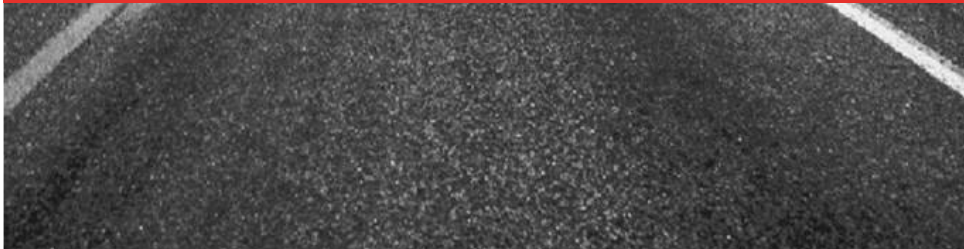




EU and US proposals from the Asian perspective

For Hong Kong Venture Capital and Private
Equity Association

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Overview

- Background and Rationale for Regulation: how did we get to this?
- Update on US Regulatory Proposals
- The draft EU Directive on Alternative Investment Fund Managers
- What might it mean for Hong Kong?

Background and Rationale for Regulation

- G20 (2nd April 09) Summit critical starting point
 - Financial Stability Board (FSB)
 - Systemic Risk – “all systemically important financial institutions, markets and instruments should be subject to an appropriate degree of regulation and oversight”
 - Banks, Hedge Funds, Credit Rating Agencies
 - Accounting
 - Executive pay
 - Credit Derivatives

Focus of G20 was on “Systemic Risk”

- Impact - G20

“Strengthened regulation and supervision must promote propriety, integrity and transparency; guard against risk across the financial system; dampen rather than amplify the financial and economic cycle; reduce reliance on inappropriately risky sources of financing; and discourage excessive risk-taking.”

The Global Plan for Recovery and Reform, 2 April 2009
Paragraph 14

Indeed, was it not principally a banking led crisis?

- *“It should be noted . . . that the recent financial crisis is not actually a ‘hedge fund crisis’. Hedge funds have been affected by the crisis, like many other financial market players . . .”* IOSCO – Hedge Fund Oversight Paper
- Even the EU say in explanatory memo to proposed EU Directive *“. . . private equity funds, due to their investment strategies and a different use of leverage than hedge funds, did not contribute to increase macro-prudential risks.”*
- But the net has been widely cast: and regulators have linked “systemic” with financial institutions whose activities have become “bank-like”, i.e., Turner Report

Even before the credit crunch and financial melt down

- UK Walker Report 2007: voluntary initiative by BVCA
 - Voluntary guidelines on a comply-or-explain basis
- At EU level: the Rasmussen Report March 2008
 - EU level supervisory body
 - Euro wide system of registration and approval for asset management and fund management companies
 - debt limit for capital investment funds
- And locally, the SFC was proposing a review of scope of licensing for local PE managers and advisers

What has emerged at EU level – much industry criticism

- *“the draft directive has not been discussed with key interested parties nor is it consistent with the analysis and recommendations of the Commission’s own experts – as outlined in the well received De Larosiere Report. The Directive also ignores the efforts already underway to develop global proposals such as those taking place under the G 20 process”*

Hedge Fund Standards Board – 29 April 2009

“There is no rationale for the Commission to intervene against private equity. Yet, if this directive were to become law, it would have a dramatic and damaging impact on the industry”

Chief executive of BVCA – FT 29 April 2009

US Proposals: Both US Treasury and sponsored Bills

- Change is proposed by Treasury (i) at regulatory structural level (ii) specifically in relation to “hedge funds and other private pools of capital” and (iii) regarding “systemically significant financial firms”
- All **advisers** to hedge funds (and other private pools of capital, including **private equity and venture capital funds**) whose assets exceed some modest threshold should be required to register with the SEC under the Investment Advisers Act
- Objective, to assess potential systemic implications and promote investor protection
- Once registered, would be required to, amongst other things, comply with disclosure (to investors, creditors and counterparties)

But not just registration: further implications for large PE houses

- Fed and Treasury to develop special rules for any “systemically significant financial firm” – (a “Tier 1 FHC”)
 - inter-dependence, size, leverage, reliance on short-term funding
 - both US and non-US firms based on whether their US operations pose a threat to financial stability
 - could be applied to worldwide operations (including Asia)
- Not just banks or bank holding companies: under the proposal, those Tier 1 FHC that have no banking operations would be subject to same rules as Tier 1 FHCs that have banking operations
- PE firm designated as a Tier 1 FHC would face imposition of prudential banking regulator standards: higher capital, liquidity and risk management rules

