

The Defense of Economic Interests in the European Union: The Case of Hedge Fund Regulation

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Introduction

After an initial shock caused by its inability to provide a collective response to the financial crisis, the European Union (EU) reacted by drawing up an impressive list of regulatory initiatives (see Quaglia in this volume). The roadmap ranges from financial supervision to the regulation of financial services, covering areas such as capital requirements, deposit guarantee schemes, bank remuneration and credit rating agencies. While some seemed to provide rather technical solutions to problems that were unveiled by the crisis, other proposals were accused of being politically motivated and driven by a pro-regulatory agenda. The financial crisis, the argument went, gave momentum to member states in favor of tighter supranational regulation and disfavored countries with a more light touch approach to financial regulation (Quaglia 2011). In addition, it provided European institutions with an opportunity to seize power and expand their activities, even when there was no direct need for supranational intervention.

The regulation of hedge funds through the so-called Alternative Investment Fund Managers (AIFM) directive adopted in November 2010 seems to be emblematic of this development. Highly politicized, the member state negotiations, that lasted for 18 months, pitted most notably France against the United Kingdom. Since even the Commission's original proposal acknowledged that hedge funds were not responsible for the financial crisis (European Commission 2009b: 3), the battle seemed to represent an ideological commitment to supranational regulation on the one hand, and national autonomy and a continued lack of intervention on the other.

Should one conclude that the AIFM directive arose from mere opportunism, from politicians exploiting the momentum of the financial crisis to drive a pro-regulatory agenda? Did ideologically driven governments instrumentalize the turmoil to attack the suspect industry, all the more because only the UK had considerable economic interests at stake? What explains the regulation of hedge funds in 2010 if they are not directly linked to the financial crisis as some argue?

This chapter counters analyses of European politics that center on ideological battles. By unpacking the positions of the French, British and German governments in the particularly heated debate over hedge fund regulation, I will demonstrate that each defended the interests of their industries, even those that appeared not to have very visible economic stakes. We tend to assume that business interests and the influence of the financial stakeholders are more effective in technical debates, where they benefit from “quiet politics” and the reduced accountability of politicians (Culpepper 2011). However, even in areas of high political salience, business interests can influence the course of European negotiations.

Yet the links between industry and government positions are often surprising and do not neatly reflect the distribution of economic stakes in a given country. Most importantly, *which* industries are most successful in influencing the government depends on how their demands fit the government agenda on financial regulation. In the case of hedge fund regulation, I will show that business influence hinged centrally on its importance to an overarching political objective: a Franco-German alliance on regulatory reform that went well beyond the issue of hedge fund regulation.

In theoretical terms, European negotiations are thus neither driven by economic interests only, as liberal intergovernmentalism assumes (see Moravcsik 1998), nor are they determined entirely by paradigmatic changes or the activism of the supranational institutions, which try to expand their activities. The following account emphasizes the strategic interplay of *some* business interests at the domestic level with the geopolitical strategies of governments at the supranational level.

The empirical account draws on qualitative interviews with industry representatives and policymakers in Brussels and the member states between December 2009 and May 2011, as well as primary documents, such as legislative and policy documents and industry briefs.¹ The chapter is divided into four parts. The first part lays out the history and context of hedge fund regulation prior to the EU’s recent regulatory initiative. The second part, “Economic interests in European alternative investment,” discusses the lobbying efforts and industry stakes in the member states that most actively influenced the discussion. The fourth part, “Geopolitical stakes and the Franco-German alliance,” moves to the intergovernmental level to explain the issue linkage and alliances that were

1 Interviewees included officials from the European Commission, members of the European Parliament, representatives of member state governments and regulatory authorities, industry associations and lobbyists representing the affected sectors, as well as a public official from the US Securities and Exchange Commission.

at stake. I conclude by discussing how these two levels became linked and why they explain the final outcome of the negotiations, and lay out the lessons of this case study for the general examination of business–government relations.

