



INVESTMENT MANAGEMENT

Feeling the heat?

Alternative Investment Fund Managers
Directive – Asset Managers Global Survey

February 2010

FINANCIAL SERVICES

Foreword

Since April 2009, when the EU Commission's Draft Alternative Investment Fund Managers Directive was released, following much lobbying and various proposed revisions we have arrived at a crucial time for its future.

As the proposed amendments submitted by the Members of the European Parliament (MEPs) are now being debated, this survey seeks to establish the thinking of the investment management community on how they might react to the proposals as they stood at the start of 2010.

The directive has the potential to significantly alter the market for alternative managers across the globe.

Understanding the thoughts and intentions of the investment management community is crucial:

- to allow EU MEPs to deliver a balanced and effective directive;
- for managers to gauge the strength of feeling on certain aspects of the directive; and
- so that industry service providers can consider the impact on their operating models.

Our foremost thanks go to all respondents who answered our online survey questionnaire. It is thanks to your input that we have been able to produce this brief report, which we hope will play a part in taking the industry's views forward in this debate.

Additionally, our team would be delighted to talk through the key issues with industry participants seeking to identify the implications for their businesses.



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About the research

This report is based on the findings of a focused global survey of C-level and senior executives from across a range of alternative investment management firms from large groups, to specialist niche alternative managers.

The survey was conducted during January 2010 and its aim was to measure the industry's sentiment towards the EU Alternative Investment Fund Managers Directive (AIFMD) and to explore the impact it could have on alternative investment management businesses. Participants came from 15 countries from across EU and non-EU jurisdictions.

Fifty three percent of participants represent companies that manage over EUR 1 billion in assets. Seventy one percent of participants came from companies that manage funds in more than one jurisdiction. The survey represents perspectives from companies with international business models. The participants cover a range of alternative investments including hedge funds, private equity and real estate funds.

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Executive summary

It seems clear that the AIFMD will fundamentally alter the alternative funds market for institutional investors.

While the uncertainty this draft directive has generated should be of no surprise, the scale of that uncertainty is. Over half of participants in the survey are waiting for the final text before absolutely committing to the location of their funds and not many fewer to the location of their management businesses.

Although they believe negotiations are moving in the right direction many respondents still think this directive will lead to lower investor returns, impair growth and potentially lead to an outflow of talent from Europe. They are effectively now resigned to the fact it will be counter-productive for the industry.

The respondent managers' preferred outcome is a competitive AIFM "product" that their investors can opt for — a UCITS equivalent for institutional investors in alternatives —

not a catch-all regime. Alongside continuing private placement regimes this would offer knowledgeable investors a choice they should be educated enough to make.

There is an implicit warning here that the AIFM "product" needs to be competitive on both investor protection and cost. At this stage, however, the real likelihood is that parallel structures could become commonplace.

Finally, with only a few months left until the directive is finalized, the majority of participant managers have yet to formally assess the impact on their businesses or products, despite the fact that they are resigned to it being counter-productive for the industry.

While there will be implementing measures and the process may take some time, an understanding of the likely impacts is vital to a consideration of product strategy and business model evolution.

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Survey highlights

The AIFMD has created significant uncertainty in relation to the location of investment managers, but more so for their funds.

- Eight percent of managers are actively thinking about a change in location with 32 percent awaiting the outcome of the directive before committing to their current location.
- Ten percent of managers are actively thinking about a change of location for their funds, with 50 percent awaiting the outcome of the directive before committing to their current location.
- There is significantly more uncertainty in non-EU jurisdictions, with 26 percent more non-EU managers actively considering a change in domicile for their funds.

Might AIFMD deliver a UCITS equivalent for institutional investors – a competitive product to choose from rather than a catch-all regime?

- Thirty two percent of managers believe there will be investor demand for the AIFM regime.
- Sixty eight percent of managers indicate a desire to use both the AIFM product and private placement if both are in existence post directive – potentially leading to parallel fund structures.
- Fifty three percent of managers believe that investors might prefer to use either a UCITS product (for better investor protection) or a private placement product (for lower cost) instead of AIFM.



Returns will suffer under AIFM (principally due to increased costs) and there may be a moderate outflow of talent to other jurisdictions.

