INVESTMENT ADVISER
ASSOCIATION

September 13, 2011

Via Electronic Mail

Steven Maijoor
Chair
European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris

Re: ESMA's Draft Technical Advice to the European Commission on Possible Implementing Measures of the AIFM Directive

Dear Mr. Maijoor:

The Investment Adviser Association (IAA) appreciates the opportunity to comment on the consultation paper by the European Securities and Markets Authority (ESMA) proposing draft technical advice to the European Commission on the detailed implementing measures that will form part of the Alternative Investment Fund Managers (AIFM) Directive framework.[1] The IAA is a not-for-profit US association that represents the interests of investment adviser firms registered with the US Securities and Exchange Commission (SEC). IAA's membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, and many of our members manage funds and assets on behalf of clients in the European Union.

In response to the Commission's request for advice last December, the Consultation Paper provides an extensive set of proposed advice. Specifically, ESMA sets forth its draft advice on three significant areas: (1) general provisions for managers, authorization, and operating conditions; (2) depositaries; and (3) transparency requirements and leverage. Certain matters – including measures related to the passport for third country entities and cooperation agreements with third countries – that are of particular importance to our members are covered in another consultation paper.[2] We will submit comments on those issues in a separate response.

[1] *See* ESMA, Consultation Paper: Draft Technical Advice to the European Commission on Possible Implementing Measures of the Alternative Investment Fund Managers Directive, ESMA/2011/209, July 13, 2011 (Consultation Paper), *available at* http://www.esma.europa.eu/popup2.php?id=7625.

[2] *See* ESMA, Consultation Paper: Draft Technical Advice to the European Commission on Possible Implementing Measures of the Alternative Investment Fund Managers Directive in Relation to Supervision and Third Countries, ESMA/2011/270, Aug. 23, 2011, available at http://www.esma.europa.eu/popup2.php?id=7702.

Since the Commission's original proposal in 2009, the IAA has closely monitored the legislative journey of the AIFM Directive. Throughout the trialogue negotiations, we submitted comment letters to the Presidency of the European Union, the Economic and Monetary Affairs Committee of the European Parliament, and the European Commission with our specific concerns regarding the proposal.[3] We applaud the European Union for reaching agreement on the text of the Directive although we note that much work remains in terms of the measures that will implement the provisions of the Directive. Given the relatively brief consultation period and the myriad of issues presented by the lengthy consultation paper, in this letter, we focus on three aspects of the proposed advice that are of significance to our members: (1) delegation; (2) transparency; and (3) remuneration. We describe our concerns below.

Delegation

In the original Commission proposal, the AIFM Directive only permitted delegation to another authorized AIFM, and it was unclear whether a non-EU manager could be authorized as an AIFM under the Directive. At that time, the IAA urged the EU institutions to ensure that the Directive take into consideration the global nature of the investment management industry and the benefits, including international diversification and expertise, internationally-based managers provide to EU investors. The IAA, therefore, urged that the text of the Directive be amended to permit AIFMs to delegate portfolio management to US-based managers. We were pleased that the final Directive included text to permit non-EU managers to provide investment management services through delegation.

To ensure the protection of investors and proper supervision, the level 1 text of the AIFM Directive includes a number of conditions for delegation of portfolio management to another manager. We generally support these conditions as appropriate safeguards for the proper delegation of portfolio management but we caution that the conditions imposed should not become overly cumbersome and, in effect, prevent efficient delegation. If AIFMs determine that the conditions are too onerous or the obligations are unclear, they may determine not to delegate portfolio management to another investment manager.

