Irish Funds Industry Association's response to ESMA's 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

Introduction

The Irish Funds Industry Association (IFIA) is the industry association for the international investment fund community in Ireland, representing the custodians, administrators, managers, transfer agents and professional advisory firms involved in the international fund services industry in Ireland. As the leading centre for alternative investment funds (AIFs), Ireland services over 40% of all hedge fund assets globally, with EUR 210 billion of assets in Irish domiciled non-UCITS funds, EUR 158 billion of which is in "qualifying investor funds" (QIFs) regulated by the Central Bank of Ireland (CBI) as of July 2011. Accordingly, all developments in the alternative investment arena are of particular importance to the Irish industry. The IFIA welcomes both the publication of, and the opportunity to comment on, ESMA's Consultation Paper (ESMA/2011/270) setting out its proposals for the advice to the European Commission on possible implementing measures for the Alternative Investment Fund Managers Directive (AIFMD) in relation to supervision and third countries.

General Observation and Scope of EMSA's Technical Advice

By way of a general observation we would suggest that in relation to the issues raised by ESMA in this consultation that ESMA ensure there is alignment with the mandate made by the Commission (as extracted and referenced in consultation) and that there is overall compatibility with the requirements in the Level 1 text of the Directive.

We also believe that there are areas (most of which we highlight below) where the inclusion of the explanatory text directly into the Boxes would assist in interpretation and reduce the risk of divergent views among Member States.

IFIA Response

Below are our specific responses to the questions posed in the Consultation Paper and other general comments on the content of the Consultation Paper. All responses and questions refer to the numbering used in the Consultation Paper.

III. Delegation (Articles 20 (1)(c), 20(1)(d) and 20(4)

Box 1

1. In order to fulfil the requirement set out in Article 20(1)(d) of the AIFMD a written arrangement should exist between the competent authorities of the home Member State of the AIFM or ESMA and the supervisory authorities of the undertaking to which delegation is conferred.

2. Where the undertaking sub-delegates any of the functions delegated to it, a written arrangement should exist between the competent authorities of the home Member State of the AIFM or ESMA and the relevant supervisory authorities of the undertaking to which sub-delegation is conferred.

3. Where the sub-delegate further delegates any of the functions delegated to it the conditions in paragraph 2 shall apply mutatis mutandis.

4. With respect to the delegated functions from the entity to which functions were delegated or sub-delegated, the arrangement referred to in paragraphs 1 and 2 above should entitle the competent authorities to:
   (a) obtain on request the relevant information necessary to carry out their supervisory tasks as provided for in AIFMD;
   (b) obtain access to the documents relevant for the performance of their supervisory duties maintained in the third country;
   (c) have the right to request an on-site inspection on the entity to which functions were delegated or sub-delegated. The practical procedures for on-site inspections should also be detailed in the arrangement;
   (d) receive immediately information from the supervisory authority in the third country in the case of breach of regulations;
   (e) ensure that enforcement actions can be performed in cases of breach of regulations.

5. The third country undertaking should be deemed to satisfy the requirement under Article 20(1)(c) when it is authorised or registered for the purpose of asset management based on local criteria which are equivalent to those established under EU legislation and is effectively supervised by an independent competent authority.

Q1:
Do you agree with the above proposal? If not, please give reasons.

With regard to the text in Box 1 we agree that the written arrangements contemplated in paragraphs 1 - 3 are appropriate, however, we would urge ESMA to consider the grandfathering or reliance on existing arrangements between EU regulators and third countries as part of this process.

It should be clarified either by new insertion into Box 1 or by including parts of explanatory

text so that it is clear that the requirements only apply in case of delegation of core functions such as portfolio management and risk management.

With regard to paragraph 4 we have some concerns that the conditions prescribed will be difficult to negotiate or enforce either within the timeframe for implementation or at all. As an overall comment, we believe that ESMA should draw upon the work already completed pursuant to international MMoUs and the existence of delegation frameworks in existing EU legislation (e.g. the UCITS Directive).

We believe that the following sub-paragraphs merit further consideration or redrafting:

- Sub-paragraph (a) does not clarify to whom the requests should be addressed the delegate or competent authority.

- Sub-paragraph (b) contains a similar omission and leaves the some uncertainty around the scope of relevant documentation raising confidentiality, data protection and proportionality concerns.

