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European rules alarm fund managers

By Alex Barker in Brussels

City banks must draw up 'resolution plans' by mid-year

Some fund managers' worst fears over pan-European regulation have re-emerged, prompting the hedge fund and private equity industries to hit back at Brussels' proposed technical standards that they say will damage business and shut out the US and Asia.

The European Commission's 110-page draft text of "supplementing rules" to enforce the contentious Alternative Investment Fund Managers Directive (AIFMD) is causing alarm, partly because it diverges from the European Securities and Markets Authority advice.

While the debate revolves round specialist rules on how to apply the directive, the industry sees the hawkish Commission interpretation as unpicking some of the hard-fought political compromises that underpinned the AIFMD deal in 2011.

Beyond the substance, the Commission's decision to overrule key parts of Esma's recommendations, submitted last November, also raises questions about the influence of a pan-European supervisor that is usually championed by Brussels.

European officials insist that most of the Esma advice was adopted by the Commission as it translated the advice into legal text. They say the divergences were needed to enhance legal certainty or to ensure methods were comparable across the European Union.

"Implementing measures are made to make the directive operational, not to try and get back what might have been lost in earlier compromises," said a Commission spokesperson. "There is very broad support for the direction of travel. Some issues still need to be ironed out which is completely normal at this stage."

Banks and investment managers are adamant that the Commission is adopting a tougher line on numerous areas and will drive up the cost of alternative investments. They say that custodian banks would face increased liability for investment losses, overall fund borrowing would be limited and fund managers in non-EU jurisdictions would have more difficulty accessing EU investors.

Concerns are so acute that industry representatives are speaking out while the draft is still under negotiation with member states. Andrew Baker, chief executive of the Alternative Investment Management Association which represents the $2tn global hedge fund industry, said: "We are concerned that this draft regulation appears to significantly and substantially diverge from the Esma advice."

Mr Baker's primary concern is that the Commission rules for non-EU fund managers imply that EU and non-EU regulators will sign legally binding co-operation agreements. "This would be extremely problematic if not impossible to conclude if the regulation prescribes that the co-operation agreements ensure that third-country regulators enforce EU law in their territories."

Arguing it was unclear and too discretionary, the Commission scrapped Esma's "advanced method" for calculating leverage and systemic risk – a move that ensures the tighter rules for highly leveraged funds will apply much more widely.

Other provisions restrict the ability to delegate tasks – for example to expert investment managers in the US or Asia – in a manner that would overturn how many funds are structured. A confidential Irish Funds Industry Association note to its members described the tightened rule as "hugely disruptive".

Some asset managers are, in addition, unhappy about changes to rules for depositories, particularly for assets subject to collateral arrangements.

On relations with outside jurisdictions, the Commission said it was trying to find a balance that would ensure common standards across the EU. "We are conscious of the issue and will ensure that the tension between flexibility and uniform application will be resolved in the final text," the spokesperson said.