British Private Equity & Venture Capital Association

KING'S College LONDON

A Report on Lessons Learnt From the Negotiation of the Alternative Investment Fund Managers' Directive

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Report on the Negotiation of the Alternative Investment Fund Managers Directive (AIFMD)

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Introduction

The European Union policy making process plays an increasingly important role in defining the rules and regulations which affect the UK's private equity and venture capital industries. At the same time, the reach of the institutions and the balance of power through which decisions are made has changed markedly over recent years, in large part owing to the financial crisis. This has arguably led to decisions to regulate sectors or activities which were previously left to the discretion of individual member states. Despite this there remains across industry a low level of understanding of the EU institutions, the means through which they develop policy, and the methods through which policy development can be influenced.

Constructive engagement at the European level is vital to ensure that policy makers are able to access the necessary informational resources and technical expertise required to design appropriate regulation. For the UK private equity and venture capital industry, the ability to engage effectively in the EU policy process is of particular importance, as recent years have seen a significant increase in both the direct and indirect regulation of the sector from Europe. In particular, the Alternative Investment Fund Managers (AIFM) Directive now directly regulates the entire sector on a European scale. It is therefore vital that both industry and regulators acquire a clear understanding of the nature of the policy process that led to the AIFM Directive, and learn the lessons as to how the UK could have engaged more effectively in the design and development of the legislation. This is intended to inform and strengthen the ability of the UK's financial services sector to interact with future EU regulatory initiatives.

The study was led by Dr Scott James at King's College London and kindly supported by the BVCA. It is based on a series of private interviews conducted between December 2013 and August 2014 with twelve practitioners with first-hand knowledge and experience of the AIFMD process, including members of private equity firms, industry representatives, and regulators at the UK and EU levels. The interviews were conducted on a non-attributable basis and the author is indebted to them for their time, assistance and invaluable insights.

The final report presented here is divided into four sections. Section 1 provides an overview of the negotiation of the AIFMD and the political dynamics driving and steering the process. Section 2 analyses the response of industry and regulators in detail, assessing the strengths and weaknesses of their policy engagement strategy. Section 3 concludes with the six principal lessons learned from the process. Finally, the appendix in section 4 includes a summary of the EU ordinary legislative procedure through which Level 1 financial regulation is adopted.

Executive Summary

1. The Level 1 Directive

- Prior to the financial crisis responsibility for regulating the AIFM industry lay with national regulators. During 2008 Charlie McCreevy, the Internal Market Commission, assured the AIFM industry that it would not be regulated by the EU.

- In order to secure French, German and Socialist support for his reappointment as Commission President, Manuel Barroso intervened during 2009 to push for a draft directive to regulate AIFM.

- The draft was rushed out without the usual preparatory work and sought to create a single harmonised regulation covering all alternative investment funds. Although the early EU passport proposal was welcomed by industry, last minute amendments imposed stringent requirements on third country access, disclosure, leverage and depositary banks.

- The influence of France and Germany in the design of the draft proposal reflects the confluence of domestic politics, geopolitical strategy and economic interests.

- Two factors helped to pave the way for compromise on a Level 1 text: the Socialists suffered heavy electoral losses in the June 2009 Parliament elections; and US intervention was critical in breaking the deadlock on third country access.

2. Industry engagement

- Regulators and industry were caught off guard by AIFMD owing to a lack of awareness about the Commission's intentions and insufficient awareness of the political dynamics in the Council and Parliament.

- Industry engagement was hampered by two factors: poor organisation of collective lobbying at the European level which it had hitherto done before; and the broad scope of the directive meant that diverse sectors of industry were impacted with little or no experience of cross-sectoral coordination.

- The BVCA were amongst the directive's most outspoken critics, but this masked the fact that the industry's initial response was chaotic. There was little coherent strategy in terms of what the UK wanted to achieve and naivety that the new Commission would lose interest. This contributed to a duplication of resources, over-lobbying and the antagonism of EU officials.

- However the strategic decision to seek clear blue water between private equity/venture capital and the hedge fund industry facilitated the projection of its central message that the imposition of a one-size-fits-all solution would be highly damaging.

3. Regulator engagement

- UK ministers engaged actively in defending AIFM, and industry had good access to both the Labour and Conservative-led governments. The lobbying effort by the City of London and Mayor was particularly effective in targeting the US administration.

- However the influence of ministers in Brussels was curtailed by the level of public hostility towards financial services generally, particularly in the run up to the 2010 general election. The UK's influence in the European Parliament was also severely weakened by the withdrawal of Conservative MEPs from the European People's Party following the June 2009 election.

- At official level the industry's early engagement was characterised by mutual recrimination at the failure to anticipate the nature of political developments, perceived government inaction, and unrealistic expectations of what UK negotiators could achieve.

- The Treasury's initial response was weakened by its limited institutional knowledge of the sector, high turnover of staff and delegation to relatively junior officials which prevented it from formulating clear aims and objectives.

- The FSA was better resourced, better organised and better able to deal with their EU counterparts, but its influence and effectiveness waned over time, hampered by a brain drain of talent in anticipation of being broken up.

4. The Level 2 Regulation

Industry faced four main challenges in trying to shape the Level 2 process:

- **Complacency:** Many assumed that the ambiguity in the level 1 text provided an opportunity to further water down the legislation. But it also provided scope for divergent national interpretations and was used as a pretext by some regulators to reopen negotiations.

- **National differences:** Some working groups were chaired by countries with no significant private equity sector and so their regulatory knowledge was limited. By default national regulators also looked to their home legislation in drafting proposals, which was often inappropriate.

- **Inter-institutional dynamics:** The UK failed to recognise that the Commission had a clear sense of what the Level 2 regulation should look like. The Commission remained under pressure from Parliament to act and ESMA lacked authority as a new institution, and so much of its initial advice was disregarded.

- **Implementation:** The Treasury was slow to respond to the Level 2 Regulation, resulting in a very narrow timetable for industry consultation over implementation.

5. Lessons

Six principal lessons emerge for UK government and industry:

- **Investment in EU engagement** requires a permanent presence at the EU level to anticipate and respond to events; alliance building with counterparts from other EU member states; and engaging regulators and industry from the US and emerging economies.

- **Shape the agenda before others do:** industry/regulators should be prompt and assertive in defining their regulatory aims and objectives at the pre-proposal stage, and enhance capacity to anticipate new EU-level initiatives by monitoring developments and sharing intelligence.

- **Recognise that power has shifted:** the UK needs to respond to a post-financial crisis context in which the role of Parliament is increasingly pivotal and recognise the Commission as a potential ally which frequently needs strengthening in the face of political pressure from MEPs.

- **Trust is vital in an iterative game:** the most effective engagement is that which seeks to inform and help EU regulators when they are making technical mistakes, rather than seeking to persuade them that they are politically misguided.

- **Know your audience:** arguments have to be positive but forensic in detail, tailored to particular target audiences and which address their particular concerns.

- **Be the voice of reason:** UK regulators/industry should recognise that in a sector with limited political capital, their most powerful weapons are reason and logic. They should aim to engage positively to draw the politics out of financial regulation.

Section 1. The Negotiation of AIFMD

1.1 Pre-crisis

Agreement on the AIFM Directive was reached in November 2010 and marked the EU's earliest legislative response to the financial crisis. The directive was framed by the European Commission and European Parliament, allied with the French and German governments, as an essential response to the financial crisis necessitating the regulation of those parts of the sector that had hitherto escaped EU attention. The target included disparate organisations from the private equity, venture capital and hedge fund industries, grouped together by the EU as the 'alternative investment fund management' (AIFM) industry.[1]

Prior to the financial crisis responsibility for regulating the AIFM industry lay with national regulators. The EU had showed little interest in an industry of which its knowledge was limited. The EU's Financial Services Action Plan had produced two initiatives which did impact on aspects of the industry: the revision of the Directive for Undertakings for Collective Investment in Transferable Securities (UCITS); and a new directive on investor protection in 2004, the Markets for Financial Instruments Directive (MiFID). In 2005 the Commission initiated a debate on AIFM regulation with the publication of a Green Paper which aimed to strengthen the EU framework for investment funds (Commission 2005). This led to an institutionalised dialogue with industry through the establishment of an Expert Group to explore regulatory proposals designed to promote the cross-border development of the investment fund industry (Commission 2005, p.9). The White Paper which followed aimed at the removal of marketing and sales restrictions of hedge funds' products and the removal of national barriers to 'private placement' of financial instruments with institutional investors and eligible counterparties (Commission 2006, pp 13-4). The initiative fitted with the Commission's broader objective of facilitating the integration of the financial services industry across Europe through the development of 'market-making' legislation (Quaglia 2010).

The Commission's preferences at this time were closely aligned with those of the US and UK whom favoured indirect regulation. By contrast, support for direct regulation was growing in France and Germany. In both countries the deregulation of financial services undertaken during the 1990s and early 2000s fuelled a political debate about the risks associated with open capital markets. In France, discussions most notably focused on the issue of a Tobin tax, which was to be levied on financial transactions. In Germany, the role of a British company in a battle to take over Deutsch Börse and the London Stock Exchange prompted the leader of the Social Democratic Party, Franz Müntefering, to refer to private equity as 'locusts'. The industry was also roundly criticised by German politicians in the mid-2000s after cutting thousands of jobs at Gröhe, a German tap maker (Buckley and Howarth 2011). With French backing, the newly elected Chancellor, Angela Merkel, vowed to push for a tighter regulatory regime for hedge funds and made this a central issue of the G8 summit Germany chaired in 2007 in Heiligendamm. At the summit Germany called for greater transparency and oversight of hedge funds through mandatory registration in a global database and a greater supervisory role for the FSF. The US and UK were however only willing to support unbinding declarations of intention, while the Commission also recorded its opposition to increased regulation. A compromise was agreed to strengthen existing 'indirect supervisory approach', publicly endorsed by all EU leaders in 2007 (Ecofin 2007). Soon after Merkel signalled a shift of strategy, pledging to renew her push for EU regulation in the belief that agreement would strengthen Europe's position at the international level (Zimmerman 2010, p.128).