- Sub-paragraph (c) would benefit from narrowing of its scope and further drafting or clarification that the text in paragraph 11 of the explanatory text should directly apply and be inserted.

- Enforcement pursuant to sub-paragraph (e) will be difficult to "ensure" owing to conflict of laws and regulatory restrictions. Given the timeframe for implementation we would see the requirement for ensuring enforcement to be prohibitive in agreeing written arrangements within the timeframe.

The IFIA is concerned that the language used in paragraph 5 of Box 1 goes beyond the scope of the Level 1 text. There is no requirement in the Level 1 text for equivalency with EU legislation and to our knowledge very few third countries impose asset management conditions which are "equivalent" in to EU AIFMD, UCITS or MiFID criteria. The test in the Article 20(1)(c) is rather: that the delegate be "authorised or registered for the purpose of asset management and subject to supervision".

We see the proposed equivalency criteria as contrary to the text of Level 1 and also at odds with the measures which have been taken to implement the text of Article 13(d) of Directive 2009/65 (UCITS Directive) which provides:

> *"when the delegation concerns the investment management, the mandate must be given only to undertakings which are authorised or registered for the purpose of asset management and subject to prudential supervision; the delegation must be in accordance with investment-allocation criteria periodically laid down by the management companies;"*

We note that a substantial number of third country entities are carrying out delegated functions on behalf of UCITS funds and would urge ESMA to look to the arrangement

already in place with EU regulators, including the Central Bank of Ireland. We believe that it would be efficient to work from this existing base.

Q2:
In particular, do you support the suggestion to use as a basis for the co-operation arrangements to be signed at EU level the IOSCO Multilateral Memorandum of Understanding of May 2002 and the IOSCO Technical Committee Principles for Supervisory Co-operation?

The IFIA generally supports the use of MoUs based on international standards such as the IOSCO MMoU. We believe that MMoUs would assist in creating a level playing field across the EU and would be and efficient method of negotiating with some third countries or groups of third countries rather than each Member State concluding MoUs on a bi-lateral basis.

However, we do not believe that such a proposal should exclude the ability of individual Member States to negotiate MoUs or give the "prior approval" contemplated by Articles 20(1)(c) and 20(1)(d) individually. There are a large number of MoUs already in place between Member States and third countries which should not be completely rewritten or made redundant. Therefore, ESMA should include into Box 1 parts of the explanatory text in paragraph 12 stating that where the conditions cannot be met delegation may still take place subject to prior approval by the competent authorities of the home Member State of the AIFM.

IV. Depositary (Article 21(6))

Box 2

1. For the purposes of the assessment provided for in Article 21 (6) the following criteria should be met:
   - (a) The entity should be subject to authorisation and on-going supervision by an independent competent authority with adequate resources to fulfil its tasks;
   - (b) The local regulatory framework should set out criteria for the eligibility to act as depositary that are equivalent to those set out for the access to the business of credit institution or investment firm;
   - (c) The capital requirements imposed in the third country should be equivalent to those applicable in the EU as set out in Article 21 (6) (b) depending on whether the entity is equivalent to a credit institution or to an investment firm;
   - (d) The operating conditions are equivalent to those set out for credit institutions or investment firms within the EU depending on the nature of the entity;
   - (e) The requirement on the performance of the specific duties as AIF depositary established in the third country regulatory framework are equivalent to those provided for in Article 21 (8) to (15) and in the relevant implementing provisions;
   - (f) The local regulatory framework provides for the application of sufficiently dissuasive sanctions in cases of violations by the depositary;
   - (g) The liability to the investors of the AIF can be invoked directly or indirectly through the AIFM, depending on the legal nature of the relationship between the depositary, the AIFM and the investors.

Q3:
Do you agree with the above proposal? If not, please give reasons.

The IFIA support the view that there should be a level playing field between depositaries from third countries and those within the EU. This is extremely important to avoid regulatory arbitrage and producing a possibly unintended consequence whereby EU AIFs must appoint depositaries subject to the full provisions of Article 21 (including the liability provisions in Article 21(12)) and find themselves at cost and competitive disadvantages to non-EU AIFs.

