"THE PERFECT STORM" – IMPACT AND ASSESSMENT OF THE PROPOSED ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE

Jennifer Hourihane *

ABSTRACT

"Never let a good crisis go to waste".

Since the advent of the financial crisis in 2007, many lessons have been learned, and an overhaul of financial systems globally has been underway. Banks have been recapitalised, toxic loans have been grappled with, and lending conditions have tightened. However further and necessary remedial action to complement this is cited as the imminent need to *"strengthen regulatory regimes, prudential oversight, and risk management"* of all actors who deal with financial institutions and pose a systemic risk to the global financial system.

Such targets include actors within the alternative investment fund industry, with an estimated €2 trillion in assets under management, and which currently do not come under any structured regulatory umbrella in the EU. The Proposal for the Alternative Investment Fund Managers Directive aims to alleviate this failing by providing a framework for effective regulation of those who manage the industries activity. The Proposal is broadly welcomed regulation for Europe, and could even present opportunities for Ireland's financial services sector. However it is not completely without flaw- aspects of the draft legislation bear significant and some perhaps unintended consequences for the industry it targets. This draft legislation is critically assessed in the instant article, and its pros and cons, potential impact and suggestions for its fine tuning are outlined.

A INTRODUCTION

The financial crisis has exposed a series of vulnerabilities in the global financial system.[1] It highlighted how risks in one sector can be transmitted rapidly around the financial system, with serious repercussions for all financial market participants and for the stability of the underlying markets.[2] One identified cause of the crisis was that policy-makers, regulators and supervisors entrusted with the oversight of the financial system did not adequately appreciate and address the risks building up in financial markets.[3] The fallout politically, is a question of how best to structure regulation and supervision of the financial sector in a way that would be reactive to this problem. The recent famous observation of Rahm Emanuel comes to mind, 'never let a good crisis go to waste.' Responding to the situation in November 2008, the G20

*Jennifer is a Fourth Year Law Student at University College Cork.

[1] Directorate General Internal Market and Services 'Working Document of the Commission Services (DG Internal Market): Consultation Paper on Hedge Funds' 2 <http://ec.europa.eu/internal_market/consultations/docs/hedgefunds/consultation_paper_en.pdf> (27 February 2010).

[2] Explanatory Memorandum of the Proposal for a Directive of the European Parliament and of the Council, on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/…/EC COM (2009) 207 final (30 April 2009) (Explanatory Memorandum).

[3] The Group of Twenty (G-20) Finance Ministers and Central Bank Governors 'Declaration Summit on Financial Markets and the World Economy' 15 November 2008 <http://www.g20.org/pub_communiques.aspx> (27 February 2010).

summit[4] called for an international effort 'to strengthen regulatory regimes, prudential oversight, and risk management' in the global financial system.

In line with international G20 objectives, the European Commission has engaged in a review of the regulatory and supervisory framework for all financial market actors in the European Union that embed significant systemic risks to the financial system.[5] In the course of this review the need to design a comprehensive and efficient regulatory scheme for the AIF industry was identified.[6] It is necessary to look at some existing problems in the AIF industry to identify the core reasons behind this conclusion.

This article will trace the impact and functional aspects of the legislation, and intends to argue that the all-encompassing scope of the draft Directive,[7] renders all AIF subject to the same provisions despite their respective differences. The discussion will the look in detail at each actor of the AIF industry potentially affected by the proposed legislation and highlight the unique consequences that its implementation will have on each of these actors respectively. Consequences of the legislation common to all actors the AIF industry will then be outlined, including cost implications and potential consequences for non-EU countries and Ireland respectively. Lastly, in the final analysis, possible ways in which the draft legislation may be improved before its implementation will be submitted.

B PERCEIVED PROBLEMS WITH HEDGE FUNDS AND THE AIF INDUSTRY

The High-Level Group on Financial Supervision in the EU and other expert groups entrusted by the European Commission with the review of financial market actors, concluded that the systemic risk embedded by AIF has not been regulated sufficiently by current rules and that enhancement of regulatory measures in financial services, to ensure the safeguarding of financial stability and the sustainability of economic growth is needed.[8] The perceived risks and existing *modus operandi* which prospective regulation will address are now discussed. The AIF industry encompasses a diverse range of investment funds including hedge funds and private equity, as well as real estate funds, commodity funds, infrastructure funds and other types of institutional funds. These funds employ a variety of investment techniques, investing in different asset markets and catering to different investor populations.[9] Unlike other structured investment vehicles which operate under consistent supervision by way of

---

[4] ibid. See also: Commission Communication for the Spring European Council *Commission calls on EU Leaders to stay united against the crisis, move fast on financial market reform and show global leadership at G20* Press Release IP/09/253 (4 March 2009) and Foundation for European Progressive Studies 'Hedge Funds and Private Equity Regulation - Assessment of the proposed AIFM directive and further proposals for a comprehensive legal framework' (15 April 2009) 2 <http://www.feps-europe.eu/fileadmin/downloads/political_economy/090425_FEPS_RegulatingHFandPE.pdf> (27 February 2010).

[5] Commission Communication for the Spring European Council *Commission calls on EU Leaders to stay united against the crisis, move fast on financial market reform and show global leadership at G20* Press Release IP/09/253 (4 March 2009). <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/351&format=HTML&aged=0&language=EN&guiLanguage=en> (27 February 2010).

[6] Foundation for European Progressive Studies 'Hedge Funds and Private Equity Regulation - Assessment of the proposed AIFM directive and further proposals for a comprehensive legal framework' (15 April 2009) 2 <http://www.feps-europe.eu/fileadmin/downloads/political_economy/090425_FEPS_RegulatingHFandPE.pdf> (27 February 2010).

[7] The Directive encompasses all non UCITS regardless of legal form.

[8] The de Larosière Group *The High-Level Group on Financial Supervision in the EU Report* (25 February 2009) 15 < http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf> (27 February 2010).

[9] (n 2) 1.

European regulation,[10] no such framework exists for the AIF industry. Around two trillion euro in assets is currently under management within the AIF industry.[11] Given the large presence of the AIF industry on European financial markets, the need for official regulatory engagement with the sector is definite.

