

## **AIFMD - what will it entail for the hedge fund industry and its risk management?**

On July the 22<sup>nd</sup> 2013, the Alternative Investments Fund Managers Directive (AIFMD) will come into effect in Sweden. Hedge funds, both domestic and foreign ones, will have one year to comply. How will this affect the Nordic Hedge Fund industry, where Sweden accounts for 69%?

Legislation surrounding the EU fund industry is not new; the Undertakings for Collective Investments in Transferable Securities (UCITS) directive has been in place since 1985. Hedge funds, in Sweden called "Specialty funds", have however been exempt from much of the regulations surrounding UCITS, something that the implementation of AIFMD will change. The extent and effects of these changes depend on certain factors, as I describe below.

A fund relying on continuous and dynamic strategy changes might find it difficult to continue doing so; the AIFM specifies that strategy changes need to be reported to the regulators (Finansinspektionen or the funds domestic regulator) one month before such a strategy change is implemented.

Other restrictions which will greatly affect small hedge funds will be the minimum capital requirement, which is 300,000 EUR. What makes matters more complicated is that a fund's total AUM may not be less than the minimum capital requirement under any given business year, which will force the fund to have an additional financial cushion in case of a drawdown. Funds are required to have extra capital or an insurance against liability for damages in accordance to the risks taken by the fund.

A big relief to some would be that the taxation will not be affected for hedge funds, as AIFMD does not involve changes to their legal structure.

For foreign hedge funds, the AIFM will make it easier to market their products in Sweden, something that might be considered a competitive disadvantage to Swedish hedge funds who will be under stricter informational requirements.

Risk management remains an important part of the legislation, stressing the need to adapt these functions to the nature of the funds. It is incorporated in the AIFMD, that in order to get a license and authorization to set up a fund or sell a fund in Sweden an AIM (Alternative Investment Manager) needs to conduct both portfolio management and risk management. AIMF does also require the risk management to be separate from the operative business. The main change pertaining to risk management lies in the fact that now, risk has to be measured at any given point in time, the sole exception being trades in illiquid markets. Funds must also report to the regulators a certain maximum leverage level, which they may not exceed.

Will the changes described above, as well as the stricter informational regulation, be an expensive venture? Yes and no. For Hedge Funds who are following UCITS or in other ways already are fairly close to the new the regulations in AIFMD, the only costs incurred due to the AIFMD will be those related to the registration to become an Alternative Investment Manager (AIM). Foreign funds might actually save money, as marketing their funds toward professional investors in Sweden will become easier. For smaller funds, or

funds that are not already compliant with the main regulations in AIFMD, the changes might become a costly matter.

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