KIRKLAND**PEN**

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KIRKLAND & ELLIS LLP

Private Equity Newsletter

Private Fund Manager Regulation Continues: Proposed European Regulation of Alternative Investment Fund Managers

PENpoints

Proposed EU legislation will impose significant regulation on managers of alternative investment funds, such as private equity and hedge funds, operating and marketing within the EU.

The regulatory fallout from the global financial crisis continues with private fund managers being targeted for greater regulation in the European Union. On April 30, 2009, the EU Commission published a proposed Directive that would subject alternative investment fund managers, including private equity and hedge fund managers, operating and marketing in the EU to extensive regulation.

Covered Managers

Firms that manage alternative investment funds in or from the EU would be required to obtain authorization from the financial services regulator in the jurisdiction in which the firm is established if total assets under management exceed €100 million or, if the fund is not leveraged and investors are subject to a five-year lock-up, €500 million. Private equity funds are generally expected to be subject to the higher threshold. The Directive would not apply to alternative investment fund managers with total assets under management below these thresholds.

Regulatory Authorization

To obtain authorization, firms would be required to provide the regulator with detailed information about their operations and the funds managed. Once authorized, firms would be required to:

- Comply with conduct of business rules, including requirements relating to conflicts of interest and risk management;
- Obtain an independent valuation of portfolio company investments and fund interests at least annually;
- Appoint an independent EU custodian to hold the fund's assets; and
- Maintain "regulatory capital" of at least €125,000 plus 0.02% of the amount (if any) by which the aggregate portfolio value of all funds managed exceeds €250 million.

Enhanced Disclosure Obligations

Authorized firms would be required to disclose more information to the regulator than currently required, including copies of fund documents. Private equity firms would become subject to mandatory portfolio company transparency and disclosure rules requiring firms to disclose key information on the acquisition of a 30% stake in a portfolio company by the fund, followed by annual disclosure of information about the portfolio company's financials, capital structure and certain employee matters.

Marketing to EU Investors

Once authorized, a private fund manager would be permitted to market EU-domiciled funds to institutional investors across the EU. However, firms would be required to submit fund documents to the regulator for approval in advance of marketing, and the regulator would have the right to impose restrictions or conditions on marketing activity. Authorized firms would also be permitted to market non-EU domiciled funds, provided that the fund's jurisdiction of domicile has entered into a tax information sharing agreement with the relevant EU member state.

Non-EU fund managers would be permitted to market funds to EU-based investors only if the firm has obtained marketing authorization from and submitted fund documents to an EU regulator, and a non-EU firm would be eligible for such authorization only if the firm is subject to domestic regulation that imposes requirements equivalent to those imposed by the Directive.

Interaction with U.S. Regulation

Many U.S. private fund managers have offices in EU member states and offer private fund interests to investors in the EU. Based on recent legislative initiatives and announcements by the U.S. Department of Treasury,[1] additional regulation of large private fund managers is expected to require investment adviser registration with the U.S. Securities and Exchange Commission.[2] How dual EU and U.S. regulations would apply to private fund managers operating on a global basis will be of great interest to many fund managers given that the EU proposed rules may differ from current U.S. investment adviser regulation.

Next Steps

The draft EU Directive must now be debated and agreed upon by both the European Parliament and the Council (in effect, the governments of each EU member state), each of which may make changes to the draft or, although unlikely, even block the legislation entirely. Unless the EU Commission withdraws its support for the proposal, no member state would be able to block the legislation unilaterally.

Once political agreement has been reached, member states would likely have 18 months to implement the Directive, so the new regime could become effective during 2011, with an additional three-year transition period for the provisions relating to non-EU funds to allow time for discussion with non-EU regulators.

Industry associations, such as the British Private Equity and Venture Capital Association (BVCA) and the European Private Equity and Venture Capital Association (EVCA), are currently lobbying the EU Commission, national governments and Members of the European Parliament (MEPs), highlighting those aspects of the Directive that could cause material damage to the private equity industry, consequently limiting its ability to provide companies with much-needed capital in the current financial climate. At the same time, some MEPs are calling for even more stringent regulation. The final form of the legislation will depend upon which view prevails.

