

Regulation of Private Equity Firms: E.U. and U.S. Developments

E.U. Alternative Investment Fund Managers (AIFM) Directive

Positive developments: a decision on the E.U. AIFM Directive has been postponed pending further negotiations, and new U.S. proposals may now exempt private equity firms from SEC registration.

There has been a flurry of activity over the last few weeks, with the Spanish government (which currently holds the E.U. presidency) producing numerous revised versions of the proposed legislation in an attempt to reach inter-governmental agreement.

It was thought that the revised legislation would be put to the vote at a meeting of E.U. finance ministers taking place yesterday. However, the vote has now been postponed, indicating that there is still significant political disagreement.

Depositary and valuation requirements are still causing difficulties, but the issue that remains at the top of the agenda is how to deal with funds managed by non-E.U. fund managers, and by U.S. fund managers in particular.

The latest deal on the table would have allowed non-E.U. fund managers to continue marketing to institutional investors within the E.U. under the private placement regime in each country, but on the condition that such firms comply with the Directive's new transparency and disclosure rules in the same way as an E.U.-based fund manager. These new requirements would include:

- producing a Directive-compliant annual report for each fund with E.U. investors (primarily financial information and remuneration disclosures);
- providing Directive-compliant information to investors, which would require additional disclosures in PPMs;
- providing certain prescribed information to the national regulator in each jurisdiction in which the fund is marketed; and
- disclosure and reporting requirements in relation to majority-owned European portfolio companies.

However, it is now clear that this proposal is not agreed and further changes are likely. In the meantime, the European Parliament continues to debate the Directive, so the next key development is expected to be the publication of the Parliamentary committee's final report.

It is still anticipated that there will be a two-year implementation period after the Directive is agreed at E.U. level, so any new rules are highly unlikely to come into force before mid-2012.

U.S. Investment Advisers Act Registration

There have also been developments in the U.S. on proposed rules that would require private equity fund managers to register with the U.S. Securities and Exchange Commission (SEC).

In a significant change from the legislation passed by the House of Representatives before Christmas (the "House Bill"), the Senate's financial services regulatory reform proposals, published on Monday, would exempt private equity fund managers and venture capital fund managers from the requirement to register with the SEC. It is not yet clear which firms will qualify as "private equity fund" managers or "venture capital fund" managers; the SEC will have six months after the legislation is passed in which to publish a definition.

For non-U.S. fund managers who fall outside this new exemption, registration would still be required, unless the firm has:

- no place of business in the U.S.;
- fewer than 15 clients domiciled or resident in the U.S.; and
- assets under management (AUM) attributable to clients resident or domiciled in the U.S. of less than \$25 million (or such higher amount as defined by SEC).

It is possible that these Senate requirements will be more favourable to non-U.S. fund managers than those in the House Bill. Under the House Bill, the tests would apply on a look-through basis, so if a non-U.S. fund has \$25 million or more of commitments from U.S. investors, the exemption would not be available. Under the Senate proposals, “client” has not been defined for the purposes of the exemption but generally would mean the fund vehicle itself, so if a firm does not manage or advise any funds domiciled in the U.S., it would be wholly exempt.

However, the Senate proposal now goes to a committee hearing, and it is possible that substantial changes will be made during the committee process. If the final version of the Senate legislation is significantly different from the House Bill, a compromise committee will be appointed to reconcile the differences before the legislation is sent to the President for final approval. So—as in the E.U.—the outcome remains uncertain.

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