bvca The voice of long-term investment

1st Floor North, Brettenham House
Lancaster Place, London WC2E 7EN
T: +44 (0)20 7420 1800
F: +44 (0)20 7420 1801
E: bvca@bvca.co.uk
www.bvca.co.uk

ESMA
11-13 avenue de Friedland
75008 PARIS FRANCE
www.esma.europa.eu

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Dear Sirs

Industry Response to the CESR Call for Evidence on Implementing Measures on the Alternative Investment Fund Managers Directive ("AIFMD")

This response to the Call for Evidence on Implementing Measures on the AIFMD published by CESR on 3 December 2010 is made by the British Private Equity and Venture Capital Association (**"BVCA"**). The BVCA represents the overwhelming majority of UK-based private equity and venture capital firms (**"PE/VC firms"**). Since the publication of the Call for Evidence, CESR has become ESMA and it is therefore referred to as such throughout this response.

Please note that the following responses are only of a preliminary nature and hence reflect only our initial thoughts. The questions cover a range of issues which need more thought than has been possible in the consultation period, particularly given the seasonal holidays.

This response is submitted in addition to the response put forward by the European Private Equity and Venture Capital Association (**"EVCA"**) to which we have also contributed.

In order to focus our response appropriately we have answered only those questions which we think raise issues relevant to the PE/VC industry.

Yours faithfully

Margaret Chamberlain

Margaret Chamberlain

Chair – BVCA Regulatory Committee

A. DIFFERENTIATION

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).

Response:

We have seen, contributed to and agree with the response submitted by EVCA. This fully covers the categories in the U.K. and so we have nothing to add to it.

B. CHOICE OF LEGISLATIVE INSTRUMENT

Once CESR/ESMA has submitted its advice on the implementing measures, the Commission will have to decide which type(s) of legislative instrument would be appropriate for the level 2 measures. The choice is likely to be between directives – which require transposition at national level – and regulations, which are directly applicable on market participants without any national transposition. Regulations can be considered as promoting harmonisation across EU Member States (MS), while directives leave a greater amount of discretion to MS in their application. CESR may express an opinion on this in its advice to the Commission.

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.

Response

We believe that all topics to be covered by the implementing measures would be most appropriately addressed in the form of directives.

This is because implementation via directives allows Member States, when transposing Level 2 directives into national law, to decide how to achieve the end result provided for in those directives. This is of absolutely key importance given the very broad range of AIF and AIFM covered by the AIFM Directive, the different populations of AIF and AIFM to be found across Member States and also the continuing evolution of fund structures and strategies, which themselves will reflect national property, ownership and other laws.

PART I

GENERAL PROVISIONS, AUTHORISATION AND OPERATING CONDITIONS

ISSUE 1 – ARTICLE 3 EXEMPTIONS

Opt-in

1. CESR is requested to advise the Commission on the procedures for AIFM which choose to opt-in under this Directive in accordance with Article 3(4). CESR should consider whether there are specific reasons not to use the same procedure that applies to AIFM that do not benefit from this exemption.

2. This advice should include procedures specific to the case of AIFM from third countries seeking to opt in after the phasing-in of the third country regime; in particular the determination of the Member State of reference.

We have seen, contributed to and agree with the response submitted by EVCA.

Threshold

1. CESR is requested to advise the Commission on how to identify the portfolios of AIF under management by a particular AIFM and the calculation of the value of assets under management by the AIFM on behalf of these AIF.

2. The advice should identify options on how to determine the value of the assets under management by an AIF for a given calendar year. It should indicate the method or methods CESR regards as preferable.

3. CESR is invited to consider how the use of different forms of leverage influences the assets under management by an AIF and how this should best be taken into account in the calculation of assets under management.

4. CESR is requested to advise the Commission on how best to deal with potential cases of cross-holdings among the AIF managed by an AIFM, e.g. funds of AIF with investments in AIF managed by the same AIFM.