[1] Section one refers collectively to the 'AIFM' industry, reflecting the EU's prevailing narrative which sought to aggregate a range of different financial entities. In section two however the report explores the industry perspective and examines the important differences that existed between the firms in this sector.

The US and UK governments had until that point been able to resist the demands for stricter regulation. But there were already warning signs that their capacity to do so was declining. In the US the convulsions in the financial markets that followed the bankruptcy of Lehman Brothers in 2008 caused the attention of Congress to shift towards the regulation of AIFM. In the months that followed leading US hedge fund managers were called to testify before the House Oversight Committee and two bipartisan bills were introduced granting federal regulators a greater role in monitoring their activities. Critics also found an increasingly sympathetic ear within government as President Obama's nominee to head of the Securities and Exchange Commission (SEC), Mary Schapiro, and the Treasury Secretary-nominee, Timothy Geithner, pledged to tighten regulation further (Helleiner and Pagliari 2010). In the UK the private equity industry was still recovering from the political controversy surrounding the claim that some executives pay 'less tax than their cleaner' on their investment gains. The episode culminated in a verbal mauling of senior executives by the Treasury Select Committee and the resignation of the BVCA's chief executive in June 2007. The wider AIFM industry was also unable to escape the backlash that followed the bailouts of some British banks. The attempt by the hedge fund industry to head-off direct regulation by devising strengthened codes of practice came under attack from the Treasury Select Committee which denounced the fact that they had only attracted 34 signatories out of more than 400 UK-based funds (Helleiner and Pagliari 2010). It was clear by the end of 2008 that the political context had shifted dramatically, even in countries that hitherto had welcomed the industry with open arms.

1.2 Commission U-turn

The EU sent mixed signals to industry about the likelihood and nature of future regulation during 2008. Charlie McCreevy, the Internal Market Commissioner, was concerned about the consequences of regulation and repeatedly declared that hedge funds would not be regulated by the EU (see also Lutton 2008).[2] This gave rise to a false sense of security across industry. As one lobbyist suggested, this ignored the fact that Commission officials had regulatory proposals 'in the drawer' ready to unleash as soon as McCreevy had gone.[3] How can we explain the Commission's sudden and unexpected about-turn? Two factors are key: the EU political cycle; and international level agreements.

1.2.1 The EU Political Cycle

The European Parliament had become increasingly vocal in pressing for tighter regulation. Two reports crystallised the hardening of the opinion of MEPs towards AIFM. In June 2008 the EP's Legal Affairs Committee unanimously adopted a report by German MEP, Klaus-Heiner Lehne, which called on the Commission to bring forward legislation on the transparency of institutional investors, requiring companies to disclose their investment policies and associated risks. This was followed by MEPs voting in September 2008 by 562 to 86 to endorse a report drafted by the Poul Nyrup Rasmussen, President of the Party of European Socialists, demanding that the Commission present a legislative proposal to regulate the private equity and hedge fund industry. Rasmussen ramped up the pressure on the commissioner, accusing McCreevy of being 'the only player in Europe who doesn't believe that private equity and hedge funds should not be subject to tougher transparency rules" (quoted in Gow 2007).

The EU political cycle was fundamental to the nature and timing of the Commission's u-turn. Following the European Parliament elections in June 2009, Commission President Manuel Barroso

[2] Private interviews, March 2014.
[3] Private interview, February 2014.

faced a vote to secure his re-appointment as Commission President and the approval of a new five-year Commission. To gain the support of the French and Germans governments, as well as the Socialist group in Parliament, it is widely believed that Barroso intervened to ensure that a draft directive on the regulation of the alternative fund management industry was published by April 2009 at the latest (Buckley and Howarth 2011, p.129). This meant that it was drafted in record time with without the usual preparatory work, such as extensive industry consultation and impact assessments. Indeed David Wright, director-general for internal markets and financial services at the Commission at the time, later admitted that the proposals were drawn up 'under pressure in taut and difficult economic circumstances' (Johnson 2009). To save time the inspiration for much of the text came from UCITS and MiFID, resulting in a visibly rushed and technically flawed draft proposal.[4]

1.2.2 The International Agenda

A second turning point came in autumn 2008 at the international level. The G20 Summit in Washington in November 2008 acknowledged the limits of self-governance regime and invited industry to 'bring forward proposals for a set of unified best practices' (G20 2008, p.4). This was followed in April 2009 by the London Summit which called for direct regulation of hedge funds for the first time, with managers to be registered with national authorities and required to disclose appropriate information to allow the assessment of systemic risks (G20 2009). The US and UK were at the forefront of the G20's 'alarmed discovery' of the issue (Lutton 2008, p.168). The crisis had shifted the terms of the regulatory debate decisively in favour of those pushing for direct regulation or 'market shaping' legislation (Quaglia 2010). But it was in the interests of the US and UK for this debate to take place at the global level for two reasons. First, regulators sought to secure international agreement in order to maintain a level playing field, addressing concerns raised by industry that increased regulation could push jobs away from London and New York. Second, the US and UK hoped to secure agreement as quickly as possible in an effort to upload their own preferences for strengthened oversight and transparency. The UK in particular has historically punched above its weight in the G20 and Financial Stability Board (FSB) as it chairs many of the international-level committees tasked with drafting proposals. Its strategy was therefore aimed at deflecting calls for more stringent regulation at the European level.

However the UK's strategy of seeking to render EU-level initiatives redundant backfired. Instead the Commission responded to the G20 agreement by issuing a Communication in early 2009 which pledged to introduce a harmonised regulatory and supervisory framework for the AIFM sector as a matter of priority (Commission 2009a, p.5). Ironically this was justified as necessary to meet the political commitments made by the G20 to mitigate the risks to financial instability by extending regulation and oversight to all systemically important financial institutions, instruments and markets (G20 2009). Commissioner McCreevy explained this apparent volte face by arguing that the financial crisis had 'profoundly altered the economic and political context in which decisions on the regulation of hedge funds and private equity will be made. The ground has shifted in this debate. Closer direct regulatory and supervisory oversight of hedge funds and private equity is inevitable' (McCreevy 2009, p.5).

During the consultation exercise from December 2008, the familiar contours of the arguments to follow were laid out. With broad domestic support, the French government sought the creation of 'a strict, appropriate and secure European framework for hedge funds' which would be required to register at the EU level (Ministry for the Economy 2009; AFG 2009). The German government was equally emphatic in its rejection of the status quo, but allied with its own industry associations in expressing a preference for international agreement on transparency and disclosure standards

[4] Interview with EU official cited in Buckley and Howarth 2011, p.130.

(Bundesministerium der Finanzen 2009; Zentraler Kreditausschuss 2009). French and German enthusiasm for EU regulation of AIFM is commonly attributed to the small size of their domestic hedge fund and private equity industry. But it also reflects the strong support of the European mutual fund industry, predominantly based in France (23%) and Germany (20%), which was set to benefit directly from tougher hedge fund regulation with whom they were increasingly in competition (Woll 2012, p.9).

By contrast the UK was home to nearly 85% of the European hedge fund industry (TheCityUK 2012) and 13% of global investments in private equity (TheCityUK 2010). Like Germany the UK government believed that a global approach to addressing systemic risk would be more effective but was more strident in its opposition to new EU legislation. As a UK official noted, 'our industry can live and thrive under the G20 code, but would be disadvantaged by the Commission proposal'.[5] More fundamentally the Treasury and FSA diverged from the Commission's proposal in defending the existing regulatory regime which they argued could be strengthened, echoing the findings of the Turner Report. UK regulators encouraged industry-led efforts aimed at strengthening standards and transparency and supported its vocal opposition to plans by the EU to devise 'one size fits all' legislation.

1.3 The Draft Proposal, April 2009

The most contentious aspect of the draft proposal published in April 2009 was the attempt to create a single harmonised regulation covering all alternative investment funds previously outside realm of EU legislation. In seeking to cover 'the management and administration of any non-UCITS in the European Union' (Commission 2009b, 6), the negative definition ensured that it would capture the widest possible wide spectrum of activity. The four main pillars of the draft directive were:

1. A European passport for AIFM
2. EU authorization and supervisory regime for all AIFM above a certain size
3. Strengthened capital, governance and transparency requirements
4. Three-year transition period during which AIFM would not be able to market throughout the EU funds domiciled in third countries: after transition, funds could be marketed only if their country of domicile complied with the OECD Model Tax Convention and other requirements

The draft directive circulated prior to publication was a relatively benign document, centred round the EU passport proposal which was widely welcomed by industry. But the version published in April contained three additions, reflecting pressure from France and Germany (Saunders 2009). First, it sought to impose more stringent requirements on funds sold to professional investors than on UCITS funds sold to retail investors. Second, the passport was diluted to make it available only to EU-based funds, with non-EU funds potentially facing a three year wait before they could access the EU market. Third, the draft contained last minute changes which introduced restrictions on leverage.

The influence of France and Germany in the initiation and design of the draft proposal reflects the confluence of domestic politics, geopolitical strategy and economic interests. With respect to domestic politics, the French position on AIFMD should be seen in the wider context of President Sarkozy's preparations for the 2012 presidential election. Regulation was congruent with France's battle against unregulated financial markets which was popular with the electorate. In terms of geopolitics the strategy was part of Sarkozy's ambition to play a leading role in reconstructing the international financial regulatory architecture through France's presidency of the G20 from

[5] Interview with UK official cited in Fioretos 2010.

