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FINNISH VC/PE INDUSTRY'S RESPONSE TO THE PUBLIC CONSULTATION RELATED TO THE DISCUSSION ON ESMA'S POLICY ORIENTATIONS IMPLEMENTING AIFMD

Finnish Venture Capital Association (FVCA) welcomes the opportunity to respond to the public consultation to the discussion paper on ESMA's policy orientations on possible implementing measures under Article 3 of the Alternative Investment Fund Managers Directive by ESMA on the 15th of April, 2011.

Venture capital and private equity (VC/PE) is a specialist asset class dedicated to business growth. VC/PE investors have a strong tendency to incentivise management and employees at both the investee company and the manager by a reference to returns actually achieved and also received by investors (in cash or cash equivalent terms rather than on notional or valuation based methods).

The most frequently used model for a fund is a closed-ended self liquidating limited partnership.

In valuation there are common valuation standards for VC/PE industry recognized by investors and other stakeholders. Industry – managers and investors jointly – has developed the International Private Equity and Venture Capital Valuation Guidelines (IPEV Guidelines). Investors typically require in the Limited Partnership Agreements that fund managers follow these guidelines. Abiding by the guidelines means that fund managers will fair value the assets of the funds in consistent and accepted manners.

As a general principle, private equity and venture capital funds do not use leverage at fund level to increase the exposure of the fund. Furthermore fund's constitution will typically prohibit that. The business model and legal structure for venture capital and private equity funds are very different to that employed for example by many hedge funds.

The first point to note is that, for legal reasons, many funds structure their commitments from investors as "loans". This is necessary in order to avoid legal restrictions on returns of capital, which are not consistent with a fund's business model (i.e. funds are limited life, close-end funds and self- liquidating). It is therefore important that the final definition of leverage does not include loans to the fund made by investors in the fund as part of their commitment to the fund. These do not increase the size of the fund or the fund's exposure, even though, in a legal, technical sense, they do constitute "borrowing".

The second important point is that although most fund documents (as a result of negotiations with investors) include restrictions on the use of leverage at fund level, still many unleveraged funds do use bank facilities as part of their cash flow management. In particular, funds will typically "bridge" funding calls ("draw downs") from investors by taking out short

term borrowings with a bank, so that investments can be completed quickly and numerous small drawdowns are not needed. Not only is this administratively convenient for the funds, but it is often an investor requirement (to avoid very frequent cash calls on short notice), and it also facilitates emergency or “rescue” financings when fast action is needed to fund a portfolio company with short term liquidity issues. Again, these borrowings (which are usually secured against investor commitments and are only intended to provide short term finance) do not increase the exposure of the AIF to its underlying investments - that is neither the intention nor the effect of the arrangements.

It is important that the definition of leverage does not inadvertently cover funds, which make use of these types of banking facilities.

THRESHOLDS – CALCULATION AND OSCILLATION

Identification of the portfolio of AIF under management by a particular AIFM and calculation of the value of assets under management (pp. 7-8)

- 1. Do you agree with the proposed approach in relation to the procedure to identify the AIFs under management?**
- 2. Do you agree that were available, the gross asset value for AIFs using leverage or net asset value for AIFs not using leverage should be used to calculate the total value of assets under management? Should ESMA consider the extent to which AIFs which produce gross and net asset values apply different valuation methodologies to the underlying assets?**
- 3. Do you consider that were gross and net asset values are not calculated regularly the AIFM can include portfolio valuations, taking into account the type of underlying asset?**
- 4. Can you suggest alternative approaches which could be used for AIFs which do not produce regular gross and net asset value calculations e.g. real estate, private equity? Can you provide information on best practice in relation to the calculation of the total value of the assets under management of AIFs in the sector which you operate?**
- 5. Do you have any other suggestions in relation to the procedure for calculating the total assets under management, including leverage?**

For closed end private equity and venture capital funds the existing and widely recognized industry practice should be taken into account, and accepted. The most common calculation basis for the management fees is the AUM. During the investment period, which is defined for each fund in the Limited Partnership Agreement, the calculation basis is the total amount of the investment commitments by the investors. After the investment period the calculation basis is the cost of the portfolio less realizations. This calculation can be produced on a regular basis with reasonable costs and efforts.

