks.[6]

4. *Requirements*

As set out above, the Directive does not aim to regulate the funds themselves, but merely the AIFMs managing the funds. Also, it does not regulate the investment strategies that the AIFMs use. The requirements provided by the Directive concern the conduct of business, the organization of the AIFM, and the remuneration of its staff. In addition, the Directive aims to increase transparency by imposing wide-reaching disclosure and reporting requirements.

a. Conduct of Business

(1) General

The Directive provides both general principles and specific rules for the way AIFMs must conduct their business. In terms of general principles, the AIFMs must, *inter alia*:

(i) act honestly, with due skill, care and diligence and fairly;

(ii) act in the best interest of their AIF, their investors, and the integrity of the market as a whole;

(iii) ensure that all their investors are treated fairly; and

(iv) prevent any conflicts of interest.[7]

(2) Remuneration

The Directive contains detailed remuneration rules (also encompassing carried interest) that are in large part based on the Financial Stability Board and G20 standards. The Directive will require AIFMs to (i) implement remuneration policies and practices that promote sound and effective risk management and do not encourage undue risk-taking;

4. *Id.* arts. 6 ¶ 1, 7 ¶ 1.
5. *Id.* art. 7.
6. *Id.* art. 9.
7. *Id.* art. 12 ¶ 1.

and (ii) apply detailed rules in respect of the ways they compensate their (senior) employees (e.g., deferment of bonus payments).[8]

(3) Risk management

The Directive makes a clear distinction between (i) risk management and (ii) portfolio management, and determines that those functions must be separately operated (and thus be subject to separate reviews). The risk management systems must measure, manage, and monitor all risks associated with each investment strategy and each fund. Also, each time the fund makes an investment, it must follow a (written and regularly updated) due diligence process. It must provide insight in the risks and impact thereof on each fund's portfolio, and ensure that the risk profile corresponds to the fund's applicable terms. Also, risk management systems must enable the funds to be stress-tested. For each AIF, a maximum level of leverage shall be set by the AIFM, as well as the extent of the potential (re-use) of collateral or guarantee to be granted in respect thereof.[9]

(4) Liquidity management

Pursuant to the Directive, the AIFM must have an adequate liquidity management system in order to ensure that the liquidity profile of the portfolio corresponds with the underlying obligations. The investment strategy, the liquidity profile, and the redemption policy must be consistent. Also, in this respect the AIFM must regularly conduct stress tests.[10] These rules must prevent the problems we have seen during the recent financial crisis where large-scale redemption requests were made. Funds were not able to meet these requests, and thus, had to disinvest, which may have had an impact on the financial system at large.

(5) Investments in securitized loans

The European Commission is required to adopt specific measures setting out requirements for the originator, sponsor, and the original lender in order for an AIFM to be allowed to invest in securities of this type on behalf of an AIF.[11]

b. Organizational

(1) General

The Directive provides both general principles and specific rules for the way AIFMs are organized.[12] In terms of general principles, the AIFMs must have:

(i) adequate and appropriate resources that are necessary for the proper performance of its management activities; and

(ii) updated systems, documented internal procedures, and regular internal controls of the conduct of its business in order to mitigate and manage risks.

The European Commission believes that the risks (both for investors and for the financial system at large) associated with funds stem from not only the AIFM, but also from the other key actors in the fund structure: the valuer and the depositary. Consequently, the Directive focuses on these entities as well.

8. *Id.* art. 13 ¶ 1, Annex II.
9. *Id.* art. 15.
10. *Id.* art. 16.
11. *Id.* art. 17.
12. *Id.* arts. 18, 19, 20 ¶ 1.

(2) Valuation

The net asset value per share or unit of an AIF must be valued once a year. For open-ended funds, additional calculations need to be made at appropriate times, given a fund's issuance and redemption frequency. For closed-ended funds, additional calculations must be made whenever there is an increase or decrease in capital. Such valuation must be performed by the AIFM itself (in a way that is functionally independent from portfolio management and the setting of remuneration policy) or by an external valuer (subject to professional registration or similar credentials and able to furnish professional guarantees). The rules regarding delegation (see below) also apply to a valuation by an external valuer.[13]

