association of the luxembourg fund industry

Luxembourg, 23 March 2012

ALFI's response to ESMA discussion paper on key concepts of the Alternative Investment Fund Managers Directive and types of AIFM

ALFI represents the Luxembourg investment management and fund industry. It counts among its membership asset management groups from various horizons and a large variety of service providers. According to the latest CSSF (*Commission de Surveillance du Secteur Financier*) figures, on 31 January 2011, there are 3 837 undertakings for collective investment in Luxembourg (UCITS and non-UCITS), representing 13 273 active compartments representing a total, in terms of net asset value EUR 2.157.081billion.

ALFI welcomes the clarification that ESAM is seeking to bring to the appropriate interpretation of the Directive, and we recognise the complexity involved in this attempt.

We take advantage of the opportunity to express our views and suggestions. In addition, however, we believe it is important to voice our opinion with regard to some of the elements of the narration that are not themselves subject to specific questions.

1. We welcome ESMA's clarifications in relation to:

- Part V: Appointment of AIFM
- Part VI: treatment of UCITS management companies
- Part VII: treatment of MiFID firms and credit institutions

2. However, we do not think that ESMA's clarifications are helpful in relation to:

- Part III : definition of AIFM
- Part IV : definition of AIF

On these areas, we understand that the test of ESMA is particularly complex. We are of the view that the proposed clarifications raise more questions than provide answers.

We disagree with ESMA's approach on a number of points. ALFI therefore suggests that, during an initial period, national competent authorities shall apply the AIFM Directive in relation to " definition of an AIFM " and "definition of an AIF" on the basis of the already detailed provisions of the AIFM Directive in this regard. Competent authorities have substantial experience and knowledge in these areas, and will therefore be able to adopt a coherent approach. This does not prevent competent authorities from consulting each other, or ESMA from issuing clarification at a later time.

Furthermore, article 4(4) of the AIFM Directive provides that ESMA shall develop draft technical standards to determine types of AIFM, where relevant in the application of the directive, and to ensure uniform conditions of application of the directive. According to Regulation n° 1095/2012 of the European Parliament and European Council which forms the basis of the above technical standards, the

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regulatory technical standards are of a technical nature, do not imply any strategic decision nor policy choice, and their content is determined by the legislative acts on which they are based.

With respect to the above sections, we believe that ESMA goes beyond the purpose of mere technical standards. It identifies policy orientations (as expressly mentioned in the executive summary) which in our opinion go beyond the mandate of issuing technical standards, or suggests interpretations which go beyond the terms of the AIFM Directive.

Finally, article 4(4) refers to ensuring uniform conditions of application of the AIFM Directive. Rather than providing policy orientations or suggestions of interpretation, we believe that it would be useful for ESMA at this stage to consult the stakeholders on whether the criteria of the AIFM Directive to define the AIFM and the AIF would need further clarification.

3. In light of the above, we would like to comment on the views expressed by ESMA in points 6 to 10, although not subject to specific questions within the context of this consultation.

In respect to point 8 regarding the extent of the delegation of functions, we believe that the interpretation goes beyond the AIFM Directive, and suggests an interpretation which is contrary to the AIFM Directive. Indeed, point 8 provides that an AIFM may delegate the two functions (i.e. portfolio management and risk management) either in whole or in part, in the understanding that an AIFM may not delegate both functions in whole at the same time.

This interpretation is contrary to the provisions of the AIFM Directive which provides that "the AIFM's liability towards the AIF and its investors shall not be affected by the fact that the AIFM has delegated functions to a third party, or by any further sub-delegation, nor shall the AIFM delegate its functions to the extent that, in essence, it can no longer be considered to be the manager of the AIF and to the extent that it becomes a letter-box entity."

