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To whom it may concern

Implementing measures of the AIFM Directive

Ernst & Young LLP welcomes the opportunity to respond to ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive ("the Directive"), dated 13 July 2011, *ESMA/2011/209* ("the Consultation").

We are interested in this Consultation for two reasons. Firstly, one of the services we offer to our non-audit clients is valuation. This covers hedge funds, private equity houses, real estate fund managers and other non-UCITS fund managers. This service, together with our other offerings in Assurance, Tax, Transaction Advisory Services and Advisory, generated combined global revenues of US\$21.3 billion, for the financial year ended 30 June 2010. Secondly, given the size and scale of our business as a whole, and that potentially we may become an external valuer of AIFs as defined in the AIFMD, we have concerns about the possible implications of Article 19. For these reasons, we have limited most of our comments in this response to that Article.

Overall comments

We regard the option of undertaking by delegation valuation tasks for our clients, as envisaged by Article 20 (as part of the 'administration' function outlined in Annex I of the Level 1 text) as essential to the proper working of the market, preferable to being appointed as an 'external valuer' under the terms of Article 19.

We regard Article 19 as uncertain in scope and potentially imposing disproportionate liability on external valuers. Our primary concern with Article 19 is its reference to the liability of the external valuer for 'any losses suffered' by the AIFM, as a result of the external valuer's



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'negligence' or 'intentional failure to perform' its task. The phrase 'any losses suffered' suggests that this liability may be unlimited¹. If so, the effect of Article 19 may be to drive some firms out of the valuations market because they cannot find or afford insurance to cover this risk, unless it is clarified in ESMA's Level 2 guidance that providers of valuation services may act as a 'delegate' of the AIFM, where that AIFM chooses to conduct the valuation function themselves rather than appoint an external valuer. Whilst we fully accept that a negligent external valuer should be liable for reasonably foreseeable losses, its liability should be proportionate to its failings, which would not be the case if the valuer is exposed to unlimited liability as suggested by the final sentence of paragraph 10 of Article 19.

We are also concerned that the reference to a valuer's 'intentional failure to perform'² is wholly unclear. For the market to be able to operate there needs to be clarification as to the circumstances in which a valuer will have been considered intentionally to have failed to perform.

Without clarification on these various points, there is the potential risk of unintended consequences, for example:

- The reference to 'any losses suffered' could equate to unlimited liability for external valuers, which could potentially lead to a catastrophic litigation resulting in the closure of a firm, due to a resultant financial penalty and/or loss of reputation.
- The threat of this potential liability could lead to a reduction or possible withdrawal of valuation services by individual firms dependent on third-party insurance cover. This would have the effect of reducing choice in the external valuations market for AIFMs, which could have major implications for 'professional guarantees', if that withdrawal affects the overall capacity and professional capability of those valuation firms left in the market.
- If choice and availability is compromised in this way, this may lead to valuations being performed entirely "in-house", with the consequential independence and capability issues. This would go directly against current market practice in certain segments of the alternative investment market (e.g., real estate), denying investors and other stakeholders the assurance gained through independent external valuations.

We hope our interpretation of Article 19 does not reflect the original intention of the stakeholders who negotiated the final Level 1 text, and we trust that ESMA will take note of our concerns as part of this Consultation. To this end, and in the context of ESMA's mandate to advise the European Commission on a set of implementing measures which include the 'professional guarantees that the external valuer must be able to provide', we believe it is imperative that ESMA recommends a clarification of the following specific terms.

¹ Article 19, paragraph 10

² Article 19, paragraph 10

Specific terms that require clarification

'Intentional failure to perform'

What would constitute an 'intentional failure to perform'? For example, an audit firm may be required to withdraw its valuation service due to a conflict of interest, because an audit client of the firm acquires the fund manager whose funds were in the process of being valued. Or perhaps a dispute has arisen over a fee estimate or non-payment of a fee, which results in a temporary suspension of a valuation service.

'Any losses suffered'

The definition of loss in the phrase 'for any losses suffered' is material and applies to the AIFM, but it is unclear for which losses the valuer could be held liable, and whether valuers would be expected to indemnify the AIFM for claims made against it by its investors.

'Function' and 'task'

The terms 'function' and 'task' seem to be used interchangeably in paragraph four of Article 19. However, it is explained in the text that the external valuer is liable to the AIFM, if the valuer 'intentionally failed to perform' its tasks.

Is there a distinction between 'function' and 'task' in the Article? If so, would this have any bearing on the potential liability faced by the external valuer? For example, is it the case that the AIFM is liable for the valuation figure reported to the investor (a function), regardless of how that figure was calculated (a task), which may have been carried out by an external valuer? In this scenario the valuer would only be liable to the AIFM, but 'any losses suffered' by the AIFM could presumably reflect significant claims made against it by its clients (the investors in the fund).

Liability in calculating the 'Net Asset Value' (NAV)

Is it correct to assume that a third-party which calculates the NAV will not be liable to the AIFM, for 'negligence' or an 'intentional failure to perform', if that third-party did not also value the underlying assets of that fund? We ask this question because according to ESMA's current policy orientation contained in the Consultation Paper, solely calculating the NAV does not lead to a third-party being deemed an external valuer. This begs the question as to whether the party that valued the underlying assets would be held liable for inaccurate NAV calculations.

Article 20 'Delegation'

Finally, we note that Article 20 provides for the delegation of AIFM functions to a third-party. We believe that some AIFMs may prefer to perform the role of valuer themselves, but with the intention of delegating part of that task to a third-party service provider. In this respect the third-party may undertake various valuation tasks as part of the 'administration' function (Annex I paragraph 2(a) (iii) of the Level 1 text). This would provide an important level of flexibility and choice for AIFMs whilst benefiting investors, because AIFMs would still be able to seek and find third-parties willing and able to value AIFs. It would also be more cost-effective for the AIFM, and therefore enhance investor returns, because the delegate's liability could be limited

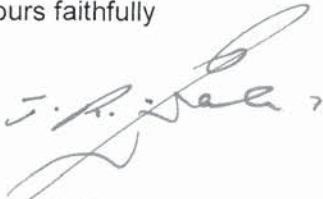
thereby avoiding increased costs in insurance cover (for those firms able to make arrangements in that regard). In the same way that ESMA's draft guidance (page 15, paragraph 11) clarifies that 'an AIFM may have different external valuers for one AIF', we believe it would be beneficial for ESMA to clarify that a third-party service provider may undertake valuation tasks as a delegate of the AIFM, where the AIFM has chosen to undertake the valuation function itself in accordance with Article 19(4) (b).

Conclusion

We are grateful to ESMA for consulting on its proposed implementing measures. Although the wording of Articles 19 and 20 is finalised, we believe there is scope within the implementing measures to address the uncertainties and concerns raised in this letter.

For the avoidance of any doubt this is not a confidential response, and we look forward to reading it alongside other replies on the ESMA website. In the meantime, if you would like to discuss any of the points we have raised, please contact me on +44 (0) 20 7951 4566.

Yours faithfully



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