
To : European Securities and Market Authority (ESMA)
From : Doctors Pension Fund Services
Subject : Comments on consultation paper AIFMD (ESMA/2011/270)
Datum : 23 september 2011

On August 23, 2011, the European Securities and Market Authority (ESMA) issued a consultation paper (the Paper) regarding the Alternative Investment Fund Managers Directive (AIFMD). The draft advice contained in the Paper covers four broad areas with respect to detailed rules on supervision and third country entities underlying the AIFMD: (1) cooperation and exchange of information arrangements for third country alternative investment funds (AIFs) and alternative investment fund managers (AIFMs); (2) delegation (and sub-delegation) of portfolio management and risk management functions to third country undertakings; (3) assessment of third country depositaries; and (4) identifying the Member State of reference for an AIFM. ESMA has proposed that provisions related to passporting for third country AIFMs should be dealt with at a later date as those provisions do not become relevant until 2015.

Below we briefly summarize the proposals and certain issues that we believe arise in connection with each.

AIFMD requires cooperation arrangements between the relevant third country regulator(s) and the relevant EU Member State regulators. ESMA has proposed that such arrangements should take the form of written agreements and that ESMA negotiate and establish a single template cooperation agreement for use by all third country regulators. This would provide for a consistent approach (as opposed to each EU Member State negotiating with each third country regulator).

- This proposal will require the additional step of having the EU Member States authorize ESMA to negotiate on their behalf;
- Query the approach ESMA will take. They have suggested using the same approach used in connection with the IOSCO memorandum of understanding, but it is unclear how and with whom the template agreement will be negotiated. Will the United States Securities and Exchange Commission stand as proxy for the other third country regulators or will other relevant authorities (Cayman Islands Monetary Authority, Hong Kong Financial Services Authority, etc) be consulted as well?
- One point that is not addressed in the proposal is the scope of the information sharing and the restrictions around the use of that information. Certain parties have suggested that a UCITS-like framework be adopted which makes disclosure of information an obligation of the regulators and also restricts how that information can be used and shared by the receiving regulator.

AIFMD requires that delegation of portfolio and risk management functions may only be made to "undertakings which are authorized or registered for the purposes of asset management and subject to supervision". ESMA proposes that a third country undertaking should be deemed to satisfy this requirement if "it is authorized or registered for the purpose of asset management based on local criteria which are equivalent to those established by EU legislation."

- This proposal raises several issues in connection with the issue of equivalency. Primarily, to what degree can the EU require other jurisdictions to conform to their legislative requirements?
- Further, what is the meaning of equivalent in this context? Does this mean, at least as stringent as the EU legislation, or stringent to the extent required by local regulators?
- Further, who will determine whether local criteria are equivalent to those established by EU legislation and based on what criteria? The proposal seems to indicate that AIFMs will be responsible for this determination but this seems to leave a great deal of uncertainty in this area.

- Additionally, what about jurisdictions that do not currently have regimes that would be deemed equivalent? It seems at this time that there will be no exceptions made and no “grandfathering” of such regimes; regulators in those jurisdictions will need to bring their regulatory framework up to a level that is deemed acceptable.
- In the event that some agreement can be reached on the concept of equivalency or some substitute criteria, it would be most helpful for ESMA to provide a list of acceptable jurisdictions and regulatory regimes to provide consistency to AIFMs.

Under AIFMD, if a non-EU’s AIF’s depositary is located in a third country, that third country depositary must be “subject to effective prudential regulation, including minimum capital requirements, and supervision which have the same effect as EU regulations and are effectively enforced.” ESMA has proposed criteria to be taken into account when determining whether a third country depositary is subject to equivalent standards and notes that the European Commission may issue decisions declaring same.

- This proposal raises similar issues as noted above with respect to equivalency and jurisdiction in connection with the delegation of portfolio and risk management services proposal.
- Many national regulators have capital adequacy requirements, but these are usually modest. They do not (or do not plan to) impose restrictions on leverage and depositary (custody) arrangements. Therefore, complexities may arise depending on where the EU insists that securities be custodied; either within the EU or native jurisdictions.

AIFMD requires that, to the extent an AIFM intends to market several AIFs in the EU, that AIFM must determine its Member State of reference. AIFMD defines that as “the Member State in which the AIFM intends to develop effective marketing for most of those AIFs.” ESMA proposes that that phrase be interpreted to mean the Member State where the AIFM “intends to target investors by promoting and offering...most of the AIFs.”

- It is unclear whether this proposal intends to measure “most of the AIFs” by number of investors or assets under management (AUM).
- Also, it is unclear what, if anything, would be required if the Member State of reference as defined by ESMA changes given changing marketing conditions. For example, if the Member State of reference is determined based on AUM and an AIFM is authorized by the UK as the initial focus of its marketing efforts but later receives a large investment from an investor in France thereby changing the balance of its AUM, would it be required to move its authorization to France? What process would be required? What if the AIFM were not approved in France for some reason, etc.?

As you can see from the above, certain themes run through the ESMA proposals and the issues that arise from them. First, there are the issues raised by the use of the concept of “equivalent” legislation. As discussed, this also raises the issue of what could be considered an attempted extension of EU jurisdiction to non-EU territory and whether the regulators in those territories will be amenable to same. On a smaller scale, there is some question as to whether ESMA has the authority under AIFMD to take on the roles they are proposing for themselves (e.g., negotiation and execution of the cooperation agreements). On a larger scale, there is a question as to the enforceability of any such agreements. As the Commission highlighted for ESMA, any cooperation agreements put in place will not have the status of international treaties. Another important issue is consistency for the sake of investors and market participants. There is a good deal of detail missing as to who determines appropriateness and based on what criteria. Finally, the elements of proportionality and flexibility are missing in the proposals. It is possible that the effect would be to disallow certain jurisdictions and market participants out of hand.