

European Securities and Markets Authority
103 Rue de Grenelle
75007
Paris

13 September 2011

Dear Sirs

Response to Consultation on ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive (AIFMD).

F&C Asset Management plc ("F&C") is a leading diversified investment management group. As at 30 June 2011 we managed £108 billion of assets and our sole activity is asset management. Our clients comprise a wide range of institutional, insurance, pension and retail investors, across multiple jurisdictions and we manage a diverse spread of investments including equities, fixed income, UCITS and non-UCITS funds, investment companies, property and other alternative asset classes including hedge funds, funds of hedge funds, private equity and funds of private equity funds. Given our broad range of activities, the Directive has the potential to impact many areas of our business and investors in our products.

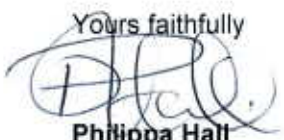
We are grateful for the opportunity to comment on the Level 2 measures and welcome further constructive dialogue to work towards a practical solution to achieve the Commission's objectives and, at the same time, deliver effective, proportionate regulation which meets the needs of investors, firms and markets.

- We support the comments made by the UK's Investment Management Association on behalf of their members.
- We welcome ESMA's recognition of the scope and diversity of the market and the different types and structures that Alternative Investment Funds (AIFs) can take and ESMA's recognition that a one size fits all approach to implementation of the Directive is not appropriate.
- We welcome ESMA's use of both the UCITS and MiFID Directives as the basis for much of their advice in order to align the Directive requirements to existing regulation.
- AIFMD Level 1 captures a much wider range of non UCITS investment vehicles than was originally intended. It is therefore a key concern for F&C and our clients that the detail of the Level 2 measures recognises and takes account of the diversity in the AIF population. The Commission's request to ESMA (then CESR) directs that it should respect the principle of proportionality. In particular *"Solutions proposed by CESR should not go beyond what is necessary to achieve the objectives of the AIFMD. They should be simple, and avoid creating excessive administrative or procedural burdens either on AIFM or on the national competent authorities responsible for their supervision. The assessment of*

proportionality and administrative burden will be a core element of the impact assessment work." Given this statement, we ask that ESMA:

- avoid implementing requirements that are over and above what either UCITS or MiFID Directives require in order to help to minimise the cost of implementation for both firms and investors and to ensure that the Directive is practically workable for firms who may be also conducting UCITS and/or MiFID business along with AIFMD business in the same group or the same regulated firm;
 - adopts proportionate, flexible and risk based requirements which reflect the scale nature and complexity of the AIF and the AIFM which is essential for the Directive to be workable in practice;
 - explicitly refers to compliance with UCITS and/or MiFID as meeting required standards of compliance for the Directive in order to ensure alignment; and
 - takes into consideration the considerable cost of compliance with the Directive's requirements both in terms of initial implementation and also on an ongoing basis. We are particularly concerned with the cost of compliance with the transparency provisions which we believe are overly burdensome and are not justified on a risk assessed basis. Many of these costs would have to be passed on to end investors with little benefit to them.
- We are aware that the Directive is positioned largely as an investor protection measure, yet there are areas where the requirements could have a material adverse impact on investor choice and returns without any apparent commensurate increase in investor protection. We expand further on this point in our general comments and responses to the consultation questions.
 - Currently the wide scope of the Directive includes many AIF types and structures where no material systemic risk issues have been identified and which are already regulated by robust national and EU legislation. This emphasises the need for the Directive to be implemented in a proportionate and risk based manner.
 - We would like to reiterate the need to deliver risk based, proportionate and effective regulation which allows AIF and AIFM to continue to operate in an appropriate manner based on size, nature and complexity and that regulation should not reduce the choice of products and managers available nor significantly increase costs for firms and investors.

If we can be of further assistance, please do not hesitate to contact us.

Yours faithfully

Philippa Hall
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Appendix I General Comments
Appendix II Response to consultation questions

APPENDIX I - General Comments

ALIGNMENT WITH MIFID AND UCITS

We welcome the fact that much of the advice is based on existing provisions in MiFID and, where appropriate, UCITS regulation and guidance. However in a number of instances the proposals unnecessarily go beyond or are different to MiFID and/or UCITS requirements. Some of the requirements are also overly prescriptive. E.g. requirements regarding PII and requirements with regard to the good repute of the delegate, which, as they stand, could restrict the choice of delegates, particularly outside the EU to the disadvantage of AIF investors, as the AIF would be unable to benefit from the expertise of that delegate.

DEPOSITARY LIABILITY

Depositary liability is a key issue to get right for the Directive to be workable in practice. This is a complex legal area and it is essential to balance the need to address perceived weaknesses in the current system with the costs of so doing for firms and investors.

