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ESMA's Call for Evidence regarding Implementing Measures on the Alternative Investment Fund Managers Directive (CESR/10-1459)

Dear Mr. Comporti,

BVI¹ welcomes the opportunity to express its preliminary views on the upcoming implementing measures to the Alternative Investment Fund Managers Directive (AIFMD). We are glad that ESMA has chosen to engage in a dialogue with the industry and other stakeholders at this early stage of discussion. We understand that this first consultation is targeted on preliminary opinions regarding the broad range of topics at hand and that critical issues will be subject to more detailed and specific consultations in the months to come. BVI stands ready to assist ESMA throughout this process and would like to encourage ESMA to retain its open-minded attitude as regards exchange of views with the industry.

Preliminary Statements

We are clearly aware of the immense challenge posed to ESMA by the Commission's mandate on Level 2 measures to AIFMD in terms of both

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extent and timing. Given the mandatory nature of most implementing measures provided for by the Level 1 Directive, the latitude to set priorities for the commencing legislative process is considerably limited.

Nevertheless, in view of the complexity of the subject matter, we urge ESMA not to take hasty decisions on legislative standards applicable to the AIF universe. On the contrary, it should be a clear premise of the regulatory action that the implementing provisions to AIFMD must allow for appropriate treatment of all fund types covered by the EU Directive. Where such a satisfactory outcome cannot be guaranteed, or in respect of particularly contentious issues, it appears preferable to confine Level 2 measures to broad principles, while leaving the elaboration of detailed requirements to further discussions at Level 3.

Furthermore, the Commission's mandate does not cover regulatory and implementing technical standards which may be developed by ESMA in order to harmonise authorisation procedure for AIFM / notification procedure for AIF as well as details of information to be submitted to the authorities (cf. Article 7 para. 6 and 7, Article 31 para. 5, Article 32 para. 8). However, it is obvious that such standards, once adopted, would constitute significant elements of the regulatory framework for AIFM. Therefore, should ESMA Members decide to exercise these regulatory options, it would be most important to launch the respective work as soon as possible in order to ensure adoption of technical standards in due time before the AIFMD entry into force at national level.

Specific Comments

In the following, we would like to submit some deliberations upon the questions for the call for evidence posed by ESMA before turning to the details of the Commission's mandate for possible Level 2 measures.

Question for the call for evidence

1. Which categories of investment manager and investment fund will fall within the scope of the Alternative Investment Fund Managers in your jurisdiction? Please provide a brief description of the main characteristics of these entities (investment strategies pursued, underlying assets, use of leverage, redemption policy etc).

BVI, being the representative body of the industry in charge of open-ended collective investment undertakings, would like to focus its comments on implications of AIFM Directive on open-ended products. In Germany the legal framework for these vehicles is, in principle, modelled after the UCITS Directive. The main investment objectives of most open-ended AIF can even be considered as “UCITS-like” or “UCITS style”, i.e. the management aims at generating long-term capital growth in addition to gaining income in conformity with the market. Thus, most of the following fund types invest in assets which either would qualify as eligible assets for UCITS or are equivalent to those. Furthermore, the managers of most of these products observe the risk-spreading rules as well as the investment limits as provided by UCITS III, or such rules and limits which can be considered equivalent to the UCITS III provisions. The following description highlights the major features of the German AIF.

Among the open-ended investment funds existing in Germany, the following vehicles will be covered by the AIFM Directive:

1. Special Funds

This fund category is designed exclusively for institutional investors in the sense that fund rules of Special Funds allow no acquisition of units by natural persons. Special Funds are regulated vehicles enjoying some more flexibility in terms of available investment options and supervision compared to retail funds. They can invest in both financial instruments and real estate in a discretionary proportion; however, the existing vehicles do not tend to mix up these elements. Special Funds set up for credit institutions and investment firms do even adhere to the catalogue of eligible assets and investment limits specified by the UCITS Directive. Special Funds are extremely popular with German institutional investors – their AuM have constantly risen over the last years (with a temporary break-in due to the financial crisis) and account today for over 800 bn of assets.²

The structure of Special Funds differs profoundly from Hedge or Private Equity Funds. Investment in private equity is limited to 20%. In terms of leverage, Special Funds generally have to adhere to the UCITS standards. The same applies to the principle of risk spreading. Short

² According to BVI statistics by 31 October 2010.

selling is generally forbidden. Special Funds investing in real estate are subject to the same investment limits as retail Open-Ended Real Estate Funds. The limit for short-term borrowing agreements is set at 30% of the fund assets.

A further particularity of German Special Funds is the usually very limited number of investors. By far the most Special Funds are launched for a single institution. In practice, this means that the initial fund design and its subsequent modifications are developed in close contact with the investor which renders Special Funds truly bespoke investment instruments.