Specifically, in the case of delegation to a US-based manager, unless delegation is permitted without undue burden, European investors may lose the benefits of international diversification. For example, we are concerned with the proposed criteria –whether the AIFM and the delegate are members of the same group and the extent that the delegate controls the AIFM or has the ability to influence its actions – in determining whether a delegation would result in a material conflict of interest. We seek confirmation that existing conflicts

[3] *See* Letter to Jean-Paul Gauzès, MEP, European Parliament from Jennifer S. Choi, IAA, dated January 7, 2010; Letter to Dolores Durán Bono, Ministry of the Economy and Finance (Spanish Presidency), from Jennifer S. Choi, dated January 7, 2010; Letter to Emil Paulis, Director, DG MARKT/G, Financial Services Policy & Financial Markets, and Ugo Bassi, Head of Unit, Asset Management, European Commission, from Jennifer S. Choi, IAA, dated July 29, 2009; Letter to Charlotta Erikson, Financial Attaché, Permanent Representation of Sweden to the EU (Swedish Presidency), from Jennifer S. Choi, IAA, dated July 29, 2009.

management processes under existing regulation in place for asset management firms would address adequately any concerns about potential conflicts of interest.

EU AIFMs may delegate to an affiliate or parent in the US because of the expertise of the affiliate or parent and for the efficient management of the AIF. The European affiliates of our members may be authorized under the UCITS Directive and/or under MiFID. Under these regulatory regimes, these EU firms already have policies and procedures to address and manage potential conflicts of interest. Moreover, US asset managers registered with the US SEC also have procedures in place to identify and mitigate potential conflicts of interest. ESMA should confirm that these processes already in place for many asset managers should be sufficient to satisfy the criteria for delegation and would not result in a material conflict of interest with the AIFM or the investors of the AIF. Given the broad scope of the Directive, which covers not only managers of hedge funds but all non-UCITS funds, it is important for the benefit of EU investors and for the efficient functioning of the markets to allow non-EU managers to provide investment management services to non-UCITS funds without placing a substantial burden on the ability of AIFMs to delegate.

Objective Basis for Delegation

In the Consultation Paper, ESMA provides two alternative options for how an AIFM would be able to justify its entire delegation structure on objective grounds. Option 1 would permit an AIFM to comply with this requirement by being able to demonstrate that the delegation is done for the purpose of a more efficient conduct of the AIFM's management of the AIF. Option 2 delineates a set of non-exhaustive objective reasons for the delegation, including optimizing of business functions and processes; cost savings; expertise of the delegate in administration, specific markets or investments; and access of the delegate to global trading capabilities. ESMA has noted that option 1 is based on the UCITS approach on delegation.

In our view, Option 1 is preferable to Option 2. First, many AIFMs also may be UCITS managers and, thus, already familiar with the delegation provisions under the UCITS Directive. Investment managers have been operating under the UCITS Directive's delegation provisions for many years, and both industry and regulators have significant experience with this standard. The delegation provisions have worked well under the UCITS regime, and Member State authorities will be able to supervise delegation through the same mechanisms currently in place for UCITS funds. Second, although Option 2 does provide for a "non-exhaustive" list of objective reasons for delegating tasks, we believe it is preferable to permit the AIFM to articulate the reason for delegating as long as the manager can demonstrate that the delegation is done for a more efficient conduct of the AIFM's management of the AIF. Member State authorities may be hesitant to accept an objective reason that is not listed even though ESMA has intended the list to serve as an example. Third, to the extent that there are no particular or articulated reasons for having different rules for delegation for managers of AIFs and UCITS funds, we believe there are benefits to harmonizing the regulatory regimes with respect to these provisions. Differences in regulations without justification or rationale will only cause more confusion among the industry and Member State authorities.

Transparency

In addition to AIFMs authorized under the Directive, non-EU AIFMs that intend to continue to market non-EU AIFs under the national private placement regimes during the transition period must comply with the transparency provisions of the new Directive. We have two general comments on these provisions and two specific comments with respect to the advice on the possible implementing measures on reporting to competent authorities.