Regulation needs to deliver risk based, proportionate and effective rules which provide an appropriate level of investor protection and at the same time allow AIFs, AIFM and service providers to operate in an appropriate manner based on size, nature and complexity. Regulation should not reduce the choice of products available nor significantly increase costs for firms and investors.

With these factors in mind, the outcome of regulation with regard to depositary liability should be a fair and transparent allocation of custody risk, which appropriately incentivises service providers to deliver a good standard of service to their clients. In relation to loss events we agree with the IMA that prevention is better than cure and consequently the emphasis should be on proper due diligence by the depositary of its delegates plus appropriate oversight of the chain of delegation, coupled with appropriate disclosure to the AIF/AIFM.

LEVERAGE

An appropriate metric to measure 'leverage' is critical for the Directive to be workable in practice as it is to be used to identify those AIFs that are thought to be more likely to contribute to systemic risk and because any prescribed metric should be informative for investors. The current metrics for leverage in UCITS regulation, while improved is not ideal. We welcome ESMA's consideration of this question however we have some significant concerns about the proposed approach. Our comments are as follows:

- Leverage does not always equal risk and is one of many measures of the risks of a portfolio.
- Too much importance is placed on leverage and in particular gross leverage.
- Individual measures taken alone and out of context can be misleading for both regulators and investors. In particular, gross leverage is not necessarily correlated to the risk of a portfolio and could be highly misleading for investors and regulators. Gross leverage is also too simplistic a measure to determine whether a fund is contributing to the systemic risk of a particular market.
- Risk is determined by the volatility of the underlying assets of the portfolio, rather than by leverage per se.
- We are particularly concerned with the potential impact on liability-driven investment (LDI) solutions. Swaps are regularly used in LDI. The main goal of LDI is to ensure that any change in the value of a

pension scheme's liabilities due to changes in interest rates is matched by a similar change in the value of the assets held to cover those liabilities. In order to ensure that this 'matching' takes place, pension schemes have traditionally held bonds, which are subject to the same discounting valuation process and therefore change in value in a similar way to liabilities as interest rates fluctuate. However, holding bonds has a flaw in that the cash flows which arise from them are fixed and cannot be adjusted to match a scheme's liability profile exactly. Because interest rate swaps are bespoke, they can be tailored to target a specific liability profile. They also tend to be unfunded, which means that the notional amount of the investment does not change hands and is therefore not at risk. Efficient execution of this type of strategy is a key issue and one that can result in very substantial unnecessary costs being incurred by funds if not handled effectively. Execution costs can be mitigated through careful planning of a fund's transition and implementation strategy in combination with sensitive management of the execution process itself. In particular, when unwinding or reducing an existing position, it is predominantly more economically beneficial to trade an equal and opposite position with another counterparty (or indeed the existing counterparty) than it is to actually unwind the existing position. Clearly, the gross method of calculating exposure will potentially give a meaningless result.

- The rights of investors to not be subject to unnecessary de-leveraging must be considered as well as the wider responsibility to the financial system. Many regulators already possess the powers defined in Box 100 and it is critical that the power to impose a leverage limit is only used in exceptional circumstances. A mandatory first step should be for the regulator to enter into dialogue with the AIFM.
- If a regulator imposed a leverage limit, local funds would be forced to de-leverage, but funds in other Member States, and funds outside the remit of the AIFMD, would still be able to pursue their investment strategies. This would create a detrimental impact on the investors in the local AIF, while not achieving the aim of the concerned regulator. Regulators must engage with others in order to ensure that any intervention is done so on a harmonised basis and ESMA should have oversight of such intervention.
- In addition, given that LDI is at the centre of many pension schemes' strategy, we are extremely concerned that any AIF could be subject to potential limits on leverage. If AIFMs were forced to reduce leverage in these funds without allowing clients sufficient time to provide extra capital, their protection against movements in interest rates and inflation expectations would also be reduced. This would leave the pension schemes exposed to adverse movements in interest rates and inflation; the very situation they were using the LDI funds to avoid. If rates were to fall post the leverage reduction, for example, this would lead to a deterioration in the funding level and make it harder for the pension scheme to meet its pension promise. It is essential therefore that regulators carefully consider the impact of any restrictions they may impose on leverage, weighing the systemic benefits against potential damage to investors.
- Gross Leverage does not helpfully measure volatility, counterparty risk or liquidity risk. It is not, therefore, a helpful headline measure of how risky a fund is. Gross Leverage should not be used to monitor the risks an AIF poses. Instead, appropriate use should be made of VaR, volatility, drawdown, counterparty risk, and/or liquidity measures.
- For many AIFs the commitment approach as described will not be simpler to operate than an advanced method. This could result in a significant number of AIF having to use an advanced method which will reduce comparability for investors and regulators concerned with systemic risk issues. We believe that further work is required in order to ensure that appropriate metrics are applied that can be operated efficiently and effectively.
- We disagree with ESMA's comments on VaR methodologies. VaR is a very helpful methodology in many market conditions and is one of the more helpful measures of portfolio risk, especially when combined with other appropriate portfolio analytics and attribution techniques.