(3) Delegation

AIFMs that intend to delegate part of their functions to other parties need to notify the authority before effecting such an arrangement and comply with certain conditions, such as, *inter alia*: (i) being able to provide a justification for the delegation; (ii) the delegatee having sufficient resources and staff as well as a good repute and sufficient experience; (iii) the delegatee being authorized or registered and supervised as a manager (if the delegation concerns management functions); (iv) the AIFM being able to monitor the delegation, give instructions to the delegatee, and cancel the delegation with immediate effect, if in the interest of the AIF's investors; (v) the delegation not preventing the AIFM from acting in the best interests of investors; and (vi) the delegation not preventing oversight by the AIFM's regulators.[14] Delegation of management functions may not be made to an AIF's depositary or other entity whose interests may conflict with the AIFM or the investors of the AIF (unless measures have been taken to adequately address such conflict of interest). Delegation of portfolio-or risk-management functions to a non-E.U. country can only be permitted if co-operation between the AIFM's regulator and the regulator of the non-E.U. country is ensured. Furthermore, the AIFM's liability to a fund and its investors is not affected by any delegation. In other words, the AIFM is responsible for acts and omissions of the delegatee.

(4) Depositaries

The Directive also aims to ensure that the party that actually takes custody of the money and assets of an AIF (except for non-E.U. AIFs that are not marketed in the E.U.) is under E.U. regulation as well. Under the Directive, (i) an independent E.U. credit institution (bank); (ii) another E.U. regulated entity authorized to provide custodial services and meeting certain capital requirements; or (iii) an entity that is regulated and authorized to act as depositary under the UCITS (Undertakings for Collective Investment in Transferable Securities) Directive, must be engaged as depositary of the funds' assets. For non-E.U. AIFs, the depositary may be a bank or other custodian located outside the E.U., provided it is regulated in a way that is equivalent to E.U. law and that is effectively enforced.[15]

The Directive provides for further rules concerning the location of the depositary and the functions it is required to perform, as well as the depositary's liability vis-à-vis the AIF and its investors, which in most cases, is near strict. This means that the depositary is

13. *Id.* art. 19 ¶¶ 3-5.
14. *Id.* art. 20 ¶¶ 1-3.
15. *Id.* art. 21.

liable for (i) a loss of assets under its custody, unless it can prove that the loss was caused by "an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary;"[16] and (ii) losses suffered by the AIF or its investors caused by its negligence or intentional failure to comply with the Directive.

Delegation of the custody functions by a depository is only possible in observance of strict rules.

5. *Disclosures and Reporting*

The Directive contains rules regarding the AIFMs' transparency to investors, regulators, and others. The AIFM must produce an annual report for each fund that it manages and make that available to the investors and the regulators. Also, the AIFM must submit certain specified information to the regulators (regarding liquidity, leverage, and the principal exposures and concentrations of the fund) and to prospective investors before they invest. Furthermore, there are ongoing disclosure requirements to investors regarding leverage (on a regular basis), on liquidity and risk management (periodically), and with respect to material changes to any information previously provided.[17]

The Directive provides further rules for the required disclosures by specific funds: (i) funds using leverage on a substantial basis and (ii) funds that acquire major stakes in companies.

a. Leverage

AIFMs that manage funds that are leveraged (on a substantial basis) must make certain additional disclosures to regulators.[18] The Directive itself does not impose any flat limits on leverage, though. But, the AIFM is required to set the limits for each fund it manages, demonstrate compliance with those limits, and demonstrate that they are reasonable.

The E.U. member states will have the power (but not the obligation) to set further limits in exceptional cases, in order to ensure the stability of the financial system.

Note that only leverage at the fund level, and not at the portfolio level, is taken into account.

b. Significant Stakes

The Directive imposes a notification obligation to the regulator whenever the voting rights held by an AIF reach, exceed, or fall below the thresholds of ten percent, twenty percent, thirty percent, fifty percent, and seventy-five percent of a company, listed or unlisted.[19] If an AIFM acquires a controlling interest in a listed company or a large unlisted company (which in the latter case means that it becomes able to exercise fifty percent or more of the voting rights), specific requirements apply. The AIFM must in such a case inform the company and the other shareholders of the company of (i) the fund's identity; (ii) the fund's development plan for the company; (iii) the fund's policy to deal with conflicts between the fund and the company, and (iv) the fund's communication pol-