5. CESR is requested to advise the Commission on how to treat AIFM whose total assets under management occasionally exceed and/or fall below the relevant threshold in a given calendar year. As part of this work, CESR is requested to specify circumstances under which total assets under management should be considered as having occasionally exceeded and/or fallen below the relevant threshold in a given calendar year.

6. CESR is requested to advise the Commission on the content of the obligation to register with national competent authorities for the entities described in Article 3(2).

7. CESR is requested to advise the Commission on suitable mechanisms for national competent authorities in order to gather information from these entities in order to effectively monitor systemic risk as set forth in Article 3(3). To that end, CESR is requested to specify the content, the format, and modalities of the transmission of the information to be provided to competent authorities. CESR is invited to consider the consistency with its advice regarding the Issue 25 (reporting obligations to competent authorities).

8. CESR is requested to advise the Commission on the obligation of AIFM to notify competent authorities in the event they no longer comply with the exemptions granted in Article 3(2).

Response

We are currently working with EVCA on this matter and we will provide a response following the conclusion of our work with them.

ISSUE 2 – ARTICLE 9 INITIAL CAPITAL AND OWN FUNDS

1. CESR is requested to provide the Commission with a description of the potential risks arising from professional negligence to be covered by additional own funds or the professional indemnity insurance referred to in Article 9(7).

2. CESR is requested to advise the Commission on how the appropriateness of additional own funds or the coverage of the professional indemnity insurance to cover appropriately the potential professional liability risks arising from professional negligence referred to in Article 9(7) should be determined, including – to the extent possible and appropriate – the methods to calculate the respective amounts of additional own funds or the coverage of the professional indemnity insurance.

3. CESR is requested to advise the Commission on the best way to determine ongoing adjustments of the additional own funds or of the coverage of the professional indemnity insurance referred to in Article 9(7).

4. CESR is invited to take account of work done in the context of the Capital Requirements Directive and to liaise as appropriate with CEBS and CEIOPS on this issue.

Response

We have seen, contributed to and agree with the response submitted by EVCA.

In addition, we note that fund managers will typically purchase Professional Indemnity Insurance (**"PII"**) to help manage the consequences of claims of professional negligence. The quantum of that insurance should be determined by the manager's experience of past claims, the size of investments being made, the likelihood and types of claims that may be received and the conditions in the insurance market. The experience of member firms is that such claims are relatively rare.

To the question of the assessment, quantification and adjustment of the risks we follow the merits of adopting an Article 7 Capital Adequacy Directive (2006/49/EC) approach. We note that it has the advantage of certainty for fund managers and consistency within the wider European internal financial services market.

ISSUE 4 – ARTICLE 14 CONFLICTS OF INTEREST

1. CESR is requested to provide the Commission with a description of the types of conflicts of interests between the various actors as referred to in Article 14(1).

2. CESR is requested to advise the Commission on the reasonable steps an AIFM should be expected to take in terms of structures and organisational and administrative procedures in order to identify, prevent, manage, monitor and disclose conflicts of interest.

The Commission would encourage CESR to target an appropriate level of consistency with the corresponding provisions of other directives, such as UCITS and MiFID, while taking due account of the differences between the regulated populations.

Response:

The issue of conflicts of interest within the private equity and venture capital industries has been subject to extensive work by the International Organization of Securities Commission (**"IOSCO"**). We would therefore refer ESMA to IOSCO's commendable work in this area. IOSCO's November 2010 Final Report on Private Equity Conflicts of Interest can be found at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD341.pdf).

ISSUE 5 – ARTICLE 15 RISK MANAGEMENT

1. CESR is requested to advise the Commission on the risk management systems to be employed by AIFM as a function of the risks that the AIFM incurs on behalf of the AIF that it manages and on the criteria that competent authorities should take into account when assessing for the AIF managed by the AIFM whether the risk management process employed by the AIFM is adequate in order to identify, measure, manage and monitor appropriately all risks relevant to each AIF investment strategy and to which each AIF is or can be exposed.