2. Open-Ended Real Estate Funds

Open-Ended Real Estate Funds (OEREFs) offer both retail and professional investors indirect participation in real estate markets in combination with adequate liquidity and investor protection. Like all the other investment vehicles described herein, they are regulated in a manner very similar to UCITS. In particular, OEREFs have to provide for equivalent issuance and redemption policies and adhere to equivalent risk spreading rules with regard to the specifics of real estate.

OEREFs invest in real estate either directly or through Special Purpose Vehicles. They are obliged by law to provide for liquidity buffers which must amount to at least 5% of AuM (in practice usually 10-20%).

Valuation of immoveable property is provided by independent experts. Their appointment by a management company, the exercise of their functions and the valuation methods are subject to strict regulation. In general, the assets will be valued prior to their acquisition and disposal, and at least every twelve months.

Leverage in OEREFs is allowed only by means of direct borrowing which is limited to 50% of the market value of the real estate held by the fund. In this case, only the existing assets held in the fund serve as collateral for the debt. As a result, there is usually no recourse to the fund as such or its investors. In addition, OEREFs are entitled to 10% temporary borrowing in accordance with the UCITS rules.

Since decades, OEREFs have been very popular with retail investors in Germany and reach a volume of currently more than 86 bn of AuM. In the course of the financial crisis, a number of these vehicles experienced liquidity problems as mostly institutional investors had claimed their redemption rights. As a consequence, OEREFs are currently subject to a legislative review with the aim of optimising provisions on redemption rights and the frequency of the valuation of assets.

3. Balanced Funds

Balanced Funds are meant for retail investors and allow for greater diversification of assets through investments e.g. in OEREFs, Hedge Funds and "Other Funds" (cf. below).

4. "Altersvorsorge-Fonds"

These so-called Old Age Provision Funds are distinguished by a portfolio structure deemed particularly suitable for the purpose of retirement saving. Altersvorsorge-Fonds invest exclusively in securities and units of OEREFs with maximum quota for equity (75%) and OEREF investments (30%).

5. Employee Participation Funds

This new type of fund is meant to encourage tax-privileged employee participation in employer companies. At least 60% of assets of Employee Participation Funds must be invested in shares, debt instruments or non-securitised debts of companies granting their employees related tax benefits.

6. Infrastructure Funds

Infrastructure Funds are admitted to invest up to 80% of their assets in PPP companies and up to 30% of their assets in real estate used for public purposes.

7. So-called "Other funds"

This fund type is allowed to invest up to 20% of the fund assets in companies whose shares are not admitted to trade on regulated markets

(private equity) and up to 30% in noble metals, derivatives and non-securitised titles.

8. Hedge funds and funds of hedge funds

German hedge funds are regulated vehicles (so-called funds with additional risks) which, according to their fund rules, engage in physical short selling and/or unlimited leverage. They are not admitted to public marketing, but can be sold to retail investors.

In general, all types of funds can be engineered as both contractual and corporate-type vehicles. The use of a contractual structure is compulsory only with regard to OEREFs, Infrastructure Funds, Special Funds investing in real estate or infrastructure projects and Employee Participation Funds.

The existence of such divergent vehicles in the German open-ended fund sector alone makes clear that **the detailed requirements for AIFM to be determined at Level 2 must be subject to reasonable differentiations**. We are aware that, just because of the varying fund types existing at national level, the differentiation cannot depend on generic fund labels but, as suggested by the Commission in the introductory part of the mandate, should be based on objective characteristics of AIFM and AIF. As regards the latter, we strongly suggest differentiating not only between vehicles of open-ended and closed-ended type, but to take into account variations in fund assets, risk and liquidity profile and target investor or group of investors.

Beyond the open-ended fund universe, there are also several variations of closed-ended funds in Germany which will be affected by the AIFM Directive. BVI is, however, not able to provide more detailed information on the extent of expected AIFMD application in this regard as its members do not offer products of the closed-ended type.

Question for the call for evidence

2. Among the topics that will be covered by the implementing measures, which do you consider would be most appropriately adopted in the form of regulations or directives? Please explain your choice.

BVI believes that the Level 2 measures for the UCITS Directive strike a reasonable balance as regards topics to be covered by the implementing

Directive respectively Regulation. In general terms, we are of the opinion that technical issues like content and format of reporting and disclosure obligations as well as elements of leverage definition should be subject to a directly applicable EU Regulation. EU Directive, on the other hand, appears an appropriate legislative instrument for aspects like internal organisation, conduct of business and duties / liability of depositary which all have certain implications for the national civil law. With respect to the Commission's mandate, this would mean that measures relating to Part I and II would be more eligible for EU Directive, whereas Level 2 provisions on Part III should be adopted rather in the form of EU Regulation.