A short history of hedge fund regulation

Hedge funds are investment vehicles that are notoriously difficult to define, but they generally refer to highly leveraged funds open only to wealthy or institutional investors who pay a performance fee to the fund's manager. Using a variety of investment methods, they tend to hold both long and short positions, where investment in supposedly overvalued securities is counterbalanced by investment in undervalued securities. Such strategies should rather be termed “leveraged speculation,” which is the opposite of how the term “hedging” is traditionally used in finance (Edwards 1999: 189).

Hedge funds have developed in particular in countries where securities markets occupy a central role, most importantly the United States and the United Kingdom.² In both these countries, the regulation of hedge funds has tended to be through indirect regulation. Rather than imposing registration or disclosure requirements on the hedge funds themselves, regulation applied to the counterparties. In the United States, hedge fund managers were explicitly exempt from the oversight of the Securities and Exchange Commission (SEC) until recently, while British managers had to be accredited by the Financial Service Authority. In continental Europe, hedge funds were most often directly regulated, including registration, disclosure, and reporting requirements. In Germany, hedge funds, or more specifically the investment techniques they employed, were even prohibited until 2004. By comparison to the United States and the United Kingdom, the French and German hedge fund sector remains negligible (see IOSCO 2009; see Fioretos 2010).

Nevertheless, over the course of the late 1990s and 2000s, hedge funds became an issue of public debate and underwent some scrutiny from international bodies, in particular the International Organization of Securities Commissions (IOSCO) and the Financial Stability Forum (FSF, later renamed the Financial Stability Board, FSB), which both issued a series of principles, guidelines, and recommendations (cf. IOSCO 2009: 39). Even though the indirect supervisory ap-

² The fund itself is a legal entity distinct from its manager and can be domiciled in another country. Most often hedge funds are registered in offshore financial centers, which attract funds through tax exemptions or low regulatory requirements.

proach remained in place, public authorities and industry in the United States and the United Kingdom moved to set up a credible self-governance regime in order to avoid further regulation. In the United Kingdom, the industry created a Hedge Fund Working Group (HFWG) in order to develop an industry-based code and the London-based Alternative Investment Management Association (AIMA) also issued a series of recommendations (IOSCO 2009: 40; Fioretos 2010).

Simultaneously, the European Central Bank became involved in the issue of systemic risks posed by hedge funds and the European Union began working on two directives in the early 2000s that touched directly on the operation of hedge funds. First, it continued revising a directive for collective investment schemes, such as mutual funds, the directive for Undertakings for Collective Investment in Transferable Securities (UCITS). UCITS are investment funds available to retail customers – that is, the general public – rather than to large institutional investors. These mutual funds obtained a European passport through the UCITS directive, originally adopted in 1985, which continued to be revised throughout the 2000s in order to remove barriers to cross-border trade and specify the conditions of their operation. Second, the EU drew up a new directive on investor protection in 2004, the Markets for Financial Instruments Directive (MiFID), which also touched upon certain requirements for alternative investment. But hedge funds were still largely left outside the reach of these initiatives and the European Parliament in particular pressed for tighter regulation of hedge funds and private equity, most notably through the Rasmussen report and the Lehne report in 2008 (see Lutton 2008).

The financial crisis moved the salience of the issue up to a new level (Fioretos 2010; Quaglia 2011). After two decades of simple guidelines and codes of conduct, members of the G20 declared at the London summit in April 2009 that they intended to strengthen financial regulation and to extend it to sectors that were previously not covered, including “for the first time, systematically important hedge funds” (G20 2009: 4).

