



Hedge Fund Returns

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Weil Gotshal's multidisciplinary hedge fund practice group spans the United States, Europe and Asia. We represent blue chip hedge fund managers around the globe as well as investors in hedge funds.

We provide seamless service and unparalleled transactional advice to hedge fund managers. Our hedge fund manager clients benefit from our substantial expertise and reputation in fund formation, mergers & acquisitions, leveraged finance, real estate and structured finance transactions as well as our pre-eminent restructuring practice.

Our representation frequently includes the following:

- establishing hedge funds, hybrid funds, special situation funds and distressed debt funds and seeding new hedge fund managers
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- control and non-control acquisitions and dispositions and investments in senior and subordinated debt and structured products
- leveraged lending transactions and debtor-in-possession financing
- advice with respect to the management of CLOs and CDOs
- out of court and in court workouts and restructurings of debt

The members of our hedge fund practice group are listed on the last page of this publication.

EU Proposals To Regulate Alternative Investment Fund Managers: An Update

By James Cole (james.cole@weil.com) and James Cousins (james.cousins@weil.com)

In *Hedge Fund Returns* issue 2009 No. 8, we outlined European Union (EU) proposals to regulate alternative investment fund managers (AIFM) by way of a proposed directive (the Directive). The purpose of the Directive is to create a harmonized, comprehensive and effective regulatory and supervisory framework for AIFM in the EU. The initial reaction among industry participants was that the Directive went too far in its reach and, given the large number of hedge funds and private equity funds based in London, there was significant pressure on the UK government to take a strong stance against the Directive in its initial form.

Since then, various parties, including Lord Myners, Financial Services Secretary to the UK Treasury, have been lobbying Members of the European Parliament (MEPs) on the scope and provisions of the Directive. In particular, the Alternative Investment Management Association (AIMA) has organized a campaign to coordinate the response of the European hedge fund industry. The European Private Equity and Venture Capital Association (EVCA) has also been playing a key role in responding to the Directive on behalf of the private equity industry.

On September 2, 2009, the Swedish Presidency of the EU published a note following initial working group meetings with, and written comments received from, finance ministry officials from all 27 member states, identifying a number of key issues in the Directive which they considered needed amendment.

The UK Financial Services Authority (FSA) also joined the debate and, in October 2009, published a report on the impact of the Directive. Their key concerns for hedge funds were in relation to: (1) impact on non-EU funds: the Directive, in its current form, will greatly reduce the availability of funds in which EU investors may participate; (2) increased compliance costs; and (3) leverage restrictions: there is concern that limits will reduce investor choice (and returns) and could add to pro-cyclicality at a time of crisis, as hedge funds would be forced to sell to stay within prescribed leverage limits. Furthermore, there is a concern that because leverage restrictions would not affect non-EU domiciled hedge funds that could still trade on EU regulated markets, this would distort competition and place EU domiciled funds at a disadvantage.

AIMA published its position paper on the Directive in October 2009, highlighting three key issues:

- registration and authorization;
- the reporting of systemically relevant data (to authorities in the interests of financial stability and globally accepted standards); and
- a workable “passport” arrangement whereby non-EU domiciled funds could become available to EU investors.

On November 12, 2009, the Swedish Presidency published its compromise proposal on behalf of the Council of the EU (the Council) containing amendments to the Directive. The Council is one of the two legislative bodies in the EU, the other being the European Parliament. The Council is composed of 27 national ministers (one per state), whereas the European Parliament is the directly elected parliamentary institution of the EU, composed of 736 MEPs. The EU’s legislative procedure is such that both the Council and Parliament must jointly adopt legislation based on a proposal by the European Commission in order for it to become law under the “codecision procedure”.

The Council’s compromise proposal was welcomed by AIMA and addressed many of its initial concerns. However, the AIFM industry still has concerns on the compromise proposal.

In particular, the compromise proposal includes new restrictions on remuneration, which includes deferring up to 60% of investment managers’ pay over a certain period and requiring large hedge funds to establish independent remuneration committees. Some argue that these restrictions, on top of the pending UK higher rate income tax of 50% tax on salaries above £150,000, could result in hedge fund managers moving their base of operations away from London.

On November 23, 2009, MEP Jean-Paul Gauzès, Parliament’s rapporteur, published his draft report on the Directive, which many commentators believe went some way to striking a balance between efficient operation and proportionate regulation and supervision. For example, the draft report seeks to align the Directive with G20 principles of remuneration policies and move towards greater transparency on systemic risk issues. However, there are still concerns that other aspects will negatively impact the industry without necessarily delivering the desirable regulatory outcome. Following publication of the Parliament’s rapporteur report, the Council’s compromise proposal was revised as recently as December 15, 2009 and it is generally agreed that the broad principles contained in the revised compromise proposal are aligned with the Parliament’s report.

Both the Council’s compromise proposal and the Parliament’s rapporteur report are non-binding and subject to further discussions, but will be influential documents in shaping the Directive’s development via the codecision procedure.

So, what does the future hold for the Directive? Sweden has not managed to secure a compromise agreement between member states on changes to the Directive and has opted instead to produce a progress report before its handover of the Presidency to Spain on January 1. It will be interesting to see what impact the new Spanish Presidency of the EU has on the path of the Directive in 2010. On the current timetable, the next milestone occurs when the wider body of MEPs express their views on the Directive on January 21, 2010, and then discussions between the Council, Parliament and European Commission take place, culminating in a final vote in plenary on July 1, 2010. However, given that the Directive requires approval by both the Parliament and Council in order to become law, many commentators believe the timetable may be extended—perhaps even into Belgium’s Presidency of the EU in the second half of 2010.

We will be updating you further as the process continues.

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