

EU directive threat

Although the final draft of the directive on alternative investment fund managers has yet to be published, it is increasingly clear that there is substantial opposition to the proposals. Margie Lindsay reviews the main points of contention.



There is an Irish saying that seems particularly apt for the commission-inspired draft funds legislation: "If I wanted to get there, I wouldn't start from here." Given that the commissioner for the internal market and services, Charlie McCreevy, hails from Ireland, the irony of this should not be lost on him.

At times during the press briefing announcing the directive – which has still to be published in its final form – he seemed apologetic about unleashing such a hodgepodge of poorly thought out ideas on an unsuspecting fund industry.

The directive encompasses all alternative investment fund managers. According to the EU definition, this includes private equity, property, real estate, infrastructure, property and hedge funds. The inability of the EU to distinguish between fund types is at the heart of its seriously flawed legislative attempt.

Condemnation for the directive is fierce and vocal. The Alternative Investment Management Association (AIMA) kicked off the opposition with a fierce statement from its executive director, Florence Lombard. "This directive is not a proportionate regulatory response to any of the identified causes of the current crisis. ... Hastily prepared and without consultation, the directive contains many ill-considered provisions which are impractical and may prove unworkable. The unintended consequences of these measures may put thousands of jobs in several major European industries under threat and slow down any economic recovery," she said. "Additionally many of the provisions will disadvantage European hedge fund managers against those outside Europe, which could prove an incentive for them to move

business elsewhere, negatively impacting badly needed tax revenues for member states," Lombard added.

Andrew Baker, formerly chief operating officer of Schroder Investment Management and now AIMA's deputy chief executive, is equally scathing about the draft law. He sees no attempt by the EU authorities to work with the Group of 20 and others to co-ordinate a legislative response to what some see as a potential systemic risk posed by the alternative investment industry and in particular hedge funds.

He said the draft was "unworkable in its current form" as it does not even recognise the role prime brokers play within the industry.

The draft at present talks about the concept of a depository, something borrowed from the Ucits directive. While this works for product-specific regulation, it does not in the hedge fund world where prime brokers fulfil functions far in excess of simple custodian.

The draft law does not recognise the concept of a master/feeder structure, something many hedge funds use as a way of helping investors from different parts of the world put money into funds.

Many are also concerned that the draft regulation is protectionist. While Baker is still waiting for the final version, which should include crucial details, he points out that the three-year passport transition could exclude a significant part of the hedge fund industry. If, as many suspect, the measures are a backdoor protectionist move by the EU, the US industry is unlikely to take lightly the possibility of being denied access to Europe's investment community.

The Managed Funds Association (MFA) which

represents the US industry is still studying the EU draft. MFA's focus at present is on the significant legislative proposals on Capitol Hill. Although AIMA confirmed it has briefed MFA, so far the organisation has only offered a rather weak statement expressing concern "about certain aspects of the directive, including those that could potentially establish minimum capital requirements for managers." Its statement also urged that "any reporting of information include appropriate confidentiality of certain information for fund managers."

The proposal for a three-year transition of non-EU domiciled funds to a system that could allow them access throughout every member state, is less than clear. Given that the commission draft seems unaware that EU-domiciled hedge funds account for an insignificant part of the industry, it is equally worrying how jurisdictions outside the union would ever be able to meet standards that are so poorly thought out.

James Greig, partner at PricewaterhouseCoopers Legal, expressed concern that the existing draft is too wide-ranging, "catching all collective investment vehicles other than Ucits in its nets, which is unnecessary and misguided." Like MFA, Greig is concerned that funds caught by the directive will be made "subject to significant disclosure and transparency obligations and will, as investors, be at a competitive disadvantage to, for example, the sovereign wealth funds and other investors expressly excluded from its ambit."

Looking at the directive from an international perspective, Greig said the draft gives rise to "serious competitive concerns, given the lack of clarity and detail about the position of EU-resident administrators, asset managers and advisors servicing non-EU fund complexes."

According to Tom Brown, investment management partner at KPMG, there is a danger that political interference could legislate funds out of existence. "Politicians need to ensure that the optical agenda doesn't end up destroying the European hedge fund industry by imposing sweeping changes that are unworkable or unnecessary," he said.

The final form the directive takes has still to be determined. Intense lobbying at national, European parliament and commission level is expected to substantially change the legislation before it comes before the council for a qualified majority vote. Although it is likely anything that resembles the present draft will be defeated then, many are advocating the "nuclear option" of simply throwing the draft out altogether and writing one that takes into account the unique aspects of the hedge funds industry as well as toes the line internationally rather than breaking out with separate, regional legislation. ■

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"I think it is pretty clear that the agenda of the French and German establishment is to discourage shareholder activism, which threatens the ruling politico-industrial elite in both countries. As they don't understand what a PE fund, or a hedge fund are they just want to kill both and to return to the cosy cartelism, they have 'enjoyed' for decades."

Peter O'Dwyer, CEO, Hainault Capital

Grant access to the European market to third-country funds after a transitional period of three years. This should allow the EU to check whether the necessary guarantees are in place in the countries where the funds are domiciled (equivalence of regulatory and supervisory standards, exchange of information on tax matters).

"You ought to be kidding me! Three years for the bureaucrats to find excuses to protect EU-based funds?"

Fabiano Deffenti, partner, Carvalho, Machado, Timm & Deffenti Advogados

"This is an attack by France, Germany and the Party of European socialists, who suddenly have a common aim. We need to lobby, but taking the draft as a starting point plays into their hands. We need a sensible alternative position as our starting point. I have made some suggestions to AIMA, and I believe they are taking this seriously. An organised attack on the industry needs an organised response. Our default position should be that the EU market must be opened up without unnecessary restrictions."

Christopher Miller, CEO, Allenbridge HedgeInfo

Hedge Funds Review has started a discussion group at LinkedIn. To join go to www.linkedin.com/groups?gid=1910998 or email the editor and request an invitation (margie.lindsay@incisivemedia.com).