The AIFM Directive thus does not limit the possibility to delegate both functions at the same time, the limit to the delegation being for the AIFM to remain liable and not to become a letter box entity. In this regard, it is worth mentioning that the extent of the delegation (i.e. the concept of letter box entity) is already part of the ESMA Final Report (as one of the delegated acts to be adopted by the Commission according to article 20(7) b)), which defines the above concept as the situation where the AIFM is no longer able to effectively supervise the delegated tasks and to manage the risks associated with the delegation nor is it able to take decisions in key areas which fall under the responsibility of the senior management.

Therefore, neither the AIFM Directive nor the ESMA Final Report contain a limitation as to the possibility to delegate both risk and portfolio management at the same time.

The suggested interpretation does not stand the terms of the AIFM Directive and cannot in our opinion be maintained.

Equally, point 10 goes beyond the AIFM Directive, and imposes an additional liability on the AIFM which may itself be in opposition to the possibility otherwise afforded by the AIFM Directive of making the most appropriate entity the AIFM, irrespective of the legal structure and administrative roles and responsibilities of the parties involved in the legal structure (GP, Management Company etc…). We would advocate that this introduces complexity and additional cost (ultimately borne by the investors) without a corresponding demonstrated benefit, and advocate remaining with the original terms of the AIFM Directive. For the avoidance of doubt, we respectfully disagree with the suggestion made under

point 10 that a combination of Article 20(3) and Article 5(1) of the AIFM Directive should be read to mean or imply that (i) the appointed AIFM is deemed to have delegated "other functions" where as a legal and factual matter it actually has not (because the relevant AIF has done so direct) and/or (ii) the AIFM must accept liability towards the AIF and its investors for services which are out of the scope of their contractual arrangements. In particular, Article 5(1) specifically refers to the single AIFM being responsible "for ensuring compliance with this Directive" – which is entirely different from taking on full ultimate liability for the actions or omissions of other service providers (which do not take on investment management functions and are not the AIFM's contractual delegates). This becomes even more apparent when reading paragraphs (2) and (3) of Article 5 which deal with the obligations of the AIFM where the latter is unable to ensure compliance with the Directive and which clearly direct towards the regulatory nature only of these obligations. We therefore take the view that the opinion expressed by ESMA under this point is not in line with the AIFM Directive.

In addition, we would like to stress the fact that the AIFM Directive is clear, precise and unconditional on the fact that it is sufficient, for an AIFM to so act, to provide (take the responsibility of) both portfolio and risk management without having to perform the additional activities (administration, marketing) and without providing in such a case that those activities are to be considered as having been delegated to third parties. Therefore again, the proposed interpretation goes beyond the terms of the AIFM Directive.

4. Answers to the questions

1. **Do you see merit in clarifying further the notion of family office vehicles? If yes, please clarify what you believe the notion of 'investing the private wealth of investors without raising external capital' should cover.**

It is not necessary to further define the concept of family office vehicles which is sufficiently defined by the notion of investing the private wealth of investors without raising external capital. The definition of AIF refers to the concept of "raising capital" and we believe that the notion of family office vehicles referred to in Recital 7 of the AIFM Directive is just one example of situations where no external capital is raised, since there is a prior relationship between the family office and family members.

2. Do you see merit in clarifying the terms 'insurance contracts' and 'joint ventures'? If yes, please provide suggestions.

Similarly, the terms "joint ventures" refer to a situation where no capital is raised since two or more investors undertake a specific business project and take the initiative of investing together without any initiative for raising external capital.

Regarding the terms "insurance contracts", we do not find it adequate to introduce a definition of "insurance contract" in the context of the AIFM Directive. If these terms are to be defined, it would be adequate to define them in the context of a directive specific to insurance sector and by involving the competent authorities and relevant stakeholders.

3. Do you see merit in elaborating further on the characteristics of holding companies, based on the definition provided by Article 4(1)(o) of the AIFM Directive? If yes, please provide suggestions.

We do not see any benefit in a further clarification of what constitutes a holding company which is already clearly defined in the AIFM Directive.

