



CAYMAN ISLANDS MONETARY AUTHORITY

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

Ref: jp/cs

September 23, 2011

Submitted Online

Dear Sir or Madam,

SUBJECT: Consultation Paper – Draft Technical Advice on Possible Implementing Measures on the Alternative Investment Fund Managers Directive in relation to Supervision and Third Countries

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 August 23, 2011 regarding the proposed implementing measures of the Alternative Investment Fund Managers Directive ("AIFMD") in relation to supervision and third countries. The Authority is the principal regulator for the securities and investment funds industries in the Cayman Islands. The Cayman Islands is the world's largest hedge fund domicile.

Question 1

Article 20 of the AIFMD sets out the conditions that must be met before a manager can delegate its functions to another entity. Where the delegation is conferred to a third country undertaking, the third country regulator must enter into a cooperation arrangement with the relevant competent authorities in the European Union. Moreover, the AIFMD stipulates that portfolio management and risk management functions can only be delegated to an undertaking licensed for that purpose. Box 1 of the consultation paper seeks to provide details about the contents of the cooperation arrangements and the licensing requirements mentioned in the AIFMD. The Authority believes that many provisions proposed in Box 1 are vague and in need of clarification.

The provisions proposed in paragraph 4 in Box 1 should provide more clarity about the respective responsibilities of the competent authorities and third country regulators in the performance of on-site inspections and the conduct of enforcement actions. Moreover, as currently drafted, the proposed provisions are not pragmatic and fail to consider the resource and financial costs of implementation, which could result in a significant burden being imposed on regulators' resources. A high frequency of onsite inspections to be performed on behalf of competent authorities, a high volume of information requests from competent authorities and numerous requests for the performance of enforcement actions on behalf of competent authorities could all result in considerable unexpected costs for a third country regulator, particularly if requests are received simultaneously from several competent authorities in respect of the same issue. Given these considerations, the procedures outlined in the cooperation arrangements should be practical, reciprocal and

mindful of the resource constraints that could be faced by regulators. The Authority believes the IOSCO MMOU as well as the provisions of Commission Regulation (EU) No 584/2010 that relate to supervisory cooperation could provide a good basis for the framework of the cooperation arrangements.

In respect of the licensing of third country delegates, the technical advice proposed by ESMA states that the regulation of portfolio management entities in third countries must be equivalent to European Union legislation. It is submitted that this equivalency standard is outside the scope of the AIFMD. Article 20 of the AIFMD does not require the regulation of the third country to be equivalent to the regulation in force in the European Union and this requirement cannot be read into the text of Article 20. In this respect, the language of Article 20 should be contrasted with the language in Article 21(6), which mentions “regulation (...) and supervision which have the same effect as Union law”, which clearly indicates an expectation of equivalency. If the equivalency requirement is retained, greater clarity on the method of assessing equivalency and the criteria used during the assessment would be welcomed. The development of criteria and a methodology would ensure that the equivalency requirement is applied consistently throughout all member states.

Greater clarity would also be welcomed in paragraphs 4(d) and (e) in Box 1. In both paragraphs, it is unclear what is meant by the word “regulations”. A wide interpretation of such word would go beyond the requirements of the AIFMD. As such, the word “regulations” should be replaced with language that refers to breaches of legislation governing investment managers.

It is also unclear which jurisdiction’s regulations the breach applies to and who is responsible for ensuring that enforcement actions are performed. The third country regulator is responsible for ensuring the compliance of the entities registered in its jurisdiction with the laws applicable in that jurisdiction and for taking appropriate enforcement action when such laws are breached. The responsibility for monitoring compliance with EU regulations and taking enforcement action for breaches of EU regulations should fall to the EU competent authorities, rather than the third country regulator. In the latter case, the role of the third country regulator would be to provide information and documentation requested by the competent authority to assist the competent authority in assessing compliance or enforcing breaches. Finally, paragraph 4(e) should specify that third country regulators are required to notify the competent authorities only of a breach that is known to that regulator.

Question 2

The Authority supports the suggestion to use the IOSCO multilateral memorandum of understanding as a basis for the cooperation arrangements referred to in Article 20(1)(d) of the AIFMD.

Question 3

The Authority disagrees with the proposal in Box 2 of the consultation paper. Article 21(6) of the AIFMD allows funds to appoint a depository in their country of domicile provided that, inter alia, “the depository is subject to effective prudential regulation, including minimum capital requirements and supervision, which have the same effect as Union law and are effectively enforced”. ESMA has interpreted this provision as requiring full equivalency of regulatory frameworks, including capital requirements and operating conditions, between

European Union law and the law in force in the third country. The Authority submits that this interpretation is not in line with the requirement in the AIFMD. The AIFMD requires that the depository be subject to effective prudential regulation and supervision which have the same effect as European Union law. The AIFMD does not speak about operating conditions, which are broader than prudential regulation and supervision. Moreover, the AIFMD only requires an equivalency in the effect of such regulation rather than a textual comparison of the relevant laws and regulations. It is also uncertain which European Union laws ESMA will use to compare with the regulatory framework in third countries. Finally, it is unclear what criteria ESMA will use to determine whether sanctions are “sufficiently dissuasive” or whether the depository has “sufficient resources”.

Question 4

Instead of using the method of assessing equivalency proposed in Box 2 of the consultation paper to determine whether the regulatory regime of a third country is of the same effect as European Union law, the competent authorities should assess the third country’s compliance with international standards (e.g. Basel Core Principles, IOSCO Principles). Reliance on international standards as the assessment measure would bring transparency and consistency to the assessment process. It would also reduce the costs of assessment for competent authorities, as they could rely on international assessments (such as the International Monetary Fund’s Financial Sector Assessment Program) to determine the degree of compliance with international standards and by extension the AIFMD.