Other bills before Congress

- Hedge Fund Advisors Registration Act (Jan 2009)
 - remove the exemption from SEC registration for investment adviser with fewer than 15 US clients (that is “direct” clients, i.e., fund entities) in any 12-month period
 - advisers to any types of funds
 - would require non-US based advisers to register where they have US investors
- Last week: New – Private Fund Transparency Act
 - may provide some exemption for non-US advisers if less than 15 US clients and less than US\$25 million of assets “attributable to clients in the US”
- Grassley/Levin Bill – would have required funds themselves to register: but unlikely to proceed

EU Directive - Scope

- EU Directive on Alternative Investment Fund Managers published 29 April 2009
 - Applies all non-UCITs managers in EU
 - Including private equity managers – and managers of real estate, infrastructure commodity funds and, of course, hedge funds
- Subject to *de minimus* exemption where AUM is less than
 - 100 million Euro (US\$130M)
 - 500 million Euro (US\$660M) for unleveraged fund with 5-year lock up
- In force 2011

EU Directive – Scope and Requirements

- “Management Services” conducted in EU requires authorization and on-going supervision irrelevant of the fund’s location
- Authorization requires
 - Minimal capital requirement
 - Detailed disclosure of information to regulators and investors
 - EU approved depository for EU managed fund
 - relevant to assets of a private equity fund?
 - Appoint independent valuer and auditor
 - Annual valuation of fund assets in accordance with relevant member state
 - query the need for private equity funds?

EU Directive - Controlling influence in Companies

- Where fund managed by authorized EU manager takes more than 30% of voting in certain non-listed companies:
 - notification and disclosure to target company its shareholders, and target employee representatives
 - not later than 4 trading days after the fund can exercise voting rights
 - disclose of identity of fund, development plan for the company and policy for preventing and managing conflicts of interest
- Impact on competitive position of PE houses?

EU Directive - Delegation

- Delegation and outsourcing requirements are strict
 - prior approval from regulator to delegate portfolio management
 - only to other authorized Manager managing fund of same type
- Delegation to third country managers
 - not addressed but implication is that this will not be possible as current draft stands
- Pure advisory activities may not be included
 - so could delegate pure advisory functions

EU Directive - Marketing

- Situation 1: Manager established and authorized in EU member state
 - Granted passport to market to Professional Investors in other members states BUT if fund established outside EU (i.e., Cayman)
 - that offshore jurisdiction must have agreement with the relevant EU country on sharing tax information (based on OECD model)
 - passport to market offshore funds only available for period of 3 years after directive comes into force