- Forty three percent of managers believe that returns will suffer due to a reduction in investment opportunities, but 44 percent believe this hasn't been proven – a finely balanced point.
- Fifty four percent of managers believe that returns will suffer due to increased costs, with a much lower 35 percent believing this hasn't been proven.
- Forty seven percent of managers believe that investment management talent will not relocate to non-EU jurisdictions, however, 26 percent believe it will solely be due to the AIFM and 26 percent for other reasons.

Negotiations on the AIFMD are moving forward, but respondents had concerns that industry growth will suffer and certain boundaries should not be crossed.

- Fifty one percent of managers believe that negotiations on the Directive's text are moving in the right direction.
- Fifty seven percent of managers believe that the AIFMD will directly impair growth in the industry.
- Seventy eight percent of managers believe the EU should respect its subsidiarity principle (the principle of local government), particularly in relation to national private placement regimes.

Managers are leaving a consideration of the impact of the AIFMD until it is finalized.

- Only 33 percent of the managers have conducted an internal impact analysis with the remainder believing it is too early.

Fifty three percent of the managers believe that investors might prefer to use either a UCITS product (for better investor protection) or a private placement product (for lower cost) instead of AIFM

Detailed survey findings

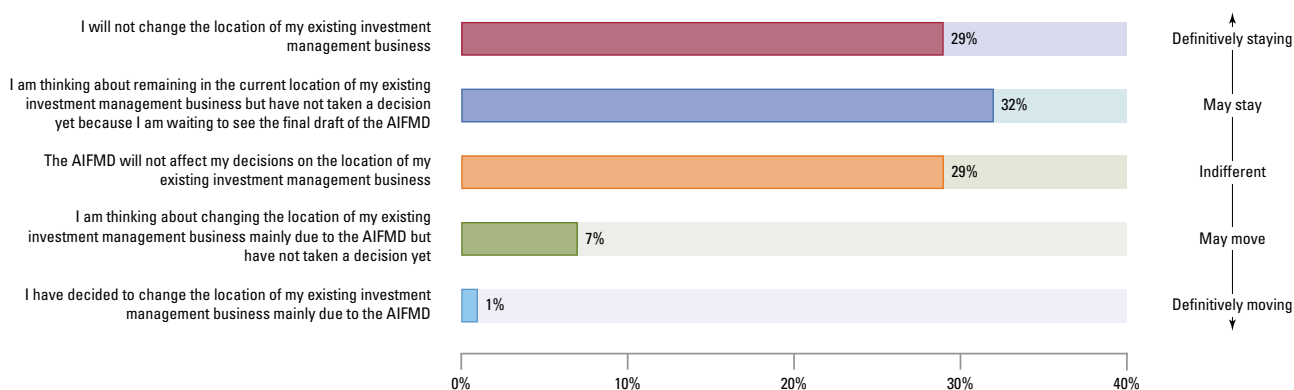
Location of investment funds and managers



Which of the following options best describes your view on the location of your existing investment management business?

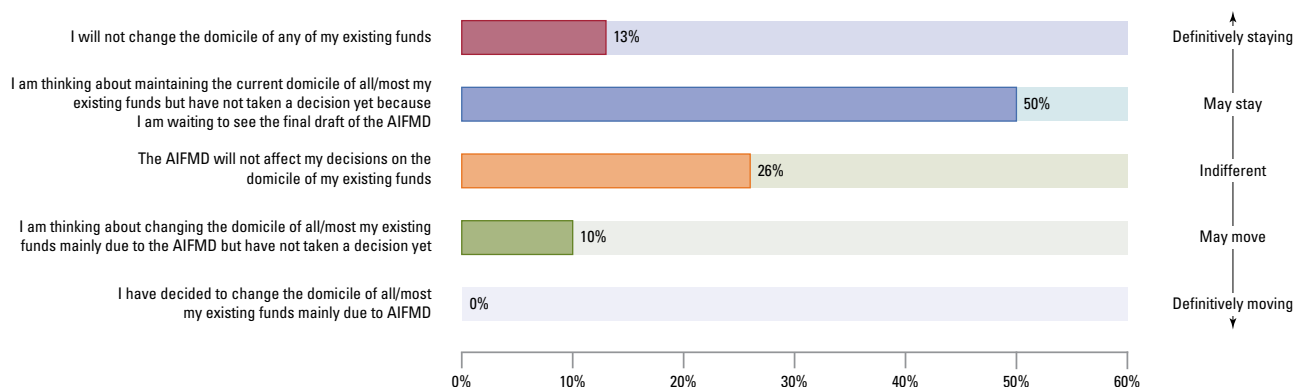
AIFMD has created significant uncertainty regarding the location of existing management businesses; 40 percent of participants admit to some uncertainty about their location while the AIFMD is being finalized.

