

September 23, 2011

Submitted online at www.esma.europa.eu

Steven Maijoor

Chair

European Securities and Markets Authority

103 Rue de Grenelle

75007 Paris

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

Dear Mr. Maijoor:

The Investment Company Institute ("ICI")¹ appreciates the opportunity to comment on the August consultation paper of the European Securities and Markets Authority ("ESMA") proposing draft technical advice to the European Commission regarding implementing measures under the Alternative Investment Fund Managers Directive ("Directive") for supervision and third countries ("August Paper").²

In response to the Commission's request for assistance regarding implementing measures for the Directive, ESMA published a consultation paper in July 2011 with draft advice concerning many articles under the Directive (*e.g.*, general provisions, authorization and operating conditions, depositary, leverage and transparency requirements) but did not specifically address third country alternative

¹ The Investment Company Institute is the national association of U.S. registered investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.9 trillion and serve over 90 million shareholders.

² 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, available at <http://www.esma.europa.eu/popup2.php?id=7702>.

investment funds (“AIF”) or alternative investment fund managers (“AIFM”) (“July Paper”).³ Nevertheless, because investment companies registered under the U.S. Investment Company Act of 1940 (“RICs”) that market shares of AIF to professional investors after July 2013 will need to comply with the transparency requirements of the Directive, we submitted a letter commenting on the proposals relating to the transparency requirements and delegation.⁴ In the August Paper, ESMA has provided draft technical advice on implementing measures 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. The August Paper does not address the third country passport.

Overall, we continue to believe that further discussion is needed on the framework that will apply to third country entities. We urge ESMA to consult with both industry and regulators around the world, to understand the range of third country entities and regulatory regimes to ensure that implementation of the Directive does not operate to effectively restrict, or result in a barrier to, access for third country entities. Given the wide variety of AIF and AIFM around the world, we believe that the implementation of the Directive must be sufficiently flexible to accommodate the diversity of the global fund industry as well as the goals of the Directive. We describe our concerns below.

Cooperation Agreements for Delegation (Box 1, Questions 1-4)

With regard to the delegation of portfolio or risk management functions to third country entities and cooperation arrangements, ESMA proposes that a cooperation agreement exist between the home Member State of the AIFM or ESMA and the supervisory authority of the entity to which a delegation is made (*e.g.*, the U.S. Securities and Exchange Commission (“US SEC”)) that entitles European authorities to the following:

1. obtain on request the relevant information necessary to carry out their supervisory tasks under the Directive;
2. obtain access to documents relevant for the performance of their supervisory duties maintained in the third country;

³ 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, *available at* <http://www.esma.europa.eu/popup2.php?id=7625>

⁴ For purposes of our analysis, we consider a RIC to be internally managed; it is, therefore, both the AIF and the AIFM for purposes of the Directive. See Recital 20 of the Directive.

3. have the right to request an on-site inspection on the entity to which functions were delegated (or sub-delegated). The practical procedures for on-site inspections should also be detailed in the arrangement;
4. receive immediately information from the supervisory authority in the third country in the case of breach of regulations; and
5. ensure that enforcement actions can be performed in cases of breach of regulations.

ESMA anticipates that these agreements will be based on existing agreements, including the IOSCO precedent contained in certain memorandums of understandings among IOSCO members.

As proposed by ESMA, we strongly support utilizing the significant work of IOSCO in the area of information sharing and supervisory cooperation. We support using the IOSCO Multi-Lateral Memorandum of Understanding as well as existing bilateral agreements that are in place between certain EU jurisdictions and third countries as documents that can be used, or built upon, for purposes of the contemplated cooperation agreements. For the US SEC, these agreements indicate a substantial and existing commitment to information sharing and supervisory cooperation with European regulators and other regulators around the world.⁵

We recommend, however, that ESMA clarify that, with regard to breaches of European law, the agreements are intended to obtain commitments from the third country regulator to *assist* EU regulators in their activities related to conducting investigations of a third country AIFM or bringing enforcement actions under European law against a third country AIFM, and not a commitment to bring an action for the breach of European law. Such authority is likely to be limited or may be unavailable to third country authorities.⁶ We recommend clarifying that the arrangements are intended to provide for this type of assistance from third country regulators.

⁵ The U.S. Securities and Exchange Commission ("US SEC") has extensive experience in negotiating such agreements and has agreements with the regulators in several European countries and is a signatory to the relevant IOSCO memorandum of understanding. More information regarding the US SEC's international enforcement assistance is available at http://www.sec.gov/about/offices/oia/oia_crossborder.shtml#framework. More information regarding US SEC cooperation arrangements with foreign regulators is available at http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml.

⁶ Section 21(a)(2) of the Securities Exchange Act of 1934 only authorizes the US SEC to assist foreign regulators in conducting investigations, including compelling testimony or the production documents, on their behalf (even if there are no violations of US law). Under section 203 of the Investment Advisers Act of 1940, the US SEC, however, 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 (emphasis added)."

Regulatory Equivalence and Delegation to Third Country Entities (Box 1, Question 5)

Under the Directive, when delegation concerns portfolio or risk management, the delegation must only be to 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. ESMA's technical advice proposes that a third country entity should be deemed to satisfy this requirement based on local criteria that are equivalent to those established under EU legislation. ESMA also advises 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.

We strongly believe that ESMA's technical advice contemplating "equivalence" for delegation extends beyond the intentions of the Directive⁷ and could have detrimental consequences for EU investors by limiting their access to foreign expertise. Instead, we urge ESMA to follow the "plain" language of Article 20 of the Directive. In addition, we believe the framework under the delegation provisions of the UCITS Directive, which does not have an equivalence procedure, would be useful for this purpose. The UCITS framework has been in place for many years and has worked well in the context of third country entities. Consequently, based on the language of the Article, we believe that it should be sufficient that the third country entity is authorized to perform asset management by their third country supervisory authority.