- We note that ESMA uses the terms 'exposure' and 'leverage' interchangeably throughout this section, which is misleading.

Box 93 - We agree with the IMA's comments.

Box 94 – We agree with the IMA that the definitions of Netting and Hedging are much too restrictive.

Box 95 - We agree with the IMA's comments.

Box 96 - We agree with the IMA that the proposed definitions of an eligible hedge are much too restrictive.

Box 97 - We agree with the IMA's comments.

Box 100 - We agree with the IMA's comments.

REPORTING TO COMPETENT AUTHORITIES

Box 109 and Annex V propose extensive quarterly reporting to Competent Authorities on all AIFs. We do not see how such an approach can be justified under the principle of proportionality which the Commission has requested ESMA's advice to comply with and have significant concerns about the implications of such an approach and the substantial costs for both firms and regulators in gathering, collating, analysing and disseminating this information. Perversely this could have the effect of increasing risk in that regulators could miss important markers due to the volume of information they are having to review. ESMA should reconsider differentiating the amount and frequency of reporting by reference to size of AIF/ the AIF's strategy.

ARTICLE 3 EXEMPTIONS

The Level 1 text is already detailed in this area and the full range of AIF is not yet known. We agree with the IMA that it would be better for ESMA to issue minimal guidance at this stage and to review the need for and format of more prescriptive requirements at a later date once the population of AIF is clearer.

ADDITIONAL OWN FUNDS AND PROFESSIONAL INDEMNITY INSURANCE (PII)

The EUR 10 million cap in Article 9(3) is critical to ensuring that the directive does not impose an undue burden in terms of the amount of own funds required to be held. It is essential that this cap is preserved.

Self-managed AIFM will not have PII cover if they do not have employees *per se* but have board directors who decide to delegate functions to qualified third parties. Action against the directors of the AIFM would be covered by directors' liability insurance. We assume in such situations it is permissible to have directors' liability insurance, rather than PII.

Box 6 - We agree with the IMA's comments.

Box 7 – Includes quantitative risk requirements. The call for advice does not request ESMA provide any guidance on this area. AIFMs will already have risk management policies and processes in place and should be free to determine and implement risk management strategies which reflect their size and internal organisation, and the nature, scale and complexity of their activities within existing regulations. As a consequence, we do not support the inclusion of Box 7 as this is too prescriptive. If any reference is needed this should simply be an obligation to implement risk management facilities which reflect the size and internal organisation of the AIFM, and the nature, scale and complexity of its activities.

GENERAL PRINCIPLES

Box 13 – Counterparties - We agree with the IMA's comments.

Box 14 and 15 – Execution of decisions to deal and placing of orders – Given the Commission's request to ESMA to respect the principle of proportionality we see no justification in going beyond the requirements of MiFID.

Box 18 – inducements - We agree with the IMA's comments.

CONFLICTS OF INTEREST

We agree with the IMA's comments.

Given the Commission's request to ESMA to respect the principle of proportionality we see no justification in going beyond the requirements of MiFID.

RISK MANAGEMENT

We agree with the IMA's comments.

Given the Commission's request to ESMA to respect the principle of proportionality we see no justification in going beyond the requirements of MiFID.

LIQUIDITY MANAGEMENT

We welcome ESMA's approach to liquidity management which, overall, seeks to be flexible enough to cover the diversity of funds captured by the Directive.

We agree with the practical points that the IMA have raised.

SECURISATIONS

We agree with the IMA's comments.

ORGANISATIONAL REQUIREMENTS

We agree with the IMA's comments.

VALUATION

We agree with the IMA's comments.

Valuation provisions are helpful, particularly where they set out general principles with regard to valuation, which can be adapted to the specific characteristics of the diverse types of assets in which an AIF may invest.

DELEGATION

We agree with the IMA's comments.

Given the Commission's request to ESMA to respect the principle of proportionality we see no justification in going beyond the requirements of MiFID.

DEPOSITARY PROVISIONS

We agree with the IMA's comments.

TRANSPARENCY

We agree with the IMA's comments.

REMUNERATION

Given the Commission's request to ESMA to respect the principle of proportionality we believe remuneration requirements need to be proportionate in their application.

