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## Which European framework for microfinance investment funds?

For quite a while now, some have been calling for the creation of a specific European regulatory framework that could adequately govern microfinance funds and offer them the benefits of a European passport in order for them to be easily marketed throughout the EU. The objective is twofold: namely to enhance fundraising for the microfinance sector while providing adequate protection for investors.

Today, in order to benefit from such a European passport, a fund must qualify as a UCITS under Directive 2009/65/EC (the so-called UCITS Directive). For the sake of completeness, a European passport is available under Directive 2003/71/EC (the so-called Prospectus Directive); yet only closed-ended funds may benefit from this passport and the passport is in principle attached to the prospectus itself, although a series of member states have actually extended it to the product.

If UCITS are allowed a certain exposure to microfinance, any such exposure must remain very limited due to specific rules imposed on UCITS, which aim at ensuring actual liquidity of the investment portfolio.

As of July 2013, another European passport will be introduced for funds not qualifying as UCITS, namely the European passport of the Directive on Alternative Investment Fund Managers, the so-called AIFMD (Directive 2011/61/EU). Yet, contrary to that granted under the UCITS Directive, the AIFMD passport will be restricted to marketing to professional investors.

The AIFMD aims at regulating investment managers, the AIFMs and, indirectly, the funds they manage – the AIFs.

The passport thus comes with a series of rules and conditions to be complied with at the level of both the manager and the fund. Among the requirements applicable at the level of the fund, there is a requirement for a depositary, a valuation agent and a series of reporting vis-à-vis the investors and regulators.

The AIFMD has a truly all-encompassing scope (outside of that covered by the UCITS Directive). It is applicable to all EU managers who manage EU and non-EU funds. It also applies to all non-EU managers who manage EU funds and who market EU funds or non-EU funds in the EU.

This directive is also all-encompassing in terms of asset classes in which funds invest. In that respect, it covers a variety of funds, such as private equity funds, real estate funds, commodity funds or hedge funds, but also microfinance funds.

The 'one size fits all' approach of the AIFMD is often pointed out as being a major inadequacy of the directive that does not consider the diversity of funds covered.

With respect to microfinance funds in particular, the fear is that some requirements will not only be inappropriate but will also imply significant burden and costs likely to be difficult to cope with for funds that are usually particularly cost-sensitive, and their managers.

It should be noted, however, that the AIFMD allows for a series of exclusions and exemptions that may be relevant for microfinance funds. First, some types of vehicles are out of scope as they are not considered as investment funds, such as holding companies and securitisation vehicles. Also, supranational institutions, such as the World Bank, the EIB and the European Development Finance Institutions, are out of the scope of the AIFMD if the funds they manage are acting in the public interest. In addition, certain grandfathering provisions also apply to existing funds that do not accept any further subscriptions.

More importantly, a lighter registration regime is offered to small managers with assets under management of less than €100m or less than €500m in relation to non-leverage funds, where investors have no redemption rights for a period of five years.

The flip side of those exclusions and exemptions is the lack of benefit of the European passport granted under the AIFMD. In that respect, it is worth noting that small managers referred to in the foregoing paragraph may choose not to be exempted and opt in to the full regime of the AIFMD, thus including the benefit of the European passport.

An adequate European framework for microfinance funds could be the outcome of a recent consultation paper on social investment funds released by the European Commission (The Social Business Initiative: Promoting Social Investment Funds, European Commission, Public Consultation, 13 July 2011). This paper discusses possible measures to support social business via private investment funds.

Although at this stage there are no certainties as to the European measures that could be adopted in that context, one of the possible options could be the creation of a European ad hoc regime dedicated to social investment funds. This regime could be accompanied by a European passport for those funds complying with it.

It should be noted that there is also uncertainty surrounding the scope of the contemplated measures such that it is difficult to determine at this stage whether microfinance funds, or rather, which of them would be covered. The consultation paper notably discusses the definition of social business and the features of social investment funds in that specific context. Among others, it discusses whether or to what extent social investment funds may have the distribution of profits to investors as an objective besides the achievement of social goals.

In any case, this initiative of the European Commission and its future developments are definitely to be closely watched by those involved in the microfinance funds sector. It is already merited with having somewhat acknowledged that existing European frameworks are not adequate for all types of investment funds and having given the opportunity to highlight the specific needs of investment funds with a social focus.