If the above method is considered not to be adequate, the basis after the investment period could be the commitments less the realizations (at cost).

Influences of leverage on the assets under management (pp. 8-10)

- 6. Do you agree that gross asset value, when available, is an appropriate measure of the leverage generated by the AIF?**

Gross Asset Value can be seen as an appropriate method to measure the leverage generated by the AIF but only to the extent of the committed capital. For example any bridge loans that are assumed by the AIF in order to finance short term capital needs, like loans assumed to finance potentially delayed capital calls are to be excluded from this calculation unless exceed the amount of unpaid committed capital.

- 7. Can you suggest an alternative measure of leverage?**

Debt provided by third parties to AIF for making investments (other than short term capital needs) and any collaterals or guarantees issued by the AIF on the behalf of the portfolio companies. Both only to the extent they exceed the amount of unpaid committed capital of the AIF.

- 8. In particular can you suggest a method by which leverage created at the level of an AIF-controlled entity, other than portfolio companies of private equity funds, can be captured in the calculation?**

The AIF can only be responsible for its own direct and hence any liabilities, guarantees, etc. provided by e.g. AIF portfolio companies entities should be excluded from this calculation unless AIF is liable for them.

Determination of the value of the assets under management by an AIF for a given calendar year (pp 10-11)

- 9. Do you support the proposal for AIFs to calculate the total assets under management at least annually?**
- 10. Please provide your views on the impact of requiring the calculation of the total value of assets under management at least annually?**

In order to properly assess the AIFM's position in relation to the threshold the decisive point of time should be the final closing of the AIF unless the first closing is considered more appropriate by the AIFM. Commitments of the investors made in connection with the closing should be decisive. If the AIFM manages several AIFs the assets under management should in relation to each AIF during the investment period be determined by the commitments and after the investment period by materialized investments at cost. If this approach is followed the proposal of calculating the total value of assets under management annually and also calculating and / or monitoring them quarterly can be supported and cost efficiently produced.

If other valuation methods of assets under management of an AIF in relation to threshold are considered, the principle of proportionality in the Community law

should be noted: Any action shall not go beyond what is necessary to achieve the objectives of the regulative measure in question. Administrative regulations should only be taken if they are appropriate, necessary and reasonable. Valuation methods of non-quoted companies are expensive and the results are always inexact, controversial and disputable. Therefore a requirement of valuation of each portfolio company on a yearly or on a quarterly basis can be considered inappropriate and not necessary when implementing the Directive to AIFM engaged in management of private equity AIFs.

11. Can you suggest any alternative procedure for the calculation of the total value of assets under management throughout the period that would provide an accurate picture of the total assets under management?

No. See above responses to questions 1-5.

Treatment of political cases of cross-holding among the AIFs managed by an AIFM (pp. 11-12)

12. Do you have a view on which option ESMA should apply, taking into account that excluding cross-holdings may result in the exclusion of certain AIFMs which perhaps should be included (such as those managing significant master-feeder structure)?

Option number 2 is clearly preferable.

13. Please give reasons for your choice, taking into account the potential cost and administrative burden of excluding cross-holdings while considering the effect of leverage?

Double counting of assets under management should be avoided. It is quite common for AIFM to use pooling/feeder vehicles e.g. tax or pooling of smaller investor purposes. These types of structures do not really add to the underlying amount of assets under management and should be in most cases rather easy to exclude in calculating total assets under management.

If feeder/pooling structures are geared then any such gearing should indeed be considered as gearing of the AIF and added to funds under management. Here a clear distinction however has to be made between AIF and acquisition vehicles used by AIF to acquire target assets (the latter not being gearing of the AIF).

Treatment of AIFMs whose total assets under management occasionally exceed and/or fall below the relevant threshold (pp. 12-13)

14. Do you agree with the proposed approach to addressing circumstances where the threshold occasionally exceeds the limits?

The question is closely linked to how AUM is calculated and should be assessed in light of the outcome on that issue - in any event, it would not seem practical that AIFMD

applies in situations where the threshold is temporarily exceeded. The method proposed above in responses to questions 1-5 should eliminate this problem.