APPENDIX II – Response to consultation questions

- Q1: Does the requirement that net asset value prices for underlying AIFs must be produced within 12 months of the threshold calculation cause any difficulty for AIFMs, particularly those in start-up situations?

We have no comments.

- Q2: Do you think there is merit in ESMA specifying a single date, for example 31 December 2011 for the calculation of the threshold?

No - AIFMs should be able to use the date most appropriate to them. The value of the assets will usually be the subject of an annual, external audit report and this will generally be the preferred date for AIFMs. If a single date is specified this could lead to increased operational costs due to concentration of workload.

- Q3: Do you consider that using the annual net asset value calculation is an appropriate measure for all types of AIF, for example private equity or real estate? If you disagree with this proposal please specify an alternative approach.

The value of assets should follow the methodology set by relevant recognised accountancy standards. Specific asset types should have the flexibility to be valued in accordance with industry best practice guidelines.

- Q4: Can you provide examples of situations identified by the AIFM in monitoring the total value of assets under management which would and would not necessitate a recalculation of the threshold?

An increase in AUM due to market movements should not generally require a recalculation unless there is evidence that this is an established trend e.g. increasing level of subscriptions over redemptions.

Monitoring mechanisms should not be overly prescriptive or burdensome particularly for AIF which do not calculate regular NAVs.

- Q5: Do you agree that AIFs which are exempt under Article 61 of the Directive should be included when calculating the threshold?

No. If a fund is exempt, it should not be included in the AIFM's AUM.

- Q6: Do you agree that AIFMs should include the gross exposure in the calculation of the value of assets under management when the gross exposure is higher than the AIF's net asset value?

No - A one-size-fits-all approach to leverage calculation is not appropriate given the diversity of AIF. The approach should be risk based, proportionate and sufficiently flexible to adopt the option which best meets the type of AIF. This is consistent with other regulation e.g. UCITS.

Including gross leverage in the calculation of AUM would be misleading for both regulators and investors.

Q7: Do you consider that valid foreign exchange and interest rate hedging positions should be excluded when taking into account leverage for the purposes of calculating the total value of assets under management?

Yes.

Q8: Do you consider that the proposed requirements for calculating the total value of assets under management set out in Boxes 1 and 2 are clear? Will this approach produce accurate results?

For Box 2, see comments in Q6 above. We have the following comments on Box 1:

Para 3 - We agree with excluding investment in other AIFs under management by the same AIFM. With regard to leverage, it should not be necessary to look through to the underlying funds.

Para 5 is too onerous and too prescriptive. The three month period in 5b is too short. The application process will take time to complete, particularly if structural changes are required. We suggest up to 12 months. In practice AIFMs are likely to want to wait until the next valuation point to see if a trend is developing (unless there is a material change they are aware of such as a significant increase in leverage).

Q9: The risk to be covered according to paragraph 2(b)(iv) of Box 6 (the improper valuation) would also include valuation performed by an appointed external valuer. Do you consider this as feasible and practicable?

No - we do not consider this to be feasible or practicable. Insurance policies are unlikely to cover the acts of a third party. Even if cover could be obtained, the cost is likely to be prohibitive.

Q10: Please note that the term 'relevant income' used in Box 8 includes performance fees received. Do you consider this as feasible and practicable?

No - we do not consider this to be feasible or practicable. There is no correlation between performance fees and risk levels so this should be excluded.

Q11: Please note that the term 'relevant income' used in Box 8 does not include the sum of commission and fees payable in relation to collective portfolio management activities. Do you consider this as practicable or should additional own funds requirements rather be based on income including such commissions and fees ('gross income')?

We consider it appropriate to exclude these commissions and fees, and welcome the text of the ESMA guidelines which specifies that an AIFM also managing UCITS must not take into account income and commission and fees expenses in relation to those activities. It would be inappropriate and inconsistent with the Directive to require an AIFM to hold additional own funds against any risks which arise from business outside of those associated with the AIF.

Q12: Please provide empirical evidence for liability risk figures, consequent own funds calculation and the implication of the two suggested methods for your business. When suggesting different number, please provide evidence for this suggestion.

We do not have any evidence as to figures as yet.

Q13: Do you see a practical need to allow for the 'Advanced Measurement Approach' outlined in Directive 2006/48/EC as an optional framework for the AIFM?

No we do not. AIFMs will already have risk management policies and processes in place (arising from MIFID, UCITS and CRD etc.) and should be free within the standards set within these regulations to determine and implement risk management strategies which reflect their size and internal organisation, and the nature, scale and complexity of their activities.

Q14: Paragraph 4 of Box 8 provides that the competent authority of the AIFM may authorise the AIFM to lower the percentage if the AIFM can demonstrate that the lower amount adequately covers the liabilities based on historical loss data of five years. Do you consider this five-year period as appropriate or should the period be extended?