Lastly, we also believe it is very important to recognize that Article 20 makes it very clear that the AIFM remains ultimately responsible under the Directive even if certain functions are delegated to others. The Article specifically prohibits delegation from preventing effectiveness of supervision and states that delegation may not prevent the AIFM from acting, or the AIF from being managed, in the best interests of investors. The AIFM may not delegate to the extent that it would not be the manager or would be viewed as a letter box entity. Recital 30 also states this overarching policy regarding delegation: "... AIFMs should, however, remain responsible for the proper performance of the delegated functions and compliance with this Directive at all times."

⁷ The level 1 text of the Directive simply requires that the entity is authorized or registered for the purpose of asset management, but does not specify the criteria for authorization or registration. The level 1 text also includes a carve out for the circumstance where an entity (EU or non-EU) is not authorized or registered, in which case it must seek prior approval from its supervisor prior to proceeding with delegation. Further, the issue of equivalence was debated, and ultimately rejected, in the level 1 discussions regarding passport standards of third country managers. To include equivalence in this context appears to be at odds with the consensus reached in adopting the level 1 text.

Cooperation Agreements for Supervision (Box 3, Questions 1-3)

For purposes of supervision, including systemic risk oversight, ESMA expects cooperation agreements with third country authorities in relation to third country entities similar to those described for delegation arrangements. ESMA proposes that the cooperation agreements be in writing and provide for the following:

1. exchange of information for supervisory purposes;
2. exchange of information for enforcement purposes;
3. the right to obtain information necessary for the performance of the duties provided for in the Directive; and
4. the right to request an on-site inspection to be performed or to perform directly such an on-site inspection.

ESMA intends to use existing cooperation agreements as models. Consistent with our comments above, we recommend that ESMA clarify that the agreements contemplate assistance with supervisory or enforcement matters, and not that third country authorities will bring legal actions on behalf of European authorities for a breach of European law.

With regard to information exchanges for systemic risk oversight, the agreements are expected to allow EU authorities to receive certain information on an on-going basis. ESMA also wishes to have a provision to allow the intra-transfer of information to other EU authorities, ESMA or the European Systemic Risk Board. The third country authority is also expected to meet the data standards of the Data Protection Directive.

We believe that ESMA needs to take a reasonable approach to the request for, and receipt of, this information and for its production on an on-going basis. Systems to gather, organize and sort this type of information are only in the first stages of development in many countries. Operating budgets and staff of supervisory authorities also are under stress. We urge ESMA to more carefully draft this technical advice to ensure reasonable and workable information sharing arrangements are contemplated with third country authorities.

With respect to the confidentiality of this information, we believe that confidentiality is vitally important. We therefore recommend that ESMA use the existing frameworks for confidentiality set forth in the various multilateral and bilateral memorandums of understanding on information sharing. We believe that ESMA must have a framework that serves to sufficiently protect this information while accommodating the various local rules that may shape how confidentiality and privacy are protected, or

how other laws may limit disclosure, in different jurisdictions. In addition, the approach must be capable of accommodating any future changes that may impact confidentiality or the type of information sought under these arrangements.

Member State of Reference (Box 5)

ESMA proposes that in cases where more than one Member State could be the Member State of Reference (“MSR”), the MSR should be identified taking into account the Member State in which the AIFM intends to “develop the most effective marketing for its AIF,” meaning where the AIFM intends to target investors by promoting and offering, including through third party distributors, most of the AIFs. The authorities identified by the third country AIFM as well as ESMA will jointly decide on the MSR.

We are concerned that this approach does not take account of the substantial operations that an AIFM may have in a Member State that serve as a central base for launching or engaging in effective marketing but is a different Member State from those Member States where there are direct marketing activities. For example, it seems important to consider the location where overall strategy and plans for effective AIF marketing are developed, staffed, coordinated and supervised (*e.g.*, where the AIFM may hold meetings with investors and/or where it may have substantial operations, including where significant administrative or other functions are carried out). We also note that under the proposed advice it is unclear what would happen if the balance of marketing activities shifted to another Member State. This issue could be limited if ESMA included the consideration of the central or primary location from which the AIFM develops its marketing. Lastly, we also believe that it is important that an AIFM be provided with an opportunity to participate in the process for determining the MSR, and that this process must be open and transparent.

Depository

While we recognize that the application of the Directive’s articles relating to depositaries for third country AIF are not the subject of this paper, we remind ESMA that RICs are subject to certain US laws that will effectively prevent them from being able to comply with the depository provisions of the Directive. We have explained this unique RIC issue in a previous letter to ESMA in January 2011.⁸ Therefore we are not in this letter commenting on the August Paper’s specific discussion of depositaries

⁸ See letter from Susan M. Olson, Senior Counsel – International Affairs, Investment Company Institute, to European Securities and Markets Authority, dated January 14, 2011, available at <http://www.ici.org/pdf/24891.pdf>.

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established in third countries and will wait for a future consultation that addresses depositaries and third country AIF.

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The Institute appreciates the difficult challenges faced by ESMA in developing technical advice for the implementing measures for the Directive. We look forward to continuing to work with ESMA on its work related to third country AIF and AIFM.

If you have questions or require additional information, you can reach me at +1-202- 326-5813.

Very truly yours,

A handwritten signature in black ink, appearing to read "Susan Olson". The signature is fluid and cursive, with the first name "Susan" and last name "Olson" clearly distinguishable.

Susan M. Olson
Senior Counsel – International Affairs