16. *Id.* art. 21 ¶¶ 5, 11, 13, 15.
17. *Id.* arts. 22 ¶¶ 1-2, 23 ¶¶ 1-2.
18. *Id.* art. 25 ¶¶ 1-3.
19. *Id.* arts. 26 ¶ 5, 27 ¶ 1.

icy.[20] If the investment concerns an unlisted company, the AIFM must provide additional information, such as its intentions as to the future business of the company, including consequences for employees, and in its annual report for the relevant AIF, the company's likely future development.[21]

6. *Asset Stripping*

At the insistence of certain members of the E.U. Parliament, the final text of the Directive contains provisions to prevent "asset stripping" where an AIF (individually or jointly) acquires control of a company. The provisions apply for a period of two years following such acquisition. The AIFM of the relevant AIF is, during this period, not allowed to facilitate or support (by vote or otherwise) certain distributions, capital reductions, and share redemptions where this would lead to a greater distribution than is justified by the company's profits or where the effect would reduce net assets below subscribed capital and reserves that may not be distributed.[22]

7. *Passport Rights and Third Country Issues*

An authorized E.U. AIFM may manage and market (units in) an E.U. AIF to professional investors within its home state. The passport right, to be in place from January 2013, entails that an authorized AIFM may market the E.U. funds it manages to professional investors in each E.U. member state.[23] The only requirement to market in an E.U. member state other than the AIFM's home state is that it must first notify its home state regulator, who must forward the information to the host state regulator. The Directive also provides a passport right to provide management services throughout the E.U., either on a cross border basis or via the establishment of a branch. Again, the AIFM must notify the home state regulator of its pan-European aspirations.

The most controversial aspect of the Directive was the treatment of third country (non-E.U.) managers and funds. In the end, it now seems likely that the issue has been resolved in favor of granting non-E.U. funds a form of passport. But, this will be delayed until 2015.[24] In the final text of the Directive, different marketing rules are provided for (i) E.U. AIFMs managing non-E.U. AIFs; (ii) non-E.U. AIFMs managing E.U. AIFs; and (iii) non-E.U. AIFMs managing non-E.U. AIFs. With respect to (i), E.U. AIFMs are allowed to manage non-E.U. AIFs but for certain provisions relating to depositaries and the annual report must fully comply with the Directive. Furthermore, additional requirements apply, such as the existence of adequate cooperation agreements between the regulator of the AIFM's home state and the regulator of the country where the AIF is established.[25]

As to marketing, as stated above, until 2015 there will not be a passport, but E.U. AIFMs are allowed to market non-E.U. AIFs to professional investors under individual member states' private placement regimes, provided (1) that the AIFM complies with the

20. *Id.* art. 28 ¶ 1.
21. *Id.* art. 29 ¶¶ 1-2.
22. *Id.* art. 30 ¶ 1.
23. *Id.* arts. 32 ¶¶ 1-3, 33 ¶¶ 1-2, 4.
24. *Id.* art. 63 bis ¶ 1.
25. *Id.* art. 34.

Directive and (2) that the jurisdiction where the non-E.U. AIF is established is not determined to be a Non-Cooperative Country and Territory by the Financial Action Task Force on anti-money laundering and terrorist financing (an "NCC").[26] It is likely that, in the course of 2015, a marketing passport for non-E.U. AIFs will become available provided that the above requirements are met and there is also a tax sharing information agreement in place between the state where the relevant AIF is established and the home member state of the AIFM as well as the other member states into which marketing is to take place.[27]

Non-E.U. AIFMs that intend to manage E.U. AIFs need an authorization from the member state in which the AIF is established (the "member state of reference").[28] This can be done cross-border or by the establishment of a branch office in the member state of reference (a minimal presence needs to be established).