Particular concerns surround the lack of regulation of hedge fund activity. Hedge funds have grown fifty fold in terms of assets under management since 1990.[12] These investment vehicles use complex and high risk hedging techniques and flexible investment strategies.[13] Currently, a high level of uncertainty and an unsatisfactory level of transparency subsist with regard to these practices.[14] Hedge fund investment strategies typically involve a high and systematic use of leverage – through borrowing, short-selling and derivatives positions,[15] and with the high use of leverage, is the attaching systemic risk.

The main reports expressing the need to extend a framework of regulation to the AIF industry were in consensus that the individual and collective activities of large AIF employing high levels of leverage amplify market movements and have contributed to the instability of financial markets across the European Union.[16] Particular concerns were raised regarding the lack of transparency and oversight of AIF vis-à-vis systemically important financial institutions.[17] This is true particularly in relation to hedge funds, as hedge funds embed significantly more leverage on the financial system than other AIF counterparts.[18] The EU High-Level Group on Financial Supervision highlighted the cause for concern surrounding the direct exposure of systemically important banks to AIF activity, stating that large AIF, having no deposit base and often relying on leverage from the legitimate banking system, can be very vulnerable when liquidity evaporates, leading to market turbulence. Greater transparency with regard to hedge fund investment strategies and leverage levels is called for on the basis that banks, the main source of leverage to hedge funds, need to be able to get a global view of the risks they are engaging in. In recent years, trading by hedge funds has accounted for over 50 percent of the daily trading volume in equities markets.[19] Given this scale, it is conceivable that highly leveraged and high risk investment funds, directly linked with the systemically important banking system, should be subject to stringent oversight. As of yet there are no regulatory frameworks which would facilitate this by setting

---

[10] Structured investment funds such as UCITS regulated under Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) [2009] OJ L 302/32.

[11] (n 2) 1.

[12] (n 1) 2.

[13] Adrian Blundell-Wignall 'An Overview of Hedge Funds and Structured Products: Issues in Leverage and Risk' (2007) 1OECD Journal: Financial Market Trends 37 < http://www.oecd.org/dataoecd/36/62/40972327.pdf> (27 February 2010).

[14] The Technical Committee of the International Organization of Securities Commissions 'Elements of International Regulatory Standards on Funds of Hedge Funds Related Issues Based on Best Market Practices Final Report' (September 2009) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD305.pdf> (27 February 2010).

[15] (n 1).

[16] The roots of existing systemic risk were exposed in the Report of the European Parliament with recommendations to the Commission on hedge funds and private equity (A6-0338/2008) ('Rasmussen' report), and European Parliament report with recommendations to the Commission on transparency of institutional investors (A6-0296-2008) ('Lehne' report), the major cause of systemic risk was identified in these reports as the impact of the activities of highly leveraged investment vehicles on the stability of the financial system.

[17] (n 7).

[18] The extent to which hedge funds embed leverage on the financial system and thus contribute to systemic risk is discussed in more detail at text between (n 62) and (n 65).

[19] (n 1).

down mechanisms for the gathering, pooling and analysing of information on these risks at European level.[20]

1 Current Legal Position

Evidently the AIF industry has a large presence in the European financial system and has grown significantly in recent years. However regulation and oversight of its activity has not developed to match this growth. Unlike other funds operating under harmonised European regulation, the activities of AIF industry in Europe are currently regulated by a combination of national laws, company law, and corporate governance practices. This is supplemented in some areas by industry-developed standards; however, levels of regulation can vary significantly across the EU.

There is a cross-border dimension to the AIF industry. Investors, creditors and trading counterparties of AIF can often be domiciled in different Member States. It has been concluded that the financial crisis exposed serious failings in cooperation and consistency between national supervisors, and that the currently fragmented and nationally-based supervisory model for the AIF industry is not responsive to the reality of today's European financial markets, in which many AIF operate across borders.[21]

C FUNCTIONAL ELEMENTS AND IMPACT OF THE AIFM DIRECTIVE

In response to the existing problems, the European Commission proposed the Alternative Investment Fund Managers Directive (‘the Proposal’)[22] on 19 April 2009.[23] The Proposal seeks to introduce a harmonised regulatory and supervisory framework for Alternative Investment Fund Managers (‘AIFM’) in the EU, with particular focus on the authorisation, ongoing operation and transparency of AIFM.[24] The Proposal follows from the Commission’s conclusion that effective monitoring and mitigation of the risks posed by AIFM activities to their counter parties and, more generally, the financial system, requires legally binding and enforceable measures to ensure a high standard of regulation and oversight throughout the EU.[25]

The Proposal applies to all AIFM that manage, and market non-UCITS[26] funds in the EU, unless the assets of the alternative investment fund (“AIF”)[27] under management does

---

[20] (n 1) 5.

[21] Communication from the European Commission on European financial supervision, COM (2009) 252 final (27 May 2009) <http://ec.europa.eu/internal_market/finances/docs/committees/supervision/communication_may2009/C-2009_715_en.pdf> (27 February 2010).

[22] “The Proposal” is also referred to in this document intermittently as “the Directive”.

[23] Proposal for a Directive of the European Parliament and of the Council, on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/…/EC COM (2009) 207 final (30 April 2009) (The Proposal).

[24] (n 2).

[25] Commission Staff Working Document accompanying the Proposal: Executive Summary of the Impact Assessment (30 April 2009) 6 <http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_executive_summary_en.pdf> (27 February 2010).

[26] Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (“UCITS”) [1985] OJ L375.

[27] The abbreviations of AIFM and AIF contain both singular and plural.

not exceed 100 million euro, or 500 million euro when the AIF under management are not leveraged and have no redemption rights exercisable for a period of five years after the incorporation of the AIF.[28] The definition of AIF under the Proposal is extremely broad and captures hedge funds, private equity funds, commodity funds, and real estate funds. The fulcrum of the Proposal is the authorisation requirement for AIFM in order to operate in the EU. Thus AIFM marketing or managing AIF to professional investors in the EU may only do so with prior authorisation from the home Member State competent authority, which may approve, restrict or reject an application by AIFM.

Authorisation pursuant to the Directive would allow AIFM provide management services to funds established elsewhere in the EU and market its funds to professional investors in other Member States, subject to a simple notification procedure.[29] Notably, and as will be discussed at a later stage,[30] this new marketing passport will only be available to non Member States three years after the transposition of the Directive, subject to stringent compliance with regulation and supervision of an equivalent level to those laid out in the Proposal.

