



## FINANCIAL SERVICES ALERT

26 October 2009

### The FSA Commissioned AIFD Impact Assessment

The European Commission published its proposed Alternative Investment Fund Managers Directive ("Directive") on 29 April 2009.

Since then there has been significant pressure on the Commission to modify the Directive as it could put thousands of jobs in the European financial services industry under threat and slow down economic recovery. Sources in Brussels indicate the European Commission are currently working in association with the Swedish government to modify the proposal.

Following publication of the original proposal the FSA commissioned Charles Rivers Associates to collect evidence and publish a report (the "CRA Report") analysing the impact of the proposed Directive across Europe. This was published on 15 October 2009. One concern that was highlighted by the report was the substantial one-off compliance costs estimated to total up to €3.2 billion on fund managers.

### Summary of Findings

- If funds do not re-domicile, the Directive will greatly reduce the availability of Alternative Investment Funds ("AIF") to EU investors.
- Availability of hedge funds shrink by 40% and Private Equity by 35%.
- Substantial one-off compliance costs of €3.2 billion and ongoing costs of €311 million which will be passed on to investors, ultimately resulting in lower returns.
- Hedge funds would bear the brunt of the costs shouldering €1.4 billion.
- There is little evidence to say that funding provided by private equity through buyouts would be drastically reduced by the implementation of the Directive. However, this is not the case for venture capital funds because local knowledge is more important for start-ups than buy-outs. This is a real concern as start-ups are important to economic growth.

### Conclusion

Prior to the CRA Report there had been no empirical research undertaken on the impact of the Directive, therefore the Report is very helpful. It is clear from the Report that the Directive will have significant impacts in terms of reduced investor choice and substantial compliance costs for the AIF industry.

AIF contain a wide variety of financial instruments, bringing different benefits to investors, using different business models and representing different regulatory challenges. The CRA Report concludes that although the Directive attempts to address particular concerns arising from some types of funds, the universal application of one set of rules on such different types of fund results in compliance costs which are significant. The Directive will cause a fundamental re-organisation in the business model of global fund managers (with significant one-off costs) and may lead to costly changes of legal structures and domicile. It also brings associated costs to valuers and depositaries which do not seem to be matched with benefits for at least some of the fund types considered.

It is likely, however, that the CRA Report will not lead to the abandonment of the Directive. Instead it is likely to lead to amendments designed to reduce some of the most negative impacts of the original proposal. In particular, there is likely to be more focus on different requirements for different types of AIF and, one would hope, a greater focus on limiting the impact on venture capital.

The media are reporting that the Swedish presidency has developed a new draft of the proposed Directive

and are currently circulating it to the members of the capital council working group. Initial indications are that, while this draft is an improvement, it does not deal adequately with the impact of the proposal on private equity and venture capital.

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