2010-2011. Agreement on AIFMD was an attempt to strengthen the EU's collective position at the global level, as well as facilitating alliance-building with Germany. The initiative was strongly supported by Merkel who had little faith in the self-regulation of financial markets and criticised the UK and US for thwarting the efforts of the German presidency of the G8 in 2007 (Helleiner and Pagliari 2010). As with most financial regulation, the Franco-German alliance was therefore central to the development and eventual agreement on AIFMD. As a French regulator acknowledged:

> 'Ten years ago, we were like the Germans, but we have liberalized a lot recently [. . .]. But on [alternative investment] we do not argue against the German position for political reasons, which come from the highest level. President Sarkozy has asked us to support Germany all the way.'[6]

Economic self-interest also explains French and German position. With a predominant base in France, the UCITS industry forged a close and effective relationship with the French Finance Ministry which sought to defend its interests against the perceived threat from AIFM (Buckley and Howarth 2011, p.130). By contrast with private equity and hedge funds, the retail funds sector was comparatively well organised and monitored developments in Brussels closely. This helped them to make a forceful case against the idea of an EU passport for non-EU domiciled funds that would compete directly with them.[7] Crucially this was to the detriment of the French investment industry which 'looks much more similar to the British industry than one would be led to believe':

> '[French Finance Minister] Lagarde took issue with third country passports, even though it was not the position of the banking and private equity industry, or of French investors. But a small portion of the UCITS industry ended up being in competition with hedge funds and was afraid that these would be exempted from the regulatory costs weighing on the UCITS industry. They therefore said 'If they get a passport, we are dead' and the government ran with it all the way.'[8]

Germany was primarily concerned over the impact of investment funds on company structure and corporate governance of firms. It therefore favoured the most comprehensive regulation possible to ensure that any type of investment would not threaten co-decision procedures or workers' rights (Buckley and Howarth 2011).

1.4 The Swedish Presidency, July-December 2009

The poor quality of the April 2009 draft left even supporters disgruntled.[9] Socialist MEPs were unhappy that alternative investment funds – as opposed to their managers – had escaped regulation and that the proposed standards on capital requirements, disclosure rules and performance constraints were too lax. This led one the directive's leading architects, Poul Nyrup Rasmussen, to denounce the draft as containing 'more holes than Swiss cheese' and vowing to overturn the last minute concessions granted to the private equity industry: 'Private equity can pop the champagne today but they may not be celebrating for long as we will not accept such an ineffective regulation' (Tait and Hollinger 2009). France viewed the Commission's first draft as the bare minimum that they would be willing to accept. Christine Lagarde, French finance minister, argued that it the EU passport risked opening the door to a 'Trojan Horse' of offshore hedge funds, doubting the Commission's ability to effectively vet funds based in third countries (Hollinger, Tait and Arnold 2009). Similarly, the French regulator suggested that while they were willing to compromise on a range of issues, such as the liability rules for depositaries and legally binding

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[6] Interview with French regulator cited in Woll 2012.
[7] Interview cited in Woll 2012.
[8] Interview with business representative cited in Woll 2012.
[9] Interview cited in Woll 2012.

leverage caps, France's top priority was to oppose a passport for offshore funds.

The outcome of the European Parliament elections in June 2009 worked in industry's favour in two ways. First, the main architects of the directive, the Socialists, had suffered heavy electoral losses. In the aftermath MEPs pledged to devote considerable attention to the issue in response to industry concerns (Tait 2009). Second, the approval of the new Barroso Commission was delayed until February 2010 as a result of Parliament's concerns about particular commissioners. This extended process had the effect of strengthened the hand of MEPs at a critical time in the negotiations, forcing the Commission to listen and respond to their mounting concerns about AIFMD.

The need to amend the legislation was recognised by MEPs on both sides of the political spectrum. For example, German MEP Wolf Klinz, from the Alliance of Liberals and Democrats for Europe, argued that 'the problem is the one-size-fits-all approach', while Labour MEP Catherine Stihler accepted that some funds would be 'innocently caught up' in the new regulation (Tait 2009). In a significant development, Sharon Bowles, chair of the EP's powerful ECON committee, insisted that the directive had to be amended to correct 'unintended consequences', such as the risk to institutional investors and pension would face 'ex-communication' from global capital markets. In addition, the Parliament's own formal impact assessment into AIFMD, undertaken by the think tank Europe Economics, found that the draft rules were 'premature', based on a 'dearth of evidence' and risked reducing the EU's annual growth rate by as much as 0.2% (Jones and Tait 2009). The intervention of the European Central Bank in October 2009 was also very significant. It warned that the Commission's legislation risked putting the industry at a significant competitive disadvantage and urged it to seek greater international coordination instead.

In late 2009 the directive was significantly amended. Sweden, which held the EU's rotating presidency from July 2009, favoured more effective regulation but was sceptical that new rules would eliminate financial market instability. Under its direction many controversial elements were removed (including the introduction of a leverage cap on funds) or watered down (such as the rules governing third country access and the depositary requirements) (Buckley and Howarth 2011, p.132). However the Swedes did annex a series of new remuneration rules to the directive, which provoked a further storm of protest: only 30% of bonus could be paid straight away in cash; and only 20% for large bonuses; and at least half to be deferred to be paid in shares or securities. Similarly although the Parliament's ECON committee agreed 130 changes in November 2009, they provoked criticism by proposing to remove the *de minimis* rules for private equity firms and added new guidelines on proportionality that would spare funds that posed few risks (Buckley and Howarth 2011, p.131).

1.5 The Spanish Presidency, January-June 2010

In January 2010 the Council of Ministers and the European Parliament brought out reports proposing further amendments. There was a lukewarm reaction to the draft of the new Spanish EU Presidency which appeared to go back on Swedish plans for EU passports by reinserting the need for 'appropriate cooperation arrangements' with third countries. Throughout the negotiations the French government sought to restrict access to third country funds domiciled in jurisdictions with equivalent regulatory regimes to the EU. In opposition the UK government pushed for less prescriptive third country standards, supported by Ireland, Czech Republic, Malta, Sweden and Austria. In March 2010 there was a concerted effort by the UK and French governments to reach a compromise. This was pushed strongly by the Spanish Presidency who aimed for agreement by July, but also by several EU governments who feared a change of government in the UK after the May general election could lead a new Conservative government to reopen the negotiations.

In the event the initiative failed after an eleventh-hour call from Gordon Brown to Spanish Prime Minister Zapatero insisting the UK could not accept the deal on the table.

Rather than force a vote in the Council, Sarkozy agreed to defer the negotiations until after the election UK defeated in May 2010. With hindsight this proved to be a shrewd move for the French. Within days of the formation of the new coalition government in the UK, the French and Germans successfully called for a vote in the Council on 18 May 2010 following approval by the ECON committee in Parliament, ignoring Prime Minister David Cameron's call for more time to prepare. Realising that the UK was in a weakened position, George Osborne took the strategic decision to engage constructively with his EU counterparts, while David Cameron embarked on a charm offensive in Paris and Berlin, in an effort to conserve political capital for the trialogue discussions ahead.

US intervention proved critical in paving the way for eventual agreement. US Treasury Secretary Timothy Geithner made his concerns about third country access clear in two letters: the first on 1 March 2010 which he wrote to Michel Barnier, the new Internal Market Commissioner and the Spanish Chair of the ECOFIN Council; and the second letter to national finance ministers of UK, France, Germany and Spain on 5 April 2010 (see Buckley and Howarth 2011, pp 133-4). Although there was no threat of retaliation, industry warned that EU funds could face reprisals in Congress in response to discrimination against US funds. This was supported by the SEC which suggested that it was unlikely to be able to comply with equivalent criteria in the draft proposal. Although the Commission insisted that its proposals were in line with G20 principles, Geithner's letter carefully detailed the differences between AIFMD and US legislation in Congress which treated all advisers and funds as equal regardless of origin.

The immediate impact of US involvement was to antagonise the French and contribute to the breakdown of negotiations. As the French became increasingly isolated in the Council, German Finance Minister Wolfgang Schauble intervened to provide more time for France to propose a compromise based on giving ESMA responsibility for licensing third country fund access to the EU (EurActiv 2010a). The failure to break the deadlock in the Council led the Parliament's rapporteur, Jean-Paul Gauzes, to propose a compromise based on a weaker definition of regulatory 'equivalence' closer to the UK position. With German support waning, the French finally decided to accept a continuation of the private placement regime until 2018 in return for the UK accepting a delay in the introduction of EU passports for non-EU funds. Moreover, ESMA was charged with drawing up the requirements that funds would have to fulfil and resolving disputes between national regulators over the eligibility of a given fund (EurActiv, 2010b). The final deal was brokered by the FSA during the final stages of the trialogue negotiations in July 2010.

1.6 Trialogue negotiations, May-October 2010

During the trialogue negotiations the three main EU institutions – the Commission, Council and Parliament – sought to reconcile the divergent legislative proposals that had recently been approved. The negotiations were concluded on 26 October 2010, and the final agreement was approved by Parliament on 11 November 2010 and the Council on 17 November 2010. The tortuous nature of the negotiations is reflected in the fact that Parliament proposed no fewer than 1,690 amendments. This unusually high number was necessary according to Jean-Paul Gauzès in order to bridge the wide gap between supporters and opponents.[10] It also involved extensive engagement with industry representatives in order to realign the hastily written draft text: the EP rapporteur held no fewer than 198 meetings with AIFM representatives, while the Commission official following the directive had over 150 meetings (Woll 2012).