15. Do you have any alternative suggestions?

As response in question 14.

REGISTRATION PROCEDURES

Content of the obligation to register with national competent authorities and suitable mechanisms for gathering information

16. Do you agree with the proposal to require information on the value of assets under management of AIFs? Please provide information on any potential cost impact.

ESMA suggests that the total assets under management of an AIF should be notified to the competent authority upon registration. This is an additional requirement compared to the text of the Directive. Given the intention to create a lighter regime for smaller entities, additional requirements should be avoided.

However, the burden of this requirement depends on the applicable method for calculating the assets under management. If a complicated method must be applied to calculate the “correct” AUM, then the mere requirement to notify AUM may cause disproportionate amount of effort and costs to smaller entities.

17. Do you agree with the minimum information provided in relation to the AIFs investment strategy? Do you consider that the information requirement would be sufficient or can you suggest additions or amendments to the proposal?

ESMA proposes a couple of optional methods for notifying the investment strategy of AIF to competent authorities. This is a proportionate approach as the different types of AIF may apply different methods in how and where the investment strategy is disclosed, and the intention of this requirement should not be to change the way in which the AIF communicate with the investors. It is also important that the investment strategy may be notified on a general level (main categories of assets, sectors, focus and borrowings) since the final negotiations with investors may affect the details of the investment strategy at least in private equity and venture capital funds.

18. Do you agree that the information referred to in Article 3(3)(d) should be provided at least annually?

For most closed ended funds such as private equity and venture capital funds, annual reporting is sufficient since the status of such funds may be fairly stable over years. We also suggest a “no changes” type of reporting method for those funds where the reported information has remained unchanged since the previous annual update.

19. Are there any other matters which should be considered?

ESMA often refers to article 48 regarding the exchange of information in the discussion paper. It is important, that if the registration information would become subject to the exchange of information between the competent authority and ESMA, this should not impose additional requirements for reporting methods (such as specific form or more dense frequency) or otherwise.

Moreover, if ESMA intends to draw up templates or forms for reporting, we find it important that such forms take into account the differences in information requirements between exempt entities and authorised entities since no additional workload for exempt entities should be allocated.

Notification to national competent authorities for AIFMs that no longer comply with the exemptions granted in Article 3(2) (pp. 15-16)

20. Do you think that ESMA should be more prescriptive in relation to what constitutes a permanent or temporary increase above the threshold, for example by specifying the term "occasionally"? Do you have any suggestions?

21. Do you have any alternative suggestions?

For closed-ended private equity and venture capital funds the net asset value is not relevant and the commitments during the investment period and the cost of the portfolio less realizations after investment period should be the base for the calculation of the threshold. When this is the case, there is no need for ESMA to be more prescriptive in relation to what constitutes a permanent or temporary increase above the threshold, for example by specifying the term 'occasionally' in private equity.

OPT IN PROCEDURE (pp. 16-17)

22. Do you agree that all AIFMs which are obliged to be authorised, or which choose to be authorised under the opt-in procedure, should be subject to the same authorisation procedure under article 7?

Article 3(4) is quite clear on this point: "Where AIFMs opt in, this Directive shall become applicable in its entirety." If an AIFM otherwise falling outside the scope chose to opt-in, it should assume the same position as an AIFM falling within the scope in terms of the application procedure, also. Different procedures for different categories would lead to unnecessary complexity and unequal treatment.

23. Do you agree that AIFMs previously registered under Article 3(2) of the AIFMD should submit all documents required under Article 7?

24. Alternatively, should AIFMs only be required to submit information not previously provided for registration purposes and to update information previously provided?

25. Please provide justification for your preferred choice between the two alternatives set out under questions 23 and 24.

For the sake of simplicity and given the scope of information required by the Directive to be submitted when applying for authorization there would seem to be very few reasons for creating different criteria for different applicants. In case an authority prefers not to receive same documentation multiple times it can instruct the applicants accordingly by suitable means. The possibility will not need to be stated in the Directive or other regulation based on the Directive.

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