Question for the call for evidence

3. Can you identify useful sources of data and statistical evidence from which CESR could benefit in the preparation of its advice?

The official statistics prepared by the Deutsche Bundesbank or other central banks might prove to be helpful for this purpose. Another source of data could be industry statistics, in particular data collected and processed by EFAMA. BVI itself is in possession of extensive statistical information on the German fund market. We will be happy to provide ESMA with further details on request.

Part I of the Commission's mandate: General provisions, authorisation and operating conditions

II.1. Issue 1 – Article 3 Exemptions

Due to the considerable volume of their assets under management, BVI members will not benefit from any exemption from the AIFMD scope of application. Therefore, we have no comments on implementing measures for exemptions.

II.2. Issue 2 – Article 9 Initial capital and own funds

Questions:

1. CESR is requested to provide the Commission with a description of the potential risks arising from professional negligence to be covered by additional own funds or the professional indemnity insurance referred to in Article 9(7).

2. CESR is requested to advise the Commission on how the appropriateness of additional own funds or the coverage of the professional indemnity insurance to cover appropriately the potential professional liability risks arising from professional negligence referred to in Article 9(7) should be determined, including – to the extent possible and appropriate - the methods to calculate the respective amounts of additional own funds or the coverage of the professional indemnity insurance.
3. CESR is requested to advise the Commission on the best way to determine ongoing adjustments of the additional own funds or of the coverage of the professional indemnity insurance referred to in Article 9(7).
4. CESR is invited to take account of work done in the context of the Capital Requirements Directive and to liaise as appropriate with CEBS and CEIOPS on this issue.

As regards professional indemnity insurance, it is important to take into account any insurance protection provided for delegated activities at the level of a delegatee company. As a rule, no double insurance coverage of operational risks should be required.

II.3. Issue 3 - Article 12 General principles

Questions:

1. CESR is requested to advise the Commission on criteria to be used by the relevant competent authorities to assess whether AIFM comply with their obligations under Article 12(1).

In order to ensure consistent regulation of companies providing multiple asset management services (management of AIF and UCITS as well as individual portfolio management), Level 2 measures on organisation and conduct of business rules should be very closely aligned with implementing provisions for UCITS Directive and MiFID.

II.4. Issue 4 - Article 14 Conflicts of interest

Questions:

1. CESR is requested to provide the Commission with a description of the types of conflicts of interests between the various actors as referred to in Article 14(1).
2. CESR is requested to advise the Commission on the reasonable steps an AIFM should be expected to take in terms of structures and organisational and administrative procedures in order to identify, prevent, manage, monitor and disclose conflicts of interest.

For reasons stated above, Level 2 measures relating to conflicts of interests should be modelled upon the implementing provisions for UCITS Directive and MiFID.

II.5. Issue 5 – Article 15 Risk management

Questions:

1. CESR is requested to advise the Commission on the risk management systems to be employed by AIFM as a function of the risks that the AIFM incurs on behalf of the AIF that it manages and on the criteria that competent authorities should take into account when assessing for the AIF managed by the AIFM whether the risk management process employed by the AIFM is adequate in order to identify measure, manage and monitor appropriately all risks relevant to each AIF investment strategy and to which each AIF is or can be exposed.

In particular, CESR is requested:

- a) to advise on the categories of risk relevant to each AIF investment strategy and to which each AIF is or can be exposed and the methods for identifying the risks that are relevant for the particular AIF investment strategy or strategies so that all risks are adequately identified.
- b) to advise, to the extent possible, on methods for quantifying and measuring risks including the conditions for the use of different risk measurement methodologies in relation to the identified types of risk so that overall risk exposures as well as contributions to overall risk from each risk factor are properly measured.

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| c) to advise on adequate methods for managing and monitoring all such risks so that the AIF risk exposures respect at all times the risk objectives of the AIF. |
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In general, implementing measures for risk management should take account of the recently overhauled provisions for UCITS. In our view, the risk management concept introduced by the UCITS IV Directive represents a high quality standard which should be appropriate also for management of risks arising from the management of AIF which can be deemed “UCITS-like” as elaborated above.

Therefore, the implementing measures should comprise principles similar to those laid down in CESR Risk Management Principles for UCITS. AIFM running sophisticated / complex investment approaches engaging e.g. non-linear risks or arbitrage models should be bound to implement sophisticated risk measures like VaR in combination with stress test analytics, or even further mechanisms appropriate for the management of specific risks posed by the relevant product type, such as regular qualitative risk assessment for each newly employed strategy or regular risk inventories following the identification of material risk factors. In this respect, the definition of “material” should be ascertained beforehand. These risk factors should then be monitored and tested continuously.