[10] Interview cited in Woll 2012.

Section 2. Industry Engagement

2.1 'Caught off guard'

There was general agreement that both regulators and industry were caught off guard by AIFMD owing to a lack of awareness about the Commission's intentions and insufficient knowledge and expertise of the political dynamics in the Council and Parliament. Consequently there was a failure to engage effectively at the pre-proposal stage to shape the unfolding regulatory agenda. It took a while for industry to organise and begin contributing constructively to the negotiations. As one industry figure noted:

> 'Hedge fund managers have been quiet for a long time on regulation because I think there's a general assumption that it won't come to pass…We've assumed that the political will would follow the economic will. Historically that's wrong. And now lots of us are beginning to think that maybe we've been a bit complacent.' (Jones 2009a)

Industry's knowledge of how the basic dynamics of the political game in Brussels worked were limited at the start of the process, focused on the Council negotiations and how many national governments they could seek to influence in their favour.[11] This emphasis on the closing 'political' stages of the negotiations ignored the more critical pre-proposal phase during which the Commission and Parliament vie for influence in shaping the nature of the regulatory agenda. It is widely acknowledged across the sector that they under-estimated the importance of the Parliament and the influence that the report authored by Rasmussen, as the former Danish prime minister, would have in shaping the drafting process.

Engagement was hampered by two structural factors. First, the industry was not well organised at engaging in collective lobbying at the European level as it had had little reason to do so before. Second, the broad scope of the directive meant that diverse sectors of industry were impacted with little or no experience of cross-sectoral coordination. For example, the UK-based industry was represented by no fewer than five associations (including the BVCA, AIMA, AIC, IMA, NAPF). In order to assess the strengths and limitations of industry's engagement, we need to explore the response of the different sectors involved in more detail.

2.2 Private Equity and Venture Capital

At the outset an internal debate took place about whether the different sectors of the AIFM industry should lobby separately or collectively. It was recognised that the attempt to agglomerate private equity and venture capital with the hedge funds suited the interests of the Commission as it maximised the scope of the regulation. But there was a concern that differentiation would weaken industry's collective influence, enabling the Commission to 'pick them off' one by one.[12] In the end the UK-based private equity industry made a strategic decision to seek clear blue water between itself and the hedge funds, reflecting important structural differences between the two sectors. This facilitated the projection of private equity's central message that the imposition of a one-size-fits-all solution would be highly damaging, necessitating that it be granted important exemptions:

> 'A major part of the defence of private equity was that…we are fundamentally different. Regulate hedge funds if you want to, they're different, they've got nothing to do with us. So there wasn't

[11] Private interview, December 2013.

[12] Private interview, December 2013.

a great deal of co-ordination with the hedge fund sector. In fact it suited our message to maintain a separation as we were making different arguments from the hedge funds'.[13]

It also had the tactical advantage of minimising the risk that private equity would be tainted by the bad press surrounding the hedge fund sector in the wake of the financial crisis. With the benefit of hindsight there was a broad consensus across industry that the strategy of differentiation was correct. As one industry representative put it:

> 'One has to bear in mind the climate at the time. On the spectrum of nastiness, hedge funds were seen to be more nasty than private equity, and private equity was a little less nasty than the banks. So this was a creature of its time'.[14]

The directive provoked fierce opposition from the BVCA and throughout the process they were amongst the directive's most outspoken critics. The draft was variously attacked as illogical, disproportionate, inappropriate and anti-competitive by industry leaders who warned that it would prove unworkable and drive business away from London. As the negotiations reached a critical phase in March 2010, the BVCA even called on the government to invoke the Luxembourg Compromise to defend the national interest, arguing that it was equivalent to an attack on manufacturing in Germany or farming in France:

> 'If we aren't going to say that our financial sector is a strategic national industry, then what the hell is? ... There is a well understood right for EU countries to invoke national interest. It must be credible of course, but I think this is blindingly obvious.' (Barber, Arnold and Barker 2010)

The apparent robustness of the BVCA's response masked underlying weaknesses. When the Commission consultation was launched in late 2008, the BVCA was seeking to rebuild itself under the direction of a new Chief Executive, Simon Walker, in the wake of the Treasury select committee hearings in 2007. The episode had severely damaged the reputation of the industry and the BVCA shrank from twelve to just two staff.[15] In response the UK-based private equity industry recognised that more effort needed to be devoted to public affairs where hitherto there had been almost none. It was agreed at an early stage that a collective effort would be more effective, as public campaigning by individual firms was unlikely to be helpful.[16] The BVCA's strategy was to defend the interests of the larger global firms during the AIFMD negotiations and to protect the smaller private equity groups by ensuring they would not be caught by the legislation.

The strategy faced numerous challenges. Given the turmoil in the financial markets during 2007/08, it was difficult for financial services representatives to lobby ministers and officials. There was an 'air of apology' hanging over the City of London which meant that its grievances risked being dismissed and aggressive lobbying could backfire. At the start of the process these constraints hampered the formulation of a coherent defence of the industry which would stand up to regulators' scrutiny in Brussels.

> 'This was the height of the financial crisis, [there was] a desire to find scapegoats and a blatantly political push by Paris and Berlin to have legislation in this area. I don't think anybody felt there was anything that could be done to stop it at the time, it was not a time for the UK to be trying to kill pieces of legislation…It just wasn't a context in which you were going to have any success in persuading the commission that they should go slow'.[17]

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13 Private interview, February 2014.
14 Private interview, February 2014.
15 Private interview, December 2013.
16 Private interview, April 2014.
17 Private interview, February 2014.

With hindsight lobbyists admitted that the initial response was an exercise in ‘firefighting’ designed as a holding operation to get beyond the European elections. There was no real strategy beyond drawing up a set of ‘red lines’ and doing a lot of ‘huffing and puffing’.[18] Many in the industry were guilty of wishful thinking, ‘naively’ hoping that the Commission would lose interest in regulation once it had been re-appointed and that the outgoing Internal Market Commissioner, Charlie McCreevy, would be replaced by an equally pro-market Anglophile.

The initial industry response at the EU level was described as ‘chaotic’ and loosely coordinated owing to the disjointed nature of national lobbying strategies. This contributed to a duplication of resources, over-lobbying and the antagonism of EU officials: ‘We were desperately trying to talk to everyone and anyone as often as we possibly could who might have an impact on the outcome’.[19] In some respects the industry went from ‘under-kill’ to ‘over-kill’ with respect to lobbying in Brussels. Even the Commission expressed frustration at receiving twenty-seven different submissions and appealed to industry to ‘get its act together’ and speak with a single voice. Not only was this national scramble for influence ultimately self-defeating, it was also unrealistic given the clamour for increased regulation in Parliament. Some in the UK, both within government and industry, were criticised for spending too long pushing for special treatment:

> ‘The strategy [should have been] to get constructively engaged, getting expertise to those who need to be educated, and trying to get an appropriate piece of regulation, instead of wasting resources and also wasting a lot of goodwill asking to get exempted from the regulation.’[20]

In order to reach national regulators, the BVCA had to rely on other national associations to lobby their home governments. But this strategy was itself weakened by the fact that most EU member states had no significant AIFM industry: their capacity to lobby their respective governments, let alone influence their vote, was therefore extremely limited. At the EU level the BVCA recognised that its representation of ‘British’ industry interests would constrain, and perhaps even hamper, its policy engagement. In Brussels the UK was ‘seen as part of the problem not the solution’:

> ‘We took a conscious view that fronting this through Number Eleven would have been a big mistake, the Europeans post-crisis did not want to hear lectures from Britain on regulation.’[21]

The BVCA’s ability to shape Council negotiations was also undermined by a general lack of awareness and knowledge about the importance of issue linkage: that is, the ability of negotiators to trade support for different policies in which their home government had a particular stake. This was symptomatic of a wider lack of knowledge about the political landscape and the EU legislative process. In the Parliament it had not only under-estimated the importance of key MEPs, such as Ramussen and Gauzes, but also failed to anticipate the election of Sharon Bowles as chair of the powerful ECON committee after the 2009 election.[22] According to one leading regulator, this fatally undermined the influence of industry in Europe:

> ‘[Within the EU] if you fail to convince at the technical and technocratic level, it does not help you to be friends with the finance minister of your country or to be able to stand on your head. [. . . Knowledge of the procedure is very important. [The investment managers], taken individually, may be falcons, but taken together, they behaved like a bunch of frightened sparrows trying to stop a steam-roller.’

[18] Private interview, December 2013.
[19] Private interview, February 2014.
[20] Private interview, February 2014.
[21] Private interview, April 2014.
[22] Private interview, December 2013.
[23] Interview cited in Woll 2012.

During the later stages of the negotiations, industry lobbying efforts were strengthened through the reconfiguration and expansion of the European Venture Capital Association (EVCA). Nonetheless its response probably appeared more unified than it actually was as institutional and cultural differences continued to undermine the formation of common positions. Given that the first draft of AIFMD was inspired by existing regulatory approaches in France and Germany, private equity firms in those countries were unsurprisingly much more comfortable with the proposed legislation. By contrast the BVCA had to perform a balancing act by accommodating the regulatory preferences of a wider and more diverse range of members, many of whom were based in the US or offshore centres across the world. As a consequence many still feel that the private equity industry failed to project a sufficiently robust argument at the EU level:

> 'I still feel that the industry gave in too quickly, that it didn't mobilise enough people to say "you know, Rasmussen's an outsider here, if there is a need for regulation of private equity funds that ought to be discussed separately, and one size does not fit all"…We certainly should have been resisting this for as long as possible.'[24]

Despite this the strategy of differentiating private equity from other AIFM sectors met with universal approval, not least because it contributed to one of industry's most notable early victories. The first drafts of the directive were a 'cold shower' as the Commission did not recognise the important differences between the sectors. This led it to propose an across the board *de minimis* exemption of €250m for both private equity firms and hedge funds. However the private equity industry was eventually able to persuade the Commission of the merits of differentiation, leading to private equity being granted a higher *de minimis* exemption of €500m in the published directive.