4. Do you see merit in clarifying further the notion of any of the other exclusions and exemptions mentioned above in this section? If yes, please explain which other exclusions and exemptions should be further clarified and provide suggestions.

We do not see the merit in clarifying any of the other exclusions and exemptions at this stage, i.e. before the AIFM Directive is implemented in the various Member States.

5. Do you agree with the orientations set out above on the content of the criteria extracted from the definition of AIF?

We feel that point 25 does not truly clarify the question of what is to be considered as "raising capital" – the specific land example could imply that a "time share" arrangement, marketed by a promoter to investors could conceivably fall within the scope of this definition, which we believe not to be the intention of the Directive. We would suggest the removal of the example.

As to point 29, we agree that in the case of a nominee arrangement where a single investor represents a number of underlying beneficial owners, the fund is still to be considered as addressed to a number of investors for the purpose of the AIFM Directive.

However, in the case of feeder / fund of fund investments, the answer is different. Indeed, if an entity (such as a pension fund or similar entity) is investing in target assets through a wholly owned conduct vehicle, such vehicle shall not be considered as an AIF. Considering that it would characterise as an AIF would be contrary to the directive.

The look through approach is therefore limited to true nominee arrangements, *i.e.* where a legal entity holds units of an AIF for the sole purpose of holding them for the benefit of beneficial owners. Therefore, for feeder /fund of und structures, a look through approach should not be applied.

6. Do you have any alternative/additional suggestions on the content of these criteria?

No, we do not have any additional suggestion.

7. Do you agree with the details provided above on the notion of raising capital? If not, please provide explanations and an alternative solution.

We would take the view that the absence of capital raising precludes an entity from being considered an AIF as capital raising is specifically foreseen by Article 4.1(a). Moreover, it would be logical to understand this concept in the context of what constitutes marketing under the AIFM Directive or this could otherwise create an uneven playing-field with third country funds. By way of example, two commercial companies deciding to establish a joint venture vehicle in order to develop an investment strategy would not be regarded as raising capital although the creation of such joint venture vehicle necessarily entails some kind of communication by way of business.

8. Do you consider that any co-investment of the manager should be taken into account when determining whether or not an entity raises capital from a number of investors?

One of the criteria provided by the Directive to define AIFs is approaching investors to seek capital from them. Co-investment in this respect is only an example of a situation which may occur and must be taken into account as a factual situation in the determination of whether or not an entity raises capital from a number of investors.

It would be illogical to include the co-investment of the Manager as in such a case the manager is taking the initiative of the investment. Therefore there is no capital raising from a number of investors but only capital raising from the single investor with whom the manager is co-investing.

9. Do you agree with the analysis on the ownership of the underlying assets in an AIF? Do other ownership structures exist in your jurisdiction?

10. Do you agree with the analysis on the absence of any investor discretion or control of the underlying assets in an AIF? If not, please explain why.

Questions 9 and 10

We do not agree with the above analysis under point 9 and 10 which goes beyond the purpose of mere technical standards and beyond the terms of the AIFM Directive. We refer in this regard to our preliminary remarks.

11. Do you agree with the proposed definition of open-ended funds in paragraph 41? In particular, do you agree that funds offering the ability to repurchase or redeem their units at less than an annual frequency should be considered as closed-ended?

We support this definition and welcome the intention to avoid burdensome additional reporting without a corresponding economic or operational imperative.

12. Do you see merit in clarifying further the other concepts mentioned in paragraph 37 above? If so, please provide suggestions.

We welcome the explanation with respect to paragraph 37 and consider that they are sufficiently clear.

VI. Treatment of UCITS management companies

13. Do you agree with the above analysis? If not, please provide explanations.

We agree with the above analysis.

VII. Treatment of MiFID firms and Credit Institutions

14. Do you agree with the above analysis? If not, please provide explanations.

Yes, and we welcome the clarification.