Hedge funds and private equity

2007/2238(INL) - 23/09/2008 - Text adopted by Parliament, single reading

The European Parliament adopted by 562 votes to 86, with 25 abstentions, a resolution with recommendations to the Commission on Hedge funds and private equity.

The own initiative report had been tabled for consideration in plenary by Poul Nyrup **RASMUSSEN** (PES, DK) on behalf of the Committee on Economic and Monetary Affairs.

Stressing the need to ensure the consistent implementation and application of the regulation on financial markets, the Parliament calls on the Commission to submit, by the end of 2008, a legislative proposal or proposals covering all relevant actors and financial market participants, including hedge funds and private equity, responding to the following seven principles:

1. existing Community legislation should be reviewed to identify any regulatory gaps, national variations should be reviewed and harmonisation should be promoted;
2. capital requirements should be mandatory for all financial institutions and should reflect risk from the type of business, exposures and risk control;
3. to achieve a better alignment of the interests of investors and originators, originators should generally retain exposure to their securitised products by holding a representative stake in the product; disclosure should be made of the level of the stakes originators keep in loan products;
4. a smoothing technique to counter the pro-cyclical effects of fair value accounting should be considered.
5. Credit Rating Agencies should adopt codes of conduct regarding visibility of assumptions, product complexity and business practices; conflict of interest should be managed and unsolicited rating should be independently categorised and not used as a means of pressure to obtain business;
6. open and visible trading of derivatives should be promoted whether on-exchange or otherwise;
7. reward packages should be aligned with longer term outcomes, reflecting losses as well as profits.

MEPs ask that these proposals be implemented in accordance with the following principals:

Recommendation 1 on financial stability, capital and universal regulatory coverage:

- investment firms including partnerships and limited partnerships, insurance companies, credit institutions, conventional funds (such as UCITS and pension arrangements) should be required to comply with capital requirements;
- the Commission's proposal(s) concerning capital requirements should require that originators hold portions of securitised loans on their balance sheets, or provide other means to align the interests of investors and originators;
- the Commission should establish a mechanism for EU review of Credit Rating Agencies, procedures and compliance, with duties allocated to existing bodies such as the Committee of European Securities Regulators (CESR);
- the Commission should adopt principle-based legislative measures on the valuation of illiquid financial instruments in order better to protect investors and the stability of financial markets;
- the transparency requirements applicable to any institution providing prime brokerage services should be increased in line with the complexity and opacity of the structure or nature of the exposures to which their dealings with all products and actors, including hedge funds and private equity, expose them;

- the Commission should propose legislation to provide a harmonised EU-wide framework for venture capital, and particularly so as to ensure cross-border access to such capital for the SME sector.

Recommendation 2 on transparency measures:

- the Commission should submit a legislative proposal for the establishment of a European private placement regime allowing for cross-border distribution of investment products, including alternative investment vehicles, to eligible groups of sophisticated investors;
- the Commission should, in cooperation with supervisory authorities, devise rules to ensure clear disclosure and communication of relevant and material information to investors;
- the Commission should ensure that Directive 2001/23/EC always grants the same rights to employees, including the right to be informed and consulted, whenever control of the undertaking or business concerned is transferred by any investors, including private equity and hedge funds;
- an increasing number of pension funds and insurance companies have holdings in hedge funds and private equity. The Commission should therefore ensure that employees or staff representatives are informed about the way in which their pensions are invested and the associated risks.

Recommendation 3 on excessive debt measures:

- the Commission should, while reviewing Directive 77/91/EEC on capital, ensure that any amendments adhere to the following fundamental principles: (i) there is capital held according to risk; (ii) there is a reasonable expectation that the level of leverage is sustainable both for the private equity fund/firm and for the target company; and (iii) that there is no unfair discrimination against specific private investors or between different investment funds or vehicles that use similar strategy;
- in terms of **capital depletion**, the Commission should propose harmonised supplementary measures at EU level in order to avoid unreasonable asset stripping in target companies.

Recommendation 4 on conflicts of interest measures:

- Credit Rating Agencies should be required to increase information and eliminate or mitigate asymmetric information and uncertainty and disclose the conflicts of interest under which they operate without destroying the transaction oriented financial system. In particular, they should be required to separate their rating business from any other services (such as advice on structuring transactions) that they provide in respect of any obligations or entities that they rate;
- the Commission should launch a general review of the effects of market concentration and of the effects of dominant players in the financial services industry.

Recommendation 5 on existing financial services legislation: the Commission should undertake an examination of all existing Community legislation relevant to financial markets and, based on the results of such examination, submit a legislative proposal or proposals amending the existing directives, where necessary.