Duly authorized non-E.U. AIFMs can market E.U. AIFs under the future passport regime provided they comply with the Directive and that notification is made to the regulator of each member state in which it intends to market.[29]

A duly authorized non-E.U. AIFM will, from 2015 on, be allowed to market units in a non-E.U. AIF to professional investors under the passport regime subject to, *inter alia*, the following requirements: (a) compliance with the Directive; (b) notifications to the regulators of member states into which it will market; (c) the existence of cooperation agreements between the regulators; and (d) the jurisdiction of the AIF is not an NCC.[30]

Non-E.U. AIFMs will be allowed (until 2018) to market units in an E.U. or non-E.U. AIF under the national private placement regime of individual member states. They must, however, in that case also comply with a number of additional requirements which, broadly, are the following: (a) compliance with provisions of the Directive regarding the annual report; disclosure and reporting; (b) if applicable, compliance with the provisions on the disclosure of control and asset stripping; (c) compliance with appropriate cooperation agreements between the relevant regulators; and (d) demonstration that the jurisdiction of establishment of the non-AIF is not an NCC.[31]

8. *Retail Investors*

Member states may also permit the marketing of units in a fund to retail investors, if they so wish. In such a case they may also impose stricter requirements on the AIFM or the AIF in question than are set forth in the Directive in respect of the marketing to professional investors.[32]

9. *ESMA*

ESMA may, under certain conditions and in certain circumstances, require that the regulator of a member state take any of the following actions: (i) a prohibition on market-

26. *Id.* art. 36 ¶ 1.
27. *Id.* art. 35 ¶ 2(c).
28. *Id.* art. 37 ¶ 1.
29. *Id.* art. 38 ¶¶ 1-2.
30. *Id.* art. 39.
31. *Id.* art. 40 ¶ 1.
32. *Id.* art. 41.

ing shares or units in E.U. AIFs that are managed by non-E.U. AIFMs or in non-E.U. AIFs that are managed by E.U. AIFMs; (ii) impose restrictions on non-E.U. AIFMs in respect to the management of an AIF where excessive risk is concentrated in a specific market on a cross border basis; and (iii) impose restrictions on non-E.U. AIFMs relating to the management of an AIF where their activities pose an important counterparty risk to a credit institution or other systemically important institutions.[33]

10. *Concerns In The Market*

Many lobbyists and interest groups have, during the legislative process, expressed their views on the Directive. For obvious reasons, many of them welcome the passport rights granted to AIFMs to market funds and provide services across the internal market of the E.U., but oppose the other side of the medal. Generally, the interest groups believe that the new rules impose significant administrative burdens and costs while they do not create significant additional value for investors.

The Alternative Investment Management Association ("AIMA") has argued that hedge funds have neither caused nor played a significant role in the financial crisis and that hence it is unfair to confront them with more rules and supervision.[34] Although they have over time, as the draft text developed, significantly softened their stance towards the Directive, they remain concerned about the compliance burden and regret the potential abolition of private placement regimes which, in their view, worked well.[35]

Many investors also point out that the costs of compliance will, in the end of the day, have to be borne by the investors.[36]

11. *Further Steps*

The final text is yet to be adopted by the Council. Following translation into all official E.U. languages, the Directive will be published in the Official Journal. The Directive will come into force in early 2011 and must be implemented by member states in the beginning of 2013. From that time on, there will be a passport for E.U. AIFMs marketing E.U. AIFs. For non-E.U. AIFMs and managers of non-E.U. AIFs, the national private placement regime will (continue to) apply. As from the beginning of 2015, it is likely that the passporting regime will become available in parallel with the national private placement regimes. From 2018, the private placement regimes may be abolished, leaving the passport regime in place.

On practically every subject that the Directive addresses, the European Commission must produce additional "level 2" rules. The Directive is very detailed in some respects but is also still unclear in many others. Hopefully, "level 2" will provide more certainty as to its practical, everyday impact.

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33. *Id.* art. 45, ¶ 4(a)-(c).

34. *See* Florence Lombardo, *AIMA Statement on European Commission Directive*, AIMA, Apr. 23, 2009, http://www.aima.org/en/announcements/aima-statement-on-european-commission-directive.cfm.

35. *See* Andrew Baker, *AIMA Statement on AIFMD*, AIMA, Oct. 19, 2010, http://www.aima.org/en/announcements/aima-statement-on-aifmd.cfm.

36. *See, e.g.*, Letter from Johcarlo R. Mark, Institutional Ltd. Partners Ass'n Chairman, to Jean Paul Gauzès, Rapporteur for the AIFM Directive (Mar. 8, 2010), *available at* http://www.ft.com/cms/ed7c1252-2b98-11df-a5c7-00144feabdc0.pdf.