Response:

The key elements of a PE/VC's fund's operation, and therefore the areas where risks may arise, are investment, portfolio management and divestment.

Each of these elements can take significant time and are typically the focus of substantial management attention. For instance, processes to buy or sell companies may take several months, whilst companies are usually held in portfolios for 3 to 5 years.

Given the management time devoted to these issues already, the appropriate focus for a risk management function in a PE/VC firm is to check that these processes are operating effectively and in accordance with the AIFM's policies and procedures.

As a general point we believe that considerable caution should be exercised in producing Level 2 measures setting out detail on risk management systems. Although we strongly support careful risk management we believe there is a real risk that detailed regulation on the subject may narrow the focus of risk management to only those aspects which are set out in the regulations, rather than genuinely monitoring appropriately the risks of the relevant fund. In addition, the risks in PE/VC funds are much less, and very different, from those in certain other types of AIF. Whilst the investment, usually in unquoted securities, carries an investment risk, this is not the same as risks which can arise in more complex portfolios containing, for example, leveraged or volatile positions or complex derivatives. The value of a PE/VC investment does not fluctuate hourly or daily.

We suggest that in order to preserve the necessary flexibility, ESMA's response focuses on the need for appropriate governance around risk management. This might include the following requirements:

- An AIFM will appoint a 'Risk Officer' who will report to the AIFM's governing body.
- The governing body shall have responsibility for ensuring that risks are managed effectively.
- A risk register will be maintained by the Risk Officer for each AIF setting out the principal risks relating to that fund, measures of the likelihood and impact and mitigating controls.
- The risk register will be updated with sufficient regularity so that it accurately reflects those risks at any time.
- The Risk Officer shall:
    - monitor the effective operation of the mitigating controls, including but not limited to the existence of and compliance with due diligence procedures for new investment;
    - report the results to the governing body; and
    - recommend to the governing body changes to these controls where appropriate.
- The risk registers will be reviewed by the AIFM's governing body at least annually and more often where appropriate. The review should consider the completeness of the register whether the mitigating controls are operating effectively and whether the risk profile of each AIF (as evidenced

by the content of the relevant register) is consistent with its instruments of incorporation and marketing documentation.

The introduction of such measures would not obviate the risks of making investments; however it would provide a framework for their prudent management.

We believe that the risk management function should therefore consist of a small number of individuals within the AIFM, quite possibly a single person in smaller organisations, who may have other responsibilities such as finance and/or regulatory compliance. Accordingly this would form part of the firm's existing compliance or internal audit function.

This function could, for example, be assumed by one employee of the AIFM which assumes the risk management function for all AIF managed; or, depending on the size of the AIFM and the number of AIF managed, by different members of the team for different AIF.

In particular, CESR is requested:

a) to advise on the categories of risk relevant to each AIF investment strategy and to which each AIF is or can be exposed and the methods for identifying the risks that are relevant for the particular AIF investment strategy or strategies so that all risks are adequately identified.

Response:

Any Level 2 measures which are produced should be flexible enough to fully recognise the different asset classes and types of investment and investment strategy. The risks faced by a typical PE or VC fund will be very different to those faced by a hedge fund.

It should be noted that investors in AIFs are making a conscious decision to be exposed to a particular set of risks in order to try and benefit from the reward that taking those risks may bring. These risks are explained and set out in the AIF's investment policy and restrictions in pre-investment marketing materials. In a PE/VC context, investors negotiate and agree risk parameters with the AFM on entering the fund. These parameters set out prescriptive investment strategies, investment limits and requirements on the diversification of investments. It should not therefore be the purpose of risk management to eliminate such risk, or to manage risks which investors have actively sought to gain exposure to in a way which deprives investors of the exposure that they seek. For instance an AIF investing in mid-market companies in the UK will be very exposed to the risk that the UK economy underperforms, but investors will clearly be aware of that fact. Risk management should be concerned with managing the portfolio in line with the AIF's investment policy and restrictions as explained to investors.

