



**COUNCIL OF
THE EUROPEAN UNION**



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Council to negotiate with Parliament on draft EU rules for hedge fund managers

The Council today¹ agreed a mandate for negotiations with the European Parliament on a draft directive aimed at introducing harmonised EU rules for entities engaged in the management of alternative investment funds, such as hedge funds and private equity (*doc. [7377/10](#)*).

The negotiations with the Parliament will aim to enable the directive to be adopted in first reading. The presidency will negotiate on the basis of a Council general approach agreed today; it took note of remaining concerns expressed by delegations, for instance with respect to third country rules.

The draft directive is aimed at:

- establishing a harmonised framework for monitoring and supervising the risks that alternative investment funds pose to their investors, counterparties, other market participants and to financial stability;

¹ The decision was taken at a meeting of the Economic and Financial Affairs Council.

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- allowing alternative investment fund managers (AIFM) to provide services and market EU funds throughout the EU single market, subject to compliance with strict requirements.

It is aimed at fulfilling commitments made within the G-20, in the wake of the global financial crisis, as well as the European Council's pledge to regulate all players in the market that might pose a risk to financial stability.

The impact of AIFM on the markets in which they operate is largely beneficial, though the difficulties on financial markets have underscored how their activities may also serve to spread or amplify risks through the financial system.

The activities of AIFM are currently regulated by a combination of national regulations and general provisions of EU law, supplemented in some areas by industry standards. The global financial crisis showed that uncoordinated national responses to the risks to which the funds were exposed made the efficient management of these risks difficult.

Besides hedge funds and private equity, the draft directive also covers real estate funds, commodity funds and all other funds that are not covered by the directive on collective investment funds¹.

The main features of the Council's general approach are as follows:

- Authorisations. To operate in the EU, fund managers would be required under the directive to obtain authorisation from the competent authority of their home member state. Once authorised, an AIFM would be entitled to market funds established in the EU to professional investors in any member state.
- Risk management and prudential oversight. AIFM would be required to satisfy the competent authority of the robustness of their internal arrangements with respect to risk management, including liquidity risks. To support macro-prudential oversight, they would be required to disclose on a regular basis the principal markets and instruments in which they trade, their principal exposures and concentrations of risk.
- Treatment of investors. In order to encourage diligence amongst their investors, AIFM would be required to provide a clear description of their investment policy, including descriptions of the types of assets and the use of leverage.

¹ Directive on undertakings for collective investment in transferable securities (UCITS)

- Leveraged funds. The draft directive introduces specific requirements with regard to leverage, i.e. the use of debt to finance investment. Competent authorities would be empowered to set limits to leverage in order to ensure the stability of the financial system. AIFM employing leverage on a systematic basis would be required to disclose aggregate leverage and the main sources of leverage, and competent authorities would be required to share relevant information with other competent authorities.

- AIFM acquiring controlling stakes in companies. The draft directive introduces specific requirements for AIFM acquiring controlling stakes in companies, in particular the disclosure of information to other shareholders and to representatives of employees of the portfolio company. It however avoids extending such requirements to acquisitions of SMEs, so as to avoid hampering start-up or venture capital.

- Funds located in third countries. EU-based AIFM would be able to market funds located in third countries, provided that they comply with certain but not all provisions of the directive and the member state allows it. Non-EU AIFM would also be able to market funds established in third countries in an EU member state, provided that there is sufficient information for investors and competent authorities and there are appropriate cooperation arrangements between the competent authorities in the EU and those of the third country manager for the purpose of systemic risk oversight.

- Optional exemptions for smaller funds. The draft directive gives member states the option not to apply the directive to smaller AIFM, namely funds with managed assets below EUR 100 million if they use leverage, and with assets below EUR 500 million if they do not. Smaller funds would however be subject to minimum registration and reporting requirements.

The need for regulation and oversight of hedge funds is also the subject of ongoing discussion at international level within the G-20, the International Organisation of Securities Commissions and the Financial Stability Board.