Question 5

In order for third country funds to be marketed in the European Union without a passport, the AIFMD requires that competent authorities enter into a cooperation arrangement for the purpose of systemic risk oversight with regulators in third countries. In Box 3 of the consultation paper, ESMA proposes the minimum contents of these cooperation arrangements. The Authority is of the opinion that the proposed provisions are vague and that the implementation of the provisions as drafted could impose an undue burden on third country regulators.

Box 3 provides for the right of competent authorities to request third country regulators to perform on-site inspections and to assist competent authorities in the enforcement of European Union legislation. As stated in our response to Question 1, the provisions proposed in Box 3 should provide more clarity about the respective responsibilities of the competent authorities and third country regulators in the performance of these actions. This could help avoid the unexpected costs and resource constraints that third country regulators could incur if they receive several requests for assistance in a short period of time. The cooperation arrangements between competent authorities and third country regulators should also circumscribe the type of assistance that can be sought by competent authorities, the circumstances under which requests for assistance or the performance of on-site inspections can be sent to third country regulators, and provide for situations in which the request for assistance entails a substantial cost for the third country regulator. In sum, the procedures outlined in the cooperation arrangements should be practical, reciprocal and mindful of the resource constraints that could be faced by regulators. The assistance sought by competent authorities should be limited to what is required for competent authorities to carry out their enforcement duties under the AIFMD rather than the enforcement of “EU legislation” as currently stated in the proposed advice.

Paragraph 3 of Box 3 of the consultation paper states that, in relation to information about systemic risk, competent authorities should receive all the information listed in Annex V of the consultation paper dated July 13, 2011 on an ongoing basis. This provision could be interpreted as requiring the third country regulator to forward the information to the relevant competent authorities continuously and in respect of every fund marketed in the European Union. The Authority believes that such a requirement imposes an onerous obligation on both the sending and receiving authorities. As an alternative, it is suggested that the cooperation arrangement enable the competent authorities to receive information from the third country regulator as may be requested from time to time.

Finally, from a practical perspective, competent authorities should attempt to receive the information in Annex V from the regulator of the third country manager rather than the regulator of the fund, as the manager is the first source of such information, has direct access to the information sought and can provide information aggregated across all the funds it manages. Such an approach is also consistent with the intention of the AIFMD, which is to regulate managers rather than the funds themselves.

Question 6

The Authority supports the use of the IOSCO multilateral memorandum of understanding as a basis for the cooperation arrangements referred to in articles 34(1), 36(1) and 42(1) of the AIFMD.

Question 7

The Authority disagrees with the proposal made in Box 4 wherein ESMA states that the final decision on the contents of the cooperation arrangements required to allow the marketing of funds into the European Union with a passport will be made before the entry into force of the relevant provisions in 2015. The Authority would urge ESMA to issue such standards as soon as possible to allow third countries to assess the standard they must meet and to make any necessary adjustments to their regulatory frameworks. Subject to our response to Question 5, ESMA should adopt the framework stipulated in Box 3 for cooperation arrangements in the case of marketing non-EU funds with a passport.

Question 9

The criteria for determining the member state of reference listed in the AIFMD and the procedure proposed in Box 5 of the consultation paper do not provide sufficient legal certainty to managers about their potential member state of reference. Generally, the outlined procedure for determining the member state of reference will lead to costs and delays for non-EU managers. It will also lead to an uneven playing field between EU and non-EU managers.

Specifically, ESMA should provide additional clarification on what "most effective marketing" means and the criteria it will use to determine where "most effective marketing" is conducted. It is likely that a manager would market one fund equally in several jurisdictions or have different marketing strategies in various jurisdictions for several funds in its portfolio. It is unclear whether "most effective marketing" refers to the number of investors targeted, the frequency and visibility of publicity or the value of the assets raised in each jurisdiction. It is also uncertain whether the member state of reference will change when the

manager adopts new marketing strategies for a fund subsequent to registration in one member state of reference.

The procedure outlined in Box 5 does not indicate ESMA's role in the determination of a member state of reference, the basis on which ESMA could involve third country authorities pursuant to paragraph 3 of Box 5, whether the manager is notified at any point during these proceedings, the consequences for competent authorities that do not adhere to the timelines stated in Box 5 and whether the procedure outlined in Box 5 can be bypassed if there is only one possible member state of reference.

Question 10

It would be beneficial if ESMA provided a list of criteria that would help managers determine with more certainty what their member state of reference could be. For example, ESMA could list the factors that it will use to determine where the most effective marketing takes place. Greater certainty would reduce the risk of regulatory arbitrage, and reduce costs and processing time for all competent authorities concerned, as the manager would only apply to those competent authorities that are most probably the member state of reference.

It would also be helpful if ESMA could specify the basis on which competent authorities will make the ultimate decision about the member state of reference pursuant to Article 37(4) of the AIFMD, which stipulates that once a manager submits a request to all the possible member states of reference "those competent authorities shall jointly decide the member state of reference". The criteria that will be used to make that joint determination are unclear.

Finally, article 37(5) of the AIFMD suggests that member states of reference chosen pursuant to the procedure laid out in Article 37(4) are allowed to review the choice of member state of reference. It is uncertain on what basis such a review or refusal of registration would be allowed if the procedure set out in article 37(4) is followed.

Question 11

To reduce costs and uncertainty, the process between competent authorities for determining the member state of reference should be as streamlined and short as possible.

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,



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