In this context, the principle of proportionality must not lead to underestimation of complex risks in AIF run by smaller managers.

Questions:

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| 2. CESR is requested to advise the Commission on the appropriate frequency of review of the risk management system. CESR is invited to consider whether the appropriate frequency of review varies according to the type of AIFM or the investment strategy of the AIF. |
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The risk model / system should be reviewed / re-assessed on a yearly basis.

Questions:

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| 3. CESR is requested to advise the Commission on the conditions for the appropriate risk governance structure, infrastructure, reporting and methodology, in particular, on how the risk management function shall be |
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functionally and hierarchically separated from the operating units, including the portfolio management function.

4. CESR is requested:

- a) to advise how the principle of proportionality is to be applied by competent authorities in reviewing the functional and hierarchical separation of the functions of risk management in accordance with Article 15(1).
- b) to advise on criteria to be used in assessing whether specific safeguards against conflicts of interest allow for the independent performance of risk management activities and that the risk management process satisfies the requirements of Article 15 and is consistently effective. This advice will be particularly relevant in cases where full separation of functions is not considered proportionate. CESR is encouraged to provide the Commission with a non-exhaustive list of specific safeguards AIFM could employ against conflicts of interest referred to in the second subparagraph of Article 15(1).

Separation of the portfolio and risk management functions should be implemented at the level of managing directors (of which each AIFM should have at least two).

Questions:

5. CESR is requested to advise the Commission on the content of the requirements referred to in Article 15(3).
6. This advice should at least address the following issues:
 - a) the content of an appropriate, documented and regularly updated due diligence process when investing on behalf of the AIF, according to the investment strategy, the objectives and risk profile of the AIF;
 - b) the criteria to be used by competent authorities when assessing whether the risks associated with each investment position of the AIF and their overall effect on the AIF's portfolio can be properly identified, measured managed and monitored on an ongoing basis, including through the use of stress testing;
 - c) appropriate stress testing procedures and their frequency pursuant to Article 15(3)(b);
 - d) the criteria to be used in assessing whether the risk profile of the AIF corresponds to the size, portfolio structure and investment strategies and objectives of the AIF as laid down in the AIF rules

or instruments of incorporation, prospectus and offering documents.

As regards due diligence processes for AIF investment (Q6 letter a) and conduct of stress tests (Q6 letter c), a proper sense of proportion is necessary in order to keep the requirements at an administrable level. Especially the rules for stress testing must be commensurate to the portfolio composition of each AIF.

The criteria to be developed in accordance with Q6 letter d must not have prohibitive effects on certain business models – in practice, it usually works the other way round meaning that the investment strategy is chosen first and measures of risk management are adjusted accordingly.

II.6. Issue 6 - Article 16 Liquidity management

Questions:

1. CESR is invited to advise the Commission on the content of rules that are proportionate and necessary for specifying the general obligations placed on AIFM by Article 16(1) and (2).
2. In particular, CESR is invited to advise on:
 - a) the systems and procedures to be implemented by the AIFM in order to comply with its obligations under Article 16(1), having regard for the appropriateness of these systems and procedures for different types of AIFM and the AIF they manage.
 - b) the content of the obligation for AIFM to regularly conduct stress tests, under normal and exceptional liquidity conditions, which enable it to assess the liquidity risk of the AIF and monitor the liquidity risk of the AIF accordingly.
 - c) the circumstances under which the investment strategy, liquidity profile and redemption policy for each AIF managed by an AIFM can be considered to be consistent. In this context, CESR is invited to consider all relevant aspects of the redemption policy, including mechanisms that can be invoked in exceptional circumstances, and assess their consistency with the investment strategy and liquidity profile.

As regards Q2 letter c, it is of utmost relevance to develop appropriate objective criteria for differentiating between AIF. Among open-ended types of AIF, such criteria should as a minimum allow for differentiation on the basis

of portfolio assets and targeted categories of investors. For this purpose, we would like to encourage ESMA to take stock of the multiple AIF types existing at the national level.

Moreover, it must be acknowledged that consistency between the elements listed in Q2 letter c cannot be achieved to the same extent for all types of AIF and is most difficult to accomplish for open-ended AIF holding illiquid assets such as real estate or PPP interests. For these types of products, properly balanced regulatory measures are necessary; any provisions having the effect of banning certain business models would be definitely not acceptable without truly compelling reasons.

In this context, due regard should be given to the client structure of an AIF. In case of German Special Funds with only few investors who are in any case known by name, the design features of a fund are negotiated directly with the client(s). This means that in these cases, the consistency assumed for the purpose of liquidity management must be assessed on the basis of the needs and investment objectives of specific clients (having regard to the investment horizon, financial situation, purpose of investment etc.).