Of the remainder, half will not change their location for any reason and half believe the AIFMD is irrelevant to that decision. Of those who are uncertain, the majority are awaiting the outcome of the directive while only 8 percent are seriously considering or have decided upon a move.



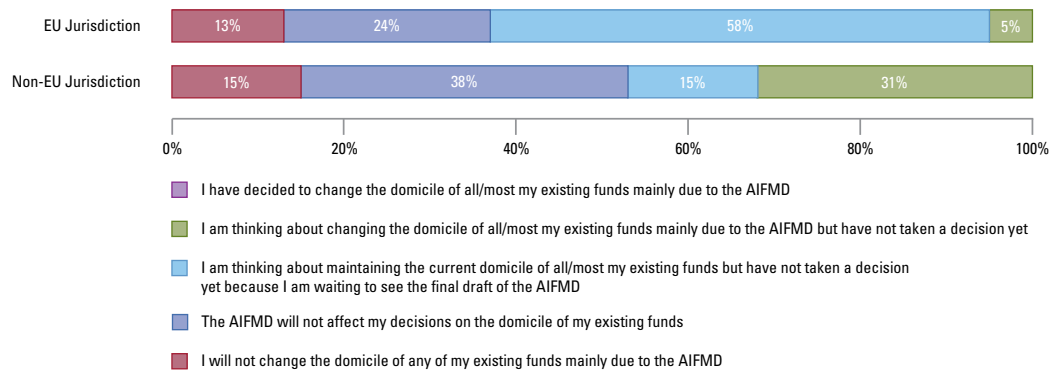
Which of the following options best describes your view on the domicile of your existing funds?

In contrast to the location of their management business, 60 percent of participants admit to some uncertainty about their fund's location while the AIFMD is being finalized.



Please note that with the graphs illustrated, not all answers add up to 100 percent because of rounding or because respondents were able to provide multiple answers to some questions.

Two interesting factors emerge from contrasting EU and non-EU responses. While there is more certainty from some non-EU managers about not changing their funds' domicile (53 percent versus 37 percent), there is also a larger percentage (31 percent versus 5 percent) who are actively considering a change as a result of the AIFMD.



EU managers appear more confident than non-EU managers that they will be able to access investors no matter where their funds are based.

Could the apparent “on-off” reaction from non-EU managers be as a result of differing levels of communication of the potential implications outside of the EU or even as a lack of awareness on the potential reach of the rules?

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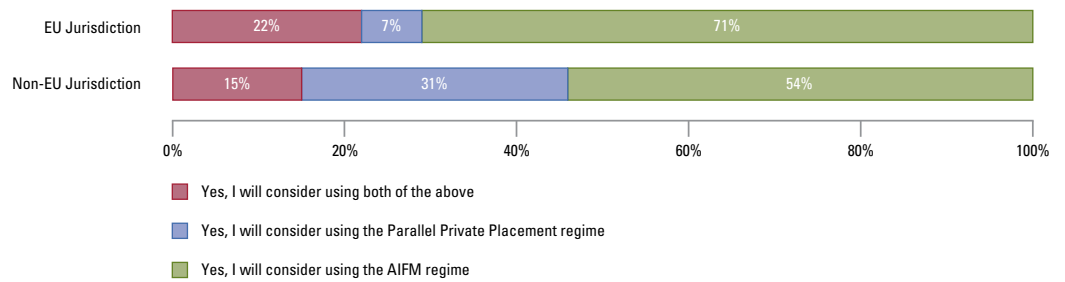
Might the AIFMD deliver a product to choose from rather than a catch-all – the institutional version of UCITS?

If proposals for an AIFM regime with continuing Parallel Private Placement regimes¹ are adopted and implemented, will you consider using one of them or both of them?

Over two-thirds of the surveyed managers would prefer to be able to use both an AIFMD product and private placement regime. Just under a quarter of the managers are content to solely use the AIFM regime for their fund products.

Seventy one percent of the managers in the EU favor being able to use both the AIFM regime and the private placement regime. Not surprisingly, non-EU managers are more in favor of solely using a private placement product (31 percent versus 7 percent).

