Luxembourg Private Equity
& Venture Capital Association

Questions asked by ESMA on the possible implementing measures of the Alternative Investment Fund Managers Directive (AIFMD).

The Luxembourg Private Equity & Venture Capital Association (LPEA) represents the interests of all actors that shape or serve the PE value chain in Luxembourg, which include:

- Fund Managers of PE focused investment vehicles ("General Partners")
- Institutional or non-institutional investors in PE ("Limited Partners")
- Service providers to the PE industry

The LPEA represents Luxembourg within the European Private Equity & Venture Capital Association (EVCA).

We thank the European Securities and Markets Authority for the opportunity to participate in this Consultation.

BOX 1 Calculation of Total Value under Management

Q1: Does the requirement that net asset value prices for underlying AIFs must be produced within 12 months of the threshold calculation cause any difficulty for AIFMs, particularly those in start-up situations?

It appears industry practice that AIFs produce at least one annual portfolio evaluation and related financial statements. Consequently, this should enable AIFMs to produce threshold calculations compliant with the 12 months requirement.

However, legislation in certain member countries (including Luxembourg) may provide for an extended first financial year (Luxembourg up to 18 months) for an AIF. Accordingly, AIFMs that are in startup situations, i.e. that are setting up a first time AIF, should be permitted to provide its initial threshold calculation on the basis of an AUM calculation that reflects such (extended) financial year (if so chosen).

Q2: Do you think there is merit in ESMA specifying a single date, for example 31 December 2011 for the calculation of the threshold?

To the extent that different AIFs may have different financial year-ends, and assuming that not every AIF produces formal interim closings, it would probably make more sense to abstain from a single date and instead recommend/prescribe (if anything) the date of the annual closing as the threshold calculation date.

Q3: Do you consider that using the annual net asset value calculation is an appropriate measure for all types of AIF, for example private equity or real estate? If you disagree with this proposal please specify an alternative approach.

The question is somewhat ambiguous to the extent that it may be targeted either at:

- the process, i.e. the annual frequency and timing of the exercise, or
- the method, i.e. - net asset value as basis for determination of AUM

⇒ **As it regards annual frequency of the exercise, we tend to believe that any AIF, whether real estate, private equity or venture capital, should take no issue with the proposal.**

⇒ **In terms of the most appropriate method for determination of the AUM of an AIF in general, and for closed-ended real estate, private equity and venture capital AIFs in particular, we believe, however, that net asset value calculation is not the most appropriate method for determining AUM.**

It is the particular nature of ***closed ended*** funds (VC, PE and RE alike) that the AUM are built over time as investor commitments are drawn down and investments/divestments are made.
As it regards venture funds in particular the net asset value of such AIFs may start deviating significantly from aggregate acquisition cost of their investment portfolios after a while (starting anywhere from 1 to 3 years into an investment), triggered typically by one or few portfolio positions being subject to significant (compared to original cost) ***unrealized*** appreciations (for example triggered by third party funding events) or depreciations (for example triggered by a portfolio company's inability to raise further financing.

Such events do neither increase nor decrease the AIFs exposure / investment amounts at risk and consequently should not trigger a recalculation of threshold amounts. Therefore:

⇒ **the method for determination of AUM should be chosen to reflect best the specific profile of an AIF in terms of nature and build up of its investment portfolio, while at the same time trying to minimize fluctuations of AUM that are of temporary nature and/or do not alter the fundamental exposure of an AIF.**

An appreciation of various alternative methods to determine AUM is provided in *Annex 1*.

As a conclusion:

For closed-ended real estate, private equity and venture capital funds:

⇒ **the method that best reflects the AUM profile of these AIFs is the one outlined under c) in Annex 1 – Net Acquisition Cost.**

⇒ **The Commitment method is inappropriate for determination of AUM for such types of AIFs**

For open-ended AIFs:

⇒ **both the Net Asset Value (NAV) as well as the (Net) Acquisition Cost concept would be appropriate.**

Q4: Can you provide examples of situations identified by the AIFM in monitoring the total value of assets under management, which would and would not necessitate a recalculation of the threshold?

