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ESMA Consultation paper. Draft regulatory technical standards on types of AIFM, ESMA (2012/844, dated 19.12.2012)

Dear Sir or Madam,

'kapital-markt intern' would like to thank you for giving us the opportunity to answer the questions raised within the consultation paper.

Within the framework of the ongoing consultation process, we will be restricting our comments here to a response to Question 2.

Q2: Do you agree with the proposed definition of AIFMs of open-ended/closed-ended AIFs? If not, do you have any alternative proposal, in particular as regards the relevant frequency of redemptions for the open-ended funds?

1. Subject:

According to the European Securities and Market Authority consultation paper, dated 19.12.2012, issued on the basis of Article 4, paragraph 4 of the AIFM Directive, closed-end funds are defined as funds that do not provide at least once a year the possibility to investors to redeem their shares. Funds that provide this possibility shall be classified as open-ended funds.

Section 4 of the Article 4 of the AIFM directive is as follows:

"(4), The European Supervisory Authority (European Securities and Markets Authority) (ESMA) shall develop draft regulatory technical standards to determine the types of AIFMs, where relevant in the application of this Directive and to ensure uniform conditions of application of this Directive."

The so-called regulatory technical standards to distinguish between open-ended and closed-ended funds, in the text of the draft, are as follows (vgl. ESMA Consultation paper, Draft regulatory technical standards on types of AIFM, ESMA 2012/844, Annex VI, S.48):

"Article 1- Types of AIFMs

1. An AIFM may be either of the following:

- an AIFM of open-ended AIF(s);*
- an AIFM of closed-ended AIF(s).*

2. An AIFM of open-ended AIF(s) shall be considered to be an AIFM which manages AIF(s) whose unitholders or shareholders have the right to redeem their units or shares out of the assets of the AIF where all the following conditions are present:

- (a) the right may be exercised at least once a year;*
- (b) the transaction is carried out at a price that does not vary significantly from the net asset value per unit/share of the AIF available at the time of the transaction;*
- (c) no restriction or power provided for in the rules or instrument of incorporation of the AIF or any prospectus to apply special arrangements, such as side pockets, gates, suspensions, lock-up periods or other similar arrangements arising from the illiquid nature of the AIF's assets, is to be taken into account for this purpose.*

The lock-up period referred to in the first subparagraph shall be considered to cover any minimum holding period during which unitholders/shareholders shall not have the right to exercise their redemption rights. Whether that period is set at the AIF level, with reference to the date of creation of that AIF or the date of commencement of activities, or at each individual unitholder/shareholder level, with reference to his or her date of subscription, shall be of no significance.

- 3. An AIFM of closed-ended AIF(s) shall be an AIFM managing AIF(s) other than the one described in paragraph 2.*
- 4. Where a change in the redemption policy of the AIF(s) has the effect of changing the type of AIF(s) an AIFM manages, that AIFM shall follow the rules appropriate to the new type of AIF(s)."*

2. Our position:

To the related question 2, we respond as follows

- The (sole) focus on the criterion of the return option (redemption policy)
 - although that term would require in any case a more detailed definition
 - to distinguish between open- and closed-ended funds is unrealistic given the funds practice. For example, in Germany, it is inappropriate and contrary to usual definitions of these investment vehicles. In this respect we would like to refer to the definition of the U.S. Securities and Exchange Commission/SEC of closed-ended funds, inter alia:

"Here are some of the traditional and distinguishing characteristics of closed-end funds:

Closed-end funds generally do not continuously offer their shares for sale. Rather, they sell a fixed number of shares at one time (in an initial public offering), after which the shares typically trade on a secondary market, such as the New York Stock Exchange or the Nasdaq Stock Market."

Cp.: <http://www.sec.gov/answers/mfcclose.htm>

The SEC rightfully identifies the main difference between open- and closed-ended funds, i.e. that closed-end funds have a temporary placement or 'Offering period', after which no further investors may join directly via the primary market. This is a fundamentally different criteria than the fungibility in the operational phase: The limited fungibility of closed-ended funds on the other hand represents a derived feature – compared to mutual funds.