¹ Definition of Private placement regime: A national set of rules that allow investors to invest in private funds on the basis of terms in a prospectus.



Do you believe there will be demand from institutional investors for the AIFM regime?

In considering where the AIFM regime might lie in terms of competitiveness, 32 percent of the managers feel that there will be demand for this product for reasons like superior investor protection. However, 32 percent feel that substitutes like UCITS will have higher demand, 21 percent believe that investors would prefer lower cost products and 15 percent believe that managed accounts will be more attractive.

With the desire to maintain private placement and the competitive considerations of cost and investor protection, it is clear that managers are demanding a future for private placement alongside an AIFM product to which investors can actively opt.

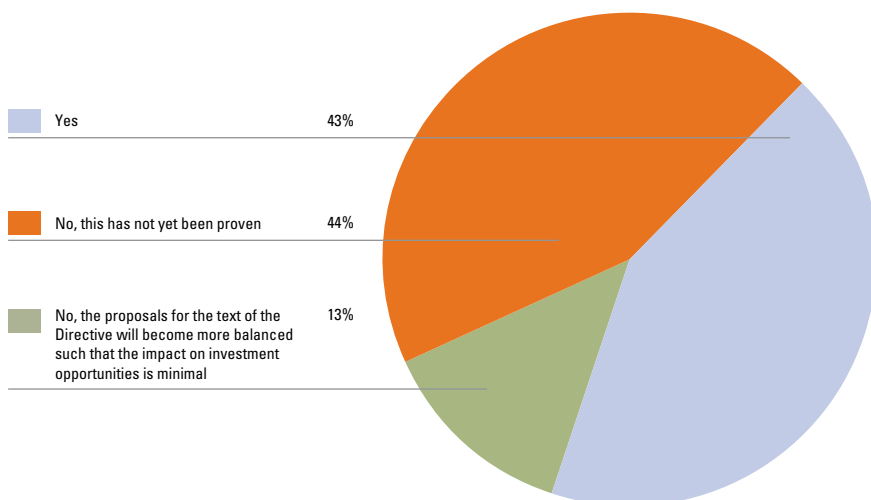
It is clear that many managers have expressed desire for a competitive AIFM product and that is something that should remain in the minds of those influencing and drafting the Directive's text.



Cost & talent – Impact on investor returns & costs and movement of talent

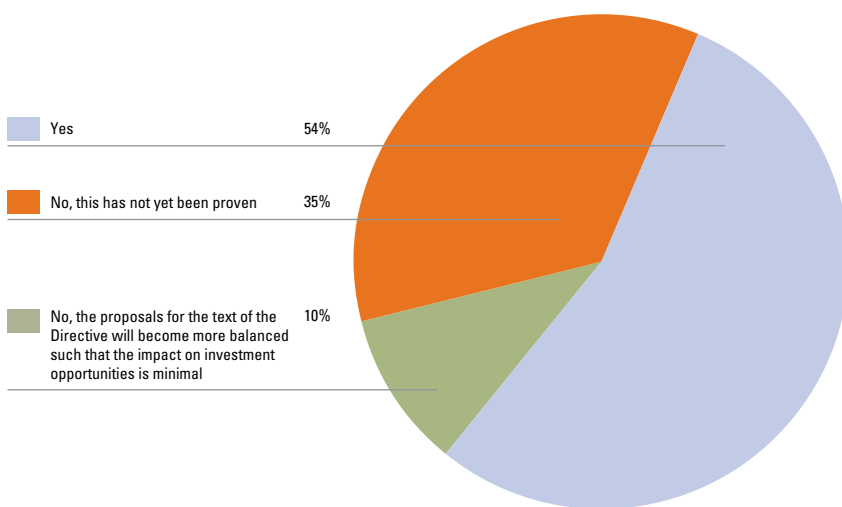
Do you believe that the AIFMD will lessen investment opportunities such that investor returns will materially suffer?

Forty three percent of the managers surveyed feel that the AIFMD will impact returns due to a reduction in investment opportunities, while an almost equal percentage feels that this is yet to be proven; conversely, 13 percent of the participants believe that the final outcome of the directive will be much more balanced, in a way that the impact on investment opportunities turns out to be negligible.



Do you believe that the AIFMD will increase costs such that investor returns will materially suffer?