Aside from the strategy of differentiation, coordination of lobbying activity with other sectors was hampered by the fact that other associations had divergent priorities and agendas. The debate also spanned a huge range of issues – from third country access to investor protection to remuneration – which constantly shifted over time, making meaningful cooperation complex and time consuming. For the level 1 regulation coordination was therefore limited to cross-sectoral industry roundtables through which to share intelligence and keep each other informed of developments. Nonetheless it is worth reflecting briefly on how other impacted sectors approached the AIFMD.

2.3 Hedge Funds

AIMA led the charge for the hedge fund industry during the negotiations. It was consistently critical of the directive which it regarded as ill-considered, impractical and unworkable:

> 'The unintended consequences of these measures may put thousands of jobs in several major European industries under threat and slow down any economic recovery. Additionally, many of the provisions will disadvantage European hedge fund managers against those outside of Europe, which could prove an incentive for them to move business elsewhere – negatively impacting badly needed tax revenues for member states.' Florence Lombard, Executive Director, AIMA (AIMA 2009)

[24] Private interview, February 2014.

The hedge fund industry interpreted the process as a knee-jerk reaction to the losses suffered by EU citizens through a series of scandals in which hedge funds had been implicated, most notably that involving the Madoff scandal. The third country provisions were the subject of stinging attacks by industry leaders which accused the Commission of 'prejudice' and 'protectionism' against the industry:

> 'If opponents of the European Union are looking for evidence of political meddling and overreach, they could hardly find a better example than the new draft directive. The proposal…is a politically driven effort to place obstacles in the way of an industry that is almost exclusively based in the US and the UK…All it does is enhance the suspicions held by some in the UK that it is highly risky to engage with the continental Europeans on matters of crucial British interest.' Paul Marshall, Chairman of Marshall Wade (Marshall 2009).

Many of the UK's largest hedge funds warned the Treasury they would be forced to leave the country, with some claiming to be making back-up preparations for a move to Switzerland. US and UK regulators took this threat sufficiently seriously to organise a meeting with industry leaders in June 2009 to reassure them that they would fight for changes to be made.

However the limits of the AIFM industry's lobbying strategy was revealed in a survey of 112 'opinion formers' conducted by Populus in October 2009 which found that 60% of public sector figures interviewed were supportive of the draft directive, with only 20 per cent opposed to it. Populus concluded that this was 'a case of the City convincing itself of the merits of its arguments but not convincing others' (Populus 2009). Similarly Sharon Bowles expressed frustration at the resistance of industry representatives to engage constructively, saying that 'the UK hedge fund mood music just puts people's backs up' (Jones 2009c).

The strident approach of UK lobbying contrasts with the more measured approach adopted by US funds. The Managed Funds Association (MFA), the US hedge fund trade group played an important behind-the-scenes role in pushing Brussels to relax the third country provisions. However they realised that a loud and highly visible intervention by US industry would be counter-productive. Instead it struck a positive note, calling AIFMD 'the basis for a continued dialogue toward the shared goal of a "smart" approach to the regulation of fund managers' (Masters, Arnold and Tait 2009). More importantly, it enlisted the support of US regulators in the SEC, the Commodity Futures Trading Commission, and the US Treasury to help relay its message to Brussels. It also worked closely with Bermuda, the Cayman Islands, Hong Kong, Switzerland and other nations that would be impacted by the new EU rules. But this conciliatory approach mirrored a more deep rooted style of engagement at home aimed at restoring confidence: 'This is an Enron moment for hedge funds … Regulation would be welcome, primarily from a trust standpoint' (quoted in Ivry, Kishan, Katz 2008).

2.4 Institutional Investors

Some of the most effective lobbying conducted during the process was by institutional investors and pension funds. Their message that the directive would increase compliance costs and reduce investor choice was simply too powerful for the Commission to ignore. The success of investors was in part attributable to the genuinely European nature of their concerns, meaning that their complaints could not be dismissed as narrow British self-interest. In contrast to much of the AIFM industry however investors adopted a more conciliatory tone, noting that the regulation was not something to fear. Rather indignation should be reserved for the process by which the directive has been drafted:

> ‘The Commission drafted the directive under political duress; that is no way to approach financial regulation. There has been no consultation, no due process and no cost-benefit assessment. But that is the fault of national governments, not the Commission.’ Richard Saunders, Chief Executive, IMA (Saunders 2009)

The IMA suggested that railing against the directive was pointless as the political momentum behind it was too strong. Instead it urged industry and regulators to ‘bring forward proposals for improving it’ as it could present ‘excellent opportunities’ (Saunders 2009). This tone was mirrored by the ABI. Peter Montagnon, Director of Investment Affairs, suggested that the debate had been ‘marred by unseemly and strident exchanges between those afflicted by blind prejudice against hedge funds and the funds themselves, some of which have been guilty of unhelpful public tantrums.’ While highly critical of the third country restrictions, compliance burden and legal liability rules, he called for both sides to abandon ‘posturing and grandstanding’ and instead work together to meet legitimate public policy objectives (Montagnon 2009).

In the later stages of the negotiations, other interested stakeholders began to intervene. For example the National Association of Pension Funds, together with leading pension funds such as Hermes, criticised the increased cost burden and reduced investor choice in a letter to Charlie McCreevy. Similarly at the European level, the European Fund and Asset Management Association finally broke its silence on AIFMD in August 2009 with a position paper criticising the EU for ‘excessive’ and ‘inconsistent’ regulation and calling for greater coherence with UCITS and MiFiD.

Over time the success of these messages encouraged other industry associations to emulate them. As part of its strategy to demonstrate the effects that the directive may have on ordinary EU citizens, the EVCA and AIMA increasingly emphasised the damaging effect of the legislation on pension funds. In a deliberate attempt to appeal beyond financial regulators, AIMA argued that ‘it’s not only Europe’s pension funds but Europe’s pensioners of both today and tomorrow who will suffer’ (Jones 2009d). But a continued source of regret is that the private equity industry failed to engage and mobilise with investors at a sufficiently early stage: ‘The industry did have a couple of goes at trying to mobilise the investor community, but I don’t think it was ever particularly successful’.[25] Lobbyists now recognise that this was a huge mistake, albeit an understandable one given that they could not have predicted at the start how central the issue of investor protection would during the negotiations.[26]

Another important stakeholder was the depositary banks. The original Commission proposal called for fund assets to be independently valued and kept by a depository bank that would be subject to unlimited liability in case of problems. This was championed by the French and Spanish to strengthen investor protection in response to a series of court rulings on liability following the collapse of Lehman Brothers and the Madoff scandal which exposed the lack of harmonisation across the EU. After the publication of the first draft, depositories went on to lead a quiet but productive lobbying exercise in the corridors of Brussels. In contrast to AIFM, the banks praised the EU’s attempt to provide much needed clarity to the depositary regime. But they cautioned that the legal responsibilities for depositaries set out in AIFMD risked changing the ‘whole wiring diagram’ of the industry, forcing banks to look very hard at whether they would remain in the depositary bank business. This strategy paid dividends as they succeeded in amending the rules on the grounds of potentially increased costs for investors, the constraints that this would impose on starting up new funds, and the possible growth of systemic risks due to sector consolidation (Buckley and Howarth 2011, p.136).

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[25] Private interview, February 2014.
[26] Private interview, December 2013.

2.5. UK Regulators

Like industry the draft proposal for AIFMD took UK regulators by surprise. The default reaction of many was to interpret AIFMD as an attempt by France and Germany to undermine the City of London: 'You wait until a fight breaks out and then take a swing at the guy you have always wanted to hit…whether or not he had anything to do with starting the fight is not the point' (quoted in Beattie 2009).

During the early phase of the negotiations, industry's limited European expertise meant that they had to rely on well-established ties with the UK government to lobby. National associations therefore focused their lobbying on national ministries, regulators and national MEPs to gain support for a common UK position. After an initial phase of apportioning blame and mutual recrimination, the relationship with ministers and officials on the whole was amicable and constructive.

