



Association of the Luxembourg Fund Industry
Association Luxembourgeoise des Fonds d'Investissement

13 January 2011

To ESMA

Re: Call for Evidence: Implementing measures on the Alternative Investment Fund Managers Directive (the “Call for Evidence”)

Introduction

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 30 November 2010, there are 3,656 undertakings for collective investment in Luxembourg (UCITS and non-UCITS), representing 12,877 active compartments and a total, in terms of net asset value (“NAV”), of EUR 2.160,872 billion.

In the non-UCITS fund arena, two types of fund are included in the CSSF statistics, namely the UCI Part II funds (629 funds, NAV EUR 220 billion) and the SIF funds (1,176 funds, NAV EUR 207 billion). While these funds do include significant numbers of the traditional alternative investment segments, namely hedge funds, private equity funds and real estate funds, Luxembourg also supports a wide variety of other investment strategies in its funds, including (but not limited to) microfinance, socially responsible investment, commodities, infrastructure, carbon credits, renewable energy, islamic finance, wine, art, timber, agriculture, distressed debt, shipping, aircraft leasing, etc. In addition, the SICAR venture capital/private equity regime and some non-regulated legal arrangements under Luxembourg corporate law may also partly fall under the scope of the AIFMD.

We thank ESMA for the opportunity to participate in this Call for Evidence.

Response to the consultation

We have carefully considered the questions raised on pages 4 and 5 of the Call for Evidence (“**ESMA’s questions**”) and our responses are herewith attached in the Annex.

We also reviewed the Provisional Request for Technical Advice on the Alternative Investment Fund Managers (AIFM) level 2 measures, which was annexed to the Call for Evidence (the “**Provisional Request**”).

There were some uncertainties as to whether an answer to all the questions raised by the Commission was expected by ESMA from the Industry at this stage. We have therefore taken the option to outline below for each section identified by the Commission, the general principles on which the level 2 AIFM measures should be designed. As the timeline to review this document was extremely short, we reserve the right to revert to you later and in more detail on the specific questions raised in the Provisional Request.

The general principles are the following:

1) General provisions of the AIFMD

As we have suggested for the AIFM Directive itself, level 2 measures should leverage the extensive regulatory work done as part of the implementation of other directives such as UCITS. UCITS provides indeed a good benchmark of what AIFMD should achieve in areas such as delegation, risk management and other operating conditions.

At the same time, we should not forget that AIFMD aims at regulating the management and marketing of AIF to institutional investors while UCITS focuses on products sold to retail investors. In this context, UCITS can be a good benchmark but should not always be the norm.

2) The Depositary

The depositary related provisions have been the object of an intense debate. Level 2 measures in this area will certainly be some of the most difficult to draft. For example, ALFI believes that the Level 2 measures should take into consideration the different types of funds, as to provide depositary services to a hedge fund, a real estate fund or a private equity fund is far from being the same. Level 2 measures should confirm that this "one size fits all" approach is not appropriate, that differentiation must be included in the basic framework and that all measures should be proportionate to the risks and returns involved. Moreover, level 2 measures will have to ensure that depositary banks are not liable for issues beyond their control.

For these reasons, we believe that a directive approach to implement Level 2 measures around depositary related provisions is the best approach. As discovered during the debate which followed the issuance of the first AIFM Directive draft back in 2009, the depositary business is incredibly complex, especially in an alternative context, and well understood by only a minority of specialists, with further, major differences depending on the alternative industry segment represented.

In light of the wide variety of alternative investment fund strategies accommodated today in Luxembourg fund vehicles, many of which do not fit a single segment definition, it has been ALFI's experience that it is important to leave the fine detail to the competent supervisory authority who will have to authorise and monitor individual funds in the future.

3) Supervision of the AIFM, including third country AIFM

In implementing the AIFM Directive, a proper level playing field should be ensured between non-EU AIF/AIFM and EU AIF/AIFM. The alternative investment management industry is indeed a global business targeting institutional investors. Any competitive distortion between Europe and the rest of the world will risk the departure of this important part of the global asset management industry from the European Union.

In this respect, it is of essence to ensure that a level playing field is achieved across the board. For example, both EU AIF and non-EU AIF managed by non-EU AIFM shall benefit from the grandfathering period until 2018 regarding private placement rules in Europe and shall thus be able to be marketed in Europe under the same conditions (according to article 40 of the AIFMD). Imposing stricter conditions on EU AIF than on non-EU AIF would be highly detrimental to the European industry.

Annex: ALFI responses on the ESMA's Questions

Question 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.).

Luxembourg law currently provides for three potential AIFM regimes and four potential AIF regimes each time subject to meeting the conditions for falling within the scope of application of the AIFMD.

