

September 22, 2011

*Via ESMA Website*

Steven Maijoor  
Chair  
European Securities and Markets Authority  
103 Rue de Grenelle  
75007 Paris

**Re: ESMA's Draft Technical Advice to the European Commission on Possible Implementing Measures of the AIFM Directive in Relation to Supervision and Third Countries**

Dear Mr. Maijoor:

The Investment Adviser Association (IAA) appreciates the opportunity to comment on the consultation paper by the European Securities and Markets Authority (ESMA) proposing draft technical advice to the European Commission regarding third country issues raised by the Alternative Investment Fund Managers (AIFM) Directive.<sup>1</sup> The IAA is a not-for-profit US association that represents the interests of investment adviser firms registered with the US Securities and Exchange Commission (SEC). IAA's membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, and many of our members manage funds and assets on behalf of clients in the European Union.

In response to the Commission's request for advice, ESMA provided an extensive set of proposed advice on many significant issues, but left for later a separate consultation on measures related to cooperation agreements with third countries and the passport for third country entities.<sup>2</sup> With respect to the earlier consultation paper, we have provided our views in a separate letter on aspects of the proposed advice that are of importance to our members.<sup>3</sup>

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<sup>1</sup> See ESMA, Consultation Paper: 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, ESMA/2011/270, Aug. 23, 2011 (Consultation Paper), available at <http://www.esma.europa.eu/popup2.php?id=7702>.

<sup>2</sup> See ESMA, Consultation Paper: Draft Technical Advice to the European Commission on Possible Implementing Measures of the Alternative Investment Fund Managers Directive, ESMA/2011/209, July 13, 2011 (July Consultation Paper), available at <http://www.esma.europa.eu/popup2.php?id=7625>.

<sup>3</sup> See Letter to Steven Maijoor, Chair, ESMA, from Jennifer S. Choi, IAA, dated September 13, 2011.

In this Consultation Paper, ESMA proposes advice regarding supervision, delegation to third country entities, and the general criteria for assessing equivalence of the effective regulation and supervision of third countries for depositaries.

As a general matter, although we appreciate the work that is reflected in the Consultation Paper, we believe that further ESMA guidance is necessary on many aspects of third country provisions.<sup>4</sup> Moreover, ESMA has deferred finalizing provisions related to the third country passport. We urge ESMA to work closely with regulators around the world, especially those in significant jurisdictions, to ensure that implementation of the AIFM Directive does not operate as a de facto barrier to third country entities. We strongly believe that the implementation of the Directive should be reasonable and effectuate the intent of the Directive to permit third country entities (1) to provide certain services permitted under the AIFM Directive, such as delegation of portfolio management, and (2) to become authorized under the AIFM Directive in the future. Given the extremely brief consultation period, we focus in this letter on our views regarding delegation and the determination of a Member State of Reference. We describe our concerns below.

#### Cooperation Agreements for Delegation

Article 20 of the AIFM Directive requires appropriate cooperation between the competent authority of the home Member State of the AIFM and a third country supervisory authority when portfolio management and risk management are delegated to an entity established in a non-EU country. ESMA advises that such cooperation be based on written arrangements so that the competent authority of the home Member State of the AIFM has the authority to obtain information on request or to have access to information and to the delegated entities. ESMA takes the view that these arrangements should be based on existing international standards and in particular on the IOSCO Multilateral Memorandum of Understanding (MMoU) concerning consultation and cooperation and the exchange of information of May 2002 with respect to cooperation for enforcement purposes and the IOSCO Technical Committee Principles for Supervisory Cooperation for supervisory purposes.

We support ESMA's proposal to build upon the significant work of IOSCO over the years to facilitate global regulatory cooperation. Moreover, we recommend that ESMA use the existing bilateral supervisory agreements that currently are in place in certain EU jurisdictions with non-EU jurisdictions (such as with the US SEC) as a model for similar agreements in all the EU Member States or for a centrally negotiated MMoU. These bilateral agreements reflect considerable work by EU regulators and third country authorities. Unless there is evidence that the arrangements are inadequate, we believe these arrangements should be the foundation upon which the arrangements for delegation are based.

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<sup>4</sup> For example, in our letter in response to the July Consultation Paper, we discussed our concerns regarding how the transparency provisions may indirectly require non-EU managers to comply with operating conditions that the level 1 text of the Directive explicitly provides would not apply to them.

ESMA advises that these arrangements should entitle the competent authorities: (1) to obtain information necessary to carry out their supervisory tasks; (2) to obtain access to documents relevant for the performance of their supervisory duties; (3) to request an on-site inspection of the entity to which delegation has been given; and (4) to receive information immediately from the third country authority in cases of breach of regulation. In addition, ESMA proposes that the arrangement should ensure that enforcement action can be performed in cases of breach of regulation.

We seek clarification regarding the last element that should be incorporated into a cooperation arrangement. It is unclear whether ESMA intends the third country regulator to assist EU regulators in conducting investigations or to bring an enforcement action independently. The latter reading of the provision may be problematic for regulators in certain jurisdictions because the authority provided under their domestic laws to bring action for breaches of foreign law may be limited. For example, under section 21(a)(2) of the Securities Exchange Act of 1934, the US SEC is authorized to assist foreign regulators to conduct investigations on their behalf even if there are no violations of US laws. The SEC, however, may not be able to pursue an independent enforcement action if there are no breaches of US laws.<sup>5</sup> We request that ESMA clarify this provision to state that the arrangement should provide for regulators in third countries to assist EU regulators to conduct investigations of any breaches of EU regulation.

#### Determination of Regulatory Equivalence for Delegation to Third Country Entities

In situations in which delegation concerns portfolio or risk management, the AIFM Directive requires delegation to be conferred only on institutions authorized or registered for the purpose of asset management and subject to supervision or (where the supervision requirement cannot be met) prior approval by the AIFM's home Member State competent authorities.