The Proposal introduces capital requirements for AIFM[31] of 125, 000 euro where the value of the portfolios managed exceeds 250 million euro. Additional own funds of 0.02 percent of the amount in excess of 250 million euro must be provided. A Depository nominated by AIFM must be an EU established credit institution, and an AIFM must appoint an independent valuator for each AIF it manages. Additionally, in the interest of enhanced transparency, the Proposal imposes annual and periodic reporting requirements on AIFM towards the competent authority of their home Member State, including reports on the main markets and instruments in which the AIFM trade, and the main categories of assets in which the fund is invested. The AIFM must also provide investors with specific information comprising of the valuation procedures, liquidity risk management, percentage of illiquid assets, and periodic disclosure of risk profile of the fund. The Proposal also provides specific reporting obligations for AIFM managing leveraged AIF, and those who acquire controlling influence in companies.[32]

D “BARKING UP THE WRONG TREE?”

Aside from legislative action at European level, the G20 objectives also sparked off expert and political debate at the European Commission, which pre-empted the drafting of the current Proposal. It is submitted that the all-encompassing regulatory approach of the draft legislation does not sit squarely with the views of certain significant participants in that debate. The European Commissioner for Internal Market Services spoke of the need for caution in devising regulation specific to the AIF industry, and the need for targeted and proportionate measures, stating that any regulatory action should distinguish between hedge funds, private equity and other forms of alternative investment, on the basis that the vehicles raise different issues which call for suitably differentiated responses.[33]

Furthermore, the all encompassing approach of the Proposal is not akin to the Commission's initial approach; the Commission’s consultation paper in the lead up to

[28] (n 22) 6 art 2 of the Proposal.
[29] ibid 31art 31 (2), (3) of the Proposal.
[30] See full discussion at text after (n 76).
[31] (n 22) 31 art 14 of the Proposal.
[32] ibid 34 ch V of the Proposal; see further at text after (n 37).
[33] Concerns voiced by Charlie McCreevy under whose aegis the Directive was drafted.

drafting the Proposal was premised on hedge fund issues.[34] Similarly the EU High-Level Group on Financial Supervision Report focused on concerns related to, and recommendations specifically associated with hedge funds,[35] and most importantly, it established that hedge funds contributed to the systemic risks which both international and European regulators now wish to target. On an international platform identical conclusions were drawn,[36] and yet the instant Proposal does not regulate hedge fund activity exclusively; rather, the entire AIF industry falls within the remit of its measures.

A possible reason for this is that the Commission, in drafting the legislation, felt that it would be too difficult to define a hedge fund, because of the diverse nature of investment policies associated with such funds, and that any attempt to do so would make arbitrary circumvention of the regulations possible. It is conceded that effort was made to incorporate some differentiation into how the provisions are applied to different types of AIFM, for instance those using leverage or those with controlling interests in companies.[37] However the hot topic prevailing is whether this effort to tailor provisions really cuts it for the AIF industry, and what the consequences of an all-encompassing regulation will be for its various actors.

E “ONE SIZE DOES NOT FIT ALL”

The G20 statement of November 2008 insisted that regulatory advances towards enhanced financial supervision should ‘ensure that all financial markets, products and participants are regulated or subject to oversight, as appropriate to their circumstances.’ The question in the instant context is whether the proposed Directive as it stands will prove itself appropriate for each respective player in a diverse industry. It is contended that the Commission may have drafted legislation aimed ambitiously at an industry as a whole, without fine-tuning its provisions appropriately for the particular ‘products and participants’ within that industry.

The month following the foregoing G20 declaration, the Commission issued a consultation paper,[38] which served as the basis for the Proposal. Here, the Commission noted that responses to the paper from interested parties, including from investors and the hedge fund industry, would be indispensable - serving as the foundations for the Commission to draw an appropriate regulatory initiative.[39] This was also to be in line with the G20 action plan, which foresees that private sector bodies that have already developed best practices for private pools of capital and/or hedge funds should bring forward proposals for the movement towards strengthened regulatory regimes. Thus, the Commission initially set out to allow industry-developed standards have a role to play in informing and guiding the drafting of the current Proposal, however this is scarcely evidenced in its provisions. This is also reflected in the Commissions impact assessment of the Proposal, which fell short of either accurately estimating or considering the ultimate consequence and cost of compliance for the AIF industry.[40] But the industry has spoken for itself on this issue.

---

[34] (n 1).
[35] (n 7).
[36] Technical Committee of the International Organisation of Securities Commissions ‘Hedge Funds Oversight - Final Report’ (22 June 2009) which emulates G20 objectives <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf> (27 February 2010).
[37] (n 32).
[38] (n 1).
[39] ibid 3.
[40] (n 24) 7.

The Alternative Investment Manager Association ("AIMA")[41] response confirmed that the Proposal had been drafted without anything like the usual standards of consultation (with the AIF industry) normally expected from the Commission, and that as a direct consequence *the draft presumes a structure for the industry which does not resemble reality*.[42] **Similarly,** the European Venture Capital Association, in its assessment of the Proposal,[43] criticised the fact that whilst the Explanatory Memorandum of the legislation identifies the different types of AIF and their associated risks, the Proposal itself imposes undifferentiated provisions. The message at grassroots level is clear – throwing a blanket regulation on the AIF industry may in theory cover the objectives which the Proposal intends to achieve, but in practice has unintended consequences for each of the different sectors in the industry.

F PRIVATE EQUITY – IMPACT AND CRITICISMS

It is established that the draft Directive should accommodate the significant differences between the main types of AIF actors and their strategies. Private equity groups in particular have levied trenchant criticism against certain aspects of the regulation on managers in their sector, and feel that not enough has been done by the Commission to distinguish their sector from hedge funds. Indeed it was unequivocally acknowledged that private equity and venture capital sectors did not contribute to an increase in macro-prudential or systemic risk.[44] As will now be discussed, the private equity sector holds that it is in risk of being burdened by disproportionate measures and submits that provisions should be tailored more precisely for different investment strategies, particularly in certain areas relating to capital, disclosure and depository requirements.

The Directive would require that private equity fund managers have a depository that is an EU credit institution and provides that it shall be the task of the depositary to receive all payments, book them on separate accounts and verify whether the fund or the AIFM on behalf of the fund has obtained the ownership of all other assets invested in. EVCA argues that such a principle does not justify a separate depositary to be appointed by the fund manager. Before making an investment the private equity manager engages counsel to proceed with a thorough due diligence to make sure that the fund obtains ownership in the portfolio company. An additional exercise by the depositary would substantially increase the costs for no investor benefit.[45] It is further submitted that the disclosure requirements imposed on AIFM in the proposed Directive[46] may damage a process of engagement between AIFM and investors, which is widely considered necessary and positive during the period of marketing funds in private equity.[47] The industry insists that any provision which imposes prior approval of marketing material, and subsequent changes to marketing provisions, will severely curtail the collaboration between manager and professional fund investors in

---

[41] The International Association representative of the hedge fund industry and its managers.