1 CATEGORIES OF LUXEMBOURG AIFM WHICH WILL FALL WITHIN THE SCOPE OF THE AIFMD

Luxembourg law currently recognizes three potential AIFM regimes:

1.1 Managers of non-coordinated foreign undertakings for collective investment (UCIs) (Art. 28-8 Law of 5 April 1993 on the financial sector, as amended)

- Managers of non-coordinated UCIs are professionals engaging in the management of undertakings for collective investment other than UCIs established in Luxembourg and other than UCITS authorized in accordance with Directive 85/611/EEC as amended by Directive 2001/107/EC.
- The activities of managers of non-coordinated UCIs may include the provision of central administration services for entities the management of which is provided for by the professional.
- Authorization to act as a manager of a non-coordinated UCI or UCIs may be granted only to legal persons and shall be conditional on the production of evidence showing the existence of a share capital of not less than 125,000 euros.

1.2 Management companies of Luxembourg UCIs/UCITS (Law of 17 December 2010 on undertakings for collective investment)

The law of 17 December 2010 on undertakings for collective investments (i.e., implementing UCITS IV into Luxembourg law) provides for a revised management company regime in respect of undertakings for collective investment.

1. The management company may not engage in activities other than the management of UCIs/UCITS, the administration of its own assets being only of an ancillary nature, it being understood that it must manage at least one UCI/UCITS subject to Luxembourg law.
2. A management company may under certain conditions be authorized to delegate to third parties, for the purposes of a more efficient conduct of its business, the power to carry out on its behalf one or more of its functions.
3. The management company authorization is *inter alia* subject to the following conditions:
 - a) it must have sufficient financial resources at its disposal to enable it to conduct its business effectively and meet its liabilities; in particular it must have a minimum paid-up capital of one hundred and twenty-five thousand euro (as the case may be, in respect of UCITS compliant management companies, certain additional requirements);

- b) the minimum paid-up capital is to be maintained at the management company's permanent disposal and invested for its own interests; and
- c) the conducting persons of the management company must be of sufficiently good repute and have the professional experience required for the performance of their duties.

1.3 Self-Managed AIF

You will find below, in Section 2, a summary overview of Luxembourg investment fund regimes which may potentially fall within the scope of application of the AIFMD, i.e. which may qualify as AIFM, where self-managed.

2 **CHARACTERISTICS AND CATEGORIES OF LUXEMBOURG INVESTMENT FUNDS WHICH MAY FALL WITHIN THE SCOPE OF THE AIFMD**

2.1 Characteristics of investment funds in Luxembourg

In the non-UCITS fund arena, two types of fund are included in the CSSF statistics, namely, on 30 November 2010:

- UCI Part II funds (629 funds, NAV EUR 220 billion) and
- SIF funds (1,176 funds, NAV EUR 207 billion).

In addition, the SICAR venture capital/private equity regime extends to 236 vehicles (NAV EUR.17 billion) on 31 December 2009.

Some non-regulated legal arrangements under Luxembourg corporate law may also partly fall under the scope of the AIFMD.

While these funds do include significant numbers of the traditional alternative investment segments, namely hedge funds, private equity funds, and real estate funds, Luxembourg also supports a wide variety of other investment strategies in its funds, including (but not limited to) microfinance, socially responsible investment, infrastructure,.....

Underlying assets for non-UCITS funds include, but are not limited to, financial instruments (exchanged traded or not), derivatives, loans, real property and other physical assets, private equity securities and other privately negotiated instruments and holdings in other fund vehicles. These assets may be held in physical form, via custodians, sub-custody networks, central securities depositories or registered at the issuers agent or documented on paper. These holdings may exist in European, Global or Emerging markets.

Leverage exists in a wide variety of forms and levels, dependent on the individual investment strategies. Normal practice is for a fund to establish a maximum leverage level relevant to its strategy, to disclose this to investors and to monitor ongoing compliance with this level.

Redemption policy is similarly varied across the market, with large numbers of closed-ended and open-ended funds in existence, which may adopt flexible redemption policies that often allow ready access to redemptions when markets are healthy but also allow managers to restrict, defer or suspend redemptions in more extreme market conditions, including a range of mechanisms, such as notice periods, deferrals, gates and suspension that can be invoked in exceptional circumstances.

2.2 Categories of Luxembourg investment funds which may fall within the scope of the AIFMD

2.2.1 Investment structures Undertakings for collective investment (UCIs) – Law of 17 December 2010 on undertakings for collective investment

- Subject to CSSF authorization and ongoing prudential supervision.
- Means an investment vehicle/arrangement in the form of a SICAV, SICAF or FCP:

- whose sole object is to invest its funds in assets in order to spread the investment risks and to ensure for its investors the benefit of the results of the management of its assets, and
- whose shares/units/interests are intended to be placed with the public by means of a public or private offer.
- Minimum capitalization: one million two hundred and fifty thousand euro.
- Available for distribution/placement with all retail, institutional and professional investor categories. Restrictions may apply.
- The following terms will be determined by the UCI's promoter and may be subject to review/regulation by the CSSF:
 - a) the minimum frequency for the determination of the issue and, where the constitutive instruments provide for the right of investors to have their shares/units/interests repurchased, the repurchase prices for shares/units/interests;
 - b) the minimum percentage of the assets which must be represented by liquid assets;
 - c) the maximum percentage of the assets of the UCI which may be invested in transferable securities which are not listed on a stock exchange or dealt in on an organized market offering comparable safeguards;
 - d) the maximum percentage of securities of the same kind issued by the same body which the UCI may hold;
 - e) the maximum percentage of the assets which the UCI may invest in securities issued by the same body;
 - f) the conditions under which and possibly the maximum percentages the UCI may invest in securities of other UCIs;
 - g) the maximum percentage of the amounts the UCI is authorized to borrow in relation to its total assets and the terms and conditions for such borrowings.
- The frequency and percentages determined in accordance with the foregoing paragraph may be differentiated depending on whether or not the relevant UCIs display certain characteristics or fulfill certain conditions (i.e., whether the UCI invests in real estate assets, private equity and venture capital assets or invests in derivative instruments and assimilated assets, etc.). UCIs may invest in a vast array of asset classes and adopt investment strategies corresponding to those asset classes. The applicable terms and conditions (i.e., redemption rights, leverage, disclosure, etc.) may thus vary with the underlying assets and investment strategies.