In the Consultation Paper, ESMA states that the third country entity should be deemed to satisfy this requirement based on local criteria that are equivalent to those established under EU legislation. Moreover, ESMA states that the assessment should be made by comparing the eligibility criteria and the ongoing operating conditions locally applicable to third country entities against the corresponding requirements applicable in the EU for the access to the business and the performance of the relevant functions.

We disagree with ESMA's proposal to require a determination that the regulatory framework of a third country manager to whom functions have been delegated is equivalent to those of the EU. The level 1 text of the AIFM Directive unequivocally states that the third country entity should be authorized or registered for the purpose of asset management and subject to supervision. There is no reference to a determination of equivalent regulatory

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<sup>5</sup> The US SEC, however, may have the authority to limit activities or revoke the registration of an adviser that has violated foreign law. For example, under section 203(e)(8) of the Investment Advisers Act of 1940, the US SEC may censure, place limitations on the activities, or revoke the registration of an adviser that has been found by a foreign financial regulatory authority to have violated any foreign statute or regulation regarding transactions in securities.

regimes. In addition, the level 1 text permits the third country entity not to have to be supervised as long as the Member State authorities approve the delegation. The latter provision contemplates that there may be no supervision of the third country entity delegated functions by the AIFM, and, under those circumstances, it would be difficult (if not impossible) to make a determination that the regulatory regimes are equivalent.

Therefore, we urge ESMA to remove the reference to a determination of equivalence in the regulatory regimes in the context of delegation to a third country entity. Instead, we recommend that ESMA follow the delegation framework under the UCITS Directive, which does not depend on findings of equivalence of regulatory regimes. The delegation provision has worked well under the UCITS regime, and Member State authorities have the supervisory experience under the mechanisms currently in place for UCITS funds. As we noted in our response to ESMA's July Consultation Paper, to the extent that there are no particular or articulated reasons for having different rules for delegation for managers of AIFs and UCITS, we believe there are benefits to harmonizing the regulatory regimes with respect to these provisions.

If, despite our objections, ESMA believes some type of evaluation is necessary by the home Member State authorities of the third country regulatory framework, ESMA should advise that Member States conduct this evaluation by considering the protections provided by the entire regulatory frameworks of the third country and the EU rather than comparing individual requirements under the regulatory regimes. Although EU and third country regulatory frameworks may have been developed to protect investors and to address certain regulatory concerns (such as conflicts of interest), the regulatory approaches to those concerns may be quite different in various jurisdictions. Moreover, specific requirements under the different regimes may have evolved over time and reflect domestic historical developments. Therefore, it may be difficult to assess each and every EU requirement for an "equivalent" foreign counterpart provision. Conversely, there may be specific requirements under US law for which there are no equivalent EU counterpart provisions. We believe viewing "equivalence" holistically is more consistent with the intent of the AIFM Directive. Otherwise, unless global regulations were harmonized, it would be impossible for Member States to make this determination.

#### Determination of Member State of Reference

Although ESMA has deferred to a later date the advice regarding the passport for non-EU AIFMs, the Consultation Paper provides advice on the possible procedure to be followed in determining the Member State of Reference in situations where there are several possible Member States of Reference. The advice sets forth a process by which the potential authorities of reference and ESMA would consult and make a decision regarding the identification of the Member State of Reference. In addition, under subsections (g) and (h) of Article 37(4) of the Directive, if a non-EU AIFM intends to market several EU AIFs (or non-EU AIFs) in the EU, the Member State of Reference is the home Member State of the AIFs or the Member State where the AIFM intends to develop effective marketing for most of those AIFs. ESMA proposes to define "develop effective marketing" to mean the Member State

where the AIFM intends to “target investors by promoting and offering, including through third party distributors, most of the AIFs.”

We have several concerns with the proposed advice regarding the selection process for the Member State of Reference. First, we urge ESMA to provide non-EU AIFMs an opportunity to participate in the determination of the Member State of Reference and to make the process fully transparent to non-EU AIFMs. We believe involving the non-EU AIFM in the deliberations to choose the Member State of Reference will allow a full discussion of the relevant facts and will more likely result in the selection of the Member State authority that is in the best position to supervise the non-AIFM in an effective manner.

Second, we believe that “intends to target” may be a difficult standard to follow and not very meaningful because there may be several Member States in which the AIFs will be marketed. Moreover, an intention to market in a particular Member State may not translate to the Member State becoming a major market for the AIFs. In other words, it would be difficult to predict which jurisdiction will become the most significant market for these AIFs before these funds are marketed and sold. Therefore, we recommend that other factors be considered in determining which Member State should be selected, such as the Member State in which marketing efforts may be coordinated or initiated. For example, non-EU AIFMs may develop marketing efforts in coordination with an EU affiliate or use the same third party distributors. In such circumstances, it may be appropriate for the competent authorities of the home Member State of the EU affiliate to regulate the non-EU AIFM. The knowledge and experience of the home Member State authorities in regulating the EU affiliate may be helpful in supervising the non-EU AIFM.

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The IAA appreciates the substantial efforts of ESMA in a short period of time to provide advice to the Commission on third country issues. We urge ESMA to continue its work on third country issues and to coordinate with third country regulators to determine workable templates for cooperation agreements. We also suggest that ESMA remove its advice on determination of equivalence for delegation. If ESMA determines not to take our recommendation, ESMA’s advice should allow Member States to make reasonable assessments of equivalence of third country regulatory regimes based on the entire regulatory framework of such regimes. Finally, we urge ESMA to revise its advice on the procedures for the selection of the Member State of Reference. We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

/s/ Jennifer S. Choi

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