We note that extensive work has identified the generally low risk nature of PE/VC investments and the fact that the risks incurred do not have the potential to lead to further systemic risk. Investment risks in a PE and VC context are:

- due diligence risk (buying something without understanding it);
- investment risk (a combination of lots of different risks which lead to the company performing less well than expected);
- currency risk (fund's performance affected by exposure to currencies other than that in which it is denominated); and
- market risk (on buying or selling, risk that market conditions are sub-optimal).

b) to advise, to the extent possible, on methods for quantifying and measuring risks including the conditions for the use of different risk measurement methodologies in relation to the identified types of risk so that overall risk exposures as well as contributions to overall risk from each risk factor are properly measured.

Response:

In a PE/VC fund, it is very difficult to quantify or measure many of the risks set out above, for instance due diligence risk. There is no common set of procedures to quantify risk in this way nor is there any best practice in this regard.

We suggest that measurement of risks in the way implied by the question is more relevant to other forms of AIF, e.g. certain hedge funds which make complex investments, where the impact of a single factor such as movements in interest rates needs to be modelled and understood.

c) to advise on adequate methods for managing and monitoring all such risks so that the AIF risk exposures respect at all times the risk objectives of the AIF.

Response:

A PE/VC fund will not normally have "risk objectives" though the investment policy may include some restrictions. As suggested in the response to Q1 above, the AIFM's governing body should review the risk regularly.

Please see also our response to Q1(b) above.

2. CESR is requested to advise the Commission on the appropriate frequency of review of the risk management system. CESR is invited to consider whether the appropriate frequency of review varies according to the type of AIFM or the investment strategy of the AIF.

Response:

We suggest that in the absence of special circumstances frequent risk reviews by competent authorities are not appropriate for medium to long term illiquid investments of the kind made by PE/VC funds.

3. CESR is requested to advise the Commission on the conditions for the appropriate risk governance structure, infrastructure, reporting and methodology, in particular, on how the risk management function shall be functionally and hierarchically separated from the operating units, including the portfolio management function.

Response:

Risk governance structure

In our response to Q1 above, we have proposed a governance framework for risk management.

Functional and hierarchical separation

The portfolio managers who are engaged in investigating potential investments, taking decisions to acquire and dispose of investments and conducting ongoing monitoring, are the investment executives with the most intimate and detailed knowledge of the investee companies. We believe it would be a dereliction of duty for them to fail to consider and seek to manage risk when acting as portfolio managers. This is necessary not only when deciding whether to invest but also in negotiating the terms of investment (and divestment) since among the tools for measurement and management of risk in a PE/VC context are the reporting and consent requirements, board and other representation and rights obtained in relation to the investee company, together with the warranties and indemnities received or given on acquisition/sale. These in turn are affected by the nature of the transaction.

A separate risk management function will not be in a position to assess and negotiate such provisions, nor to monitor the investment in the same way as the portfolio managers can do. The risk management function should not end up duplicating the portfolio management function, or discouraging the latter from being fully mindful of, and seeking to manage, risk.

The remit of the risk management function should therefore be restricted to checking that portfolio managers are following the firm's risk management requirements, but this needs to be done in a way which is proportionate to the size and nature of the firm and the risks undertaken by the AIF (see response to Q4 below).

4. CESR is requested:

a) to advise how the principle of proportionality is to be applied by competent authorities in reviewing the functional and hierarchical separation of the functions of risk management in accordance with Article 15(1).

Response:

With respect to private equity and venture capital AIF, the AIFM team can be very small, sometimes consisting of five or even fewer principals who have extensive experience and knowledge in analysing investments in potential portfolio companies and also in actively monitoring such companies.