No we do not consider this period to be appropriate.

We support the lower requirement and agree with the IMA's suggestion that a competent authority may authorise the AIFM to lower the percentage if the AIFM can demonstrate that the lower amount adequately covers the liabilities based on historical loss data of three years or more, or where the AIFM has been in existence for less than three years, for data which covers the entirety of its existence as an AIFM. This incentivises firms to improve standards of risk management and to collect and retain loss data now in order to achieve three years worth of data shortly after implementation, and also recognises that some firms may not already have collected such data. The discretion to lower the percentage where appropriate remains with the competent authority.

Q15: Would you consider it more appropriate to set lower minimum amounts for single claims, but higher amounts for claims in aggregate per year for AIFs with many investors (e.g. requiring paragraph 2 of Box 9 only for AIF with fewer than 30 investors)? Where there are more than 30 investors, the amount in paragraph 3 (b) would be increased e.g. to €3.5m, while for more than 100 investors, the amount in paragraph 3 (b) would be increased e.g. to €4 m.

No we do not consider it more appropriate and do not believe that there is any need or justifiable reason for introducing such parameters when determining the criteria with which any professional indemnity insurance policy should comply. This is because:

- *the number of investors in an AIF does not determine the risks to which it is exposed;*
- *the number of investors in an AIF and the potential liability risks arising from professional negligence are not directly linked;*
- *Existing regulatory requirements relating to the use of professional indemnity insurance contain obligations in terms of both single claims and in aggregate; and*
- *combined usage of additional own funds and professional indemnity insurance should be an appropriate mechanism through which to mitigate potential liability risks.*

- Q16: Paragraphs 4 and 5 of Box 11 set out additional due diligence requirements with which AIFMs must comply when investing on behalf of AIFs in specific types of asset e.g. real estate or partnership interests. In this context, paragraph 4(a) requires AIFMs to set out a 'business plan'. Do you agree with the term 'business plan' or should another term be used?

We do not agree with the use of the term 'business plan'. Paragraph 4 should reference the objectives, investment strategy and risk profile of the relevant AIF.

- Q17: Do you agree with Option 1 or Option 2 in Box 19? Please provide reasons for your view.

We agree with the IMA that the concept of overall material disadvantage is vague and subjective. We do not see any need for detail in Level 2 as the Level 1 requirements should be sufficient.

- Q18: ESMA has provided advice as to the safeguards that it considers AIFM may apply so as to achieve the objective of an independent risk management function. What additional safeguards should AIFM employ and will there be any specific difficulties applying the safeguards for specific types of AIFM?

None – this is because AIFMs will already have risk management policies and processes in place (arising from MIFID, UCITS and CRD etc.) and should be free to determine and implement risk management strategies which reflect their size and internal organisation, and the nature, scale and complexity of their activities.

Given the Commission's request to ESMA to respect the principle of proportionality we see no justification in going beyond the requirements of MiFID or UCITS.

- Q19: ESMA would like to know which types of AIFM will have most difficulty in demonstrating that they have an independent risk management function? Specifically what additional proportionality criteria should be included when competent authorities are making their assessment of functional and hierarchical independence in accordance with the proposed advice and in consideration of the safeguards listed?

Small to medium sized AIFMs will generally find this more problematic than larger firms and will need to rely on additional mechanisms such as segregation and oversight. AIFM should be free to determine and implement risk management policies and procedures which reflect their size and internal organisation, and the nature, scale and complexity of their activities.

- Q20: It has been suggested that special arrangements such as gates and side pockets should be considered only in exceptional circumstances where the liquidity management process has failed. Do you agree with this hypothesis or do you believe that these may form part of normal liquidity management in relation to some AIFs?

Provided investors are aware of the liquidity management tools at the AIFM's disposal, such tools should be considered part of the normal liquidity management process.

- Q21: AIFMs which manage AIFs which are not closed ended (whether leveraged or not) are required to consider and put into effect any necessary tools and arrangements to manage such liquidity risks. ESMA's advice in relation to the use of tools and arrangements in both normal and exceptional circumstances combines a principles based approach with disclosure. Will this approach cause difficulties in practice which could impact the fair treatment of investors?

We agree with the practical points that the IMA have raised. Please refer to comments in their response to Boxes 31-34 and related explanatory text.

- Q22: Do you agree with ESMA's proposed advice in relation to the alignment of investment strategy, liquidity profile and redemption policy?

We agree with the practical points that the IMA have raised. Please refer to comments in their response to Boxes 31-34 and related explanatory text.