The definition of closed-ended funds by the Closed-End Fund Association, Inc./CEFA also emphasizes that the distinctive feature between the two types of funds is the limited number of shares or investors who join a closed-ended fund during a time-limited placement period, and, related thereto, the fixed capital of a closed-end fund:

"Closed-end funds have a fixed number of shares outstanding. Following an initial public offering, their shares are traded on an exchange between investors. Transactions in shares of closed-end funds are based on their market price as determined by the forces of supply and demand in the marketplace. Interestingly, the price of a CEF may be above (at a premium to) or below (at a discount to) its NAV. The transaction price will also include a customary brokerage charge. The invested capital in a closed-end fund is fixed and will change only at the direction of management. Capital can be increased through the issuance of shares in conjunction with a rights offering or through the reinvestment of certain dividend payments. Capital can be reduced when shares of the fund are repurchased in conjunction with a stock repurchase program or tender offer."

Cp.: <http://www.cefa.com/Learn/Content/CEFBasics/overview.fs>

Namely these features temporary placement period, limited number of investors, etc. - constitute the major differences between closed-ended and open-ended funds in practice with a view to investment decisions and investment strategy (two aspects which the AIFM Directive in general pays too little attention to). In contrast to this, the fungibility of a unit/share due to the investor's redemption right is unable to serve as a meaningful distinction criteria, because these aspects can vary fundamentally from member state to member state, depending on the funds vehicles legal status and the applicable legal framework of the respective member state.

The differences between open-ended and closed-ended funds are, e.g.:

- The total investment volume of closed-ended funds is usually much lower than the volume of open-ended funds.
- Closed-ended funds usually have to successfully cope with a critical placement period until closing to be finally in a position to make the proposed investments
- Closed-ended funds often have already pre-determined investment objects and investment period
- They often have a pre-defined 'lifetime', and the assets are usually held to maturity

From the perspective of investors, the main difference between open- and closed-ended funds is – depending on the legal framework of the Member State – that investors join closed-end funds, for example, in Germany, in the legal form of a partnership and thereby assume its rights and obligations (Secondary liability, etc., cf. Lüdicke / Arndt, closed-ended funds, 6th edition, 2013, A II capital, company law principles). Unlike open-ended funds, in which investors acquire an unlimited number of shares, for closed-end funds there does not even exist a withdrawal or redemption of shares ('redemption rights'), but rather an exit or withdrawal from an entrepreneurial partnership. It is uncertain whether third-party granted put options would be considered as a redemption right. This is why there is a certain risk that the proposed definition of the ESMA to distinguish closed- and open-ended funds does not match the corporate reality, e.g. the jurisdiction in member states like Germany.

Finally, it is important to note that the German legislature wants to regulate on the basis of the investment code ('KAGB') not only – as provided by the AIFM Directive – the Alternative Investment Fund Manager ('AIFM'), but also the AIF itself. In this case – according to the current draft KAGB ('KAGB-E') – to AIF apply different requirements (also on permissible legal form) depending on whether it is an open- or closed-ended AIF. The proposed distinction by the ESMA between open- and closed-ended funds will show far-reaching effects in Germany on AIF level (due to the requirements of the KAGB-E). Following the suggestion of ESMA, in Germany, it would be likely that a closed-ended fund is reclassified as an open-ended or mutual fund, which is likely to result in hardly predictable consequences.

Referring to the above-mentioned points, it is evident that, with the definition provided ('regulation') to distinguish between open- and closed-ended funds, we expect serious implementation and interpretation problems in the context of the AIFM Directive. So threatening both investors and issuers can cause serious inefficiencies and disorders, with numerous disadvantages.

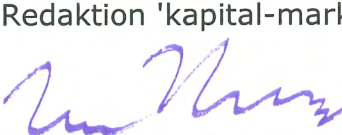
3. Alternative Proposal

- We propose to transfer the definition of competence in accordance with the principle of subsidiarity to the legislative competence of the Member States and their supervisory authorities, in order to be in a position to appropriately differentiate among the types of funds in terms of regulatory requirements and to take into account the specific characteristics of each legislative requirements and the supervisory practices in the Member States. As stated above, a distinction between open- and closed-ended funds solely on the basis of the described criterion of the 'right to return shares' ('redemption right') does not make sense and is not in accordance with the requirements of the KAGB-E and the implementing law on the national level in Germany.
- An alternative would be to define the difference according to the fact whether the fund can permanently raise capital of a third party or not. If so, it is an open-ended fund, otherwise it is not an open-ended fund.

Yours sincerely,

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Enclosures