

QUESTIONS OVER EU PRIVATE EQUITY REFORMS - SJ BERWIN

Posted on 31/12/2009



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In the UK, the campaign against the current draft of the European Commission's Alternative Investment Fund Managers Directive has gained considerable momentum. Recently, Lord Myners, the British Government's 'City Minister', said that the draft needed "major surgery". The UK's main regulator – the Financial Services Authority (FSA) – made its (many) concerns clear in a speech last month. Their voices have echoed the chorus of disapproval from the funds industry, investors, the media, and lawyers.

Parece que la campaña contra el último borrador de la Directiva sobre los Gestores de Fondos de Inversión Alternativos que ha sido formulado por la Comisión Europea esté ganando fuerza entre los

principales interesados europeos. El borrador, emitido en abril después de un período de consultas muy breve, ha identificado como sus principales objetivos el control de riesgos sistemáticos, la protección de los inversores y la transparencia. No obstante, no deben dejar de considerarse estos merecidos fines en el contexto de los tipos de fondos supeditados a la Directiva, comenta Carlos Pazos, el socio director de la oficina madrileña de SJ Berwin.

But there are encouraging signs that concerns in the UK are shared by other key European players: most importantly, including the Swedish Government (which holds the European Union (EU) presidency for the next six months, and will lead discussions on the draft Directive). It now argues that modifications to the proposals are essential.

The draft Directive, published in April after very limited consultation, identified the control of systemic risks, investor protection and transparency as its principal objectives. However, as pointed out in the response of the European private equity and venture capital industry, speaking through the Brussels Task Force (established and coordinated by the European Venture Capital Association (EVCA)), the draft fails to consider those worthy objectives in the context of the myriad fund types caught by the Directive.

The EVCA calls for revisions to take account of the different types of funds and their associated risks, and identifies a number of key areas where the private equity industry would like to see specific changes.

An important objection is the scope of the draft Directive. As well as catching too many funds within its ambit – the EVCA argues for the threshold to double to €1 billion of funds under management – it would also put private equity funds at a structural competitive disadvantage because, as the FSA says, it seeks to address "issues of general market applicability in a Directive targeted at the funds industry alone".

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The concern runs through a number of the Directive's provisions, but is particularly acute regarding portfolio company disclosure requirements. Not only do they create an uneven playing field but they are inconsistent with the fundamental principles of European company law. There are very good reasons to strike them out of the Directive altogether, which the EVCA argues.

There are also signs that the illogicality of the proposed capital requirements, which would create barriers to entry for new entrants and increase the costs of business for existing players, is being recognised. The additional capital requirement would offer little or no additional protection to investors in private equity funds. If there are worries about a fund's ability to meet professional liability claims then a requirement for insurance cover is the usual (and more sensible) way to address concerns.

Also criticised are the requirements for independent valuers and the need to appoint an EU bank to act as depositary. There would also be unworkable bureaucratic barriers to business which need to be reviewed, and inadequate provisions to allow existing fund managers to move over to the new rules.

There are also serious concerns about the third country restrictions which, as the EVCA says, could damage relations with important countries and limit the ability of professional investors to access certain types of international fund (while in no way limiting their ability to access far riskier, unregulated derivatives and other financial products). The EVCA calls for a fundamental review of the provisions (including assessment of their consistency with the EU's obligation to allow free movement of capital).

The private equity industry has argued strongly that it is part of the solution to current market strains, offering a source of much needed capital to businesses as they emerge from the recession.

Proportionate and measured regulation of the industry is both inevitable and welcome. Excessive and inappropriate regulation of the industry should be resisted at any time, but particularly now. There are clear signs that leading European policy-makers have recognised that, but there is a long way to go before significant changes to these sweeping and disproportionate proposals can be guaranteed.

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