The implementing measures refer to 2 situations where recalculation is/may be required:

1. Ex ante: if the AIFM determines that AUM may exceed the threshold in the future given current level and anticipated subscriptions/capital calls or redemptions/distributions (point 4 in Box 1); or
2. Ex post: three months after the AIFM has determined that AUM has exceeded the threshold (point 5 (c) in Box 1).

Only in the first case the AIFM has any discretion over whether or not a recalculation is required.

Examples of situations are the given below, assuming the following:

1. Scenarios are evaluated for ***closed ended funds*** as they are the more typical AIFs in venture capital and private equity, and
2. Transaction size underlying the different situations will cause the AUM threshold to be passed (individually or in the aggregate);
3. “Commitments” as a method to determine AUM is not included in the analysis as this method is considered inappropriate.

Situation	Impact on AUM[1]		Recalculation of threshold	
	NAV	NAC	NAV	NAC
New commitments • launch of new AIFs, or • subsequent closing(s) of existing AIFs (only for AIFs in scope !)	→	→	NO	NO
New (cash) draw downs / investor subscriptions	↗	→	YES	NO, as no immediate effect on AUM, which would only increase once invested in portfolio
New or follow-on investments into portfolio assets (including leverage to the extent applicable)	→	↗	NO, as already reflected at time of cash receipt (see above)	YES (see above)
Significant (but potentially temporary) unrealized value ***appreciation*** on individual portfolio position(s)	↗	→	YES (if considered lasting over more than 3 months)	NO
Significant (but potentially temporary) unrealized value ***depreciation*** on individual portfolio position(s)	↘	→	YES (if considered lasting over more than 3 months)	NO
Complete write off[2] on individual portfolio position(s)	↘	↘	YES	YES
Sale of portfolio assets	→	↘	Generally NO (only upon distribution to investors) YES, only if sales proceeds above previous NAV **and** no distribution to investors planned short term	YES (upon realization)
Dividends or similar income from portfolio assets:	↗	→	YES, if planned to be retained by AIF	NO
Distribution of proceeds (from sales proceeds and/or dividends) to investors/ redemptions	↘	→	YES	NO (already reflected upon realization)

As demonstrated:

⇒ **the AUM calculated as a result of the above methods can be different depending on which method is used; such differences can be simple timing differences, or permanent in nature;**

[1] The table sets out the results under two different methods of determination for AUM (see response to Q3 and Annex 1 for details).

[2] It has also been suggested to include « partial permanent write offs ». For reasons of anticipated difficulties in determining when a partial write off is permanent we suggest to limit to total write offs

Q5: Do you agree that AIFs which are exempt under Article 61 of the Directive should be included when calculating the threshold?

No. We fail to recognize the rationale for this. It would potentially require an AIFM, whose principle activity would consist of managing exempt AIFs to register under the Directive despite the fact that AUM related to qualifying AIFs (however determined) are below the threshold.

⇒ **This will be creating an unlevelled playing field between those which manage only 61 AIF and those who manage a mix of in scope and exempt;**

BOX 2 Calculation of Leverage – not covered by LPEA

Q6: Do you agree that AIFMs should include the gross exposure in the calculation of the value of assets under management when the gross exposure is higher than the AIF's net asset value?

Q7: Do you consider that valid foreign exchange and interest rate hedging positions should be excluded when taking into account leverage for the purposes of calculating the total value of assets under management?

Q8: Do you consider that the proposed requirements for calculating the total value of assets under management set out in Boxes 1 and 2 are clear? Will this approach produce accurate results?

