

# EC Draft Directive on Alternative Investment Fund Managers

An Investor's View

# Potential Issues for Private Equity Investors

- Four key areas of the draft directive on AIFM are of potential concern for investors:
  - Impact on returns from EU managed funds
  - Restriction on fund selection
  - Creation of an unlevel playing field for private equity
  - Loss of key mechanism for aligning LP and GP interests

# Impact on Returns

- Draft directive increases costs which will be borne by the funds managed, so reducing LP returns:
  - Requirement for an independent valuation, but what benefit to LPs?
    - Fees not based on valuation
    - There is already a rigorous and audited valuation process in place
    - The true value is known only when investments are realized
  - Requirement for independent custodian, but what benefit to LPs?
    - Assets of a fund are already segregated from the GP
    - Before investing GPs engage counsel to ensure ownership of assets is obtained

# Restriction on Fund Selection

- Draft directive reduces access to funds which exist and may deter the creation of new funds
  - GPs will need to register in the EU before promoting funds, **or** before receiving solicitations from LPs
    - Will exclude funds not managed in the EU, unless they chose to register
    - May restrict fund raising abilities of smaller EU managed funds which are exempt from legislation
    - Even if threshold for exemption is reduced or removed, smaller EU managed funds would see huge increase in costs which may deter them from raising funds

# Restriction on Fund Selection

- GPs covered by the directive will be subject to capital requirements
  - Most GPs will be required to hold capital of at least  $\frac{1}{4}$  of annual expenses
  - This may not be an issue for GPs of large or of multiple funds, but may well be an issue/deterrent for GPs of smaller funds and new entrants
- Risk that legislation will provoke retaliatory legislation outside EU
  - EU LPs are a minority of investors in funds raised in EU, so if EU GPs are unable to promote funds in other jurisdictions this could result in fewer and smaller funds being available within the EU

# Creation of Unlevel Playing Field

- The increased level of disclosure at the underlying investee company level does not apply to all investors
  - Where ownership of a company is >30%, the level of public disclosure required will be comparable with that for public companies
  - The regulations will not apply to managers of non-pooled vehicles, i.e. it will not apply to competing sources of capital to private equity funds
    - This could adversely impact deal flow to GPs as companies seek investment from sources where such disclosure does not apply
    - It could lead GPs to change investment strategy and switch to doing minority only deals

# Loss of Alignment of Interests

- The proposed directive would prevent many GP executives from investing in their funds
  - This would remove one of the key mechanisms for aligning GP and LP interests in a fund
  - It may also change GP remuneration structures as pay and bonus packages are increased to compensate for lack of wealth creation from investing in the fund
- Requirement for prior approval of all marketing material, and any changes to this, may reduce scope for LPs to negotiate terms prior to closing

# Main Contacts

Charlie McCreevey  
Commissioner for Internal Market and Services  
European Commission  
Office: C107 07/42  
B-1049 Brussels  
Belgium

Sharon Bowles MEP  
Chair of Economic & Monetary Affairs Committee  
European Parliament  
ASP 10G210  
Rue Wiertz  
B-1047 Brussels  
Belgium  
[sharon.bowles@europarl.europa.eu](mailto:sharon.bowles@europarl.europa.eu)

# Main Contacts

Jean-Paul Gauzès MEP

Rapporteur AIFM

European Parliament

ASP 13E258

Rue Wiertz

B-1047 Brussels

Belgium

[jean-paul.gauzes@europarl.europa.eu](mailto:jean-paul.gauzes@europarl.europa.eu)

Lord Myners

Financial Services Secretary to the Treasury

HM Treasury

1 Horse Guards Road

London SW1A 2HQ

# Main Contacts

Swedish Presidency of the EU  
Mats Odell  
Minister for Financial Markets  
Ministry of Finance  
Drottninggatan 21  
SE-103 33 Stockholm  
Sweden

# Other Contacts

Baroness Catherine Ashton  
EU Commissioner for Trade  
200 rue de la Loi  
B-1049 Brussels  
Belgium

Kim Darroch  
UK Permanent Representative to the European Union  
85 rue d'Arlon  
B-1040 Brussels  
Belgium