Comments

On ESMA's discussion paper "Key concepts of the Alternative Investment Funds Managers Directive and types of AIFM" – ESMA/2012/117

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VGF Verband Geschlossene Fonds e.V.

Association of Non-Tradeable Closed-End Funds

Content

I. Definition of AIFM 3

1. Issue: letter box entity 4
2. Issue: main and additional business tasks 4

II. Definition of AIF 5

1. Answer to questions 5+6: 5
2. Answer to question 7 5
3. Answer to question 10 6

VGF[1] would like to express its thanks for the opportunity to comment on ESMA's discussion paper "Key concepts of the Alternative Investment Funds Managers Directive and types of AIFM" – ESMA/2012/117. Some of our remarks are not covered from ESMA's particular questions. Nonetheless we wanted to draw ESMA's attention on our perspective of the key issues.

As background information we shall repeat that NTCEFs have thus far remained outside the scope of European capital market regulations. Under German capital market supervisory law there is a provision regarding the drafting and approval of sales prospectuses. There are also industry standards such as the obligation to compile track records (annually published records of all results of all funds under management) and membership of the NTCEFs ombudsman. Adherence to these standards is an essential prerequisite of membership of the VGF. The AIFM Directive will, therefore, be the first European regulatory regime to be applicable on German NTCEFs. The requirements of the Directive pose a major challenge for the companies in this market, who will have to adjust to a new operating context. We are pleased to submit our proposals and comments, which we hope may pave the way to practical, effective, economically feasible solutions.

I. Definition of AIFM

According to the definition set out in Art. 4 (1) (c), (x) and annex I AIFMD, the AIFM is the entity which assumes portfolio and risk management at least. Again, we would ask ESMA to take a very close look at the term portfolio management. Strictly speaking, there is no portfolio management in NTCEFs at all, as the fund usually only focuses on a single asset and not on a portfolio of assets. Furthermore, the management of a typical NTCEF is specifically not authorised to buy or sell. According to German Corporate Law and the contractual relationships between the investor and the fund, decisions of this type may only be made by the General Meeting of the fund, thus by the investors themselves. But even more typical NTCEFs do not buy or sell any other asset during the lifetime, except the one, that is initially planned to be bought, managed and finally sold. So in the end there is no one who literally practises portfolio management. The principal task of a fund manager lies in managing the fund's asset, e.g. as a property manager or a vessel owner and to be the managing director to organise and execute all fund related businesses. Actually the manager could therefore be better described as an asset manager. To conclude: towards NTCEFs

[1] VGF Verband Geschlossene Fonds e.V. (Association of Non-Tradeable Closed-End Funds) represents the interests of providers of non-tradeable closed-end funds (NTCEFs) in Germany. Through its 54 members, the association represents some EUR 140 billion (portfolio of assets under management), managed in around 3.300 funds. Related to the total market in Germany with a fund volume of some EUR 199 billion, the association therefore represents about 70 % of the NTCEF market. Further information is available at: www.vgf-online.de.

one may talk about an active asset management and either an at the utmost static portfolio or even no portfolio management at all.
Having this in mind, we see the following difficulties with ESMA's proposal about the definition of AIFM and furthermore the rules on delegation.

1. Issue: letter box entity

Given that NTCEFs do not have portfolio management the only remaining main task according to annex I AIFMD would be risk management. Firstly, we doubt that this is a satisfying result from a supervisory point of view. Secondly, according to ESMA's considerations about delegation (see recital 8), we fear that NTCEFs would already be seen as a letter box entity by delegating the (only existing) task risk management.
We therefore encourage ESMA to elaborating more qualitative measurements to define when and why an AIFM has to be seen as a letter box entity. Existing expertise about retained organisation policies could be used easily. Implying AIFM to be letter box entities only by the quantitative measurement of delegating one or two undoubtedly important tasks seems to be inappropriate. Moreover the level 1 text does not state any need for ESMA's interpretation.