Fifty four percent of the surveyed managers feel that the AIFMD will increase costs, resulting in lower returns, while 35 percent are of the view that this is yet to be proven. Only 10 percent believe the proposals will have minimal impact.

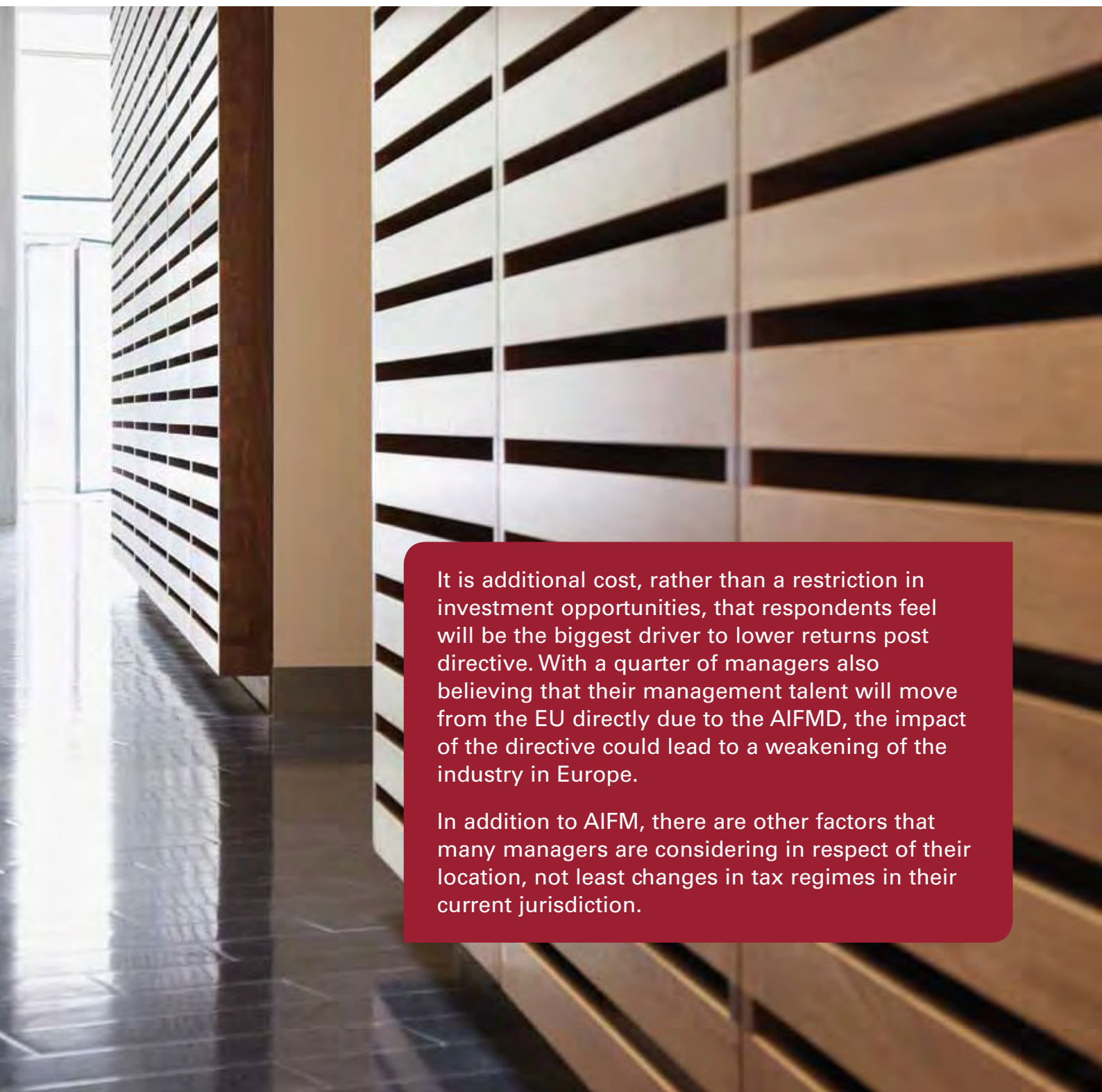


Do you believe that investment management talent will move to non-EU jurisdictions post AIFMD?

While nearly half of the managers surveyed feel that the investment management talent will not relocate to non-EU jurisdictions, a not insignificant 26 percent believe that non-EU jurisdictions which might offer comparatively fewer investment restrictions, could be more attractive for this talent. The remaining quarter believe that talent will move for other reasons.