12. *Conclusion*

On the one hand, the Directive will increase the level playing field for AIFMs across the internal market of the E.U., whereas on the other hand supervision (on both micro- and macro-prudential levels) will be materially increased. This will also increase the administrative burden, both for the AIFMs as for the regulators. The exclusion of offshore funds of the passport rights, at least for the first two years after the Directive coming into effect, gives somewhat of a head start to their European competitors.

III. Developments in Italy*

A. INVESTMENT FUNDS

On May 31, 2010, the Government of Italy issued Law Decree no. 78 on "Urgent action on financial stabilization and economic competitiveness,"[37] converted to Law no. 122 of July 30, 2010.[38] Article 32 of such Law Decree,[39] while providing for the reorganization of the tax rules of real estate close-end funds (the immediate intention of this provision is to stem the use and setting up of real estate close-end funds only to take advantage of certain tax benefits[40] applicable to those funds), introduces key amendments to the regulation of all types of investment funds in order to protect the investors, enhance the flexibility of the investment funds, and render them more competitive in the international arena.

Technically, such objectives have been achieved, *inter alia*, through the following amendments to the Italian Consolidated Law on Financial Intermediation ("TUF").[41]

First, the definition of "investment funds" has been amended and clarified by specifying the economic function and the features of the funds. According to the new provision,[42] investment funds mean equity raised independently through the issue of one or more fund units among a number of investors, with the aim of investing the equity raised in accordance with a pre-established investment policy; divided into units pertaining to a given number of investors; managed upstream in the interests of the investors and fully independent of those investors.

Second, to enhance the protection of the unit holders and attract more domestic and foreign investments, it has further specified the separation of the assets/obligations of a certain fund vis-à-vis the assets/obligations of other funds managed by the same investment company. In this regard, article 36, subsection 6 of TUF has been amended by

* Developments in Italy was contributed by Mattia Colonnelli de Gasperis and Francesca Canzani of Colonnelli de Gasperis Studio Legale in Milan, Italy (info@colonnellilaw.com), which provides legal advice on financial products and services in Italy.

37. Decreto Legge 31 maggio 2010, n. 78, in G.U. 30 luglio 2010, n. 176 (It.), *available at* http://www.altalex.com/index.php?idnot=11219.

38. Legge 30 luglio 2010, n. 122, in G.U. 30 luglio 2010, n. 176 (It.), *available at* http://www.urp.it/allegati/Legge_2010_122.pdf.

39. Commission Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and Amending Directives 2003/41/EC and 2009/65/EC, *supra* note 2, art. 32.

40. *See* Decreto Legge 25 settembre 2001, n. 351, converted to Legge 23 novembre 2001, n. 410, in G.U. 24 novembre 2001, n. 274 (It.), *available at* http://www.parlamento.it/parlam/leggi/01410l.htm.

41. Decreto Legislativo 24 febbraio 1998, n. 58, in G.U. 26 marzo 1998, n. 71 (It.).

42. *Id.* art. 1 § 1(j).

stating the fund is liable exclusively with its own assets in relation to the obligations undertaken for the fund's own account. Due to certain technicalities, that modification, among other things, increases the leverage that can be used by each fund.

Third, new article 37, subsection 2(b) of TUF sensibly limits the regulatory supervision of the Bank of Italy on the so called "reserved funds," which are funds reserved only to "qualified investors" (mostly, institutional investors). In particular, the rules of these funds are no longer subject to the prior approval of the Bank of Italy, neither same rules (i) are subject to certain drafting criteria and (ii) have to contain a certain minimum content (drafting criteria and minimum content which still apply to the "ordinary funds" (i.e. not reserved funds)). Such radical deregulation enhances flexibility and promotes efficiency of the system by reducing compliance costs and fees to be paid to the fund manager. That simplification aligns Italy with the applicable laws and regulations of other countries. At the same time, the elimination of the prior approval of the fund rules by the Bank of Italy increases the responsibility of the industry players.

Given the high degree of technicality of the subject matter, the Italian Ministry of Economy and Finance is in charge of issuing a decree implementing in details the described amendments.[43] This decree has not yet been enacted, but a draft of the decree has already been prepared and likely will be circulated for public consultation. Judging from the draft of the decree, there are many things to come, and not all related solely to the implementation of the mentioned amendments.[44] For instance, new rules will probably be introduced (i) to draw a clearer line between "harmonized funds" and "alternative funds," as defined by the E.U. regulations and directives; (ii) to extend the maximum term of close-end funds up to fifty years; (iii) to enlarge the eligible assets of the real estate funds; and (iv) to extend the period of initial contributions of close-end funds up to twenty-four months.