1. Ministers

After a slow start, UK ministers engaged actively in defending the AIFM industry. Although in public ministers could not be seen as too sympathetic to the industry, in private discussions were more fruitful. The industry associations and large firms had very good access to senior ministers in both the Labour and Conservative-led governments at the time and there was never a lack of political support. Gordon Brown and George Osborne were both regarded as very helpful in Council meetings in the later stages of the process.[27] Lord Myners, City Minister, initially sought to distance the UK government from the scathing reaction of industry. In July 2009 he told the House of Lords EU subcommittee that ministers believed there was a case for regulation at EU level and that hedge funds do have the potential to pose systemic risk. Within months however his rhetoric had notably hardened, condemning the directive as deeply flawed and 'tilted at mythical windmills' and criticising the Commission for having 'pandered to prejudices' (Jones 2009e). He accused other European countries of seeking to make 'political capital' from advocating a clampdown on the hedge fund industry, calling their actions 'woefully short-sighted' and 'bordering on a weak form of protectionism'. In a speech to AIMA Lord Myners pledged that the government would devote a huge amount of energy in fighting the legislation:

> 'The UK is reaching out bilaterally to leverage natural alliances and win over others…Officials will lobby in more than a dozen key capitals over the summer. I myself will be engaging directly with my opposite numbers in key member states.' (Jones 2009b)

The heads of all the main trade associations met with London Mayor Boris Johnson to enlist his support in championing the interests of the industry both at home and abroad. By autumn 2009 the lobbying effort by the City of London had been geared up considerably. London Mayor Boris Johnson travelled to Brussels for talks with Jean-Paul Gauzes, the directive's rapporteur in the Parliament, as well as Charlie McCreevy. In a deliberate change of strategy, UK regulators sought to garner support internationally. One important development in this respect was the initiative by the City authorities to target the US administration. This paved the way for a delegation of representatives from the City of London Corporation, led by the Mayor, to Washington in June 2009 to lobby the US Treasury and key congressional financial committees and raise awareness of the threat that the directive's third country rules posed. Within months the US was playing a largely hidden but pivotal role in lobbying Brussels. US congressmen and regulators travelled to Brussels to meet with key EU officials to express their concerns on several occasions. Paul Kanjorski, a Democrat who heads the capital markets sub-committee, told MEPs that the proposed rules had 'scared the bejesus out of the private equity and hedge fund industry in the US' (Tait 2009).

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[27] Private interview, April 2014.

However there were three serious impediments which prevented ministers from blocking the directive altogether. First, the ability of government ministers to publicly defend the industry, either at home or in Brussels, was severely curtailed by the level of public hostility towards financial services generally.

> 'There was a lot of sympathy for our position in the government…but the government was feeling fairly bruised. It was fighting quite a lot of battles in Europe. There was a sort of sense that they were sympathetic, but nobody was really sure quite how far they'd go to protect us if push came to shove.'[28]

Second, government ministers were also distracted by more pressing domestic political priorities in the run up to the 2010 election. As a result, some banking and private equity groups asked their counterparts in the EU to lobby their home governments rather than rely on the UK to fight the legislation. Although reluctant to criticise the government in public, one private equity leader argued at the time:

> 'There is a strong perception in the City that Gordon Brown has forgotten us and may even be offering us up on a platter to France and Germany in exchange for supportive noises.' (Masters and Parker 2009)

Finally, it is widely perceived by both regulators and industry that the UK's influence in the European Parliament was weakened by the withdrawal of Conservative MEPs from the European People's Party following the June 2009 election. In particular, it was highly damaging to the UK's efforts to influence conservative MEPs from Germany whose votes were decisive. The reaction of other MEPs was unanimous:

'They [the UK] are crazy. They are losing every single bit of influence by doing that. They are no longer sitting when we have the discussions, when we are preparing things. They are completely out of the process now.'[29]

2. Officials

At official level the industry's early engagement with the Treasury was problematic. In an effort to mobilise industry a series of working groups were established by the Treasury and the FSA. However the early meetings were characterised by anger and frustration at the failure to anticipate the nature of political developments and perceived government inaction:

> 'Treasury held town hall meetings with hedge fund managers. You had guys worth hundreds of millions sitting on the floor because there was not enough space. They thought it would all be fine, that there was no way [the regulation] could happen.They would just shout or yell when we told them otherwise.'[30]

Industry's general lack of understanding about how Brussels worked led to unrealistic expectations of what UK negotiators could achieve. At times too much faith was attached to the quality of technical arguments to the detriment of a broader political strategy aimed at what was achievable. As one regulator noted:

[28] Private interview, February 2014.
[29] Private interview, February 2014.
[30] Interview with UK official cited in Prabhakar 2011.

> 'It's very easy when you're on the government side to accept and buy into the technical advice that you're given by the industry…but we were the ones sat round the table counting the votes and realising that we didn't have many allies. So you're in a world of salvaging something from a pretty difficult starting point and that's not always a message that industry wants to hear.'[31]

Early interventions by industry were considered unhelpful and failed to exert any influence over the technical details:

> 'They contributed nothing to the debate. Influence means changing words on paper, but in no case did the industry change what was written on a bit of paper… They contributed to lots of stuff technically, but not that you could then take and put into policy.'[32]

Occasionally tensions boiled over as regulators tired of industry's obstinacy. At an industry conference in Berlin in February 2010 for example Dan Waters, FSA asset management sector leader, responded to criticism about 'clinically insane' regulation by responding that it was 'the arrogance of that statement that no regulation is needed that has got the industry in trouble in the first place' (Arnold and Masters 2010).

There were also failings on the part of regulators. Treasury cutbacks meant that there was a high turnover of staff and that those responsible for the directive were at a relatively junior level.[33] This was perceived as contributing to the Treasury's initial failure to anticipate the emergence of the directive and delayed the mobilisation of negotiators with sufficient skill and knowledge to engage with the process. It was also considered symptomatic of the UK's lack of political investment in Europe.

> 'The [Treasury] was less engaged than it should have been in the whole Brussels process. They should not have been caught by this and they were…It was a bit of a mess. There was just a general lack of readiness and lack of resources to deal with something as complex and actually as politicised as this.'[34]

In addition, Treasury's knowledge of the AIFM sector was fairly limited at the time. Beyond broad principles such as promoting competition, non-discrimination and open markets, the Treasury had few pre-existing preferences about how the industry should be regulated. At the start it was therefore heavily dependent on the FSA and industry for expertise and to work out what its own position was on AIFMD.[35] One industry insider suggested that this reflected a general lack of strategic direction from government: there was little attempt to define the final outcome that the UK wanted, but instead most energy was devoted to simply trying to make it 'workable'.

> 'I wasn't clear what the position of the Treasury was. I don't think they were clear either. They just wanted to pare things back and try and make the directive workable. So I didn't see any particular strategy. They were just reacting to successive iterations of policy documents on the directive and sending it to the regulator for comment…I don't think they actually really made a call.'[36]

[31] Private interview, February 2014.
[32] Private interview, April 2014.
[33] Private interview, February 2014.
[34] Private interview, February 2014.
[35] Private interview, February 2014.
[36] Private interview, April 2014.

By contrast the FSA was praised at the start of the process for being better resourced, better organised and better able to deal with their EU counterparts. It proved particularly influential in assisting the Swedish Presidency in 2009 by submitting detailed changes to the text of the directive.

'The FSA had a relatively stable group of people who knew what they were doing, by far the best equipped of the European regulators we dealt with. They're the most experienced in dealing with the sector – not surprisingly because most of it's here. They were good'.[37]

The FSA also sought to encourage industry to play a more constructive role in the negotiations: 'I think we were trying to encourage the industry to be productive…I guess indirectly the regulator influenced things by trying to get the industry to come out with some sensible suggestions'.[38] Over time however its influence and effectiveness had waned, hampered by a brain drain of talent in anticipation of being broken up by an incoming Conservative government. This collective nervous breakdown limited the capacity of UK regulators to lobby effectively and weakened their institutional memory at a critical time.

In the later stages of the negotiations relations between industry and regulators improved significantly. As a more constructive approach prevailed representatives from industry met more frequently with officials to articulate what they considered to be the industry's red lines, the most important of which was amending the third country provisions.[39] This was a powerful message which found a sympathetic ear in government. In response officials from the Treasury, FSA, FCO and the City of London Corporation made a concerted effort, touring EU capitals and financial centres to drum up support for their opposition to the draft directive. With the election of the Conservative-led coalition government in May 2010 the engagement of the UK government significantly improved. This gave negotiators a new found confidence to 'really go after' the directive and pare it back during the trialogue negotiations.[40]

The UK authorities continued to provide ammunition for critics of the directive. To maintain pressure on the EU, the FSA commissioned one of the first independent impact assessments on the cost to institutional investors of AIFMD. It found that institutional investors could see their returns dip by €1.4bn ($2.1bn) each year if the directive drives non-EU alternative funds out of Europe. On the other hand if funds relocated to Europe they would face additional compliance costs of up to €3.2bn and ongoing costs of about €311m (Jones, Masters and Burgess 2009). The Bank of England's Financial Markets Law Committee also published its own report on the EU's proposals arguing they could 'create significant legal uncertainty leading potentially to systemic failure and widespread market disruption unless they are appropriately amended' (efinancial news 03.02.10). In addition, the House of Lords EU Committee called on the government to refuse to support AIFMD unless it was brought into line with planned legislation in the US. The Lords singled out the Commission's handling of the process for criticism, suggesting that 'had the Commission followed its own better regulation principles, the shortcomings of the directive could have been dealt with at a much earlier point or might not have been there in the first place' (House of Lords 2010).

[37] Private interview, April 2014.
[38] Private interview, April 2014.
[39] Private interview, December 2013.
[40] Private interview, December 2013.