BOX 3 Information upon Registration – no questions: not covered by LPEA

BOX 4 Opt-in Procedures – not covered by LPEA

BOX 5 AIFMs falling below Threshold – not covered by LPEA

BOX 6 Risks from Professional Negligence

Q9: The risk to be covered according to paragraph 2 (b)(iv) of Box 6 (the improper valuation) would also include valuation performed by an appointed external value. Do you consider this as feasible and practicable?

In preamble to the discussion, we draw your attention to the role of the independent valuer whose responsibilities typically vary depending on the scope of the contractual engagements agreed between the independent valuer and the AIFM.
In particular, when independent valuers are appointed for a review of the valuation performed by the AIFM, the extent of the responsibilities borne by the AIFM and the independent valuer are determined on a case by case basis.

In practice, the extent of the liabilities borne by independent valuers are generally defined contractually and subject to a limitation by means of a maximum monetary amount or a multiple of the fees agreed between the independent valuer and the AIFM.
Any interpretation of this regulation that would result in an unlimited liability to independent valuers, except for gross negligence, would likely result in bringing this service in short supply and not effectively available to AIFM.

Therefore, it may be appropriate for risks to be covered according to §2 (b) (iv) of Box 6 to also include valuation performed by an external valuer.

BOX 7-8 Quantitative Requirements Additional Own Funds

Q10: Please note that the term 'relevant income' used in Box 8 includes performance fees received. Do you consider this as feasible and practicable?

The allocation of performance fees is usually made on either a deal by deal basis or on a total return basis. Including performance fees in the "relevant income" will create unequal treatment between AIFM depending upon the type of performance fees computation they are subject to.
Moreover we believe that including performance fees in the "relevant income" introduces uncertainty, potentially high variability in the determination of the additional own funds required, less predictability and thus not achieving the purpose of that measure.

Q11: Please note that the term 'relevant income' used in Box 8 does not include the sum of commission and fees payable in relation to collective portfolio management activities. Do you consider this as practicable or should additional own funds requirements rather be based on income including such commissions and fees ('gross income')?

We suggest that "relevant income" should be net of fees and commissions payable.

Q12: Please provide empirical evidence for liability risk figures, consequent own funds calculation and the implication of the two suggested methods for your business. When suggesting different number, please provide evidence for this suggestion.

We have a retained a basic example of computation for the 2 options based on the following simplified assumptions:

- AuM : 500 mio
- Management fee: 2% on AuM
- Relevant income: 20% of management fee
- Performance fee disregarded

Option 1: additional own funds: 50k€

Option 2: additional own funds: 57,5k€

Q13: Do you see a practical need to allow for the 'Advanced Measurement Approach' outlined in Directive 2006/48/EC as an optional framework for the AIFM?

We are generally of the view that the second option is complicated and not necessarily useful. We do not see any benefit in introducing further complications by a cross reference to an annex (annex X part 3) of Directive 2006/48/EC.

Q14: Paragraph 4 of Box 8 provides that the competent authority of the AIFM may authorise the AIFM to lower the percentage if the AIFM can demonstrate that the lower amount adequately covers the liabilities based on historical loss data of five years. Do you consider this five-year period as appropriate or should the period be extended?

A five years period is appropriate.

BOX 9 Professional Indemnity Insurance

Q15: Would you consider it more appropriate to set lower minimum amounts for single claims, but higher amounts for claims in aggregate per year for AIFs with many investors (e.g. requiring paragraph 2 of Box 9 only for AIF with fewer than 30 investors)? Where there are more than 30 investors, the amount in paragraph 3 (b) would be increased e.g. to €3.5 m, while for more than 100 investors, the amount in paragraph 3 (b) would be increased e.g. to €4 m.

It may be more appropriate to set a lower minimum amount for claims in aggregate since the mutualisation of several claims statistically leads to lower risk.

BOX 10-18 General Principles

Q16: Paragraphs 4 and 5 of Box 11 set out additional due diligence requirements with which AIFMs must comply when investing on behalf of AIFs in specific types of asset e.g. real estate or partnership interests. In this context, paragraph 4(a) requires AIFMs to set out a 'business plan'. Do you agree with the term 'business plan' or should another term be used?