II.7. Issue 7 - Article 17 and Article 61 (new Article 50a in UCITS) Investment in securitisation positions

Questions:

1. CESR is invited to advise the Commission on the content of rules that are necessary and proportionate for an AIFM to fulfil its obligations under Article 17.
2. In particular, CESR is invited to advise on:
 - a) the requirements to be met by the originator, the sponsor or the original lender, in order for an AIFM to be allowed to invest in securities as defined in Article 17.
 - b) the qualitative requirements to be met by an AIFM in order to comply with their obligations under Article 17.

In terms of requirements to be met by the originator, sponsor or the original lender (Q2 letter a), we would like to question the applicability of future Level 2 AIFMD standards to investments in securitisation positions which take place after 1 January 2011, but before the AIFMD rules become binding at national level. It appears utterly not acceptable to subject AIFM to legal uncertainty as to under which conditions they are able to invest in securitised

debts in order to be allowed to keep these positions after 2014 which is the date for ensuring compliance with AIFMD provisions according to Article 59 para. 1 of the Level 1 Directive. Therefore, we call upon ESMA to advise upon a practicable approach to this issue which, in our view, might be inter alia limiting the requirements of Art. 17 to investments taking place **after** the date of the AIFMD entry into force.

Also, it must be made clear that the due diligence duty of AIFM in terms of ensuring observance of the retention requirement on the part of the originator, sponsor or original lender is limited to assessing whether one of these persons has explicitly disclosed its intention to fulfil the retention obligation in accordance with Article 122a para. 7 of EU Capital Requirements Directive³. In line with the CEBS Guidelines on Article 122a, investors in securitised debts must suffer no detriments in case the originator, sponsor or original lender fails to act in the manner specified in the disclosed statement⁴. Hence, the AIFM should not be bound to dispose of a securitisation position for which no adequate retention has been made, or be subject to other kind of sanctions in this regard, provided that it has duly verified the existence of a relevant retention commitment before executing the investment.

As regards the qualitative standards envisaged in Q2 letter b, we urge ESMA to bear in mind the practicability and reasonableness of the overall approach in order not to further perpetuate the stagnancy of the securitisation market. In our opinion, the investment criteria already adopted for credit institutions are strict enough to totally discourage investments in securitisation positions.

II.8. Issue 8 – Section 2 Organisational requirements, Article 18 General principles

Questions:

1. CESR is invited to advise the Commission on the content of rules that are proportionate and necessary for specifying the general obligations placed on an AIFM by Article 18(1).

³ Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast).

⁴ Cf. para. 30-31 of the “Guidelines to Art. 122a of the Capital Requirements Directive” published by CEBS on 31 December 2010.

2. In particular, CESR is requested to advise on the procedures and arrangements to be implemented by the AIFM, having regard to the nature of the AIF managed by the AIFM, in order to comply with its obligations under Article 18(1).

As regards organisational requirements, the newly revised UCITS Directive should be deemed the model for development of implementing measures to AIFMD.

II.9. Issue 9 - Article 19 Valuation

Questions:

CESR is invited to advise the Commission on:

1. The criteria concerning the procedures for the proper valuation of the assets and the calculation of the net asset value per share or unit to be used by competent authorities in assessing whether an AIFM complies with its obligations under Article 19(1) and Article 19(3).
2. The type of specific professional guarantees an external valuer should be required to provide so as to allow the AIFM to fulfill its obligations under Article 19(5).

The German Investment Act ("Investmentgesetz - InvG") features detailed provisions for the valuation of assets and the calculation of the net asset value per fund unit (§ 36 InvG). These provisions cover both UCITS and the broad variety of Non-UCITS which qualify as AIF under the AIFM Directive (see our response to Question 1 of the Call for Evidence – pp. 3 *et seq.*). In a nutshell, the following principles apply:

- The value of each asset shall be determined on the basis of its market value.
- The value of the fund shall equal the total of the values of all fund assets.
- The value of a fund unit shall be determined by dividing the value of the fund by the number of units in circulation.

Special requirements apply to assets for which no traded prices are available, loans and like instruments. An ordinance issued by the Supervisory Authority BaFin on the accounting and valuation principles for funds (Investment-Rechnungslegungs- und Bewertungsverordnung –

InvRBV) provides for highly detailed provisions on the valuation of assets in special circumstances.