IV. Developments in Brazil

A. The Use of the IOF Tax to Regulate the Inflow Of Foreign Currency in Brazil*

The tax on credit and exchange transactions, insurance and securities (*Imposto sobre Operações de Crédito, Câmbio e Seguro, ou relativas a Títulos ou Valores Mobiliários*-IOF) in Brazil is assessed on the amount of bank loans and similar transactions, on the amount of foreign currency purchased or sold, and on insurance premiums and the price of securities purchased or sold. The applicable tax rate may vary from zero to twenty-five percent and depends on the kind of operation. The IOF is a regulatory tax and the rates are decreased or increased by the Brazilian government whenever the authorities decide to foster or reduce the inflow of foreign currency funds into the country.

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43. L. n. 122/2010 (It.).

44. *Per I Fondi Immobiliari "Alternativi" Non Sarà Più Necessario L'ok di Bankitalia* [Bank of Italy approval no longer required for "alternative" real estate funds], Il Sole 24 Ore, Nov. 11, 2010, http://www.ilsole24ore.com/art/norme-e-tributi/2010-11-10/fondi-immobiliari-alternativi-sara-222524.shtml?uuid=AYUqDiiC.

* By Walter Stuber and Adriana Maria Gödel Stuber, of Walter Stuber Consultoria Jurídica (São Paulo, Brazil).

Interest rates in Brazil are higher than those prevailing in the international market, and this difference represents an opportunity for making additional gains and thereby attracting foreign investors. Therefore, the IOF rate affects the effective cost and reduces the profitability of the transaction.

Like many other countries, Brazil decided to take a series of measures aimed to reduce the entry of foreign currency funds for short-term investments, which is considered speculative capital, not desired by the Brazilian government. The Brazilian Finance Minister, Guido Mantega, claimed that "international currency war" had broken out and argued that the increase of the IOF rate was an important measure to defend the value of the Brazilian currency (Real) in this war.

In October 2010, the Brazilian government twice increased the IOF rate levied on exchange transactions related to the inflow of funds for foreign capital investments in the Brazilian market, comprising investments in fixed income instruments, such as debentures and other private debt instruments (*títulos de dívida privada*), and investment funds, including multimarket funds (*fundos multimercado*), stock funds (*fundos de ações*), and private equity funds (*fundos de investimento em participações*-FIPs). Prior to October 5, 2010, the liquidation of such exchange transactions was subject to the IOF at the rate of two percent, in accordance with Decree No. 6.306 of December 14, 2007.[45]

The first increase was made by means of Decree No. 7.323 of October 4, 2010, which came into force on the following day, when it was published in the Official Gazette of the Union (*Diário Oficial da União*-DOU).[46] As a result, as of October 5, 2010, the transaction rate has been increased from two percent to four percent.

Very shortly thereafter, this increase was deemed to be insufficient and, as of October 19, 2010, by means of Decree No. 7.330 of October 18, 2010,[47] the applicable rate was increased again from four percent to six percent. At the same time, the IOF rate on exchange transactions for foreign capital investments related to the constitution of margins of guarantee (either initial or additional) required by the stock, commodities and futures exchanges was increased from 0.38% to 6%.

The IOF rate on foreign capital investments in the Brazilian capital market, comprising variable income instruments, such as securities traded on the stock exchange or assets traded on the commodities and futures exchange, in the form regulated by the Brazilian Monetary Council (*Conselho Monetário Nacional*-CMN), remains unchanged and continues to be two percent. Transactions with derivatives which result in predetermined income are considered fixed income and are taxed at the rate of six percent.

Currently, there is no IOF on exchange transactions related to the outflow of funds (remittances abroad) related to foreign capital investments in the Brazilian financial and capital markets, because the applicable rate is zero.

