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To Whom It May Concern:

Consultation paper: Implementing measures of the AIFM Directive

Within this statement we are responding to question No. 9 of the consultation paper, which asks whether an Alternative Investment Fund Manager (AIFM) should hold additional own funds or have professional indemnity insurance to cover the risk of improper valuation when the valuation is carried out by an external valuer.

Response:

In our view, the AIFM should not be required to hold additional own funds or insurance when a valuation of the AIF's assets are carried out by an external valuer provided the following three conditions are met:

- (a) the external valuer carries out an independent valuation;
- (b) the AIFM fulfils its duty of care in its selection of the external valuer; and
- (c) the external valuer is liable for the risks resulting from improper valuation.

a) Independent valuation

In order to guarantee that the external valuer performs the valuation as is necessary to relieve the AIFM from its duty to hold additional own funds or to have professional indemnity insurance, it is necessary that the external valuer carries out an independent valuation.

Such independent valuation should be differentiated from a negative assurance provided by an appraiser as well as a pure calculation of value.

Negative assurance

For a negative assurance an appraiser carries out certain limited review procedures on the valuation. The result of the review procedures is a statement

saying that nothing came to the attention to the appraiser of an adverse nature or character regarding the valuation. In our view a negative assurance may not be considered a valuation performed by an external valuer, because no independent valuation will be performed by an external valuer.

Pure calculation of value

When carrying out a pure calculation of value, the external valuer is not required to check the data provided (e.g. business plan) for plausibility. The external valuer simply takes the underlying data as provided and applies adequate methods to generate a valuation. We consider that a valuation utilising this methodology alone is not sufficient to relieve the AIFM from its duty to have additional own funds or to hold professional indemnity insurance.

Independent valuation

Unlike a negative assurance and a calculation valuation, an independent valuation should require the external valuer to:

- ✓ *request all information which is necessary for the valuation. In addition, the valuer has to provide assurance that they are in receipt of this information by requesting a letter of representation signed by the AIFM; and*
- ✓ *analyse all information received - this analysis includes checks for consistency and plausibility.*

b) Duty of care in the selection process of the external valuer

The AIFM needs to carry out its duty of care when selecting the external valuer. To demonstrate this, the AIFM should ensure that the external valuer:

- ✓ has sufficient personnel and technical resources;
- ✓ has carried out valuations for comparable purposes and for comparable industries; and
- ✓ has adequate procedures in place for safeguarding proper and independent valuation, including, but not limited to sufficient senior involvement.

c) Liability risk resulting from improper valuation

In cases where the valuation carried out by the external valuer is not correct, the external valuer shall be liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer's negligence or intentional failure to perform its tasks (*Article 19(10) AIFMD*). Though this liability risk includes simple and gross negligence, the directive does not outline the extent to which the liability may arise.

In order to relieve the AIFM from the duty to hold additional own funds or have professional indemnity insurance in the case that the valuation is carried out by an external valuer, the liability must be covered as if the valuation were carried out by the AIFM itself. This includes unlimited liability for intent and gross negligence.

It may be unlikely that unlimited liability for simple negligence is enforceable in the market for professional indemnity insurance. If this is the case, the remaining risk needs to be covered by the AIFM.

Recommendation

As long as the aforementioned three conditions are met, the AIFM shall have no need to hold additional own funds or have professional indemnity insurance to cover the risk of improper valuation in the case that the valuation is carried out by an external valuer and the external valuer has got professional indemnity insurance.



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