First, we are concerned that in complying with some of the transparency provisions of the Directive, non-EU AIFMs would indirectly be required to comply with other substantive provisions of the AIFM Directive that are not applicable to these AIFMs. We are of the view that the transparency provisions should not be used as a backdoor to require non-EU AIFMs to comply with the operating conditions of the AIFM Directive. For example, ESMA recommends that the original and maximum leverage level should be disclosed to investors in accordance with the methods proposed by ESMA. For non-EU AIFMs intending to market under the national private placement regimes, these managers should not be required to calculate leverage under the prescribed methods for purposes of disclosing the total amount of leverage to investors, particularly if they are required to calculate leverage under a different method by their third-country regulators. Moreover, ESMA proposes that non-EU AIFMs would be required to provide a description of the risk management systems to manage liquidity risk. The risk management systems of non-EU AIFMs should not have to comply with the liquidity management policies and procedure requirements under Article 16(1) of the Directive and ESMA's advice with respect to those requirements. We urge ESMA not to require compliance with provisions that the Level 1 text explicitly provides would not apply to non-EU AIFMs.

Second, as ESMA is aware, major jurisdictions around the globe, including the US, are requiring reports and information on AIFs. In January 2011, the US SEC proposed to require private fund advisers to provide certain information to regulators on proposed Form PF about the private funds that they manage. Given the global nature of the investment management industry and that many investment managers in Europe and the United States have affiliates in multiple countries, we appreciate the coordination among regulators for information about private funds. We, however, respectfully request that regulators coordinate even more closely on the information that should be provided. Although much of the information recommended by ESMA is similar to the information requested on proposed Form PF, some information is different. Greater coordination and uniformity in the type of information to be provided to regulators around the world will not only be less burdensome to global investment managers but improve the ability of regulators to supervise systemic risk. We urge ESMA to continue to work closely with foreign regulators, particularly the US SEC in this respect before finalizing the advice.[4]

In addition, we have two specific comments on the reports to competent authorities. With regard to the frequency of reporting to regulators, ESMA proposes that each AIFM be required to report to the competent authorities of its home Member State on a quarterly basis and that information be provided no later than one month after the end of the relevant period.

[4] We intend to encourage the US SEC also to work closely with ESMA on these issues.

We believe that quarterly reporting by all AIFMs, regardless of the nature, scale, and activities in which they are engaged, is too frequent. We recommend that reports be submitted to regulators annually with more frequent reporting by AIFMs that use "leverage on a substantial basis" or upon request by regulators based on certain systemic risk factors.

Finally, we seek confirmation that the information that will be provided to the regulators will be kept confidential. Certain information requested may be sensitive and/or proprietary (such as market risk and liquidity profiles of AIFs and results of periodic stress tests), and we believe the information provided to authorities should not be made public.[5]

Remuneration

ESMA's Consultation Paper proposes advice on the content and format of the remuneration disclosure, which must include, for example, the total amount of remuneration for the financial year, general information relating to the criteria of the remuneration policies and practices, and information necessary to provide an understanding of the risk profile of the AIF and the measures it adopts to avoid or manage conflicts of interest. Although ESMA's advice only addresses the disclosure of remuneration and does not address the substantive remuneration provisions, the IAA believes that ESMA should provide additional guidance to Member State authorities with respect to the proportional application of the remuneration policy to AIFMs. The level 1 text states that AIFMs should comply with the remuneration policy in a way and to the extent that is appropriate to their size, internal organization, and the nature, scope and complexity of their activities.

We understand that ESMA will undergo a review of the remuneration principles across various sectors in the near future. In harmonizing the application of these principles across Member States, it is critical to recognize that asset managers engage in diverse businesses and undertake different types of risks and that the application of the remuneration policies must reflect those differences. Therefore, we hope that ESMA will assist Member States in appropriately applying the remuneration principles on AIFMs.

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The IAA appreciates the substantial efforts of ESMA in a short period of time to provide advice to the Commission on the AIFM Directive implementing measures. Given the volume and complexity of the issues raised and the relatively short consultation period, we have raised several of the most significant issues for our members. We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

[5] Similarly, the US SEC has proposed not to make the information reported on Form PF public. The information will be provided to the Financial Stability Oversight Council (FSOC), which is comprised of the leaders of various financial regulators (including the Commissions' Chairmen) and other participants, to monitor for systemic risk and may be shared only with other government agencies.

Respectfully submitted,

/s/ Jennifer S. Choi

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