However, the IFIA is concerned that the proposal outlined in Box 2 goes too far and could be impossible for third country depositaries to achieve thus becoming a barrier to trade. The IFIA note that Article 21 (6) (b) does not mention 'equivalency' but rather the 'same effect'. A holistic view of the prudential regulatory and supervisory environment of a third country should be taken rather than looking for exact matching of certain requirements which may be impossible to achieve. Furthermore it is important in assessing the effect of the regulatory and supervisory environment that the EU Commission engages in open dialogue with the third country regulators to better understand the environment rather than coming to conclusions about 'adequacy' and sufficiency on its own. Overall the IFIA are of the view that a balance needs to be achieved between safeguarding the interests of investors, the integrity of the proposed passport and the ability of non EU depositaries/non EU AIFs to compete within Europe.

We also note that within Article 21(5)(b) there is the possibility for non-EU AIFs to appoint an EU depositary (e.g. in an AIFM's home Member State or a Member State of reference) and this raises the possibility of non-EU AIFs adopting the regulatory standards applicable to EU AIFs. We believe that this would address some of the "same effect" issues in the Level 1 text.

We recommend ESMA to replace the word "may" by the word "shall" in the last sentence of paragraph 7 of the explanatory text and to include it in Box 2 of its final advice so as to clarify which entity is responsible for determining that a depositary established in a third country is subject to effective prudential regulation and supervision which have the same effect as EU law and are effectively enforced.

Q4:
Do you have an alternative proposal on the equivalence criteria to be used instead of those suggested in point b above?

The IFIA are of the view that the proposed criteria at point b are very strict and may prove

difficult for third country depositaries to achieve. It effectively only allows for two categories of entities whereas Article 21 (3)(c) does provide an additional category of eligible entity for EU AIFs which should also be available for non EU AIFs. Again the IFIA does not agree that that such an entity should be 'equivalent' but rather should be of a similar nature and be subject to effective prudential authorisation and supervision.

V. Supervision

V.I. Co-operation between EU and third country competent authorities for the purposes of Article 34(1), 36(1) and 42(1) of the AIFMD

Box 3

1. The co-operation arrangement with the third country competent authority should be in writing and provide for:
   (a) exchange of information for supervisory purposes;
   (b) exchange of information for enforcement purposes;
   (c) the right to obtain all information necessary for the performance of the duties provided for in the Directive;
   (d) the right to request an on-site inspection to be performed or to perform directly such an on-site inspection.

2. The third country competent authority should assist the EU competent authorities where it is necessary to enforce EU legislation and national implementing legislation breached by the entity established in the third country.

3. Where specific reference is made to exchange of information for the purpose of systemic risk oversight, the arrangement should allow the EU competent authority to receive information on an ongoing basis as provided for in Box 109 of ESMA draft advice to the European Commission on possible implementing measures of the AIFMD in order to discharge its duties under the Directive.

Q5:
Do you agree with the above proposal? If not, please give reasons.

The IFIA does agree with the proposal with regard to co-operation agreements. However, the IFIA does not agree with explanatory text 4 which suggests that co-operation agreements "should" be centrally negotiated by ESMA. This would appear to exclude the ability of individual Member States to negotiate MoUs which is reducing the competencies of the competent authorities of the Member States beyond what is contemplated by the Directive. Similar to our comments in respect of Box 1 we are of the view that ESMA should seek to build on the existing MoU network and retain the ability of individual Member States to negotiate co-operation arrangements.

The requirements of explanatory text 7 would appear to be too onerous as it appears to

require equivalence with regard to data protection standards.

With regard to explanatory text 11, please see our responses to Box 5. We would suggest that this should not apply to Article 34 (1) and Article 36 (1).

Q6:
In particular, do you support the suggestion to use as a basis for the cooperation arrangement to be signed at EU level the IOSCO Multilateral Memorandum of Understanding of May 2002 and the IOSCO Technical Committee Principles for Supervisory Co-operation?

Yes, subject to our comment that there should be no requirement that these be centrally negotiated and Member States retain the individual competences of the Level 1 text.

V.II. Co-operation arrangements between EU and non-EU competent authorities as required by Articles 35(2), 37(7)(d) and 40(2)(a) of AIFMD

Box 4

1. The relevant provisions set out in Box 3 above could apply.

2. The final decision on the necessary safeguards in the case of a third country passport will be reassessed at the moment of the evaluation by ESMA required by Article 67 (i.e. before the entry into force of the relevant provisions in 2015)

Q7:
Do you agree with the above proposal? If not, please give reasons.