In such organisations complete hierarchical segregation is not feasible because, for instance, some or all members of the Investment Committee which takes portfolio management decisions are likely also to be on the governing body of the manager and probably also shareholders/partners in the firm. It may not be possible to achieve full functional separation either. Small firms have a significant role in providing venture capital and private equity to growing companies. Competent authorities, in applying proportionality, should therefore have regard to:

- the size of the firm;
- the nature of portfolios and related risk; and
- procedures that the firm has in place managing conflicts and risk

in determining whether they are appropriate in the overall context.

b) to advise on criteria to be used in assessing whether specific safeguards against conflicts of interest allow for the independent performance of risk management activities and that the risk management process satisfies the requirements of Article 15 and is consistently effective. This advice will be particularly relevant in cases where full separation of functions is not considered proportionate. CESR is encouraged to provide the Commission with a non-exhaustive list of specific safeguards AIFM could employ against conflicts of interest referred to in the second subparagraph of Article 15(1).

Response:

Most PE/VC funds operate under a model where the interests of the AIFM are aligned closely with those of investors through carry and/or co-investment schemes. Where this is the case, the need for safeguards to ensure that independent risk management is undertaken is limited, as it is in the interests of the AIFM itself, as well as investors, that there is effective risk management. We refer ESMA to the safeguards included in the IOSCO report which offer a useful benchmark.

Nonetheless, a list of specific safeguards might include the following:

- The creation of a specific role of Risk Officer.
- The Risk Officer to be given certain specific regulatory responsibilities with respect to the monitoring of risk management, albeit that overall responsibility for risk management must remain with the governing body.
- In cases where risk management is complex, the involvement of a third party. We strongly suggest, however, that for the vast majority of PE/VC firms, the involvement of a third party will not be proportionate to the relatively simple risk management arrangements required for their activities.

5. CESR is requested to advise the Commission on the content of the requirements referred to in Article 15(3).

This advice should at least address the following issues:

a) the content of an appropriate, documented and regularly updated due diligence process when investing on behalf of the AIF, according to the investment strategy, the objectives and risk profile of the AIF;

Response:

We suggest that ESMA should not try to prescribe the exact due diligence to be performed for each and every type of investment.

Due diligence is a fundamental part of the PE/VC investment cycle and is managed by the investment executives, with a number of third party providers very often engaged to perform different aspects such as legal due diligence. The due diligence performed on each investment opportunity will vary depending on the features of and risks inherent in that opportunity and the circumstances in which the opportunity arises. Certain tender or competitive situations or purchase of distressed companies may involve very different due diligence to other situations because of the facts of the situation. In some cases diligence risks are instead addressed by pricing and/or warranties. As noted above, the role of the risk management function should be to ensure that defined due diligence processes exist and are followed appropriately.

b) the criteria to be used by competent authorities when assessing whether the risks associated with each investment position of the AIF and their overall effect on the AIF's portfolio can be properly identified, measured, managed and monitored on an ongoing basis, including through the use of stress testing;

Response:

As noted in the response to Q1(b) above, it is usually not possible to quantify risks in a meaningful way for a PE/VC fund. It follows that stress testing is not relevant to these funds.

Effective risk management in a PE/VC fund should therefore be assessed by reference to the existence and effective operation of the governance structure around risk management set out in the response to Q1.

c) appropriate stress testing procedures and their frequency pursuant to Article 15(3)(b);

Response:

We believe that stress testing is not appropriate for PE/VC funds.

d) the criteria to be used in assessing whether the risk profile of the AIF corresponds to the size, portfolio structure and investment strategies and objectives of the AIF as laid down in the AIF rules or instruments of incorporation, prospectus and offering documents.

Response:

As set out above, the governing body should make this assessment at least annually. The competent authority should ask for confirmation that this review has been undertaken. In the case of PE/VC funds, given their relatively simple objectives, we believe that this should suffice.

ISSUE 9 - ARTICLE 19 VALUATION

CESR is invited to advise the Commission on:

1. The criteria concerning the procedures for the proper valuation of the assets and the calculation of the net asset value per share or unit to be used by competent authorities in assessing whether an AIFM complies with its obligations under Article 19(1) and Article 19(3).

CESR is invited to consider how these procedures should be differentiated to reflect the diverse characteristics of the assets in which an AIF may invest.