2.6 Outcomes

For industry itself the final agreement was a significant improvement on the original Commission proposal and they succeeded in securing the removal of the most controversial or unworkable provisions. The BVCA concluded that while 'on balance the directive is viable', it is nevertheless 'a compromise and not ideal' (Sullivan 2010). The other associations responded with a similar mix of relief and resignation:

> 'We're relieved to have reached some legal certainty ... [But] the directive ... is imperfect legislation. It will impose unnecessary cost for our investors.' Uli Fricke, Chair, EVCA (Tait and Arnold 2010)

> 'It is a lot better than the original [document]. What initially looked like a death sentence [for the industry] has not happened.' Andrew Baker, Chief Executive, AIMA (Sullivan 2010)

On the specifics of the directive, there was a broad consensus that the private equity industry was broadly successful in securing a higher *de minimis* exemption and in contributing to the relaxation of the third country provisions: specifically, the continuation of the private placement regime and relaxed equivalence rules for non-EU domiciled funds. The leverage, transparency and disclosure rules were also far less prescriptive than initially proposed, although industry was less satisfied with the outcome on the depositary rules and remuneration restrictions. Four factors help to explain the relative success of industry in amending the original proposal (Buckley and Howarth 2011):

1. Despite impacting on a range of disparate financial sectors, the position of industry was relatively homogenous
2. Opposition to the directive had a determined national champion in the UK government
3. Strong opposition to third country rules was expressed by US regulators
4. The early Franco-German push for tough regulation weakened as Germany, Parliament and the Commission accepted the need for compromise

The larger philosophical defeat however was failing to prevent the EU from designing a one-size-fits-all piece of legislation to cover a range of highly diverse financial sectors. The argument that private equity, hedge funds, venture capital should be regulated in separate 'silos' did not succeed. The Commission's insistence on a horizontal approach ultimately led to the poor drafting of the text and the ambiguity of the level 1 legislation. The UK accepted this at the time as the price for reaching agreement thinking that it would be able to unwind much of it in the level 2 negotiations. But this has not proved possible. Instead lobbyists have found that they cannot improve significantly on the level 1 outcome: instead the choice in the level 2 regulation has essentially been to accept the status quo or an even worse outcome.[41]

2.7 The Level 2 Regulation

The AIFM Directive gave express power to the Commission to adopt non-legislative acts of general application. These 'delegated acts' are used to clarify or supplement technical aspects for implementation. Enshrined in Lisbon Treaty, a delegated act is a separate category of law but can take the form of a directive or regulation: they enter into force only if no objection is received from the Council or Parliament within a set time period (for AIFMD this was three months).

[41] Private interview, December 2013.

In December 2010 the Commission requested the advice of ESMA to provide technical guidance in the drafting of the Level 2 regulation based on evidence gathered through open hearings and written submissions. As chair of a number of ESMA committees looking at different aspects of the directive, the FCA did not go with pre-defined objectives for what it wanted to achieve but instead to facilitate dialogue and consensus amongst participants:

> 'The FCA didn't write objectives in terms of what we wanted to get out for each of the areas. We collated views and then the next meeting session we had drawn up some key points of where we wanted to get to. We needed to get agreement around the table of what's a common position…The real objective was just make it workable.'[42]

To facilitate this process the FCA established six technical working groups through which to consult industry and gain feedback. By the level 2 negotiations, the main trade associations had significantly geared up their technical expertise. In particular, the BVCA provided valuable advice on the remuneration code while AIMA was particularly helpful with respect to the leverage rules.[43] The UK was well placed in these technical negotiations because of the expertise of both regulators and industry. In fact, the FCA even provided technical assistance to the chairs of other working groups from other Member States.

Industry faced four main challenges in trying to shape the Level 2 process:

1. Complacency

The successes achieved at Level 1 in amending the Commission's original draft document lulled many into a false sense of security with many believing 'we can live with this':

> 'The devil was really in the detail on level 2. So there was a sharp realisation from some people that actually perhaps level 1 wasn't as successful as everyone thought...or at least that there were a lot more unanswered questions...The attitude at level 1 was let's just agree something for now to get through the process, and then we'll sort it out at level 2.'[44]

Much of the level 1 text was sufficiently ambiguous that some within industry 'buried their heads in the sand' and assumed that there was sufficient room to improve the legislation at a technical level given that the momentum appeared to be on their side. But this ignored the danger that ambiguity works both ways. In reality it soon became apparent that the interpretation of the level 1 text by regulators in ESMA was significantly different from the way industry thought and wished to interpret the directive. Equally, some national regulators also saw level 2 as an opportunity to reopen many of the discussions to try to shift the final legislation towards their own preferences.

> 'There was a tendency to kind of to relax a bit once you got a good result on Level I. That clearly is dangerous and even when you get to Level 2 there's still enough wiggle room at the national level for some of these issues not to be quite resolved sometimes. So there's a lesson here about this process having a life of its own, even for several years after it should be done.'[45]

While the Level 1 process had been driven from Brussels and involved heavily politicised engagement with the Commission and Parliament, Level 2 was very different. At first industry was

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[42] Private interview, April 2014.
[43] Private interview, April 2014.
[44] Private interview, August 2014.
[45] Private interview, April 2014.

perhaps slow to learn that a two-pronged strategy was required. First, industry representatives needed to gear up their technical expertise in order to be able to engage on a one-on-one basis with national regulators on the ESMA working groups. This was achieved by drawing on outside expertise from legal and professional services firms. Yet this presented its own managerial challenge as a diverse range of external voices had to be moulded into a coherent industry position. At the same time lobbyists also needed to retain a good relationship with those responsible for the broader policy direction within ESMA to ensure that the two were aligned. Problems arose when a disconnection between the two emerged, necessitating careful reconciliation between the policy objectives and the final text.

2. National differences

Despite the highly technical nature of the level 2 discussions, industry under-estimated the extent to which national differences complicated the task of policy advocacy. ESMA established a series of technical working groups chaired by regulators from different member states, creating a series of challenges. First, some working groups were chaired by countries with no significant private equity sector and so their regulatory knowledge was limited, if not mistaken. This knowledge barrier proved a formidable obstacle to exerting influence as considerable time and energy had to be spent on educating regulators about the industry before detailed discussions could commence.[46] Second, by default many countries looked to their home regulation, particularly of retail funds, as the basis for new EU-wide rules. Inevitably this meant that many of the early proposals were simply inappropriate for the private equity industry, which then necessitated extensive lobbying in an effort to amend. As one explained, 'there really was a lack of understanding, and trying to explain why some of the level 2 didn't work in private equity was just a really difficult concept to get through to people'.[47] Third, different national styles of engagement were apparent. The Treasury never tried to intervene directly in the Level 2 process by directing UK regulators in a particular direction. By contrast the French Finance Ministry regularly provided instructions to the French chairs of the ESMA working groups. This led it to attempt to reopen the argument about leverage during the level 2 negotiations. One lobbyist commented that national regulators in ESMA bring 'political baggage' of their home governments with them, resulting in a 'running battle' in which you have to remain engaged because 'it's never quite over'.[48] Finally, the central team within ESMA responsible for reconciling the working group draft documents was small and under-resourced, and their detachment from the technical negotiations meant that their understanding of the 'national' logic behind particular regulatory recommendations was limited. A failure to engage adequately at this level meant that the BVCA's ability to exploit issue linkages and policy bargaining between working group dossiers was limited.

Private equity had an excellent working relationship with UK regulators in ESMA, and they were very helpful in providing feedback on drafts and frequently made requests for technical advice. The problem however was that the standing of the UK was greatly weakened within the EU more generally at this time and there was a strong 'anti-UK feeling' towards the UK-chaired working groups. With hindsight some believe that more could have been done, certainly at an early stage, to forge contacts and alliances with regulators from other member states. This collaborative approach worked well in the later phase of the process, but it was still constrained by the fact that for most financial services legislation it tends to simply produce a natural alliance of Anglo-Saxon liberal states in a stand-off with 'the rest'.

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[46] Private interview, August 2014.
[47] Private interview, August 2014.
[48] Private interview, April 2014.

3. Inter-institutional dynamics

With hindsight there was a lack of political awareness about the inter-institutional dynamics between the Commission and ESMA. One of industry's biggest mistakes was to fail to recognise that the Commission had a fairly clear sense of what the Level 2 regulation should look like and would therefore not necessarily follow ESMA's advice. One lobbyist suggested that they could have devoted more energy to 'finding out what their end position was, or at least what they wanted it to be, and then by work backwards we might have had an easier time of things.'[49] This was exacerbated by the fact that ESMA was a new and relatively untested institution which consequently lacked political clout within the Brussels institutional hierarchy. One manifestation of this was the US Securities and Exchange Commission's refusal to acknowledge the authority of ESMA. In addition, the highly technical nature of the working group discussions distracted attention from the wider political context and the fact that the Commission itself remained under intense pressure from Parliament to continue to crack down on private equity. The consequence of these dynamics was that when the Level 2 Regulation was finally published after much delay in December 2012, it appeared to disregard much of the advice of ESMA on delegation, leverage, interaction with third countries and depositary liability. This led to extensive lobbying by industry channelled through the EVCA, provoking a backlash from Michel Barnier and Jean Paul Gauzes both of whom suggested that they would be less inclined to favourable regulation.

The important lesson here is that level 2 negotiations can be just as 'political' as the level 1 process, both in terms of the regulatory preferences of different national regulators, and with respect to the inter- and intra-balance of power in the EU institutions. The key to influencing the Level 2 process is therefore constant vigilance and sustained engagement in order to raise awareness of the wider political context.

4. Implementation

The final challenge facing industry has been the extremely tight timetable for implementation at home. HM Treasury is widely perceived to have been slow in responding to the Level 2 Regulation: its consultation was only launched in January 2013, leaving only a short window of opportunity for discussion with stakeholders before the 22 July 2013 transposition deadline. Furthermore, in its submission the BVCA argued that UK regulators were seeking to 'gold-plate' the directive by imposing depositary requirements on sub-threshold AIFMs. These problems have not been helped by the high level of staff turnover which has created discontinuity and eroded institutional memory: by the time of the Level 2 process, most of the Treasury officials with experience of the Level 1 directive had left.

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[49] Private interview, August 2014.