- Q23: Should a requirement for complaints handling be included for situations where an individual portfolio manager invests in an AIF on behalf of a retail client?

No – complaints handling requirements should only apply to firms that have a direct (as opposed to indirect) relationship with a retail client.

- Q24: Do you prefer Option 1 or Option 2 in Box 65? Please provide reasons for your view.

Option 1 on the basis that it is more flexible.

- Q25: How difficult would it be to comply with a requirement by which the general operating account and the subscription / redemption account would have to be opened at the depositary? Would that be feasible?

It would not be feasible.

It would also be onerous and expensive to make the required changes to current practices and procedures with little perceived benefit accruing to investors. Currently it is common practice for the Transfer Agent/Registrar of the AIF to receive/pay out monies in respect of subscriptions/redemptions of units/shares in the AIF and duly record and account to the AIF/AIFM for those transactions. Changing these operational processes to require accounts to be opened at the Depositary is unnecessary will not lead to any enhancement in investor protection. The same effect could be achieved by requiring the Depositary to ensure that the appropriate checks and controls are in place at the Transfer Agent and that proper recordkeeping and reconciliation procedures are established and working effectively.

- Q26: At what frequency is the reconciliation of cash flows performed in practice? Is there a distinction to be made depending on the type of assets in which the AIF invests?

Frequency will depend on the type of AIF. Determinative factors include the frequency of the valuation of the assets of the AIF and the calculation of the NAV per share. The frequency of determination of value will depend on the type of underlying assets invested in by the AIF and the frequency of dealing in the units/shares of the AIF by investors.

- Q27: Are there any practical problems with the requirement to refer to Article 18 of MiFID?

Not that we are aware of.

- Q28: Does the advice present any particular difficulty regarding accounts opened at prime brokers?

Not that we are aware of.

Q29: Do you prefer option 1 or option 2 in Box 76? Please provide reasons for your view.

We prefer Option 2 as this provides greater flexibility to take account of the different types of AIFs.

Q30: What would be the estimated costs related to the implementation of option 1. or option 2. of Box 76?

Option 1 is likely to be considerably more expensive as this will require changes to systems and processes without any increased benefits in terms of investor protection.

Q31: What would be the estimated costs related to the implementation of cash mirroring as required under option 1 of Box 76?

Depositaries are best placed to provide answers to questions 30 and 31. The costs could be considerable depending on the level of new systems and processes that need to be developed these additional costs would ultimately be borne by the investors in the AIFs for little if any enhanced investor protection benefits.

Q32: Do you prefer option 1 or option 2 in Box 78? Please provide reasons for your view.

We do not believe that either option 1 or 2 are necessary. The depositary should be responsible for the financial instruments it holds in its custody network (subject to a limited carve-out for assets held directly with the issuer in the name of the AIF).

Q33: Under current market practice, which kinds of financial instrument are held in custody (according to current interpretations of this notion) in the various Member States?

Custody agreements reflect the legal and operational realities of how dematerialized book-entry securities are held by custodians. What is viewed as being held in custody is widely interpreted.

Depositaries are best placed to provide answers to this question.

Q34: How easy is it in practice to differentiate the types of collateral defined in the Collateral Directive (title transfer / security transfer)? Is there a need for further clarification of option 2 in Box 79?

Depositaries are best placed to provide answers to this question.

Q35: How do you see the delegation of safekeeping duties other than custody tasks operating in practice?

Depositaries are best placed to provide answers to this question.

Q36: Could you elaborate on the differences notably in terms of control by the depositary when the assets are registered directly with an issuer or a registrar (i) in the name of the AIF directly, (ii) in the name of the depositary on behalf of the AIF and (iii) in the name of the depositary on behalf of a group of unidentified clients?

The depositary has control in relation to (ii) and (iii) but not necessarily in relation to (i).

Q37: To what extent would it be possible / desirable to require prime brokers to provide daily reports as requested under the current FSA rules?

We believe it is possible and desirable.

Q38: What would be the estimated costs related to the implementation of option 1 or option 2 of Box 8? Please provide an estimate of the costs and benefits related to the requirement for the depositary to mirror all transactions in a position keeping record?

Depositaries are best placed to provide answers to this question. Option 2 will give rise to additional costs which could be substantial without providing any tangible investor protection benefits. Option 1 should be sufficient to provide investors with the comfort that they require regarding the safekeeping of assets.

Q39: To what extent does / should the depositary look at underlying assets to verify ownership over the assets?

Depositaries are best placed to provide answers to this question.

Q40: To what extent do you expect the advice on oversight will impact the depositary's relationship with funds, managers and their service providers? Is there a need for additional clarity in that regard?