45. Decreto No. 6.306, de 14 de Dezembro de 2007, Diário Oficial da União [D.O.U.] de 17.12.2007. (Braz.), *available at* http://www.planalto.gov.br/ccivil_03/_Ato2007-2010/2007/Decreto/D6306.htm, (article 15 was amended by Derecto No. 7.323 and repealed by Decreto No. 7.330.).

46. Decreto No. 7.323, de 4 de Outubro de 2010, Diário Oficial da União [D.O.U.] de 5.10.2010, (Braz.), *available at* http://www.planalto.gov.br/ccivil_03/_Ato2007-2010/2010/Decreto/D73.23.htm.

47. Decreto No. 7.330, de 18 de Outubro de 2010, Diário Oficial da União [D.O.U.] de 19.10.2010, (Braz.), *available at* http://www.planalto.gov.br/ccivil_03/_Ato2007-2010/2010/Decreto/D7330.htm.

To eliminate "creative solutions" aimed to avoid the six percent IOF rate and close loopholes, the CMN Resolution No. 3.914 of October 20, 2010,[48] expressly prohibited financial institutions and other entities authorized to operate by the Central Bank of Brazil (*Banco Central do Brasil*-Bacen) to lease, exchange, or lend instruments, securities, or other financial assets to non-resident investors with the purpose to enable those investors to perform transactions in the derivatives market without paying the IOF. As an exception, transactions contracted before October 21, 2010 (date of publication of CMN Resolution 3,914 in the DOU), may be maintained up to their maturity date. Up to December 31, 2010, undetermined term transactions will not be subject to IOF, but such transactions cannot be postponed nor renewed.

Furthermore, for the same reasons, CMN Resolution No. 3,915, also of October 20, 2010,[49] established that any domestic migration of funds in Brazilian currency (Real) made by non-resident investors destined to the constitution of margins of guarantee required by the stock, commodities or future exchanges, are subject to simultaneous exchange transactions, pursuant to the provisions of CMN Resolution No. 3.912 of October 7, 2010,[50] and consequently, are subject to the six percent IOF rate.

On October 6, 2010, in an extraordinary meeting, the Board of Bacen doubled the term of exchange transactions for future liquidation that the Secretariat of the National Treasury has to purchase foreign currency (United States Dollars) in the market in order to pay the External Federal Public Debt, increasing the number of days from 750 days (two years) to 1,500 days (four years). These purchases comprise interbank, arbitrage and financial transactions and the matter is regulated by Bacen Circular No. 3.507 of October 6, 2010.[51] This is another measure to control the depreciation of the United States Dollar.

The Brazilian government is determined to avoid the overvaluation of the Real and eventually might have some success in achieving this purpose, depending on the effective result of the aggregate measures taken so far. According to the analysts, however, it is very likely that the Brazilian currency, in the same line of the vast majority of currencies of other emerging countries, continues to be affected by the global movement of the weakening of the United States Dollar. The most promising flows for 2011, in the case of Brazil, are those of direct foreign investments and foreign capital investments in securities traded on the stock exchange, which will not be affected by such measures. The attempt to contain the overvaluation of the national currency is not limited to Brazil, and follows several other intervening measures announced by many countries during the last weeks, such as Japan, Korea, and Taiwan, which tried to deal with the constant depreciation of the United States Dollar vis-à-vis their national currencies.

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48. Resolução CMN No. 3.914, de 20 de Outubro de 2010, Diário Oficial da União [D.O.U.] de 21.10.10 (Braz.), *available at* https://www3.bcb.gov.br/normativo/detalharNormativo.do?method=detalharNormativo&N=110089731.

49. Resolução CMN No. 3.915, de 20 de outubro de 2010, art. 1 § 1, D.O.U. de 21.10.10 (Braz.), *available at* https://www3.bcb.gov.br/normativo/detalharNormativo.do?method=detalharNormativo&N=110089732.

50. Resolução CMN No. 3.912, de 7 de outubro de 2010, art. 1, D.O.U. de 8.10.10 (Braz.), *available at* https://www3.bcb.gov.br/normativo/detalharNormativo.do?method=detalharNormativo&N=110086413.

51. Circular No. 3.507, de 6 de outubro de 2010, teta 1, capitulo 3, seção 5, 5(a), D.O.U. de 7.10.10 (Braz.), *available at* https://www3.bcb.gov.br/normativo/detalharNormativo.do?method=detalharNormativo&N=110086742.