[42] Florence Lombard, Executive Director AIMA 'Statement on European Commission Directive' (23April 2009) <http://www.aima.org/en/announcements/aima-statement-on-european-commission-directive.cfm > (27 February 2010).

[43] European Private Equity & Venture Capital Industry 'Response to the proposed Directive of the European Parliament and Council on Alternative Investment Fund Managers' (26 June 2009) <http://www.evca.eu/uploadedFiles/News1/News_Items/2009-06-26-ResponsepaperAIFM.pdf> (27 February 2010).

[44] (n 2).

[45] See further text after (n 92).

[46] (n 22) 39 Article 31 of the Proposal.

[47] (n 43) 6.

structuring and negotiating fund terms to meet the requirements of those investors.[48] It is recommended that regulation in this area should take into account the fact that the commercial terms of venture capital funds are not 'pre-packaged'; rather, they are negotiated contracts with professional investors that develop in the course of the interaction with that investor.

On this point, EVCA highlight that the marketing of private equity funds is a complex and time consuming process, and that the application of regulatory approvals in this area does not address any identified risks, would impose a significant and unwarranted burden on home authorities and firms, and would be quite unwelcome to the professional investors that the proposed legislation intends to protect. It is recommended that the Proposal be amended so that competent authorities would receive the documents required for disclosure from AIFM only when the structuring and negotiating of fund terms with investors has reached conclusion.[49]

Another significant provision of the Proposal that is targeted specifically at the private equity sector imposes specific requirements for disclosure at the portfolio company level.[50] The understood motive behind this requirement is that additional disclosure obligations should be triggered when an increase occurs in the participation of funds or fund managers in a company.[51] The Directive imposes this requirement on a fund to report; through its annual report, when it acquires control of 30 percent of a company's equity capital. This will apply only if the relevant company is composed of more than 250 employees and a turnover in excess of 50 million euro. The provision however has been criticised by the private equity sector as it is perceived that the vast majority of companies encompassed in this definition are not of any wider public interest, and that such requirements do not withstand cost/benefit analysis.[52]

The glue knitting the foregoing arguments is the simple fact that private equity funds are usually closed ended vehicles. The sector has expressed concerns that the introduction of extra-costs, often borne by investors, after the funds launch, will result in a lower return for these funds, which could in the worst case lead to an early termination of the funds if unable to carry these extra costs.[53] Such early terminations of funds, which are almost without precedent, will imply investments to be realised prematurely, leading to value destruction for investors and creating problems for the portfolio companies in sensitive stages of their development.[54] The argument that the instant Proposal leaves private equity and venture capital firms being burdened by provisions disproportionate to the nature of their industry is well quantified, particularly in light of the fact that private equity has not been held to present systemic risk – when it is systemic risk which this legislative development initially wished to target.

G HEDGE FUNDS – ATTEMPT TO ESCAPE THE REGULATORY NET

It has been established that the Commission's initial target in legislating were actors within the AIF industry who contribute to systemic risk, and most significantly, that hedge funds fit this criteria. Of course it is right that systemically significant institutions should be subject to

---

[48] ibid.
[49] This being a reversal of what the Directive currently requires.
[50] (n 22) 36 art 27 of the Proposal.
[51] (n 6) 9.
[52] (n 43) 6.
[53] ibid 8.
[54] ibid.

oversight. The premise of the hedge fund industries argument against such oversight is that hedge funds did not play a crucial role in the crisis.[55] However the causal links with the emergence of the financial crisis are not strictly speaking the Commissions targets in this regulation, rather those which pose a systemic risk to the global economy. It will be contested that the hedge fund industry does in fact pose sufficient systemic risk to warrant the regulation.

The premise of the AIMA argument subsequent to G20 statements and the Proposal's inception was that the current crisis is a banking crisis whereas the hedge fund industry's role was marginal.[56] ALFI put forward a similar argument, suggesting regulatory initiative should take into account that the financial turmoil originally started in the banking sector.[57] Furthermore, the Turner review contested that only entities which provide banking services should be regulated, and that the vast majority of hedge funds do not fall into this category.[58] However as will now be discussed, there is an imminent need for enhanced supervision and transparency on the part of hedge funds. This is especially true with regard to banks, because banks are the main lenders to hedge funds, and their supervisors have thus far not been able to obtain full view of the risks they were engaging in.[59] Losses incurred by hedge funds, and the risk of their failure, are borne directly by investors and their immediate counterparties, with the most direct risk-transmission channel from hedge funds to the wider financial system being the banks.

One efficient way to achieve the necessary supervision is to ensure that front-line regulators are in a position to monitor the build-up of risks in this sector by way of accurate and timely judgment on the extent of aggregate leverage of hedge fund trades. The financial crisis has revealed that the level of transparency towards regulators throughout the financial markets in this regard has not been sufficiently high to allow timely judgments to be made and corrective action to be taken.[60]

The introduction of a formal authority to register these funds, assess their strategies, methods and leverage provides the perfect lens for necessary oversight.[61] This is provided in the Directive by way of provisions that target hedge funds by imposing obligations on AIFM managing leveraged AIF.[62] Where an AIFM manages an AIF, which employs 'high levels' of leverage on a systematic basis, further reporting obligations to regulators and investors will apply. For these purposes 'high levels' of leverage means a debt to equity ratio in excess of 1:1 in two out of the previous four quarters. The competent authorities of Member States will also be given express powers to impose leverage limits in the event of potential systemic risk, and emergency powers to restrict the use of leverage in respect of individual funds and managers in exceptional circumstances.

The foregoing is warranted and tailored to a specific purpose - the size of hedge fund positions is amplified by the extensive use of leverage, and the larger the fund, the greater the

---

[55] AIMA *EC Directive does not deliver proportionate response* Press Release (29 April 2009) <http://www.aima.org/en/media_centre/press-releases.cfm/id/999D2189-AD87-40C4-86B1436063D19423> (27 February 2010).