First, it is not entirely clear from Box 11 or the explanatory text what such "business plan" is supposed to relate to – the AIFM, the AIF or the target ? To that end further clarification is sought from ESMA.

Second, further clarification is sought as to what aims ESMA pursues with the information set forth in such business plan documentation.

LPEA interprets for the purpose of the following response that such "business plan" refers to the AIF and concludes that neither term business plan nor the requirement to establish one is commensurate to the nature of AIFs in the venture capital and private equity industry. As a case in point, it is not something investors typically require when marketing AIFs.

Venture capital and private equity investment funds are not entities whose business evolution lends itself to be described reasonably and with a certain degree of accuracy by way of business plans. Save for a budget for operating cost and expenses and a certain estimation as to the deployment of its investable capital (including debt as the case may be) over time, both of which determine the draw down profile of commitments, neither the timing nor the magnitude of divestment proceeds and corresponding profits and losses can be predicted.

This being said LPEA does recognize the AIFMs obligation to monitor an AIFs draw down profile and operating expense budgets initially estimated and to adjust those in the event of changes in market conditions, if their effects are material (e.g. a specific industry and/or geography initially targeted experiences economic turmoil as a result of which it is (temporarily) exluded as investment target).

The Implementing Measures as set forth in Box 10-19 generally recognize that the specific nature of (among others) private equity AIFs may permit AIFMs to adapt the scope of measures in accordance with the nature and/or scope of the AIFs activities. However, in certain cases (ex: Box 14) this is only evidenced in the Explanatory Text. LPEA would recommend to systematically include reference to such proportionality provisions in the core text.

BOX 19 General Principles

Q17: Do you agree with Option 1 or Option 2 in Box 19? Please provide reasons for your view.

PE Funds already have very concrete and efficient fair treatment rules in place. Typically a fund LPA provides for the so called "most favoured nations clause" which foresees that all investors in the Fund are entitled to see any side letter arrangements and benefits granted to other investors and to request the same unless they were granted fro tax and regulatory reasons and certain other carve outs (e.g. seat in the investor advisory board fro the investors with the greatest commitments). In that respect the requirement of the Directive in Art. 12(1) subpara. 2 of the AIFMD is reflected as Art. 12(1) states that preferential treatment is prohibited unless such preferential treatment is disclosed to the other investors. However, unlike ESMA in its consultation, Art. 12(1) subpara. 2 of the AIFMD does not differ between preferential treatment that has an overall material disadvantage to other investors and preferential treatment that has NO overall material disadvantage to other investors. Therefore, Art. 12 (1) subpara. 2 of the AIFMD should be understood in that way that also preferential treatment that has an overall material disadvantage to other investors is allowed provided that such preferential treatment is disclosed to the other investors. However, both options prohibit in principle a preferential treatment that has an overall material disadvantage to other investors regardless of whether such preferential treatment is disclosed to the other investors. This ESMA proposal seems to go beyond the wording of Art. 12(1) subpara. 2 of the AIFMD. The reference to an "overall material disadvantage to other investors" is problematic because it leaves too much legal uncertainty. A preferential treatment as such can already be seen as causing an overall disadvantage to others. This become evident also when seeing the number of examples provided in the explanatory notes where no material disadvantage is deemed to exist.

BOX 20 -24 Conflicts of Interest – not covered by LPEA

BOX 25 - 30 Risk Management

Q18: ESMA has provided advice as to the safeguards that it considers AIFM may apply so as to achieve the objective of an independent risk management function. What additional safeguards should AIFM employ and will there be any specific difficulties applying the safeguards for specific types of AIFM?

