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### **No to new loopholes in EU regulation on hedge funds and private equity!**

Dear Commission President Barroso,

Thank you for your earlier correspondence and your letter of 12 February in which you **assured** us "The Commission has made a firm and clear commitment to bring forward appropriate regulatory initiatives covering all financial actors.... These regulatory initiatives will include hedge funds and private equity." You assured us about that already before Christmas in the European Parliaments plenary. You also have promised us that the proposal would be made in due time to give the existing Parliament time to consider and discuss it. Unfortunately, we have learned that your proposal has been further delayed.

You can imagine our dismay when we read the Commission's draft "Proposal for a Directive on Alternative Investment Fund Managers". Unfortunately after six months and several delays we now see a text proposal filled with loopholes, which make the real regulatory effects highly ineffective.

Far from including hedge **funds** and private equity **funds** in new regulation, the Commission apparently proposes to regulate only fund managers and actually exclude the funds themselves from regulatory control!

**The exclusion of the funds themselves** from the proposal for a Directive is just one of a series of major loopholes which makes the proposed Directive almost worthless. Among the **other major defects** of the proposal are:

1) The directive would cover managers of any type of funds provided that they are located in the EU and require them to **be registered** in the EU in order to market their services to EU investors. Although we appreciate the extent of coverage for all EU managers, we think this scope would **create a major loophole: the funds themselves would neither be registered, nor regulated and supervised**. Non-EU managers could still operate in the EU. As it stands now, any funds, be it off shore or on shore would then be allowed to market their products in the EU as well operate in European markets, in reality without effective regulation or registration.

In the directive proposal the **registration is pure formalities** - in reality there are no specific requirements to comply with for this authorisation. No requirements in terms of effective transparency, information on leverage, portfolios, strategies, fees structures, and lists of investors as we had suggested in our report.



2) The directive as currently drafted provides for an **exemption for funds** below a threshold of **EUR 250 Millions**. We believe this threshold is too high and would allow too many funds to stay outside the directive, adding another loophole. Three funds with a size of each 80 millions Euros could go together and act like one without registrations. We think all funds, of any size should be subject to the provisions of the directive as a matter of principle.

3) No **capital requirements** are expected from funds and this would be very detrimental to financial stability in general. . We think liquidity requirements should be introduced as well, since the current crisis has shown how liquidity shortage can become a tremendous problem. This **liquidity requirement** should be coupled with a **leverage ratio** in accordance with risk-profile, in order to prevent over leveraging without safety net. In addition, the level of **leverage should be limited**. In terms of **reducing short-termism and excessive risk-taking**, we think it would be necessary to incentivise long term remuneration policy.

4) The issue of **transparency** is not well enough addressed in the draft directive, neither towards investors, nor to competent authorities (the regulators); the frequency and quality of reporting is insufficient. We believe that on-going flows of information to **regulators and supervisors** are very important to assess the stability of the financial system and that, at the very minimum, quarterly reporting is necessary. The requirement for independent valuation, critical for financial stability and investor protection, is also too weak as it currently stands. This is critical because the structure of remuneration should not be based on accounting profits but on real and independent valuation. In addition, and considering the recent scandals related to high levels of remuneration, we believe it would be necessary to introduce **disclosure of information related to fees**.

5) **The conditions of disclosure attached to funds acquiring control of companies are simply insufficient**: Acquisitions of SMEs are out of the scope, and the definition of controlling influence within non-listed companies is not adequate to reflect the reality of major share ownership. The definition needs to be corrected. This must include "special incentives" granted to the management of companies being acquired by private equity funds for instance. In addition, the **consultation and information of employees** is not sufficiently guaranteed. As currently drafted de facto this question is not dealt with at all in the Commission's proposal. We have proposed to extend the well-known EU directive 2001/23/EC to cover also consultation and information in cases of PE-takeovers.

6) It is imperative that the Commission address adequately the issue of **taxation** of investors, funds and the managers. Unfortunately the commission does **not** deal with this issue at all in this proposal. It is a priority for us to take action on this hot topic. We must provide measures to tackle tax evasion, ensure adequate taxation of capital gains and fees of managers and prevent the abuse of investment vehicles by investors for tax avoidance purpose. Therefore we would expect the Commission to present proposals to that end.

7) The Commission needs urgently to address the potential market **disruption** and destabilizing behaviour by non-EU funds buying and selling European financial assets and companies. The directive, as it currently stands makes no reference to this issue which is critical from a financial and social stability perspective.

8) It is important that the directive contains a provision making sure that **institutional Investors** (Banks, Insurance Companies, Pension funds) can **only invest in Funds complying with the directive**. This is key to protect European investors.

9) Last but not the least, we recall that the regulation of naked **short selling** remains an item of utmost important and needs to be addressed within the new regulatory framework. Within this context, we ask for a prohibition to exercise voting rights based on **borrowed shares**.



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Mr. Barroso.

On the basis of the draft which we have studied carefully, we must conclude that the proposal for the directive goes in the wrong direction. Not only does it not properly respond to the parliamentary report drafted and adopted last September with a very broad majority, nor does it give an adequate political response to address the roots of the financial crisis. We consider it would be a **major political mistake** were the Commission to adopt such a proposal. It is not up to the challenge; it is not up expectations; it will only satisfy industry and those (still) favourable to minimum regulation. It would constitute a huge competitive advantage to the hedge fund industry at a time when, in the revision of the CRD, we are being tough on banks and discussing retention requirements for securitisation.

We believe you are **failing to fulfill the commitments** you have made yourself and made by President Sarkozy during the French Presidency in debates in the European Parliament.

We demand that you address the shortcomings of this proposal for a directive before it is agreed by the Commission, and that you do so with sufficient speed to present the proposal before the European elections. Therefore, we urge you to exercise leadership and **close the loopholes as outlined in this letter and the enclosed annex.**

We want you to be fully aware that the Party of European Socialists, and the Socialist Group in the European Parliament, consider this proposal to be of the utmost importance and will not stop in its efforts to obtain the regulation that Europe needs.

We outlined our concerns in a letter to you on December 16, well before the proposal was drawn up.

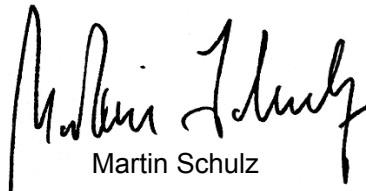
We are watching, not for further assurances, but for implementation: appropriate regulation that really does cover hedge funds and private equity as you promised. A real proposal from the Commission must be comprehensive, efficient and forward-looking. It is high time and urgent. **It is a matter of confidence** for the whole European Commission and for the European Union.

Yours sincerely,



Poul Nyrup Rasmussen

President of the Party of  
European Socialists



Martin Schulz

President of the  
Socialist Group in the  
European Parliament



Pervenche Berès

Chairwoman,  
Committee on Economic  
and Monetary Affairs