Please note that with the graphs illustrated, not all answers add up to 100 percent because of rounding or because respondents were able to provide multiple answers to some questions.



It is additional cost, rather than a restriction in investment opportunities, that respondents feel will be the biggest driver to lower returns post directive. With a quarter of managers also believing that their management talent will move from the EU directly due to the AIFMD, the impact of the directive could lead to a weakening of the industry in Europe.

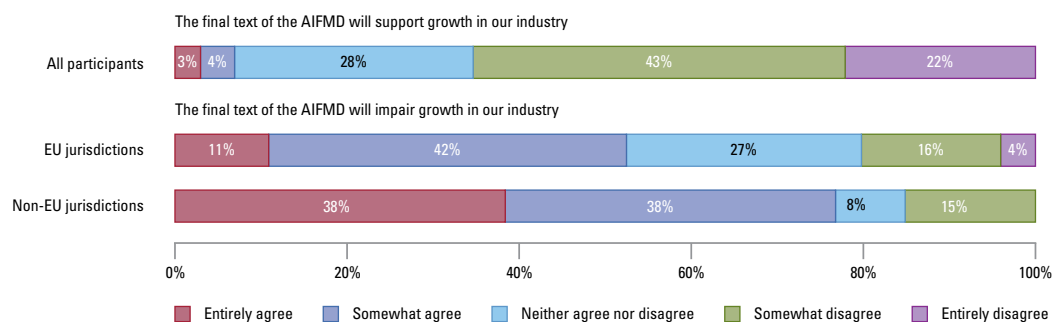
In addition to AIFM, there are other factors that many managers are considering in respect of their location, not least changes in tax regimes in their current jurisdiction.



Impact on industry growth

Do you agree that the final text of the AIFMD will support growth/impair growth in our industry?

Sixty five percent of the managers surveyed believe that the AIFMD will not directly support industry growth, while 57 percent actively believe it will impair growth of the industry. Interestingly, managers in non-EU jurisdictions who believe that the directive will impair growth are more than those in the EU itself (76 percent versus 53 percent).



Do you agree that negotiations on the text of the directive are moving in the right direction?

Interestingly, 51 percent of the managers feel that negotiations on the text of the AIFMD are moving in the right direction, while 29 percent are unsure.

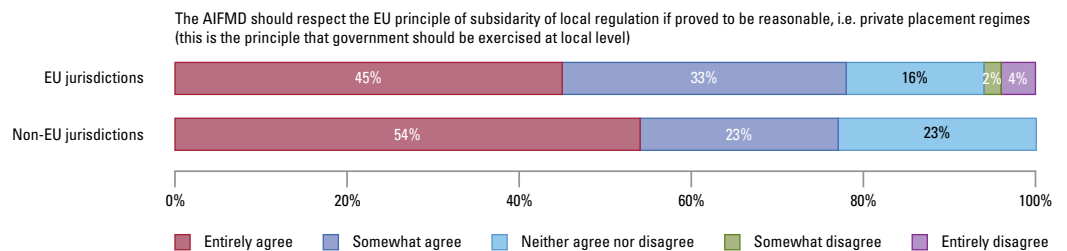
Do you agree that the AIFMD should respect the EU principle of subsidiarity of local regulation if proved to be reasonable, i.e. private placement regimes?

A majority of the managers surveyed (47 percent) are of the view that the AIFMD should entirely respect the EU principle of subsidiarity of local regulation if it is proved to be reasonable, while 31 percent somewhat agree with this view.

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In EU and non-EU jurisdictions, a majority of the managers surveyed (45 percent and 54 percent, respectively) strongly believe that the AIFMD should entirely respect the EU principle of subsidiarity of local regulation, if it is proved to be reasonable.



It is interesting that while half of the managers surveyed believe the negotiations are moving in the right direction, a larger number think that the final text of the directive will still impair growth in the industry.

Many managers appear to be resigned. At this moment, many may already be considering what strategic options they have. Others may think it is too early for a change of strategy.

Level of preparedness exhibited by companies

Have you conducted an impact analysis of the AIFMD for your business?

Two-thirds of the managers surveyed feel that it is too early to conduct an impact analysis of the AIFMD on their business, while the remaining respondents have conducted the impact analysis.



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