



CAYMAN ISLANDS MONETARY AUTHORITY

European Securities and Markets Authority
11-13 avenue de Friedland
75008, Paris
FRANCE

Ref: jp/cs

September 13, 2011

Submitted Online

Dear Sir or Madam,

SUBJECT: Consultation Paper – Draft Technical Advice on Possible Implementing Measures on the Alternative Investment Fund Managers Directive

The Cayman Islands Monetary Authority (the "Authority") welcomes the opportunity to respond to the Consultation Paper issued by the European Securities and Markets Authority ("ESMA") on July 13, 2011 regarding the proposed implementing measures of the Alternative Investment Fund Managers Directive ("AIFMD"). The Authority is the principal regulator for the securities and investment funds industries in the Cayman Islands. The response below focuses on certain key aspects of the consultation paper, namely specific issues related to delegation, depositories and reporting.

Part IV – Delegation

Comments on Box 63

Article 20 of the AIFMD requires alternative investment fund managers to notify the competent authority in their home member state before delegating their functions. Box 63 of the consultation paper issued by ESMA states that notification is required for the delegation of functions that are critical or important for the proper performance of the functions the manager provides to a fund. Functions that are not considered critical or important include the purchase of standardized services and the provision of advisory services and other services which do not form part of the functions which the manager may additionally provide in the course of the collective management of the fund.

It is unclear what is meant by the exclusion underlined above.

Part 2 of Annex 1 of the AIFMD lists functions that a manager may additionally perform in the course of the collective management of the fund, which list includes many administrative and back office functions such as marketing and customer inquiries. The Authority questions whether the text underlined above refers to the functions that are listed in Annex 1(2) or to some other functions that may form part of the manager's services but that are not defined. In the former case, it is submitted that many functions listed in Part 2 of Annex 1 should not be viewed as critical or important and that the delegation of such functions by the manager should not be subject to prior notification. In the latter case, ESMA should more explicitly state what it envisages such other services to be. Given this uncertainty, it is recommended that the text underlined above be removed from the

proposed provision, as the directions given in paragraph 2 of Box 63 are sufficient to determine whether a function that is not listed in the safe harbour provisions in 3(a) or (b) of Box 63 is critical.

Comment on Box 65

ESMA proposes two options that describe how a manager can justify its delegation structure. It is submitted that Option 1 is preferable, as it is more flexible and responsive to the diversity of reasons that compel managers to delegate certain functions. Option 1 is also more clear and objective than Option 2. Moreover, by providing a rationale for delegation rather than a list of reasons (like Option 2), it provides more certainty to managers about whether their competent authorities will view the delegation structure as being justifiable even if the reasons given by the manager do not fall into the short list of reasons enumerated in Option 2. Option 1 also increases the probability that competent authorities will interpret the provision consistently and not unduly restrict the circumstances in which services can be delegated.

Comments on Box 68

Article 20(1)(e) of the AIFMD states that delegation must not prevent the effectiveness of supervision of the manager. ESMA's interpretation of that prohibition is contained in Box 68 of the consultation paper. It is submitted that ESMA's interpretation is wider than the intention of the AIFMD and therefore that the proposed measures unduly restrict delegation.

The framework of the AIFMD requires competent authorities to supervise managers. In turn, the proposed measures require managers to supervise their delegates. As such, the implementing measures should focus on the supervision of managers by competent authorities rather than the direct supervision of managers' delegates by those competent authorities. It should not be necessary for competent authorities to require rights of access to the delegate nor require the delegate to cooperate directly with the competent authorities that regulate the manager. Such a framework would impose unnecessary costs on the manager. The effectiveness of supervision is maintained by the proposed statement that a manager must remain responsible for the delegated functions and must provide information regarding the delegated functions to competent authorities.

Finally, certain of the requirements in paragraph 1(a) and (b) hinder the delegation of functions to entities located in jurisdictions other than the manager's home jurisdiction. In that context, it is also uncertain what is meant by "effective" access to data by competent authorities.

Comments on Box 73

Article 20(2) of the AIFMD prohibits delegation of functions by a manager if as a result of the delegation the manager can no longer be considered to be the manager of the fund and to the extent that it becomes a letter-box entity.

ESMA's interpretation of this provision is contained in Box 73 of the consultation paper. ESMA is proposing to consider a manager to be a letter-box entity if, inter alia, it no longer retains the necessary expertise and resources to supervise the delegated tasks and to manage the risks associated with the delegation.

Greater clarification of what is meant by “senior management” and “retain the necessary expertise and resources to supervise the delegated tasks effectively” would be welcomed. It is also unclear whether the assessment of sufficient resources and expertise will be done at the individual company level or at a group level. Guidance on how the competent authorities will assess the sufficiency of resources would be helpful.

It is submitted that the test of whether an entity becomes a letter-box entity should focus on the manager’s ability to supervise the delegate rather than the ability to recreate the delegated tasks. Moreover, it should be clarified whether the senior management functions and responsibilities referred to in Box 73 are the same ones listed in Box 48 of the consultation paper.