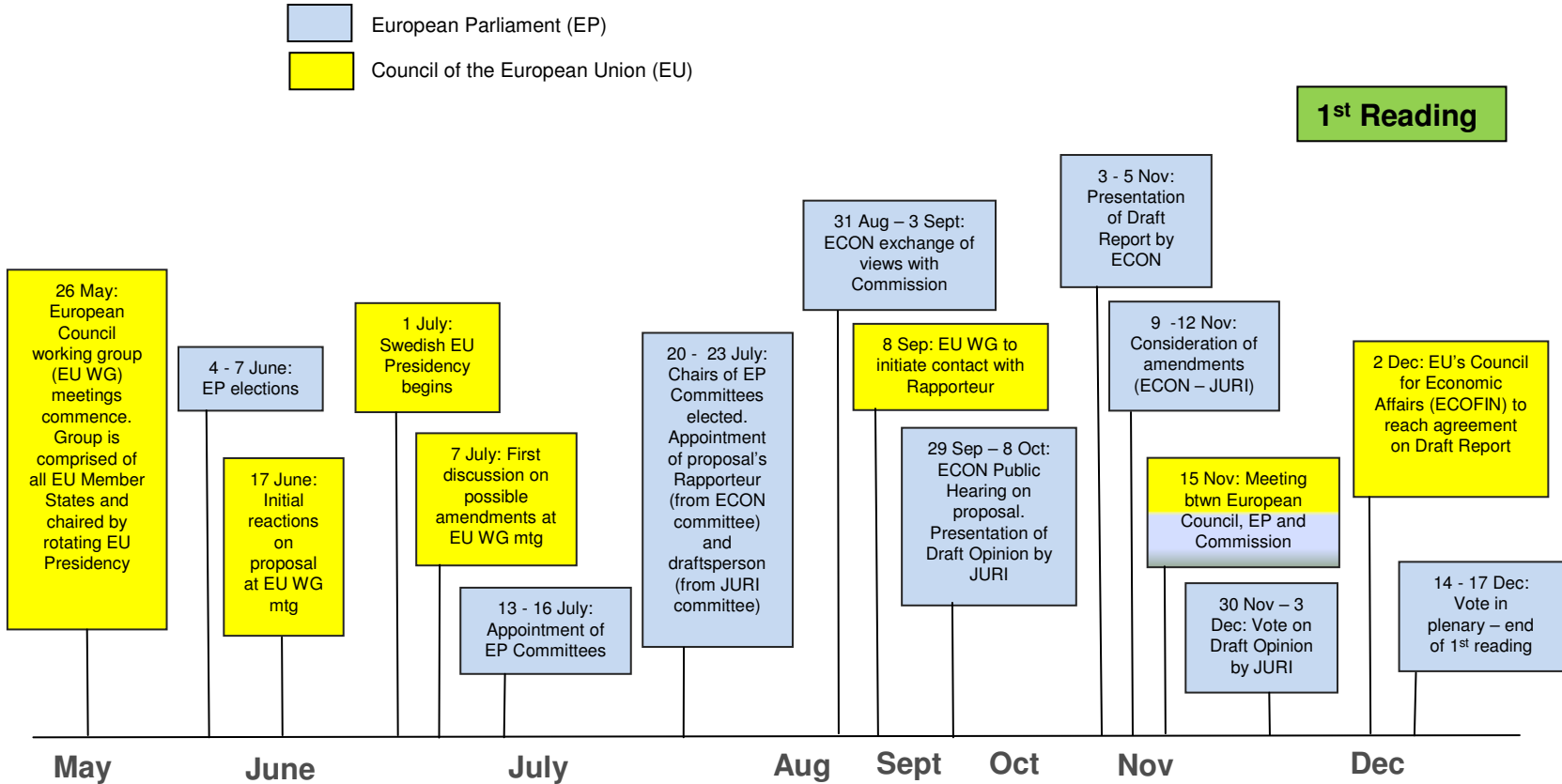
EU Directive - Marketing

- Situation 2: Non-EU Manager, i.e., Asian manager wishing to market offshore (i.e., Cayman) fund in EU
 - Asian manager would need to apply for authorization for marketing fund in relevant member state (compliance requirements)
 - Offshore jurisdiction where fund established must have tax sharing agreement
 - Non-EU country in which manager is established must have equivalent prudential regulation and on-going supervision which is effectively enforced
 - Managers in EU must be granted comparable market access
 - Again, to come into force 3 years after directive

EU Directive

- Funds may migrate and be pushed to fund domiciles which are not perceived as ‘tax havens’
 - OECD List
- “White”
 - Substantial implementation of the internationally agreed tax standards
 - Including mostly OECD and G20 members including Hong Kong
- “Grey”
 - Commitment but not yet substantial implementation
 - Including Luxembourg, Switzerland, Singapore, Cayman and the BVI
- “Black”
 - No commitment
 - Only Costa Rica, Malaysia (Labuan), Philippines and Uruguay

EU Directive – draft timeline



Note: This slide assumes that the AIFM proposal will be officially allocated to a Rapporteur in w/o 20 July. It is very likely that it could be allocated in September in which case the timing stipulated above will differ, although the overall process will remain the same.

Source: AIMA Hong Kong

For Asian based PE Advisers and Managers

- US proposals likely to impact “systemically significant financial firms” but there are potential extra territorial implications
- Adviser registration with SEC looks likely even for non-US based advisers with US investors in the funds they advise
- EU proposals could have significant impact on ability of European funds and managers to delegate to Asian sub-managers
- Could also severely restrict ability to market to European investors

From Hong Kong regulatory perspective

- SFC is intimately involved in global regulatory developments (i.e., IOSCO/short selling) and has had significant local regulatory pressure (i.e., Lehman mini bonds)
- But from EU perspective not keyed in to main debate: a “Third Country” from perspective of the draft Directive
- Key issue will be Hong Kong having equivalent prudential regulation and on-going supervision

From Hong Kong regulatory perspective

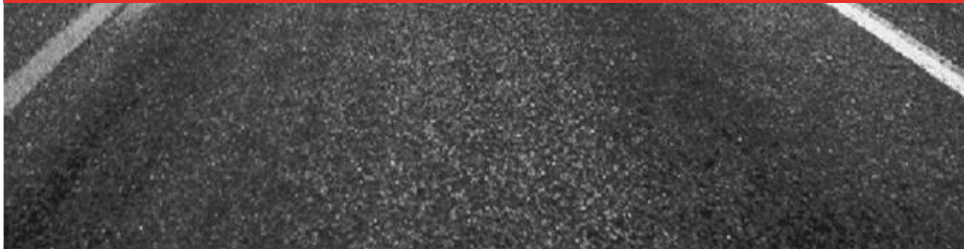
- Extension of the Hong Kong Regulatory Net
 - Refined interpretation of Type 1 (dealing in securities) regulated activity ?
 - Impact on use of Type 4 (advising on securities) “intra group exemption” or Type 4 licensee?
 - Type 9 (asset management) license
- Amendment to (narrow) “professional investor” definition
- Requests from SFC for more detailed information on an on-going basis - see recent hedge fund survey?



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