In addition, the German Investment Act holds specific regulation on the valuation of real estate (§ 70 InvG) and the calculation of the NAV per share (§ 79 InvG) for Open-Ended Real Estate Funds which could serve as inspiration for ESMA's advice in this regard. The specific nature of real estate makes clear that daily valuations of assets in the sense of fundamentally new assessment of an asset's intrinsic value is not an option. The daily calculation of NAV per share, on the other hand, is not a problem. As stated in our general presentation of OEREFs (see p. 4 above), the regulatory details are currently under revision.

Relevant criteria for valuation procedures in the sense of the Commission's mandate could comprise, *inter alia*

- Selection process of the valuer
- Evidence of the valuer's independence
- Application of traceable valuation procedures

BVI will be happy to provide more substantial contributions to the development of appropriate valuation standards for AIF in the detailed discussions in the months to come.

Regarding Question 2, we feel that professional guarantees should combine elements of occupational qualification / expertise and proper indemnity insurance. As regards the insurance coverage, however, a proportionate approach is necessary in order to avoid unreasonable increases in costs of external valuation.

Questions:

CESR is invited to advise the Commission on:

3. The frequency of valuation carried out by open-ended funds that can be considered appropriate to the assets held by the fund and its issuance and redemption frequency.

Having regard to the significant variations in terms of investment strategies and fund assets within the AIF universe, BVI members call upon ESMA to abstain from defining specific valuation cycles. Rather, it appears reasonable to develop broad criteria for assessment of appropriate frequency of

valuation by AIF managers on the basis of general characteristics of a fund. In the end, the valuation requirements must remain practicable for each type of fund assets.

II.10. Issue 10 – Article 20 Delegation of AIFM functions

Questions:

1. CESR is invited to advise the Commission on the content of rules that are necessary and proportionate to ensure that an AIFM fulfils the conditions under Article 20(1) and Article 20(2).
2. In particular, CESR is invited to advise the Commission on the following, which are applicable both to cases of delegation and sub-delegation:
 - a) the criteria that competent authorities should use to assess whether the reasons supplied to justify the entire delegation structure of an AIFM are objective.
 - b) the circumstances under which a delegate should be considered to have sufficient resources to perform the tasks delegated to it by an AIFM; and to be of sufficiently good repute and sufficiently experienced to perform these tasks.
 - c) the types of institutions that should be considered to be authorised or registered for the purpose of asset management and subject to supervision. CESR is invited to consider whether to employ general criteria or to specify categories of eligible institution in this context.
 - d) in the event of a delegation of portfolio or risk management to an undertaking in a third country, how cooperation between the home Member State of the AIFM and the supervisory authority of the undertaking should be ensured.
 - e) the circumstances under which a delegation would prevent the effective supervision of the AIFM, or the AIFM from acting, or the AIF from being managed, in the best interest of its investors.

Pertaining to Q2 letter a, the relevant criteria should in the first place encompass possible efficiency gains, increase in service quality, avail of specialised expertise, cost savings and explicit client requests (in case of AIF with a limited number of investors).

With regard to Q2 letter c, a definition of the term “asset management”, accompanied by a non-exhaustive list of eligible institutions, might be helpful.

Questions:

3. CESR is invited to advise the Commission on the content of rules that are necessary and proportionate to ensure that an AIFM fulfils the conditions under Article 20(3).
4. In particular, CESR is invited to advise on:
 - a) the type of evidence necessary for an AIFM to demonstrate that it has consented to a sub-delegation.
 - b) the criteria to be taken into account when considering whether a sub-delegation would result in a material conflict of interest with the AIFM or the investors of the AIFM; and for ensuring that portfolio and risk management functions have been appropriately segregated from any conflicting tasks; and that potential conflicts are properly identified, managed, monitored and disclosed to the investors of the AIF.
 - c) the form and content the notification under Article 20(3) (b) should take in order to ensure that the supervisory authorities have been properly notified.

As regards Q4 letter b, one case of potentially diverging interests might be delegation / sub-delegation of portfolio management to an AIF investor. Apart from this situation, we do not perceive any pronounced risks of conflicting interests in this area.

Questions:

5. CESR is also invited to advise the Commission, in relation to Article 20(2), on the conditions under which the AIFM would be considered to have delegated its functions to the extent that it had become a letter-box entity and could no longer be considered to be the manager of the AIF.

In our view, an AIFM delegating functions to other entities must in any case retain the necessary resources and expertise in order to effectively control performance of the delegated functions and to adequately manage the related risks.

Part II: Depositary (Article 21)

At the present stage of discussion, BVI has no comments on implementing measures relating to the depositary function.