Generally the proposals with regard to the depositary's oversight duties seem sensible, although we have concerns as to how this will be implemented in practice. The key question is what services Depositaries, Prime Brokers and Custodians are willing to provide and at what cost. Particularly for AIFs investing in emerging markets.

An overbearing approach may lead to negative impacts on the depositary's relationship with funds, managers and other service providers, but this will be the subject of commercial discussions and negotiation between the relevant parties.

Q41: Could potential conflicts of interest arise when the depositary is designated to issue shares of the AIF?

Potentially yes - hence the need for functional and hierarchical segregation of functions.

Q42: As regards the requirement for the depositary to ensure the sale, issue, repurchase, redemption and cancellation of shares or units of the AIF is compliant with the applicable national law and the AIF rules and/or instruments of incorporation, what is the current practice with respect to the reconciliation of subscription orders with subscription proceeds?

For many AIFs this service is usually performed by the fund administrator who will make these available to the depositary for review. For other types of AIF which do not currently have depositaries, the AIFM undertakes this function, which is subject to independent audit as part of the process of drawing up the annual accounts.

Q43: Regarding the requirement set out in §2 of Box 83 corresponding to Article 21(9)(a) and the assumption that the requirement may extend beyond the sales of units or shares by the AIF or the AIFM, how could industry practitioners meet that obligation?

The oversight duty of the depositary should be limited to the verification of information stemming from the AIF's register.

Q44: With regards to the depositary's duties related to the carrying out of the AIFM's instructions, do you consider the scope of the duties set out in paragraph 1 of Box 85 to be appropriate? Please provide reasons for your view.

Yes.

Q45: Do you prefer option 1 or option 2 in Box 86? Please give reasons for your view.

We prefer Option 1, as the level 1 requirements are sufficiently clear.

Q46: What alternative or additional measures to segregation could be put in place to ensure the assets are 'insolvency-proof' when the effects of segregation requirements which would be imposed pursuant to this advice are not recognised in a specific market? What specific safeguards do depositaries currently put in place when holding assets in jurisdictions that do not recognise effects of segregation? In which countries would this be the case? Please specify the estimated percentage of assets in custody that could be concerned.

Depositaries are best placed to provide answers to this question.

Q47: What are the estimated costs and consequences related to the liability regime as set out in the proposed advice? What could be the implications of the depositary's liability regime with regard to prudential regulation, in particular capital charges?

Depositaries are best placed to provide answers to this question.

Q48: Please provide a typology of events which could be qualified as a loss in accordance with the suggested definition in Box 90.

We do not believe that a typology is either required or desirable.

Q49: Do you see any difficulty with the suggestion to consider as an external event the fact that local legislation may not recognise the effects of the segregation requirements imposed by the AIFMD?

We see no difficulty.

Q50: Are there other events which should specifically be defined/presumed as 'external'?

We support the IMA's proposals.

Q51: What type of event would be difficult to qualify as either 'internal' or 'external' with regard to the proposed advice? How could the 'external event beyond reasonable control' be further clarified to address those concerns?

We support the IMA's proposals.

- Q52: To what extent do you believe the transfer of liability will / could be implemented in practice? Why? Do you intend to make use of that provision? What are the main difficulties that you foresee? Would it make a difference when the sub-custodian is inside the depositary's group or outside its group?

We support the IMA's proposals..

- Q53: Is the framework set out in the draft advice considered workable for non-bank depositaries which would be appointed for funds investing mainly in private equity or physical real estate assets in line with the exemption provided for in Article 21? Why? What amendments should be made?

We do not have any specific comments.

- Q54: Is there a need for further tailoring of the requirements set out in the draft advice to take into account the different types of AIF? What amendments should be made?

We would reiterate the need for the requirements not to be prescriptive. Maximum flexibility must be maintained and the requirements should be both risk based and proportionate. We also reiterate that the Directive is not a product regulation directive.

Please refer to our general comments on Leverage.

We agree with the IMA's detailed comments on Leverage.

- Q55: ESMA has set out a list of methods by which an AIF may increase its exposure. Are there any additional methods which should be included?

See comments under Q54.

We agree with the IMA's detailed comments.

- Q56: ESMA has aimed to set out a robust framework for the calculation of exposure while allowing flexibility to take account of the wide variety of AIFs. Should any additional specificities be included within the Advanced Method to assist in its application?

See comments under Q54.

We agree with the IMA's detailed comments.

- Q57: Is further clarification needed in relation to the treatment of contingent liabilities or credit-based instruments?

We agree with the IMA's detailed comments.

- Q58: Do you agree that when an AIFM calculates the exposure according to the gross method as described in Box 95, cash and cash- equivalent positions which provide a return at the risk-free rate and are held in the base currency of the AIF should be excluded?