2.2.2 Specialized investment funds (SIF) - Law of 13 February 2007 relating to specialized investment funds, as amended.

- Subject to CSSF authorization and ongoing prudential supervision.
- Means an investment vehicle/arrangement in the form of a SICAV, SICAF or FCP:
 - a) the sole object of which is the collective investment of its funds in assets with the aim of spreading investment risks and giving its investors the benefit of the results of the management of its assets;
 - b) the securities of which are reserved to one or several "well-informed investors"; and
 - c) the constitutive documents or offering documents of which provide that it is subject to the provisions of the Law of 13 February 2007.

- Minimum capitalization: one million two hundred and fifty thousand euro.
- Shares, units, interests or other securities to be issued by a SIF can only be subscribed or acquired by a “well-informed investor”, being:
 - an institutional investor,
 - a professional investor; or
 - any other investor who meets the following conditions:
 - he has stated in writing that he adheres to the status of well-informed investor, and
 - he invests a minimum of 125,000 Euro in the specialized investment fund or he has been the subject of an assessment made by a credit institution within the meaning of Directive 2006/48/EC, by an investment firm within the meaning of Directive 2004/39/EC or by a management company within the meaning of Directive 2001/107/EC certifying his expertise, his experience and his knowledge to adequately appraise an investment in the specialized investment fund.
- A specialized investment fund may invest in all asset types and classes and may pursue all corresponding investment strategies.
- A specialized investment fund must disclose the level of leverage to be used, if any, in its offering documentation.
- A specialized investment fund is not subject to pre-defined statutory risk diversification limits. It must manage its assets in accordance with the principle of risk diversification.
- A specialized investment fund may be open-ended or closed-ended.

2.2.3 Investment Companies in Risk Capital (SICAR) – Law of 15 June 2004 relating to the investment company in risk capital

- Subject to CSSF authorization and ongoing prudential supervision.
- Means an investment company:
 - the object of which is to invest its assets in securities representing risk capital in order (i.e., the investment in risk capital is to be understood as the direct or indirect contribution of assets to entities in view of their launch, their development or their listing on a stock exchange);
 - to provide its investors with the benefit of the result of the management of its assets in consideration for the risk which they incur, and
 - the securities of which are reserved to “well-informed investors”; and
 - the articles of incorporation of which provide that it is subject to the Law of 15 June 2004.
- Minimum capitalization: one million euro.
- Shares, units, interests or other securities to be issued by a SICAR can only be subscribed by or acquired by a “well-informed investor”, being:
 - an institutional investor,
 - a professional investor; or

- any other investor who meets the following conditions:
 - he has stated in writing that he adheres to the status of well-informed investor, and
 - he invests a minimum of 125,000 Euro in the SICAR or he has been the subject of an assessment made by a credit institution within the meaning of Directive 2006/48/EC, by an investment firm within the meaning of Directive 2004/39/EC or by a management company within the meaning of Directive 2001/107/EC certifying his expertise, his experience and his knowledge to adequately appraise an investment in the SICAR.
- A SICAR may invest only invest in assets qualifying as risk capital assets in order to pursue private equity or venture capital investment strategies only.
- A SICAR must disclose the level of leverage to be used, if any, in its offering documentation.
- A SICAR is not subject to statutory risk diversification.
- A SICAR is typically closed-ended.

2.2.4 Unregulated investment vehicles

Luxembourg law provides for the creation of non-regulated corporate vehicles or similar arrangements which may fall under the definition of an AIF under the AIFMD.

Question 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.

In our view, the complexity of the following topics requires implementing measures in the form of a directive:

- the scope;
- the depositary;
- the valuation;
- the third country AIF/AIFM regime.

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

Besides the information available on the CSSF's website and the ALFI's website, the reference platform for European and, in particular, for Luxembourg investment fund information is Finesti (www.finesti.com).

ALFI is also ready to contribute more substantively and to share with you any additional information that you may need, to the extent of the availability at our level, of such information.

ALFI publishes various surveys and other information on its website (www.alfi.lu). In particular, ALFI wishes to draw attention to its annual reports and our annual Hedge Fund and Real Estate Fund surveys.

In addition, ALFI would be happy to provide further information on these issues by way of interactive discussion, as specialists in all of these topics can be found amongst the ALFI membership.