[56] AIMA 'G20 reaction statement' (2 April 2009) <http://www.aima.org/en/announcements/aima-g20-reaction-statement.cfm> (27 February 2010).

[57] ALFI contribution to the working document of the Commission Services (DG Internal Market) - Consultation Paper on Hedge Funds.

[58] Lord Turner, Chairman of The Financial Services Authority *The Turner Review: A regulatory response to the global banking crisis* (Report) (March 2009) <http://www.fsa.gov.uk/pages/Library/Corporate/turner/index.shtml> (27 February 2010).

[59] (n 1).

[60] ibid 5.

[61] (n 7) 25 Recommendation 7.

[62] (n 22) 34 art 22 of the Proposal.

systemic risk. According to the International Monetary Fund, average hedge fund leverage is between 1.4 to 1.7 times the funds capital, although the level for some hedge funds may be much higher depending on their investment strategy. There has also recently been a distinct connection between high levels of leverage and large hedge fund failures.[63] In some cases, leverage of the hedge fund may be two or three times the value of the fund's equity.[64] Thus the Proposal's provisions on leverage in AIF should be a welcomed development as it enables the targeted monitoring of hedge funds, and their relationship with the banking system.

A more general move towards greater transparency and cross border oversight in relation to hedge funds is also welcomed and required. Detailed recommendations were made on an international platform, devised by the International Organisation of Securities Commissions[65] wherein the most significant recommendation was that hedge fund managers should be registered and should supply information to regulators on investment strategies, risk management mechanisms and capital requirements. These international recommendations are rightly and adequately realised in the Directive. In light of the foregoing, it is submitted that the hedge fund industry insisting it should not be met with regulation by virtue of the fact that it did not play a major role in the emergence of the crisis does not pack a punch with the G20 goal to target systemic risk. It is undisputed that hedge funds contribute to such risk, and the international support for hedge fund regulation resonates.

H COST – A COMMON GRIEVANCE

It has been argued by actors across the AIF industry that compliance with certain aspects of the Directive would impose significant cost related burdens on AIF, that many of the measures do not withstand cost benefit analysis, and that an adequate impact assessment of the potential cost of compliance was not engaged by the Commission at its drafting stages. According to the Commission, the current threshold triggering the application of the Directive[66] entails that around 30 percent of AIFM managing almost 90 percent of assets of EU domiciled AIF.[67] The AIF industry has estimated that the Directive in its current form would present an approximate 2.5 percent reduction in returns that those AIF would deliver under the Directive – largely due to leverage restrictions and increased compliance costs.[68]

The cost of compliance with regulation can impact upon smaller funds disproportionately.[69] It is argued that the thresholds as they stand do not provide an effective safe harbour for small funds, and that such funds should be exempt because they do not have

---

[63] (n 1) 5.

[64] R Kiefer F Mattern and F Scholz 'The state of the corporate board 2007: A McKinsey Global Survey' (June 2007) <https://www.mckinseyquarterly.com/Governance/Boards/The_state_of_the_corporate_board_2007_A_McKinsey_Global_Survey_2011> (28 February 2010).

[65] (n 36).

[66] The Directive will apply to all AIFM managing hedge funds above €100 million in value and private equity funds of €500 million or more not using leverage.

[67] This statistic refers to hedge funds, as the €500 million threshold applies mainly to private equity.

[68] AIMA *European Directive could cost European Pension Industry €25 billion annually* Press Release (4 August 2009) <http://www.aima.org/en/media_centre/press-releases.cfm/id/7B789862-0DD2-40C9-A0547A7687F4C51D> (28 February 2010).

[69] For example, in the U.S. during 2004 companies with revenues exceeding $5 billion spent 0.06% of revenue on the Sarbanes Oxley regulation compliance, while companies with less than $100 million in revenue spent 2.55%. 'Final Report of the Advisory Committee on Smaller Public Companies to the SEC' (23 April 2006) 33-34 <.http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf> (28 February 2010).

a significant impact on the Internal Market.[70] Rather, they are specialised in the financing of small and medium sized firms at local, regional or national level, according to national practices and rules or they are highly specialised in promising technological projects and should therefore remain subject to national regulation.[71] Yet certain groups maintain that any *de minimis* exemption whatsoever would lead to a multiplication of small funds, jeopardising the quality and accountability of their management.[72]

A workable balance needs to be struck between the foregoing conflicting viewpoints. A viable solution could be to base any *de minimis* exemption on a revised application of the subsidiarity principle[73] protecting small funds with less systemic impact from over-burdensome requirements. The Commission was clearly unsure of whether to apply this principle, apparent from the fact that the College of Commissioners had difficulty deciding on the thresholds for the application of the Directive. An initial proposal put the *de minimis* exemption at 250 million euro. Nevertheless, the Commission yielded to political pressure in Parliament to lower the exemption to that which is now contained in the Directive.[74]

It is submitted that the Commission should set the lowest threshold at 250 million euro. It is desirable that only larger funds fall within the scope of the Directive, because the larger the fund, the greater the systemic risk.[75] Perhaps therefore the Commission should rule on the *de minimis* thresholds with a lighter touch in order to make regulate in proportion to risk and cost benefit analysis.

I THIRD COUNTRIES GET THE SECOND-CLASS TICKET FOR EUROPE

Once authorised under the Directive, AIFM may market AIF to professional investors throughout the EU subject to a simple notification procedure.[76] The marketing of AIF in the EU will only be allowed with this special marketing passport that the Directive creates. This passport is said to be the reward for compliance with the Directive. It is argued that the proposed benefits of unencumbered cross-border marketing of AIF are not sufficient to outweigh the burden of compliance for some parties of the AIF industry.[77] This is specifically the case for non-EU AIF, which face significant obstacles, and a lengthy spell in the waiting room, before obtaining their passport to market in the EU, as will now be discussed. Under the Directive, AIFM may only market an AIF domiciled in a non-EU country (‘third country’) to investors within the EU if the third country in which the AIF is domiciled has been deemed compliant with requirements on regulation and supervision to an equivalent level of those laid out in the Directive. In addition to the equivalence requirement, the third country in which the AIF is domiciled must have signed an OECD-compatible double taxation agreement with the Member State in which it wishes to market.[78]

---

[70] (n 43) 2.
[71] ibid 3.
[72] (n 6) 5.
[73] It is acknowledged that in drafting the Directive the Commission did take this into account - (n 6) ‘Legal Elements of the Proposal’ - but perhaps not sufficiently; see further text after (n 92).
[74] Group of the Progressive Alliance of Socialists & Democrats in the European Parliament.
[75] (n 1); See further, discussions of the existing model in the UK, (n 7) 24.
[76] Pursuant to which relevant information is provided to the home competent authority by the AIFM and transmitted to the competent authority of the Member State in which the AIF is to be marketed.
[77] Julian Young, lead partner for the Ernst & Young European hedge funds practice.
[78] In order to market a non-EU AIF the Third countries in question must sign an agreement with the Member State in accordance with Article 26 of the OECD Model Tax Convention to ensure an effective exchange of information on tax matters.