We agree with the IMA's detailed comments.

Q59: Which of the three options in Box 99 do you prefer? Please provide reasons for your view.

We agree with the IMA's detailed comments.

Q60: Notwithstanding the wording of recital 78 of the Directive, do you consider that leverage at the level of a third party financial or legal structure controlled by the AIF should always be included in the calculation of the leverage of the AIF?

See comments under Q54.

Q61: Do you agree with ESMA's advice on the circumstances and criteria to guide competent authorities in undertaking an assessment of the extent to which they should impose limits to the leverage than an AIFM may employ or other restrictions on the management of AIF to ensure the stability and integrity of the financial system? If not, what additional circumstances and criteria should be considered and what should be the timing of such measures? Please provide reasons for your view.

See comments under Q54.

Q62: What additional factors should be taken into account in determining the timing of measures to limit leverage or other restrictions on the management of AIF before these are employed by competent authorities?

See comments under Q54.

Q63: Do you agree with the approach in relation to the format and content of the financial statements and the annual report? Will this cause issues for particular GAAPs?

The requirements need to provide sufficient flexibility to accommodate recognised accounting frameworks.

The requirements should not go beyond existing recognised accounting frameworks. Box 104 paragraph 7(a) is too prescriptive.

Q64: In general, do you agree with the approach presented by ESMA in relation to remuneration? Will this cause issues for any particular types of AIF and how much cost is it likely to add to the annual report process?

We consider that the remuneration disclosures should be subject to similar exemptions as are available to firms under Directive 2006/48/EC, which effectively allows information which is immaterial, confidential or proprietary to not be disclosed. The implementation of similar exemptions would ensure a level playing field across all firms subject to remuneration disclosures, which was one of the original objectives of the G20 when remuneration proposals were first tabled. We support the fact that it is for the AIFM to determine whether to provide the disclosures at the level of the AIF or the AIFM. This should provide sufficient flexibility for AIFMs to be able to implement a solution which reflects the nature, scale and complexity of the AIFM and consequently results in a proportionate application of the obligations. In the case of umbrella funds it is not clear whether the remuneration disclosures should be at sub-fund or umbrella level.

Q65: Does ESMA's proposed approach in relation to the disclosure of i) new arrangements for managing liquidity and 2) the risk profile impose additional liability obligations on the AIFM?

See comments under Q54.

Q66: Do you agree with ESMA's proposed definition of special arrangements? What would this not capture?

We agree with the IMA's detailed comments on liquidity.

Special arrangements applies where certain assets, owing to their illiquid nature, are subject to separate/bespoke arrangements. Permanent borrowing is not a special arrangement. Such borrowing is not an arrangement which relates to certain assets and it would be used to meet redemption requests from any investor so is not specific to a certain group of investors. We therefore recommend deletion of this paragraph.

Q67: Which option for periodic disclosure of risk profile under Box 107 do you support? Please provide reasons for your view.

Option 2 in Box 107 is significantly more demanding and less flexible than option 1. In particular, the results of stress tests would not normally be the type of information that would be disclosed in annual reports.

Q68: Do you think ESMA should be more specific on the how the risk management system should be disclosed to investors? If yes, please provide suggestions.

No this should be at the discretion of the AIFM.

Q69: Do you agree with the proposed frequency of disclosure? If not, please provide alternative suggestions.

We do not agree with the proposed frequency of disclosure. Quarterly reporting is excessive.

The frequency of reporting could in fact create additional risk as regulators are unlikely to be resourced to properly review the information provided which could mean that important matters are missed. In our view, reporting should be done annually. The competent authority has the power to require additional reporting where appropriate.

Q70: What costs do you expect completion of the reporting template to incur, both initially and on an ongoing basis? Please provide a detailed analysis of cost and other implications for different sizes and types of fund.

We are concerned about the level of detail required and the cost of both initial implementation and ongoing cost of compliance. We note from Annex V that only section 1 is applicable to all AIFMs. Sections 2 and 3 only apply to an AIF 'of a material size'. Much will depend therefore on which AIFs fall in this category.

We are also concerned about the implications for third country funds many of which will already be reporting similar (but not identical) information to their own regulators. To require separate reports to EU CAs would be disproportionate.

Again there is a risk that additional costs in these areas may have to be passed on to investors who will not gain any benefit.

Q71: Do you agree with the proposed reporting deadline i.e. information to be provided to the competent authorities one month after the end of the reporting period?

Assuming this is done annually, we believe that this should be aligned to the reporting deadline for the annual report.

Q72: Does ESMA's proposed advice in relation to the assessment of whether leverage is employed on a substantial basis provide sufficient clarity to AIFMs to enable them to prepare such an assessment?

We have no specific comments.