In parallel, the European Commission published a proposal for the regulation of hedge funds and private equity firms with the intention of imposing registration and disclosure on all funds previously left outside the UCITS directive of 1985. Despite the preceding consultation the Commission had launched and despite the staunch opposition of a substantial part of the industry to the regulatory ambitions, the proposal insisted on the need for a harmonized direct regulatory regime to apply across Europe (European Commission 2009a, 2009b). Specifically, the Commission proposed that all alternative investment fund managers operating in the European market should require authorization and oversight according to commonly defined principles. In exchange, managers authorized to operate in one member state would obtain a “European passport”

that enables them to operate anywhere in the European market without having to apply for additional authorization in the respective countries. Significantly, this passport would also be available for managers of funds domiciled in countries outside the EU.

The proposal, which was produced in record time, according to most observers, created an outcry on all sides. The investment industry and representatives from liberal market economies such as the United Kingdom and Ireland complained about the costly regulatory requirements and some even entirely rejected the proposal. Observers from pro-regulation countries were concerned about the scope of the directive and feared the consequences it would have for the access of funds from off-shore financial centers to the European market. In the intensive negotiations that followed in the European Council and Parliament, substantial revisions were introduced and several times the discussion risked breaking down entirely. In the Council, member states defended their national traditions, while party groups and other stakeholders tried to propose amendments in the European Parliament. During the following eighteen months, representatives from the Commission, the Council, and the European Parliament met in eighteen trilogues before jointly reaching an agreement on October 26, 2010. Between the initial proposal and the final agreement, the European Parliament most notably had tabled 1,690 amendments, a record number which testifies to the contestation and incompleteness of the initial draft proposal (Serrouya 2010). The following sections analyze the different positions and study the evolution of negotiations.

Economic interests in European alternative investment

Understanding the stakes and the evolution of the regulatory efforts requires a study of the interests and coalitions within the EU that led to the current regulatory framework. It is therefore important to examine in which countries the affected industries were located and how they developed their lobbying strategies.

Stakeholders within and beyond the hedge fund industry

The hedge fund industry is divided into several stakeholders: investors, the fund itself, the managers/advisors of the fund and the prime broker/dealers who provide lending to support leverage and facilitate short selling, but also clearing and settlement of trades, and custodial services. In some cases, prime brokers can outsource services to separate custodians. Similarly, hedge fund managers can

outsource administrative functions such as accounting or risk analysis to fund administrators. All in all, this implies that a considerable number of financial service activities are linked to the hedge fund industry (see Hardie/MacKenzie 2007).

The United States is the largest center for hedge fund management, accounting for 68 percent of the total industry in late 2009, followed by Europe with 23 percent, and Asia with 6 percent. Within Europe, 76 percent were managed out of London. Other important locations include Sweden (5 percent), Switzerland (4 percent), France (2 percent), and the Netherlands (2 percent). The funds themselves are predominately domiciled in offshore financial centers: the Cayman Islands are the most popular with 39 percent, followed by Delaware (US) with 27 percent, the British Virgin Islands with 7 percent, and Bermuda with 5 percent of funds. Another 5 percent of global hedge funds are registered in the EU, primarily in Ireland and Luxembourg.

The attraction of the United Kingdom for hedge fund management is linked to the concentration of related services. With approximately half of European investment banking activity conducted through London, it is a central location for prime brokerage, but also administration, custody, and auditing. However, among the largest hedge fund prime brokers, one can also find Deutsche Bank (6 percent share of the brokerage industry), and among hedge fund administrators the French CACEIS Investor Services (6 percent), and the Fortis Prime Fund Solution (6 percent) which is currently owned by the French bank BNP Paribas (all figures from International Financial Services London 2010). Ireland is another important location for hedge fund administration.

Finally, many hedge funds in Europe have recently launched fund vehicles targeting retail investors in order to benefit from the European market for mutual funds established through the UCITS directive. In other words, hedge funds not only offer institutional investors products but have adapted to the regulated retail investor market in order to provide funds which qualify for the European UCITS passport. UCITS services under hedge fund management grew an impressive 50 percent in 2009, in particular in the United Kingdom, but also in France and Luxembourg (International Financial Services London 2010). This development is significant because it implies that hedge funds are beginning to enter into competition with the traditional mutual fund industry, which has been regulated since 1985 under the UCITS directive, prohibiting both leveraging and short-selling. Second only to the United States at the global level, France is a prime location of UCITS funds in terms of both management and domicile: 23 percent of European UCITS funds are managed in France, followed by Germany (20.1 percent), and the United Kingdom (15.8 percent). In terms of domicile, France comes in second with 20.3 percent of funds, after Luxembourg (26.2 percent) (Association française de la gestion financière 2010).