2. The type of specific professional guarantees an external valuer should be required to provide so as to allow the AIFM to fulfil its obligations under Article 19(5).

CESR is asked to consider the impact of the required guarantees on the availability of external valuers to the AIFM industry.

3. The frequency of valuation carried out by open-ended funds that can be considered appropriate to the assets held by the fund and its issuance and redemption frequency.

In particular, CESR is invited to consider how the appropriate frequency of valuation should be assessed for funds investing in different types of assets and with different issuance and redemption frequencies, taking into account different (and varying) degrees of market liquidity. CESR is invited to take account of the fact that such valuations shall in any case be performed at least once a year.

Response

We have seen, contributed to and agree with the response submitted by EVCA. We suggest that the IPEV guidelines are particularly relevant to PE/VC firms but it needs to be recognised that non-European firms will not use these guidelines, so there must be flexibility.

2. The type of specific professional guarantees an external valuer should be required to provide so as to allow the AIFM to fulfil its obligations under Article 19(5).

CESR is asked to consider the impact of the required guarantees on the availability of external valuers to the AIFM industry.

The AIFMs' obligations under Article 19 (5) are to be able to demonstrate that the valuer can "furnish sufficient professional guarantees to be able to effectively perform the relevant valuation function in accordance with Article 19 paragraphs 1, 2 and 3."

It is unclear what this phrase means. It could and we suggest should mean that the valuer must satisfy the AIFM that the standards and professional requirements to which it is subject mean that it is competent to carry out the function in relation to the particular type of fund. This does not happen currently in practice. The one exception is the requirements of Auditing Standards which set out the necessary requirements for specialists in terms of the experience and expertise they are required to have.

ISSUE 10 – ARTICLE 20 DELEGATION OF AIFM FUNCTIONS

1. CESR is invited to advise the Commission on the content of rules that are necessary and proportionate to ensure that an AIFM fulfils the conditions under Article 20(1) and Article 20(2).

2. In particular, CESR is invited to advise the Commission on the following, which are applicable both to cases of delegation and sub-delegation:

a) the criteria that competent authorities should use to assess whether the reasons supplied to justify the entire delegation structure of an AIFM are objective.

b) the circumstances under which a delegate should be considered to have sufficient resources to perform the tasks delegated to it by an AIFM; and to be of sufficiently good repute and sufficiently experienced to perform these tasks.

c) the types of institutions that should be considered to be authorised or registered for the purpose of asset management and subject to supervision. CESR is invited to consider whether to employ general criteria or to specify categories of eligible institution in this context.

d) in the event of a delegation of portfolio or risk management to an undertaking in a third country, how cooperation between the home Member State of the AIFM and the supervisory authority of the undertaking should be ensured.

e) the circumstances under which a delegation would prevent the effective supervision of the AIFM, or the AIFM from acting, or the AIF from being managed, in the best interest of its investors.

3. CESR is invited to advise the Commission on the content of rules that are necessary and proportionate to ensure that an AIFM fulfils the conditions under Article 20(3).

4. In particular, CESR is invited to advise on:

a) the type of evidence necessary for an AIFM to demonstrate that it has consented to a sub-delegation

b) the criteria to be taken into account when considering whether a sub-delegation would result in a material conflict of interest with the AIFM or the investors of the AIFM; and for ensuring that portfolio and risk management functions have been appropriately segregated from any conflicting tasks; and that potential conflicts are properly identified, managed, monitored and disclosed to the investors of the AIF.

c) the form and content the notification under Article 20(3) (b) should take in order to ensure that the supervisory authorities have been properly notified.

5. CESR is also invited to advise the Commission, in relation to Article 20(2), on the conditions under which the AIFM would be considered to have delegated its functions to the extent that it had become a letter-box entity and could no longer be considered to be the manager of the AIF.

Response:

We have seen, contributed to and agree with the response submitted by EVCA.

The justification of the delegation structure is a matter for the competent authority of the home Member State. As the range of legal structures varies widely across asset classes and Member States it would not be possible for ESMA to prepare a list of what may be justifiable.