Section 3. Lessons Learned

Six principal lessons emerge from this study for UK government and industry:

1. Investment in EU engagement

The over-riding message from participants in the study was that UK regulators and industry representatives could and should do more to engage with the EU. This necessitates a permanent and powerful presence at the EU level to anticipate and respond to events. It was considered essential that the UK maintains a 'battle readiness' that it did not have prior to AIFMD. This requires an adequately staffed and resourced UK Permanent Representation, greater representation of UK seconded officials in the Commission, and the active participation of UK financial firms and groups in Brussels-based industry associations. The UK cannot rely on mobilising people and resources as and when regulatory issues emerge because it this takes too long to gear up. It is also important not to relax once the set piece battles are over as regulation is a continuous work in progress.

In a climate where the UK's status within the EU is increasingly uncertain, alliance building is all the more important. There is an important role for both regulators and industry in identifying and forging networks with counterparts in other EU member states on financial services regulation. AIFMD also demonstrated a further universal truth: getting regulators and industry representatives from outside Europe on board can be a very effective strategy for leveraging influence in Brussels. In the future this is likely to include not only the US, but also emerging economies in Asia and Latin America.

2. Shape the agenda before others do

A key lesson is the importance of proactive engagement in order to shape the emerging EU regulatory agenda. UK regulators and industry must be prompt and assertive in defining their regulatory aims and objectives at the pre-proposal stage, and using these to influence thinking in the Commission and European supervisory authorities. Waiting for draft proposals before responding is too late: it simply means that someone else has set the agenda.

The capacity to anticipate and respond to new EU-level initiatives is just as important as technical arguments. This requires UK regulators and industry to jointly monitor developments and share intelligence on the EU institutions and other national capitals so that it is 'more aware of what is likely to come down the tracks':

> 'We took the EU aspect of our regulated lives too lightly. I think as an industry we have to pay more attention to not just what's imminent, but what's bubbling up in the ether in the European process. So I think we need to be more aware of what's coming and to pre-empt where we can some of these things.'[50]

3. Recognise that power has shifted

The UK needs to respond to a post-financial crisis context in which the role of Parliament is increasingly pivotal and recognise the Commission as a potential ally which frequently needs

[50] Private interview, 2014.

strengthening in the face of political pressure from MEPs. Industry realised that it was completely ill-equipped to deal with the Parliament as it had never been taken seriously as a policy actor in financial regulation. It went through a steep learning curve in order to understand how the process worked, identifying the key players and the importance of the committee structures. This meant identifying and building up a network of MEPs in key positions (such as chairs, vice-chairs and coordinators) and encouraging national associations to lobby their respective MEPs. MEPs are often very interested and engaged in technical discussions as it enables them to exert greater influence in the wider policy debates. Greater energy also needs to be devoted to targeting German MEPs in future as their numbers and tendency to adopt median regulatory positions ensures that they are pivotal in shaping any final deal. Finally, Parliament's role in the selection of the new Commission President has further reinforced the decade-long power shift.

4. Trust is vital in an iterative game

The best advice that UK regulators and industry representatives can provide is that which seeks to inform and help EU regulators when they are making technical mistakes, rather than seeking to persuade them that they are politically misguided:

> 'There isn't any good lobbying, there is only good consultation. People point out that you're technically wrong, or there's some feature of the world that you've misunderstood. It might be a fatal misunderstanding, or it might simply be because you haven't thought through the second round effects of what you're doing. [As a regulator] you've got an imperfect understanding of the world and they can help you understand the world, because they know more about certain parts of it than we do because they live in it...So the most effective kind of consultation responses are actually intellectually honest and unexaggerated.'[51]

Key to exerting technical influence at the EU level is the quality and detail of written submissions: simply put, the easier it is for regulators make use of technical amendments, the more likely they are to do so. This necessitates high levels of legal regulatory expertise in an effort to develop interpersonal networks, foster trust, and accumulate political capital with EU regulators:

> 'The key to influencing policy is to make it personal. So you've got to persuade [people] round the table that I'm a good guy, that I knew what I was talking about, and they should listen to me…I wanted technical advice from [industry], I wanted to trust them, and you've got to form that relationship.'[52]

Bad lobbying is a deliberate attempt to deceive or distort. Because of the iterative nature of the policy engagement process, this ultimately destroys trust between the regulator and the regulated.

5. Know your audience

Effective lobbying is more about the precision of the message than the volume of projection. Projecting a simple, standardised message that regulatory reform is unnecessary and that hedge funds and private equity firms are 'good' ignores the complexity of the issues involved and is unlikely to be sufficiently robust in the face of scrutiny from EU regulators. Instead arguments have to be positive but forensic in detail, tailored to particular target audiences and which address their

[51] Private interview, 2013.
[52] Private interview, 2013.

particular concerns. This is all the more important given the myriad of institutions involved in financial regulation at the EU level.

> 'You have to understand what's important to the person you're lobbying. I think we made most impact when we were able to relate our arguments to things that mattered to the people we were talking to. So I think it's about not so much telling a standardised story to everybody. It's tailoring the message to the receiver.'[53]

This requires considerable investment of time and energy to ensuring that the message from UK regulators and industry is, wherever possible, joined up. Presenting different arguments to different audiences will ultimately be counter-productive if those messages are inconsistent and lack credibility.

6. Be the voice of reason

The final lesson is to recognise that technical negotiations are always nested within a wider politics game, making developments both unpredictable and uncertain. Throughout the AIFMD negotiations 'politics' intervened at key junctures to steer the legislative process in a particular direction. The aim of UK regulators and industry in this context should be to try to draw the politics out of the process, to exert influence through the quiet persistence of rational argument, and engage honestly and constructively to defend the founding principles of the EU single market. In a sector with limited political capital, the most important weapons are reason and logic. This will maximise the UK's ability to build winning alliances and hopefully encourage cooler heads to prevail.

[53] Private interview, 2014.

Section 4 Appendix

4.0 The EU Ordinary Legislative Procedure

Since the Treaty of Lisbon the 'ordinary legislative procedure' has replaced the former 'co-decision procedure', reflecting the fact that it has become the most widely used decision making procedure at the EU level. Under this procedure the Council of Ministers (also known as the EU Council) and the European Parliament are co-legislators. In response to a Commission proposal, the two institutions adopt legislative acts under a qualified majority system either at first reading, or at second reading. If, following the second reading, the two institutions have still not reached agreement, a Conciliation Committee is convened. This is the procedure under which all Level 1 financial regulation is adopted.

An overview of the Ordinary Legislative Procedure can be found here:

www.europarl.europa.eu/external/appendix/legislativeprocedure/europarl_ordinarylegislativeprocedure_howitworks_en.pdf

The procedure is fully detailed below:

Article 294, Treaty on the Functioning of the EU

1. Where reference is made in the Treaties to the ordinary legislative procedure for the adoption of an act, the following procedure shall apply.
2. The Commission shall submit a proposal to the European Parliament and the Council.

First reading

3. The European Parliament shall adopt its position at first reading and communicate it to the Council.
4. If the Council approves the European Parliament's position, the act concerned shall be adopted in the wording which corresponds to the position of the European Parliament.
5. If the Council does not approve the European Parliament's position, it shall adopt its position at first reading and communicate it to the European Parliament.
6. The Council shall inform the European Parliament fully of the reasons which led it to adopt its position at first reading. The Commission shall inform the European Parliament fully of its position.

Second reading

7. If, within three months of such communication, the European Parliament:
(a) approves the Council's position at first reading or has not taken a decision, the act concerned shall be deemed to have been adopted in the wording which corresponds to the position of the Council;
(b) rejects, by a majority of its component members, the Council's position at first reading, the proposed act shall be deemed not to have been adopted;
(c) proposes, by a majority of its component members, amendments to the Council's position at first reading, the text thus amended shall be forwarded to the Council and to the Commission, which shall deliver an opinion on those amendments.
8. If, within three months of receiving the European Parliament's amendments, the Council, acting by a qualified majority:
(a) approves all those amendments, the act in question shall be deemed to have been adopted;
(b) does not approve all the amendments, the President of the Council, in agreement with the President of the European Parliament, shall within six weeks convene a meeting of the Conciliation Committee.
9. The Council shall act unanimously on the amendments on which the Commission has delivered a negative opinion.

Conciliation
10. The Conciliation Committee, which shall be composed of the members of the Council or their representatives and an equal number of members representing the European Parliament, shall have the task of reaching agreement on a joint text, by a qualified majority of the members of the Council or their representatives and by a majority of the members representing the European Parliament within six weeks of its being convened, on the basis of the positions of the European Parliament and the Council at second reading.
11. The Commission shall take part in the Conciliation Committee's proceedings and shall take all necessary initiatives with a view to reconciling the positions of the European Parliament and the Council.
12. If, within six weeks of its being convened, the Conciliation Committee does not approve the joint text, the proposed act shall be deemed not to have been adopted.
Third reading
13. If, within that period, the Conciliation Committee approves a joint text, the European Parliament, acting by a majority of the votes cast, and the Council, acting by a qualified majority, shall each have a period of six weeks from that approval in which to adopt the act in question in accordance with the joint text. If they fail to do so, the proposed act shall be deemed not to have been adopted.
14. The periods of three months and six weeks referred to in this Article shall be extended by a maximum of one month and two weeks respectively at the initiative of the European Parliament or the Council.
Special provisions
15. Where, in the cases provided for in the Treaties, a legislative act is submitted to the ordinary legislative procedure on the initiative of a group of Member States, on a recommendation by the European Central Bank, or at the request of the Court of Justice, paragraph 2, the second sentence of paragraph 6, and paragraph 9 shall not apply.
In such cases, the European Parliament and the Council shall communicate the proposed act to the Commission with their positions at first and second readings. The European Parliament or the Council may request the opinion of the Commission throughout the procedure, which the Commission may also deliver on its own initiative. It may also, if it deems it necessary, take part in the Conciliation Committee in accordance with paragraph 11.

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