However, the AIFM directive is not just an issue for the hedge fund industry and their competitors. Indeed, one of the most central and most controversial decisions of the initial proposal was to address hedge funds through a directive that covers *all* investment funds that were previously left outside the realm of EU legislation. The definition of the scope of the AIFM directive is therefore a negative definition, seeking to cover “the management and administration of any non-UCITS in the European Union” (European Commission 2009b: 5). While pension funds and non-pooled investment – such as sovereign wealth funds – are excluded, private equity and venture capital funds, real estate funds, commodity funds, infrastructure funds, and other types of institutional funds will have to comply with the AIFM provisions. The private equity industry in particular was very concerned about the directive. Private equity firms, which provide funding for companies that are not publically traded on stock exchanges, are mainly managed in the United Kingdom (12.4 percent), but also in France (4.7 percent), Germany (3.3 percent), and Sweden (1.7 percent) (TheCityUK Research Center 2010). In Germany, real estate funds also play an important role.

It is thus incorrect to state that only the United Kingdom had considerable economic interests at stake because it is home to almost 80 percent of the hedge fund industry. To be sure, the City of London was concerned in almost all aspects of the hedge fund industry and also as a location for all other affected investment funds. But France and Sweden also have important hedge fund activities, all the more so if one includes related services, such as prime brokerage. As preferred locations for the registration of funds within Europe, Ireland and Luxembourg also had an interest in keeping the hedge fund industry flourishing. If one includes private equity and other investment vehicles, the spread of economic stakeholders becomes even broader. The industries and firms that we would expect to lobby in support of light-touch regulation can thus be found in the United Kingdom, France, and Germany. Further support would be likely from Sweden, Luxembourg, and Ireland, if one considers industry stakes only.

However, what is mostly overlooked is that a specific branch of the investment industry was quite concerned about the growth in the unregulated investment sector: collective investment funds falling under UCITS began to enter into the hedge fund market and were in competition with hedge funds offering UCITS-compliant products. This implied that UCITS funds had a strong interest in ensuring that this competition happened within the UCITS regulatory framework, where everybody bore the same costs. UCITS funds were located predominantly in France. In what follows, I will argue that it is the political influence of the UCITS industry that led to the French government’s refusal to accept a European passport for third-country funds.

Lobbying strategies

Many members of the investment industry realized how imminent EU regulation was only when they read the first proposal of the European Commission in April 2009. Investment funds had become used to being unregulated and only paid partial attention to the consultation procedure the Commission had launched between December 2008 and January 2009. For the private equity industry in particular, the draft was a cold shower they did not expect because they had done their utmost to insist on being exempted from investment regulation (interview with a business representative, Brussels, March 4, 2011). For a long time, private equity firms felt that they were “legitimately not regulated” because they provided financing to small and medium-sized companies; in the case of venture capital “they were the nice guys” helping firms focusing on technological innovation, even in risky contexts (interviews with a business representative, Paris, February 10, 2011; European Commission, March 10, 2011).

In the period following the publication of the proposal, the CEOs of investment funds relied on their well-established ties with national politicians and sometimes insisted even on their most basic desire: to be exempt from the pending regulation. This initial lobbying period was somewhat awkward and unsuccessful at the European level. According to one representative:

[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 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. (Interview, Brussels, March 4, 2011)

A learning period had to be gone through before investment firms got organized and begin to contribute constructively to the negotiations in order to limit the negative impact on their sector of activity. Eventually, most business associations ended up endorsing the general ambition of the proposal, but suggested substantial modifications in the heart of the text. The private equity industry’s lobbying strategy is illustrative of this evolution: their European association EVCA withdrew an initial policy statement where they had spoken out entirely against the proposal and began to support the idea of European harmonization in order to be able to shape the details of the directive (interview, European Commission, Brussels, March 10, 2011).