2. Issue: main and additional business tasks

We would like to question ESMA's interpretation as pictured in recital 10 with regard to the main and the additional business tasks of an AIFM. The business model of NTCEFs sees a variety of the additional tasks in annex I AIFMD performed by third parties. But in many cases these third parties are typically appointed by the AIF itself, so that tasks are not delegated by the AIFM. Thus it cannot be appropriate to apply the rules of delegation especially with regard to AIFM responsibility towards the delegate. This responsibility can hardly be taken over by the AIFM, when even the appointment was not in the AIFM's hands. The task "marketing" may be a good example: In many cases, the fund itself is responsible for choosing, appointing and paying the marketing partner, e.g. a bank. With ESMA consideration in recital 10, we have very serious doubts about how an AIFM could take over responsibility for the bank performing the marketing task.
We therefore recommend ESMA to consider the additional tasks in annex I AIFMD as an enumeration of options, but not of duties. If an option is used by the AIFM, the task surely has to be performed well and, in case of a delegation, it has to be monitored carefully. But if an option is neither used nor delegated by the AIFM, but by the AIF, the AIFM cannot be considered as responsible for the performance of a third party. We see a considerable need for clarification on this issue.

II. Definition of AIF

1. Answer to questions 5+6:

Do you agree with the orientations set out above on the content of the criteria extracted from the definition of AIF? Do you have any alternative/additional suggestion on the content of these criteria?

We basically agree with ESMA's findings on the criteria to define AIFs. But again, as the various business models of AIFs are very different, we encourage ESMA to clarify that <u>not all AIFs necessarily invest in a number of investments</u>. NTCEFs mostly do not – they usually invest in a single asset, e.g. one real estate, one ship or one aircraft. In order to also capture NTCEFs in the scope of the AIFMD the level 1 procedure clearly neglected the principle risk spreading, which was claimed by the Commission at first.[2] We recommend ESMA to clarify that also single asset funds are captured. Therefore it might be useful to mention this aspect explicitly e.g. in the criterion defined investment policy. Another but less preferable solution could be to use the words "investment" and "asset" more carefully and especially also in singular. By now, ESMA's discussion paper most of time deals with the plural terms "investments" (e.g. in recital 28 phrase 2) or "assets" (e.g. recital 30 phrase 2).

2. Answer to question 7

Do you agree with the orientation set out above on the notion of raising capital? If not, please provide explanation and an alternative solution.

We believe that ESMA has already found a good explanation towards the term "raising capital". From our point of view, funds structures with more than one level should remain outside the AIF definition, as long as the entity on the lower level does not acquire new capital, but only structured through the investment strategy of the upper entity. An example: some NTCEFs business models use special purpose vehicles mainly for tax reasons. In these cases, the affiliated company (SPV) does not collect capital and therefore does not raise capital. In fact the capital was acquired by the parent entity (AIF).
We therefore support ESMA's remarks in recital 26, where the definition of raising capital must *"involve some kind of communication by way of business […] between the entity seeking capital […] and the prospective investors […]".* In the example mentioned above, there is no such communication between the AIF and the SPV, and therefore the SPV would consequently remain out of the definition of AIF.

[2] See recital 5 of draft AIFMD, COM(2009) 207 final: *"The scope of this Directive should be confined to the management of collective investment undertakings which raise capital from a number of investors with a view to investing it in accordance with a defined investment policy on the principle of risk-spreading for the benefit of those investors. […]"*

3. Answer to question 10

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

We completely disagree with ESMA's analysis, because investors in NTCEFs are the only ones with material impact on the fund's and the asset's fate at all. Every material decision concerning the asset lies in the hands of the investors. Legally, the investors in NTCEFs are partners. Also for tax reasons they are co-entrepreneur. They are endowed with all entrepreneurial rights and obligations of German Corporate Law. The idea is to share in the economic success of the project, e.g. in the rental income from real estate. The entrepreneurial character of NTCEFs does mean, however, that the investor also exposes himself to the associated economic risks. The entrepreneurial rights and obligations of investors are often handled by a trustee. The latter is, however, strictly bound by instructions. So far, he is entrusted with the cash flows and represents the investors at the General Meeting. The fund's structure is vested with legal capacity, and the fund may participate in business on an independent basis. It must have a management board which reports directly to the shareholders and is appointed with clearly defined authority as stipulated by the law and the partnership agreement. The highest decision-making body is the General Meeting.

We kindly ask ESMA to take into account this special business model. It also might explain incidentally why NTCEFs do not perform portfolio management as described above (see p. 3; II. Definition of AIFM), but only stick to a very defined investment strategy, with only limited discretion for the AIFM. From our point of view ESMA should reconsider recital 34 in order to cover NTCEFs correctly.

Brussels, 23 March 2012

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