Additionally, and most significantly, even if all the foregoing were satisfied, the third country AIF cannot obtain nor benefit from the marketing passport until at least three years after the transposition of the Directive. This period of time has been set aside to allow the EC to check whether the above regulatory equivalence is in place in the third countries where the funds are domiciled. [79] This time stipulation will have major consequences for third country AIF, which face a major loss of business in the EU. *Funds outside the EU face being locked out of the EU market for three years after the transposition of the Directive and this has considerable impact upon all entities of a global AIF industry.*[80] For instance, the majority of AIF such as hedge and private equity funds are domiciled in non-EU centres,[81] and currently a significant number of EU based AIFM manage such third country AIF. For example, many third country AIF offered to professional investors in the EU have UK-based managers.[82] However, at best, these managers will not be entitled to market those funds until the expiration of three-years after the transposition of the Directive. As a consequence, European institutional investors would face a distinct reduction in choice, and a corollary reduction in returns. An interesting case study in this regard is the European pension funds industry.

It is estimated that the draft Directive could cost Europe's pension fund industry up to 25 billion euro a year if implemented in its current form.[83] The total size of assets under management by the European pension fund industry is 5 trillion euro, with an approximate allocation to AIF of 20 percent. As previously discussed, if the Directive were implemented in its current form investors could expect an approximate reduction in performance of 2.5 percent as a result of certain provisions; in the instant context, a reduced choice in investments due to the three-year lockout period for non-EU funds. Therefore the estimated reduction in returns the European pension fund industry would face is earmarked at approximately 2.5 percent of one trillion euro, or 25 billion euro.[84] This is an estimated figure but it is illustrative of the scale of the impact the Directive may have were it to be passed in its current form.

Thus the draft Directive provisions regarding third countries as they currently exist have the potential to hamper *the competitiveness of the European financial services sector or indeed the economies of Europe as whole.*[85] It must be noted however, that this timeframe is a stipulation to obtaining the passport, and that the passport, of itself, bears significant potential benefits for the AIF industry more generally. It is submitted that in some European quarters the passport is a welcomed development, and sufficient reward for compliance with the Directive. ALFI participated in consultation and examination of the main issues surrounding regulation from a hedge funds perspective.[86] It acknowledged that hedge funds, as non-harmonised products, currently do not benefit from a passport, and that such an innovation, allowing AIFM to manage and market funds throughout the EU either directly or via a branch, without having to comply with each country's particular legislative requirements- would be desirable.

---

[79] The Commission will decide through the comitology procedure on the equivalence of the relevant third country legislation and on comparable market access.
[80] *AIMA AIMA warns of the global impact of the EU AIFM Directive Press Release 27 July 2009* <http://www.aima.org/en/media_centre/press-releases.cfm/id/6D509933-0F03-4D6B-B193ECB26D844F36> (28 February 2010).
[81] (n 6).
[82] 57% of the European Private Equity industry is located there.
[83] (n 68).
[84] ibid.
[85] ibid.
[86] (n 57).

J THE PROPOSAL – IRELAND'S OPPORTUNITY?

The Proposal if implemented will have overbearing consequences on non-EU AIF, namely the three-year marketing lock out period, and the connected regulatory equivalence requirements. It is established that this will in turn increase costs and reduce returns for AIF, and especially those ran from non- EU, "offshore" centres. When this happens it can make more sense for funds in these circumstances to domicile onshore.[87] For example, domiciling a management company in Ireland, as an EU Member State, would then allow AIFM to benefit fully from the flexibilities of the Directive in terms of product and distribution; namely the marketing passport created in the Directive.

Recently the Irish Government enacted legislation which will enable existing offshore fund companies to re-domicile to Ireland. The Companies (Miscellaneous Provisions) Act 2009 was recently enacted and aims to improve efficiency in the process of funds migrating into Ireland and reduces regulatory burdens on the migrating company.[88] This is a positive step in the right direction towards Ireland becoming a favourable destination for non-EU AIF wishing to domicile in EU shores to position themselves well to deal with the potential challenges presented by the AIFM Directive.[89] As the foregoing would highlight, elements of the Proposal could spark domiciliation of AIF in Ireland which is undoubtedly a good thing from a financial services perspective. However it is established that the Proposal is not without flaw and attention must still be drawn to possible ways to make provisions of the Proposal more balanced and compliance with it more workable for the AIF industry as a whole, without negating the key objectives of the legislation.

K REVIEW OF THE PROPOSAL – AN INJECTION OF COMPROMISE?

In order for the Directive to become law, it needs to be approved by the European Parliament and the European Council. The Economic and Monetary Affairs committee ("ECON") has been assigned to review the Proposal, devise and agree amendments, and prepare a report for political approval. The European People's Party ("EPP") has overall responsibility for this report and will steer it to ultimate conclusion, where the final draft of the Directive will be put to vote, with the first vote in plenary taking place in early 2010. The EPP remains ambiguous in its view of the legislation; it labelled the existing Proposal as 'good but not good enough'. The political debate taking place on the Directive could therefore go either way. With the review of the legislation underway experts from the twenty-seven finance ministries of the EU are currently making line-by-line amendments to the Proposal, and a considerable level of political lobbying from AIF industry groups in search of an injection of compromise to its most contested provisions has been underway since the draft legislations inception. The impact of this will only come to fruition when the ECON report is drawn to conclusion and the final draft is put to vote.

---

[87] The European Journal 'The Commission's proposal on Alternative Investment Funds Managers is bad for British's businesses' **(**13 May 2009) < http://europeanjournal.typepad.com/my_weblog/2009/05/the-commissions-proposal-on-alternative-investment-funds-managers-is-bad-for-britishs-businesses.html> (28 February 2010).