Simultaneously, the national associations lobbied their ministries, regulators, and national Members of the European Parliament (MEPs) to gain support for the common position. British industry representatives from all concerned domains, furthermore, coordinated their lobbying in both London and Brussels and deployed a tremendous effort to shift the details of the draft, as well as the

general attitude in the European Parliament, and also the Commission, in favor of light-touch regulation.

Still, the British industry was initially not used to collective action because they had never been the object of substantial regulatory efforts. Firms could choose to be represented by AIMA, the Association of Investment Companies (AIC), or the Investment Management Association (IMA), but membership was not an obligation, in contrast to France, for example. A 2009 parliamentary report highlighted that the Hedge Fund Standards Board, which collectively defined industry standards, AIMA's voluntary code of conduct, had only 34 members out of 400 to 450 firms (House of Commons 2009: 128). To ward off what felt like a European attack on the British regulatory model, Her Majesty's Treasury, the FSA, and the industry mobilized in several working groups. As one public official explained:

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. (Cited in Prabhakar 2011: 119)

In contrast to these big investment funds, which grasped the importance and functioning of the European policymaking process only during the course of the negotiations in 2009 and 2010, the UCITS industry had been playing the game since 1985. Having been active in several revisions of the UCITS directive, they monitored developments in Brussels much more closely and already had well established ties at the national level with public officials working on EU regulation, as well as in Brussels. This difference in EU public affairs experience would turn out to matter immensely, since the UCITS industry was able to make a very forceful case against some of the provisions of the AIFM directive from very early on (interview with a business representative, Frankfurt a.M., February 21, 2011). According to one observer, the relationship between these funds and the French finance ministry is the only plausible reason that can explain the rigid position France defended throughout the negotiations. He argued,

[French finance minister] Lagarde and [other French representatives] took issue with third country passports, even though it was not the position of the banking or private equity industry or the 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 went with it all the way. (Interview with a business representative, Brussels, March 4, 2011)

Indeed, a French public official declared himself to be puzzled by his governments' positions, since it "does not reflect the interests of the French invest-

ment industry, which looks much more similar to the British industry than one is led to believe” (interview, Paris, November 25, 2009).

While the French government argued that their position was in line with the battle against tax havens, which often hosted alternative investment funds, several observers doubt the validity of this argument. According to the proponents of the proposal, including French MEPs such as Jean-Paul Gauzès, the acceptance of the passport system was a more efficient way of imposing constraints on tax havens than its rejection (interview, Paris, May 19, 2011).

Why was a small portion of the French industry so efficient in its lobbying that it outweighed all other business interests on these issues and almost brought the AIFM negotiations to a standstill? In what follows, I will argue that we need to consider the member states’ strategic alliances on financial regulation more generally to understand which demands translated into the ones the member states defended at the EU level.

Geopolitical stakes and the Franco-German alliance

In particular, a Franco-German alliance on regulatory reform in international finance turned out to be crucial for the evolution of the AIFM negotiations. The joint interest in hedge fund regulation began as early as 2007, at the G8 summit in Heiligendamm, but at the time, proponents of a more regulatory approach had little momentum. As the financial crisis unraveled, both French and German policymakers realized that they should seize the opportunity to move ahead on their respective objectives.