1 On March 26, 2009, the U.S. Department of Treasury issued its broad Framework for Financial Industry Reform, including the private fund manager investment adviser registration requirement for large private fund managers and other requirements, such as greater reporting/transparency and systemic risk regulation and reporting. Legislative and regulatory proposals have not yet been issued pursuant to this framework.

2 See *KirklandPEN*, “Financial Services Reform Begins: Proposed Registration of Private Funds and Their Advisers” (February 2009).

If you have any questions about the matters addressed in this *KirklandPEN* article, please contact the following Kirkland authors or your regular Kirkland contact.

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PENnotes

"What's It All About, TALFie?"
Chicago, Illinois
New York, New York *(teleconference)*
Los Angeles, California *(teleconference)*
San Francisco, California *(teleconference)*
May 19, 2009

Wondering what the Term Asset-Backed Securities Loan Facility is all about? Join us at this Kirkland seminar, held in our new Chicago office, with teleconferencing to New York, Los Angeles and San Francisco, to learn about TALF and how to make it work for you from Kirkland partner Kenneth P. Morrison, other Kirkland securitization, tax and investment management attorneys, and professionals from Barclays Capital and RBS Global Banking & Markets. Topics to be discussed include an overview of the TALF program, a discussion of the process and impact of TALF and breakout sessions on special issues regarding TALF for investors, including private equity and hedge funds, and sponsors and issuers. For more information, please visit www.kirkland.com/files/TALF_Seminar.htm.

Secondary Private Equity: A Growing Source of Returns and Liquidity in the Private Equity Ecosystem
New York, New York
May 19, 2009

Secondary private equity has traditionally been a small sector of the private equity marketplace, yet due to the current economic crisis, it is taking center stage as a solution to some of the problems faced by asset managers. At this event, sponsored by Columbia Business School's Alumni Club of New York, and hosted by Kirkland's New York office, panelists will discuss how secondary private equity aids asset managers and investors and what impact the current environment has on this asset class now and in the future. Kirkland partner Michael D. Belsley will participate in this seminar.

U.S. Real Estate Opportunity and Private Fund Investing Forum
New York, New York
June 11-12, 2009

The 10th annual Real Estate Opportunity and Private Fund Investing Forum will provide professionals in this industry with the chance to discuss the opportunities that distressed real estate and frozen capital markets have created as well as effectively managing troubled legacy assets. Kirkland partner Stephen Tomlinson will chair a session on the future of the real estate fund industry, partner Robert Buday will participate in a panel discussing infrastructure investments and partner Nat Marrs will participate in a panel on distressed debt funds.

Private Equity Tax Practices 2009
Boston, Massachusetts
June 15-17, 2009

Kirkland partner Michael D. Belsley will speak on "Tax Considerations for Secondaries" at the 8th annual Private Equity Tax Practices seminar. More than 50 tax and legal experts will discuss how to ensure tax, legal and regulatory compliance in a fast-changing private equity landscape.

Private Equity Forum 2009
New York, New York
July 13-14, 2009

A distinguished panel of experts at the 10th annual Private Equity Forum 2009 will cover key topics such as structuring private equity investments and private equity funds, dealing with fund sponsor issues, current regulatory, legislative and tax issues and how private equity funds are addressing issues raised by the current environment, including fund and investor liquidity issues. Kirkland partner Mark Mifsud will speak on EU regulatory developments in a panel titled "Implications of the New Regulatory Environment."

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Private Equity Practice at Kirkland & Ellis

Kirkland & Ellis LLP's private equity attorneys handle leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 200 private equity firms in every major market around the world.

Kirkland has been widely recognized for its preeminent private equity practice. In 2009, Kirkland received the awards for Best Law Firm (Private Equity Deals) and Best Law Firm (Fund Formation) in North America from *Private Equity International.* In 2008, Mergermarket ranked Kirkland first by volume for Global and North American Buyouts in its "League Tables of Legal Advisers to Global M&A for Full Year 2007." Also in 2008, Kirkland received prestigious first-tier rankings in both private equity and fund formation from Chambers & Partners.

The Lawyer magazine recently recognized Kirkland as one of the firms in "The Transatlantic Elite," noting that the firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent." In addition, Kirkland's London office was recently named the 2008 "Banking Team of the Year" at the Dow Jones Private Equity News Awards for Excellence in Advisory Services.

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