PART II: DEPOSITARY (ARTICLE 21)

ISSUE 13 – DEPOSITARY FUNCTIONS

Depositary functions pursuant to paragraph 6

1. CESR is requested to advise the Commission on the conditions for performing the depositary functions pursuant to Article 21(6). CESR is requested to specify conditions for the depositary to ensure that:

- the AIF's cash flows are properly monitored;
- all payments made by or on behalf of investors upon the subscription of shares or units of - an AIF have been received and booked in one or more cash accounts opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF or in the name of the depositary acting on behalf of the AIF at an entity referred to in Article 18 (1) (a) to (c) of Commission Directive 2006/73/EC in accordance with the principles set forth in Article 16 of Commission Directive 2006/73/EC.
- where cash accounts are opened in the name of the depositary acting on behalf of the AIF, none of the depositary's own cash is kept in the same accounts.

In its advice, CESR should take into account the legal structure of the AIF and in particular whether the AIF is of the closed-ended or open-ended type.

Response:

We suggest that the Level 1 text should be clarified in the implementing measures to ensure that it is clear that law firms and professional administration firms are able to provide depositary services. This is of particular importance to the PE/VC industry.

PE/VC funds generally work on a "cash to cash" basis. This means that regardless of when an investor commits to a PE/VC fund, the cash will only flow from the investor to the AIF around the time when an investment is made, and cash will be returned from the AIF to the investor when an investment is sold. This is a fundamentally different structure from other types of AIF where subscriptions or redemptions may be made on a regular periodic basis (e.g. monthly), with the cash flowing at the time of the subscription or redemption. It may be months from an investor making a commitment to a PE/VC fund before the first substantive cash flows to the AIF.

The implementing measures should not add additional steps to the investment process which will delay the receipt of new financing for investee companies. In addition it has to be recognised that cash has to move in order for an investment to be made. When a PE/VC investment is made money has to flow to the client accounts operated by the solicitors on the transaction in order to be transferred to the purchaser on completion. Care must therefore be taken when specifying the conditions under which the depositary monitors cash flows between investors and the AIF. The depositary should be able to monitor cash flows by receiving reports or audited financial statements.

Depositary functions pursuant to paragraph 7

1. CESR is requested to advise the Commission on:

- the type of financial instruments that shall be included in the scope of the depositary's custody duties as referred to in point (a) of Article 21(7), namely (i) the financial instruments that can be registered in a financial instruments account opened in the name of the AIF in the depositary's books, and (ii) the financial instruments that can be "physically" delivered to the depositary;
- the conditions applicable to the depositary when exercising its safekeeping custody duties for such financial instruments, taking into account the specificities of the various types of financial instruments and where applicable their registration with a central depositary, including but not limited to:
  - the conditions upon which such financial instruments shall be registered in a financial instruments accounts opened in the depositary's books opened in the name of the AIF or, as the case may be, the AIFM acting on behalf of the AIF;

- **the conditions upon which such financial instruments shall be deemed (i) to be appropriately segregated in accordance with the principles set forth in Article 16 of Commission Directive 2006/73/EC9), and (ii) to be clearly identified at all times as belonging to the AIF, in accordance with the applicable law; and what shall be considered as the applicable law.**

Response:

We have seen, contributed to and agree with the response submitted by EVCA.

2. CESR is requested to advise the Commission on:

- the type of "other assets" with respect to which the depositary shall exercise its safekeeping duties pursuant to paragraph 7(b), namely all assets that cannot or are not to be kept in custody by the depositary pursuant paragraph to Article 7(a);
- the conditions applicable to the depositary when exercising its safekeeping duties over such "other assets", taking into account the specificities of the various types of asset, including but not limited to financial instruments issued in a 'nominative' form, financial instruments registered with an issuer or a registrar, other financial instruments and other types of assets.