Germany had remained suspicious of hedge funds since they allowed their operation in 2004 and wished to regulate them tightly. The experience of the Deutsche Börse takeover and a general public mistrust of alternative investment funds such as private equity, made hedge funds fertile ground for political activism in Germany (cf. Milne 2008). French President Nicolas Sarkozy, in turn, sought to capitalize on the financial crisis to become known for a new financial architecture he wished to push under the French presidency of the EU in the second half of 2008 and later the French presidency of the G20 from 2010 to 2011, just months before his upcoming election. Facing countries with a more light-touch tradition on financial regulation, the two governments made a pact to support each other in order to defend a pro-regulatory agenda against the Anglo-Saxon *laissez-faire* tradition. This general agreement fundamentally shaped alternative investment negotiations. According to a French government representative:

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. (Interview, Paris, November 25, 2009)

The first person to succumb to the pressure of the Franco-German alliance was Internal Market Commissioner Charlie McCreevy. Initially, he had declared publicly that hedge funds would not be regulated under his leadership, and allegedly signaled his staff that anybody working on such a proposal would be fired (interview cited in Prabhakar 2011: 110). However, as Commission President José Manuel Barroso faced re-election in 2009, the French and German governments indicated that progress on a hedge fund directive was important in order to obtain their support. With similar signals from the European Parliament, Barroso insisted that a proposal be ready as soon as April 2009. As a result of these political imperatives, a proposal was produced in record time and without much exchange with national officials after the official consultation in January 2009. The inspiration for much of the original text came from existing European directives, in particular UCITS and MiFID, simply in order to save time, which explains why even supporters of the regulation were disgruntled when they read the first draft (interview, Paris, December 10, 2009). Arguing that British mistrust was partly unjustified, a French official underlined, “[the British] are convinced that France is behind this directive, but I can assure you that it came from DG Market, maybe with some help from the Germans” (interview, Paris, November 25, 2009).

Most importantly, German government representatives were concerned about the effects of alternative investment on the company structure and corporate governance regime of German firms. They therefore wanted the most comprehensive regulation possible to ensure that no type of investment would threaten co-decision procedures and workers’ rights. France might have not been behind hedge fund regulation in general, but they did have strong opinions when it came to the details. A European solution was advantageous because the UCITS blueprint that was copied into the AIFM proposal reflected many of the particularities of the French market. However, they were very concerned about the third-country passport, whose negative effects had been highlighted by their UCITS industry. Throughout the 18 months of negotiations and the 18 trialogues between the Commission, the Council, and the European Parliament, this issue became the most important bone of contention. The French showed no intention of opening the European market to offshore funds, which effectively made the proposal unacceptable to the British industry.

After repeated stalemates in July, September, and October 2010, it became clear that France had become isolated in its opposition to the third-country pass-

port in the Council. Nevertheless, in preparation for an Ecofin Council meeting, the representative from the treasury who was supposed to represent Germany got a call from the finance minister, Wolfgang Schäuble, who insisted “I promised Christine Lagarde that you will not isolate her” (interview, Brussels, March 4, 2011). In spite of their doubts about the substance, the Germans thus dug out time for France to propose a last compromise, suggesting that the new European Securities Market Authority (ESMA) should be charged with the licensing of third-country fund access to the EU market (EurActiv 2010a). The British refused to grant such powers to a European authority and even US Treasury Secretary Timothy Geithner intervened by writing to French Finance Minister Christine Lagarde to warn about the consequences of French protectionism.

With strong opposition from the United Kingdom and German backing waning, the French finally decided to accept a compromise, which allowed third-country access and left it up to national regulators to grant third-country funds access. In exchange, the United Kingdom agreed to delay access for third-country funds until 2015. Moreover, ESMA was charged with drawing up the requirements these funds will have to fulfill and is expected to settle disputes between national regulators if they disagree on whether a fund should have been eligible (EurActiv 2010c).

