EU storm over for alternative investment funds?

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The European Union's highly controversial Alternative Investment Fund Managers (AIFM) directive quietly came into force in July when most of us were thinking holiday thoughts. With the beach a distant memory, it is time to take stock of what precisely this new legislation means for the alternative investment industry, spanning sectors as disparate as hedge funds, private equity, real estate, venture capital, and other non-Ucits investment funds.

Under the directive, these funds will be regulated for the first time at a pan-European Union level. The directive, which will require authorisation by national regulators, will lead to ongoing supervision of capital, conduct of business (risk management, conflicts of interests, liquidity, valuation, delegation, depositories, reporting, leverage limitation, private equity acquisitions) and marketing of shares or units from within and outside the EU.

Is it safe to assume that after the long, hard slog to make the directive as workable as possible the sector can now set about implementing the requirements, adapting the necessary processes and disclosures, and generally getting back to business as usual?

In other words, from the industry perspective, has this storm blown over and can efforts to strengthen the reputation of the industry and enhance transparency towards politicians, regulators and the public at large be scaled back?

Unfortunately, this may not be the case. For two reasons:

First, not all the requirements are contained in the directive itself. The requirements of the directive will be fine-tuned in more detailed, implementing legislation. Not only will there be "traditional" implementing measures to be adopted by the European Commission, based on the advice of supervisors, but the AIFM also foresees regulatory and implementing technical standards to be developed by the new European supervisor, the European Securities and Markets Authority (Esma). These too will need to be formally adopted by the Commission. In fact, close to 100 provisions still have to be shaped at this legislative level. This means that decisions will still need to be taken on the exact content of many of the requirements and therefore the industry must remain engaged. For instance, just last month Esma launched a public consultation on the rules covering supervision of funds from outside the EU.

Second, and more important, this version of the directive may not be the end of the story. The negotiations were so difficult because there was a great discrepancy between the often knee-jerk views of many political stakeholders on the one hand and the technical understanding of the market and its benefits by other political stakeholders and market practitioners on the other. The negotiations therefore resulted in a typical European compromise. Under the resulting deal, most requirements seem workable in practice, while the most potentially detrimental proposals have not been accepted and a review clause has been inserted to assess the effects of the directive after a couple of years.

This result neither bridged the discrepancy of opinions held by the various parties nor satisfied all the stakeholders. Those politicians with concerns about the effects of private equity buy-outs, especially on employment, were disappointed by the outcome of the negotiations. Their opinion on alternative investment fund managers has probably not altered and this could very well manifest itself when it comes to reviewing the directive. Some of the more far-reaching proposals are likely to return to the discussion, such as ex ante fixed leverage limits, consultation of employees, and bans on restructuring ("asset stripping").

It is therefore clear that alternative investment fund managers must continue to engage with stakeholders and invest in their reputation. They should explain what they do and why certain decisions are made.

Scaling down efforts to win the trust of stakeholders and to improve their transparency would be a mistake. In that case, the current situation might only be the calm before the real storm, the hurricane named AIFM II.

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