Part III: Transparency Requirements and Leverage

IV.1. Issue 19 - Article 4 Definition of leverage

Questions:

1. CESR is requested to provide the Commission with a description of relevant methods by which AIFM increase the exposure of AIF whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means, including any financial and/or legal structures involving third parties controlled by the AIF. This description or mapping should distinguish between the various business models and approaches to leverage in the AIFM industry. In its advice, CESR should take into account the guidance provided in recital 14.
2. CESR is requested to advise the Commission on the appropriate method or methods for the calculation of leverage for the purpose of this Directive. The analysis should, inter alia, take into account the appropriateness, accuracy, cost, comparability and practicability of the different methods.

Due to the fact that different AIF strategies employ different types of leverage, it is crucial to account for these variations in the applicable legal definition of leverage.

For example, for a managed futures strategy fund leverage should be defined as the absolute sum of contract sizes of all future positions (in fund currency) divided by the fund's NAV. For long-short strategies, on the other hand, leverage should reflect the absolute sum of market values of all (long and short) assets divided by the NAV of the AIF.

For AIF running UCITS-like strategies, a leverage definition via VaR should also be possible. For AIF investing in other kinds of assets or employing different strategies, other criteria and methods could be considered.

In any case, the disclosure requirements on leverage stipulated by CESR in its "Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS" (CESR/10-788 dd. 28 July 2010), Boxes 24 and 25 should be applicable for consistency reasons.

IV.2. Issue 20 - Article 22 Annual report

Questions:

1. CESR is requested to advise the Commission on the content and format of the annual report. In its advice, CESR should consider whether all or any of the information referred to in Article 23 should be included in the annual report and the need for appropriate explanatory notes.
2. CESR is requested to advise the Commission on the content and the format of a balance-sheet or a statement of assets and liabilities. In its advice, CESR should specify in particular:
 - the appropriate presentation, elements and level of detail of the AIF's assets;
 - the appropriate presentation, elements and level of detail of the AIF's liabilities;
 - the appropriate presentation, the elements and level of detail of net assets (shareholders' or unit holders' equity); and
 - the statement of cash inflows to and outflows from the AIF.
3. CESR is requested to advise the Commission on the content and format of an income and expenditure account for the financial year. In its advice, CESR should specify in particular the elements and the level of detail of AIF's income and expenditure accounts.
4. CESR is requested to advise the Commission on the content and format of the report on the activities of the financial year. In its advice, CESR should consider specifying inter alia:
 - statement explaining how the fund has invested its assets during the relevant period in accordance with its published investment policy;
 - overview of the AIF's portfolio and, where appropriate, the AIF's major investments;
 - financial results; and
 - directors' and corporate governance report depending on the legal structure of the AIF.
5. CESR is requested to advise the Commission on how material changes in the information listed in Article 23 during the financial year covered by the report should be best presented in the annual report.
6. CESR is requested to advise the Commission on the content and the format of the remuneration disclosure required under points (e) and (f) of Article 22(2) including the details on the form of remuneration.

Concerning content and format of annual reports to be prepared for each AIF, we strongly suggest taking account of rules currently in place at national level. In Germany, the already mentioned ordinance on accounting and valuation (Investment-Rechnungslegungs- und Bewertungsverordnung – InvRBV) has been adopted by BaFin in late 2009 after intensive consultations with the industry and in our view, represents an excellent standard of proper fund accounting.

IV.3. Issue 21 - Article 23 Disclosure to investors

Questions:

1. With respect to the disclosure obligations in Article 23(4), CESR is requested to advise the Commission on:
 - the appropriate frequency of such disclosures;
 - the criteria for assessing the liquidity of assets and procedure for calculating the percentage referred to in Article 23(4)(a) and the format of such disclosures; the information and the essential elements to be included in the description of the arrangements referred in points a) and b) of Article 23(4) including the use of gates, suspensions and side pockets; the essential information, and the format thereof, of the risk factors, including relevant risk measures and metrics used to assess the sensitivity of the AIF portfolio to movements in interest rates, credit spreads, equity markets, etc, counterparty risks the extent of rehypothecation and information on indebtedness of entities controlled by the AIF to be disclosed by the AIFM to enable appropriate description of the current risk profile of the AIF; and
 - the information and the essential elements to be disclosed by the AIFM to enable appropriate description of the risk management systems employed by the AIFM to manage these risks including results of recent stress tests.

In general, it appears very difficult to develop universally applicable criteria for assessing liquidity of assets. Liquidity as a measure depends on multiple complexly interrelated factors and might change quite radically over time.

As regards appropriate frequency of disclosure, we deem it sufficient to provide the respective information once a year.

In any case, it should always be possible for the managers of AIF with only professional investors to agree individually on the applicable reporting requirements.