This final agreement was reached on October 26, 2010, leading to the adoption by the European Parliament on November 11, just in time to present the new EU regulatory framework at the G20 meeting in Seoul on November 12, before it was approved by the Council of Ministers on November 17. While member states concentrated on national fault-lines, the European Parliament advanced on substantial changes. The unusually high number of 1,690 amendments was necessary, according to MEP Jean-Paul Gauzès, rapporteur of the directive, to build support from both camps: those who insisted on the need for more control and those that pointed to the ensuing costs for the affected industries (interview, Paris, May 19, 2011). Bringing the hastily written draft in line with the realities of different alternative investment funds required him to hold 198 meetings with industry representatives (Serrouya 2010). The European Commission official following the directive admits having stopped counting by the time he reached 150 meetings (interview, Brussels, March 2011).

The directive came into force in January 2011. From this date on, each Member State has two years to transpose the directive into national law, accompanied by ESMA, which will provide advice on the most appropriate implementation measures for the 210 pages of the directive. This means that the directive becomes practically effective only in January 2013. The passport for third-country funds and managers will become available after an additional two-year transition period in January 2015.

Conclusion

The AIFM directive was one of the EU's most disputed post-crisis regulations, which most importantly pitted France against the United Kingdom. As with most political compromises, none of the negotiators obtained what they initially aimed for. While the United Kingdom had to accept that alternative investment would be regulated at the supranational level, France was not able to exclude off-shore funds in principle from the European market. Although the British press continued bashing French protectionism and the unjustified regulatory push of the EU, even *The Economist* defended the proposal as a useful attempt to simplify and harmonize the existing regulatory frameworks (Anonymous 2010). Indeed, the fund industry in London now has the advantage of a one-stop regulatory interaction for all operations in the European market. Rather than applying for a license from each regulatory authority of the countries they wished to operate in, they could now use a license granted in one country to operate anywhere else in Europe.

France in turn obtained a regulatory framework for institutional investment that looks quite similar to the one they initially helped to shape for the retail mutual funds market. However, despite the insistence of the French government, the origin of funds is not an issue, as long as they comply with the regulatory requirements imposed on hedge fund managers.

For the German government, any encompassing regulation is satisfactory, as the economic interests of their industry are least directly exposed. Concerned with the preservation of the German company structure, German MEPs were most interested in issues such as asset stripping, which was a central issue for private equity firms. The final agreement now limits the selling off of capital – or asset stripping – in the years after the company is bought by a private equity investor. Regulating asset stripping reduces the attractiveness for private equity firms to buy a company in order to sell off its assets and make a quick profit (EurActiv 2010b).

In sum, despite the heated political debates, the hedge fund regulation resembles other initiatives to harmonize operations in the European market. Nevertheless, the most important issue will be the implementation of the ambitious project. One will have to judge in several years whether the framework merely opened up a pan-European market or actually provided additional control mechanisms over alternative investment that can be used effectively.

What this case study has tried to demonstrate is the strategic nature of business–government interactions and intergovernmental negotiations in the EU. It is insufficient to study the distribution of business interests or to state that paradigmatic change can trigger important reorientations in the regulatory agenda. To be sure, each government is very concerned with its industry interests and

tries to make sure that policy proposals do not damage vital parts of their economies. Likewise, new economic ideas and the reorientation of public intervention after the crisis are also important to understand the momentum of political activism. However, one needs to ask *which* economic interests a government will ultimately defend and *when* paradigmatic change leads to political action.

The answer given in this study is that it depends on the strategic constellation of actors at both levels: domestically and internationally. Domestically, a specific portion of the French industry skillfully lobbied the French government from very early on to protect the competitive conditions in their sector. This lobbying turned out to be very consequential for most of the negotiations because it allowed the French government to build and maintain an alliance with Germany, which was very eager to advance on hedge fund regulation.

The feedback loops between the initial interests and the strategic advantages these provided are thus context-specific and can evolve over the course of negotiations (Farell/Newman 2011). We should therefore expect the politics of financial regulation in the EU to vary depending on the alliances countries chose to engage in but also in response of the lobbying strategies of the financial industry and other stakeholders. Importantly, those interest groups that are able to fit their demands into the overarching geopolitical objectives of their governments are most likely to influence the evolution of these international negotiations.

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