We agree that the relevant provisions set out in Box 3 should apply. Where a passport is being availed of to allow non-EU AIFs to be marketed in the EU (whether by EU AIFMs or non-EU AIFMs) or EU AIFs to be marketed by a non-EU AIFM, we believe a common and consistent standard must be applied. The objectives and scope of the cooperation agreements, which includes the modalities and conditions for the supervision of non-EU AIFMs and non-EU AIFs, should reflect this.

High standards of equivalence need to apply to such non-EU AIFMs and non-EU AIFs in order to maintain a level playing field between them and EU AIFMs and EU AIFs.

V.III. Co-operation and exchange of information between EU competent authorities

Q8:
Do you agree with the above proposal? If not, please give reasons.

We agree with the proposal to consider this at a later date.

In the interim we note that we have concerns as to the volume and frequency of reporting envisaged by previous consultations and would urge ESMA to carefully consider this in light of (a) the cost and compliance burden imposed on AIFMs to produce this; and (b) the ability of the competent authorities to digest such a significant volume of information in order to monitor systemic risk concerns in an effective and timely manner.

V.IV. Member State of reference: authorisation of non-EU AIFMs – Opt-in (Article 37(4))

Box 5

1. In cases of conflict between competent authorities of several Member States, the Member State of reference should be identified taking into account the Member State in which the AIFM intends to develop most effective marketing for its AIFs pursuant Article 37(4) (h).

2. The competent authorities identified by non-EU AIFM as the potential authorities of reference should immediately upon reception of the request, and no more than 48 hours following the reception of the request, contact each other and ESMA in order to consult on whether any other EU competent authorities or ESMA could potentially be involved pursuant to Article 37(4).

3. Where other EU competent authorities could potentially be involved, ESMA should immediately inform them.

4. The information referred to in paragraph 2 above should include the submission made by the non- EU AIFM, including in particular the details referred to in the last subparagraph of Article 37(4).

5. Within one week of their initial consultation or, where applicable, of receipt of the information by the other EU competent authorities, all the relevant competent authorities should exchange their views and jointly take a decision on the identification of the Member State of reference.

6. ESMA should facilitate the agreement between the relevant competent authorities.

Box 5, paragraph 1 seeks to provide guidance to determine the Member State of reference when there are several possibilities. Paragraph 2 of the explanatory text goes on to provide that the relevant Member State should be the Member State where the AIFM intends to target investors by promoting and offering, including through third party distributors, most of the AIFs.

Where several Member States may be the Member State of reference, it is important that the criteria laid down to make the assessment are capable of providing a single answer which can be objectively justified. The question of which Member State is the Member State where the AIFM intends to target investors has the potential to yield several competing answers and

does not lend itself to providing one objectively certain response. This is so because (i) AIFMs may target investors in several Member States; (ii) it is difficult to assess objectively the extent to which investors in any one Member State have been targeted; (iii) AIFMs may legitimately target investors in two or more Member States equally; and (iv) an AIFM may legitimately change, to any extent and at any time or over a period of time, the investors it targets.

In addition, Article 37(4)(h) and paragraph 1 of Box 5 refer to the Member State in which the AIFM intends to develop its marketing. We submit that the development of marketing refers to the development of a marketing strategy, which includes the production, design, approval, review, distribution and oversight of marketing materials, i.e. the Member State where marketing is distributed from. The development of marketing does not always refer to the location of the targeted investors and quite often the marketing material for an AIF is approved and developed by the directors or management company of the AIF or self-managed AIF and the AIFM or delegate of the self-managed AIF (e.g. acting in the capacity as distributor) executes that marketing strategy.

Q9:
Do you have any suggestions on possible further criteria to identify the Member State of reference?

Where Article 37(4) calls for a determination of the Member State in which the AIFM intends to develop effective marketing, criteria should be established to determine the Member State in which the AIFM intends to develop its marketing strategy, which includes the production, design, approval, review, distribution and oversight of marketing materials. Such criteria should replace the criteria provided in paragraph 2 of the explanatory text.

Q10:
Do you think that any implementing measures are necessary in the context of Member State of reference given the relatively comprehensive framework in the AIFMD itself?

Subject to our comments in response to question 9, we submit that no further implementing measures are required.

Q11:
Do you agree with the proposed time period for competent authorities identified as potential authorities of reference to contact each other and ESMA?

We would agree with the proposed timetable for competent authorities identified as potential authorities of reference to contact each other and ESMA.