[88] The Companies (Miscellaneous Provisions) Act 2009, enacted on 23 December 2009 <http://www.irishstatutebook.ie/2009/en/act/pub/0045/print.html> (February 28 2010).

[89] (2010) 82 (1) AIMA Journal <http://www.aima.org/en/document-summary/index.cfm/docid/234CC5A2-A424-49F3-9CCD983A01CF17CC> (28 February 2010).

L REGULATION TO FIT ALL – THE NATURE OF COMPROMISE CALLED FOR AND THE LIKELIHOOD OF THIS BEING RECOGNISED IN THE DIRECTIVE'S FINAL DRAFT

The AIF industry is not blankly opposed to regulation, rather it realises the potential benefits, and wishes to suggest material changes that would make such regulation a more workable prospect for the industry as a whole. It is noted that appropriate, proportional and risk adequate regulation is supported by all sectors of the AIF industry, and it is furthermore argued that the draft Directive in its current form would not be conducive to achieving these goals.[90]

The scope of the Directive affects a vast spectrum of actors across the AIF industry. In this context it is pertinent that the points of criticism and corresponding solutions put forward by the AIF industry should be taken into account by the Commission before the legislation is approved and all AIF are taken to Brussels for regulation in the one bag. One of the major changes called for is a revision of the provisions regarding third countries. It has been suggested that the Directive makes it so difficult and costly for non-EU funds to access the EU market that it is protectionist in effect, if not in intent.[91] On this point it is has been strongly recommended that non-EU funds be granted immediate market access in the EU when complying with the requirements contained in this Directive, so as to avoid prejudice and protectionism; it has been argues that there is no regulatory justification for the three-year delay of the EU marketing passport for AIF domiciled in third countries.

Aside from this time factor in obtaining the passport, it is submitted that the Commission also miscalculated the difficulty and cost inherent in reaching the regulatory equivalence essential to obtaining it, and furthermore that it could prove virtually impossible for some non-EU AIF to reach such equivalence. A significant hurdle for third countries in this regard is the requirement that depositories nominated by AIFM to take custody of assets for each AIF it manages must be EU established credit institutions. This would imply that delegation to depositaries outside the EU is not possible. Such provision would make it very difficult for certain third countries where local custody is a requirement to reach the equivalence standard, thereby locking them out of the EU market.

Attention has also been drawn to the Directives provision on the liability and tasks of depositories, which refers to depository liability as 'failure to perform its obligations pursuant to this Directive.'[92] It is recommended that clarification is needed as to what 'failure' means exactly, in order not to impose unlimited liability on the depositary.[93] In addition, the burden of proof with regard to liability lies with the depository pursuant to the draft Directive, thereby unnecessarily changing the UCITS concept of liability. There is concern that the foregoing provisions would create a situation where it would be difficult to get a depositary, with fees becoming untenably high.[94] A significant increase in the cost of custody is a price that would ultimately be borne by investors. This is surely an unintended consequence from

---

[90] M Thommen and Dr MD Otter 'Swiss Funds Association Position Paper on the Draft AIFM Directive' (11 August 2009) <http://www.swissalternativeinvestments.ch/user_files/press/SFAPositionPaper_AIFM_090811.pdf> (28 February 2010).

[91] ibid; AIMA *The Global Impact of EU AIFM Directive* Press Release (27 July 2009) <http://www.aima.org/en/media_centre/press-releases.cfm/id/6D509933-0F03-4D6B-B193ECB26D844F36> (28 February 2010).

[92] (n 22) 30 Article 17(5) of the Proposal.

[93] (n 89); It is argued that the depositary should only be held liable if it did not undertake appropriate due diligence and regular monitoring. This standard is reasonable and enshrined in national legislation of many Member States.

[94] (n 43) 5.

the Commissions point of view. It is argued that the provisions governing UCITS on the foregoing issues have proven their worth and ensured prudent investor protection, and that the provisions relating to depositories in the Directive should be brought more in line with the UCITS regulation. It is strongly advocated that the provisions on AIF depositaries should be negotiated and finalised by Member States and the European Parliament in their review of the Directive only after the publication of the outcome of the Commission's consultation on UCITS depositaries.[95]

These calls for certain aspects of the Directive to be made more consistent with existing UCITS regulation, is in line with the principle of subsidiarity[96] – the appropriate application of which would have a significant impact in reducing the cost of compliance with the Directive.[97] It is acknowledged that regulation of AIF is not unwarranted and it must be accepted that some compliance costs will be incurred. The impact of the cost of compliance with the Directive has already been highlighted. It is argued by some that the weight of this impact on smaller funds is largely due to exemption thresholds provided in the Directive that are too low and therefore do not fully take into account the principle of subsidiarity.[98]

To remedy this it is suggested that existing thresholds should be modified so that the Directive would impact exclusively on larger funds that could properly afford compliance, and exempt smaller funds, since these are unlikely to give rise to important systemic risks or to be a threat to orderly markets. A revised threshold of 250 million euro would capture 36 percent of managers of non-UCITS and 96 percent of the assets invested in these funds.[99] Most importantly, such a threshold would ensure most managers in niche businesses,[100] for whom the new requirements could be overly burdensome, are not caught by the Directive. The Commission has stated that the choice of a Directive as the legal instrument represents adequate application of the subsidiarity principle,[101] and makes a 'sensible trade-off between harmonisation and flexibility.'[102] The choice of a Directive as legal instrument does allow Member States a degree of flexibility in deciding how to adapt their national legal orders to the new framework.[103] Yet in some instances a Directive can actually spell out its objective in such detailed terms as to leave the Member States with scant room for manoeuvre.[104] The Commission are adamant that the choice of Directive as implementing instrument leaves sufficient room to manoeuvre regarding the thresholds, therefore it remains to be seen if they will modify them in their review.

---

[95] EFAMA *EFAMA Welcomes Commission Public Consultation on the UCITS Depository Function* Press Release (3 July 2009) <http://www.efama.org/index2.php?option=com_docman&task=doc_view&gid=1000&Itemid=35> (28 February 2010).

[96] A principle to be applied to areas of regulation where the Community does not have exclusive competence; The principle delineating areas where the Community should and should not act, as laid down in art 5(2) of the Treaty Establishing the European Community.

[97] It is recognised that funds who invested in compliance with both UCITS and MIFID regulations are now too fall under the remit if the Directive.

[98] (n 43) 3.

[99] The Commission's analysis of data from Morningstar.