Part V – Depositories

Comments on Box 76

Article 21(7) of the AIFMD requires a depository to ensure that the fund’s cash flows are properly monitored. Box 76 of the consultation paper offers two options for monitoring a fund’s cash flows by the depository. We believe Option 2 is preferable, as it provides more flexibility for the depository and is less costly to implement than Option 1 without diluting the regulatory protections offered by Option 1. Option 2 avoids duplication of work between service providers and is compatible with the principle of the depository exercising a second level of control. Option 2 allows the depository to gain a better understanding of the service providers and their internal processes. Finally, the procedures described in Option 2 can be tailored to a wide variety of assets and risks.

Comments on Box 78

ESMA requests comments on the definition of the financial instruments that should be held in custody. Option 2 in Box 78 is preferable, as it requires the depository to keep in custody all assets that it can instruct the transfer of, as such all the assets that the depository can control, and not just the assets registered or held in an account in their name.

Response to Question 40

The draft technical advice on oversight by depositories will impact the depository’s relationship with funds and managers because it imposes obligations on depositories to oversee certain aspects of the manager’s operations, which obligations do not form part of the usual scope of services provided by depositories, particularly in respect of smaller firms in many jurisdictions outside the European Union. A requirement for a depository to ensure that the manager has implemented certain policies and procedures is onerous and incompatible with the depository’s role and relationship with the manager and the fund. The proposed framework is ill suited to the structure of the business of alternative investment funds. The competent authorities rather than the depository should ensure that the manager implements such policies and procedures.

Furthermore, the responsibilities assigned to the depository extend into the duties traditionally performed by a fund administrator. The additional oversight required by the depository may not provide significant additional benefit to a fund that has its net asset

value independently calculated by a reputable administrator with an effective compliance department. It is also of concern that the AIFMD prohibits depositories from delegating such responsibilities, for example to an administrator. The rationale behind such prohibition is unclear. The added cost, burden and liability of assigning such responsibilities to depositories should be carefully reassessed.

In addition, ESMA's proposed advice on depositories' obligations gives rise to the concern that the depository will be required to verify the compliance of every transaction made by the manager before it occurs, which would lead to costs, delays and concerns about liability. For example, the obligation proposed in Box 85 that would require depositories to implement procedures to ensure that the manager and fund comply with applicable laws and regulations could lead to such an interpretation. ESMA should clarify that the depository's role is to act as a second level of control rather than as duplicating the manager's compliance function.

Response to Question 41

Potential conflicts of interest could arise when the depository is designated to issue fund units. The depository should exercise its functions independently. It is not the role of the depository to monitor compliance with legal and regulatory obligations nor to process transactions.

Comments on Box 88

A depository may delegate its safekeeping functions subject to performing due diligence on the proposed sub-custodian. Such due diligence includes assessing the regulatory and legal framework in which the sub-custodian operates (including country risk, custody risk, enforceability of contractual agreements). The requirement to assess the law in the country of the sub-custodian could lead to uncertainty for the depository and have a chilling effect on delegation. It would be prudent for ESMA to publish a list of pre-approved countries so that depositories can feel secure about the country risk of a sub-custodian. Alternatively, it would be helpful for ESMA to publish criteria of countries that would be prima facie acceptable (for example, IOSCO members or Basel II compliance). Such lists should not however preclude a depository from doing its own assessment of countries that are not included on the list.

Response to Question 47

The liability regime is quite burdensome on the depository and could cause the costs of the depository to increase significantly, particularly in respect of insurance costs and the costs related to increased oversight of sub-custodians. Such increased costs will be passed on to the funds and ultimately will decrease the return obtained by investors.

Part VIII – Reporting to Competent Authorities

Comments on Box 109

Article 24 of the AIFMD requires managers to periodically report to competent authorities in respect of each fund they manage or market in the European Union. The AIFMD does not specify the frequency of such reporting. ESMA advises that the reporting required by Article

24 of the AIFMD should occur on a quarterly basis and proposes a reporting form in Annex V of the consultation paper.

It is submitted that the proposed reporting frequency is excessive. The proposed reporting requirements will impose a significant burden and cost on managers without providing corresponding benefits to the competent authorities. It is unclear why competent authorities would choose to receive all the information contained in Annex V on a quarterly basis particularly considering that such information may not change significantly in such a short period of time. During the last financial crisis, the systemic risk in the system built up over a period of years rather than months. As such, it is suggested that the frequency of the reporting be reduced to an annual basis. The frequency could be adjusted for funds and managers that are considered systemically important. Finally, the timeline to submit returns is very short. The timeline for reporting should be extended to three months after the end of the fiscal year.

We thank you for your attention to our comments. The Authority would be pleased to provide further information or clarification in respect of any matter referred to in this submission. Please do not hesitate to contact me if you have questions about this submission or if I can be of further assistance.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Scotland", with a stylized flourish extending from the left.

Cindy Scotland
Managing Director

Tel. (345) 244 - 1530
Fax. (345) 945 - 6125
Email. c.scotland@cimoney.com.ky