We have seen, contributed to and agree with the response submitted by EVCA that holdings in securities issued by private companies should be treated as other assets pursuant to paragraph 7 b). For example, in the UK, share certificates are prima facie evidence of title only, and the register of members is the primary record of title. The depositary can hold the share certificate, which provides external evidence of title, and record that the shares are held by the AIF.

3. To that end, CESR is requested to advise the Commission on:

- the conditions upon which the depositary shall verify the ownership of the AIF or the AIFM on behalf of the AIF of such assets;
- the information, documents and evidence upon which a depositary may rely in order to be satisfied that the AIF or the AIFM on behalf of the AIF holds the ownership of such assets, and the means by which such information shall be made available to the depositary;
- the conditions upon which the depositary shall maintain a record of these assets, including but not limited to the type of information to be recorded according to the various specificities of these assets; and the conditions upon which such records shall be kept updated.

In the absence of evidence of title in the form of a certificate, the depositary could receive a report from the lawyer or advisor who worked on the PE/VC transaction which shows the resulting ownership position following the transaction.

Depositary functions pursuant to paragraph 8

1. CESR is requested to advise the Commission on the conditions the depositary must comply with in order to fulfil its duties pursuant to Article 21(8). The advice shall include all necessary elements specifying the depositary control duties when inter alia verifying the compliance of instructions of the AIFM with the applicable national law or the AIF rules or instruments of incorporation, or when ensuring that the value of the shares or units of the AIF is calculated in accordance with the applicable national law and the AIF rules or instruments of incorporation and procedures laid down in Article 19.

Response:

It should not be necessary for the depositary to undertake significant independent work to fulfil these requirements. Rather, the depositary should be able to rely on the work done by other parties.

For example, the depositary could fulfil these requirements by reviewing audited financial statements of the AIF.

PART III

TRANSPARENCY REQUIREMENTS AND LEVERAGE

ISSUE 20 - ARTICLE 22 ANNUAL REPORT

1. CESR is requested to advise the Commission on the content and format of the annual report. In its advice, CESR should consider whether all or any of the information referred to in Article 23 should be included in the annual report and the need for appropriate explanatory notes.

We have seen, contributed to and agree with the response submitted by EVCA. We note also that the content and format of the annual report should be designed so as to provide meaningful information to the users of the accounts, reflecting both the economic substance of the transactions of the AIF and the nature and legal structure of the AIF.

In a U.K. context, many PE/VC funds prepare their annual report using the accounting policies set out in their limited partnership agreement. Whilst these policies are usually based on recognised accounting standards (such as UK GAAP or IFRS) they often contain specific provisions that deviate from these recognised standards. These specific provisions are driven by investor requirements who want to ensure that the information is as relevant and meaningful to them as possible. We believe that AIF should retain sufficient flexibility in respect of the preparation of their accounts so as to continue to act in accordance with the requirements of their investors and in their investors' best interests.

bvca The voice of long-term Investment

1st Floor North, Bettenham House
Lancaster Place, London WC2E 7EN
T: +44 (0)20 7420 1800
F: +44 (0)20 7420 1801
E: bvca@bvca.co.uk
www.bvca.co.uk

ESMA
11-13 avenue de Friedland
75008 PARIS FRANCE
www.esma.europa.eu

18 January 2010

Dear Sirs

Industry Response to the CESR Call for Evidence on Implementing Measures on the Alternative Investment Fund Managers Directive ("AIFMD") - Issue 1b) (Thresholds, calculation, oscillation, obligations below thresholds)

We refer to the Call for Evidence on Implementing Measures on the AIFMD published by CESR on 3 December 2010 and the response made by the British Private Equity and Venture Capital Association (**"BVCA"**) on 14 January 2011.

The BVCA response was submitted in addition to the response put forward by the European Private Equity and Venture Capital Association (**"EVCA"**) to which we had also contributed.

We note in respect of the BVCA's response to Issue 1b that we have seen, contributed to and agree with the response submitted by EVCA.

Yours faithfully

M. Ch

Margaret Chamberlain

Chair – BVCA Regulatory Committee