[100] For example, start-up and venture capital.

[101] (n 2).

[102] ibid.

[103] A directive is binding on the Member States as regards the objective to be achieved but leaves it to the national authorities to decide on how the agreed Community objective is to be incorporated into their domestic legal systems.

[104] This has occurred in the case of directives on technical standards and environmental protection; see further Dr K-D Borchardt *The ABC of Community Law* <http://ec.europa.eu/publications/booklets/eu_documentation/02/txt_en.pdf> (28 February 2010).

The marketing passport provided for in the Directive, is essentially the dangling carrot in exchange for compliance, but also indirectly for tax compliance. The Directive permits the marketing of non EU AIF if the country of domicile has entered into an agreement on effective exchange of information on tax matters based on article 26 of the OECD Model Tax Convention with the Member State on whose territory the AIF shall be marketed. This shall ensure that national tax authorities may obtain all information from the tax authorities of the third countries activities that are necessary to tax domestic professional investors investing in offshore funds. The vast majority of AIF were incorporated in offshore jurisdictions with the Cayman Islands being the most popular;[105] this is because offshore centres offer a combination of privacy and zero tax regimes for non-citizens. It has been proven that in such cases voluntary compliance with tax codes falls to below 50 percent.[106] Addressing the tax issue is therefore critical.[107] The Directive achieves this by introducing a strong incentive for compliance with the OECD Tax code. In light of the foregoing, this innovation is welcomed, and helps implement a policy-mix that can best achieve the objectives of the G20 to enhance the transparency and the quality of regulation in off shore financial centres.[108]

While the private equity and venture capital sectors accept the objectives of the draft Directive, amendment of the text through the EU legislative process is requested which would account for the specificities of its industry and the critical contribution it plays in financing the European economy.[109] In the likely case that the Directives all-encompassing scope will not be retracted, leaving private equity within its remit, the current threshold applicable for private equity – the 500 million euro exemption threshold will most likely remain unchanged.[110] However provisions in need of revision in the context of private equity, as discussed by EVCA and in previous sections, are undoubtedly in the area of disclosure and depository requirements.

A degree of cost must be incurred by those AIF posing the greatest systemic risk. This gauge ensures the cost of compliance is proportionate. As previously discussed, large hedge funds fall into this bracket. The industry itself agrees with provision of systemically significant information by large hedge fund managers to their national regulators.[111] The revision of the *de minimis* exemptions has been discussed as an appropriate way of achieving this. A threshold of 250 million euro would capture 15 percent of hedge fund managers, managing 76 percent of assets of EU domiciled hedge funds.

However revision of exemption thresholds is not synonymous to an overhaul of the Proposal's existing provisions to meet the hedge fund industries taste.[112] The hedge-fund industry has a symbiotic relationship with the banking sector. As a result, the risk exposures of the hedge-fund industry may have a material impact on the banking sector, resulting in new sources of systemic risks.[113] Large hedge funds high and systematic use of leverage is

---

[105] Cayman Islands hold 63% of global Hedge Fund assets.

[106] (n 6). Statistics proven by the United States Department of the Treasury; Internal Revenue Service.

[107] (n 2) 7.

[108] European Commission document *Directive on AIFM: Frequently Asked Questions* (29 April 2009) 4 <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/211&format=HTML&aged=0&language=EN&guiLanguage=fr> (28 February 2010).

[109] (n 43) 2.

[110] The EVCA suggestion is €1 billion; this is unrealistic and may be too high a tide line for private equity firms to skim under, a result that is not desired by the Commission.

[111] (n 56).

[112] N Pettifer 'We do have a Clear Plan' (2009) 27 (7) International Financial Law Review 16-17 in which AIMA stated that 'manager authorisation protects investors and transparency protects markets… what more could you want'. This approach was criticised as being unrealistic.

[113] N Chan and others 'Systemic risk in Hedge Funds' in Mark Carey and René M Stulz (eds) *The Risks of Financial Institutions* (University of Chicago Press Chicago and London 2006).

often identified as one of the most notable risks to financial stability.[114] Therefore existing leverage restrictions provided in the Directive as previously discussed are a crucial component of targeting systemic risk and need to remain and apply, in tandem with revised exemption thresholds.

M CONCLUSION

It must be remembered that, in the aftermath of the recent financial crisis and scandals,[115] investors and actors in the financial markets are looking for more regulation, and it has been established the Proposal achieves this. However it is imperative that an EU regime for AIF remains flexible enough to make it competitive vis-à-vis offshore centers and the international nature of the alternatives industry. Yet, as discussed, certain aspects of the Directive fall short of realising essential international facets of the AIF industry.

There are aspects of the Directive clearly aimed at changing the very structure of the industry, for example the introduction of an EU regulated, yet universally liable depository. The passport created in reward for compliance with the Directive has potential and should be welcomed. However on this innovation the Commission struck the wrong cord past harmonisation and instead paved the way for a Europe in which investors, managers and custodians are confined to a life within its borders, or outside them. Such possibly unintended consequences of the Directive can be avoided if the opinions, arguments, and recommendations of all the relevant actors, as illustrated throughout the instant discussion, will be taken into account during the review of the legislation currently underway.

The Directive has been hailed by some of its most trenchant critics as the perfect regulatory storm – born out of economic crisis and considerable political will yet drawn from the slightest of consultation with the relevant actors. It is equally recognised that 'an open single market in fund management must be a major opportunity for Europe and we must all do our bit to ensure we deliver the best possible result for EU investors and for the future of the EU funds industry.'[116] However this will only be achieved if the relevant actors in the AIF industry seize the eye in the storm and engage with EU Parliamentarians throughout the political review of the Directive. It may be the last chance saloon to securing appropriate regulation for the industry, not just in Europe, but also around the globe.

---

[114] European Fund and Asset Management Association ('EFAMA') 'Response to the Commission's Consultation on Hedge Funds' <http://www.efama.org/index.php?option=com_docman&task=doc_details&gid=946&Itemid=-99> (28 February 2010).

[115] (n 7) 26; The 'Madoff' case in particular has illustrated the importance of better controlling the quality of processes and functions in the case of funds, funds of funds and delegations of responsibilities.

[116] The UK Financial Services Secretary to the Treasury 'AIMA Breakfast Address on the Alternate Investment Fund Management Directive' (7 July 2009) <http://www.hm-treasury.gov.uk/speech_fsst_070709.htm> (28 February 2010).