Questions:

2. With respect to the disclosure obligations in Article 23(5), CESR is requested to advise the Commission on:
 - the appropriate frequency of such disclosures;
 - the essential information, and the format thereof, to ensure an appropriate description of changes to the maximum level of leverage which the AIFM may employ on behalf of the AIF as well as any right of re-use of collateral or any guarantee granted under the leveraging arrangement; and the leverage measures or ratios, and the format thereof, to be used by the AIFM when disclosing the total amount of leverage employed by the AIF during the reporting period and at the end of the reporting period including those specified according to Article 4.

Also with respect of information on leverage, annual disclosure to investors appears sufficient.

IV.4. Issue 22 - Article 24 Reporting obligations to competent authorities

Questions:

1. CESR is requested to advise the Commission for the purposes of paragraph 4 on the criteria to be used to determine under which conditions leverage is to be considered as being 'employed on a substantial basis'.

For AIF investing in financial instruments, substantial leverage should be assumed above the cumulated level of temporary borrowing and leverage achieved through derivatives according to the UCITS Directive (>110%). This approach appears reasonable as UCITS are products meant for distribution to the retail public and thus should be deemed to employ moderate, not substantial, levels of leverage.

As regards AIF holding real estate, it should be taken into account that in most cases of borrowing only specific properties are treated as collateral

(e.g. by means of land charge or mortgage agreement) and no recourse to the fund as such is possible. In these cases, due to the considerably limited risk of loss to the entire portfolio, the threshold for substantial leverage should be set accordingly high.

Questions:

2. CESR is requested to advise the Commission on the content of the obligations to report and provide information referred to in paragraphs 1 through 5. In its advice, CESR should consider developing a comprehensive template to be used by AIFM for reporting to competent authorities the information required under Article 24. In developing such a template, CESR should take into account the reporting template issued by IOSCO on 25 February 2010 for reporting from hedge funds and templates used by national competent authorities. CESR should address inter alia the following elements:

- Assets under management
- Performance and investor information
- Market and product exposure (long and short positions)
- Regional focus
- Turnover and number of transactions, indication of markets in which trading can represent a significant proportion of overall volume, trading and clearing mechanisms
- Leverage and risk
- Asset and liability information
- Counterparty risk

The template should be sufficiently flexible to accommodate the different types, sizes and investment strategies of AIFM, without compromising the objective of effective supervision.

When developing a template for reporting to competent authorities, BVI calls upon ESMA to pay due attention to the need of keeping the corresponding operational efforts at a reasonable level. In particular, the specific items for reporting should not be assumed to have the same relevance for all types of AIF – as regards AIF investing in real estate, for instance, counterparty risk is mostly negligible. In any case, parties to rental agreements over the properties held in the fund portfolio must not be considered for the purpose of establishing counterparty risk.

Questions:

3. CESR is requested to advise the Commission on the appropriate frequency of such reporting as a function of the potential risks posed by specific types of AIFM; the modalities and forms for data transmission; and whether the same conditions should apply to the additional information requirements referred to in Article 24(5).

In our view, regular reporting to the authorities should be required annually, with further information available ad-hoc on request.

IV.5. Issue 23 - Article 25 Use of information by competent authorities, supervisory cooperation and limits to leverage

Questions:

1. CESR is requested to advise the Commission on the principles specifying the circumstances in which competent authorities shall exercise the powers granted pursuant to Article 25(3), taking into account different strategies of AIF, different market conditions in which AIF operate and possible pro-cyclical effects following from exercising the provisions. Such principles should guide competent authorities in identifying situations and circumstances in which competent authorities shall exercise the powers referred to in paragraph 3.
2. In its advice, CESR should consider inter alia to what extent the following aspects might endanger the stability and integrity of the financial system:
 - leverage used in different strategies and the size of an AIF's "footprints";
 - the concentration of risks in particular markets and risks of spill-over effects; liquidity issues in particular markets; counterparty risks to credit institutions or other systemically relevant institutions; the scale of any asset/liability mismatch; and
 - the evolution of prices of assets with respect to their fundamentals.
3. CESR is also requested to advise on the appropriate timing of potential measures referred to in Article 25(3).

The intervention powers pursuant to Article 25 para. 3 should be deemed contingency measures and thus permitted only in very limited circumstances. In order to ensure consistent application throughout the EU, we urge ESMA to develop clear-cut restrictive criteria for the exercise of these powers and

to engage in continuous exchange of views on the subject matter in order to fulfil the coordination and facilitation role assigned to it by Article 25 para. 5.

Part IV: Supervision

Currently, BVI members do not have any comments to be brought forward on issues relating to supervision.

We hope that our views will help ESMA to shape a commensurate and practicable approach to the implementation of AIFMD and would be happy to engage in further discussions on the issues at hand.

Yours sincerely

BVI Bundesverband Investment und Asset Management e.V.

signed: Thomas Richter

signed: Dr. Magdalena Kuper