Concerning safeguards related to data to be used by risk management, we can expect strong difficulties for small AIFM and also private equity and real estate managers for which scarcity of data is not uncommon and therefore mainly rely on information provided by front office roles such as portfolio managers. Therefore, degree of control over these by RM is seemed to be quite difficult. Besides, still for these type of funds/managers, requirement of independent external review (assumption is that they don't have internal audit function) would lead to an increase in costs they could not absorb and therefore either impair performance of AIF managed or create a material disadvantage compared to large AIFM. Assurance that there is at least one RM officer appointed and reporting to governing body of the AIFMD should be enough to fulfil Box 30.3.c requirements. As an alternative, all listed safeguards should be subject to proportionality principle (only Box 30.3 d&f for the moment).

The principle of proportionality shall be applied.

Q19: ESMA would like to know which types of AIFM will have most difficultly in demonstrating that they have an independent risk management function? Specifically what additional proportionality criteria should be included when competent authorities are making their assessment of functional and hierarchal independence in accordance with the proposed advice and in consideration of the safeguards listed?

Implementation of a separate RM, apart from portfolio management activities would be overly burdensome and costly for small funds/AIFM and PE/Re in particular. As the first goal of the AIFMD is to monitor systemic risks created by AIFM, requirements of an independent RM should be relaxed for funds creating low or none systemic risks such as unleveraged close-ended funds.

BOX 31 - 34 Liquidity Management – not covered by LPEA

Q20: It has been suggested that special arrangements such as gates and side pockets should be considered only in exceptional circumstances where the liquidity management process has failed. Do you agree with this hypothesis or do you believe that these may form part of normal liquidity management in relation to some AIFs?

Q21: AIFMs which manage AIFs which are not closed ended (whether leveraged or not) are required to consider and put into effect any necessary tools and arrangements to manage such liquidity risks. ESMA's advice in relation to the use of tools and arrangements in

both normal and exceptional circumstances combines a principles based approach with disclosure. Will this approach cause difficulties in practice which could impact the fair treatment of investors?

Q22: Do you agree with ESMA's proposed advice in relation to the alignment of investment strategy, liquidity profile and redemption policy?

BOX 35 - 43 Investments in Securitization Positions – not covered by LPEA

BOX 44 – 54 Organizational Requirements

Box 49: The requirements, notably permanent internal audit and compliance functions and related reporting obligations, will put a significant additional administrative and/or human resource and/or cost burden on certain AIFMs (with the number estimated to be significant given the typical personnel structure of small and medium size AIFMs) without these measure or functions necessarily being adequate in light of the AIFMs activities;

A proportionality clause appears indispensible in light of the above. LPEA would recommend to systematically include reference to such proportionality provisions in the core text.

Q23: Should a requirement for complaints handling be included for situations where an individual portfolio manager invests in an AIF on behalf of a retail client?

LPEA believes that the above situation should not lead to specific complaints handling processes (UCITS like) in this case. Retail investors (to the extent they are even relevant to the asset class) and their portfolio managers should be subject to and benefitting from the same procedures as all other professional investors in the AIFs, as they are available by law and contract (typically in the LP agreements).

BOX 55 – 62 Valuation - no questions - not covered by LPEA

BOX 63 – 65 Delegation General Principles

Q24: Do you prefer Option 1 or Option 2 in Box 65? Please provide reasons for your view.

Article 13 of Directive 2009/65/EC provides that a management company may delegate one or more of its own functions to third parties for the purpose of a more efficient conduct of the company's business.

Article 20 of Directive 2011/61/EU regarding the applicable provisions on the "delegation" provides that an AIFM must be able to justify its entire delegation structure on "objective reasons".

Setting up different layers and requirements of delegation between management companies subject to Directive 2009/65/EC and AIFMD subject to Directive 2011/65/EU should be avoided as far as possible. The objective reasons of the delegation by an AIFM should therefore be demonstrated when the delegation follows the purpose of a more efficient conduct of the AIFM's management of an AIF. The list of examples of this more efficient conduct proposed by ESMA under point 21 is satisfactory. It shall nevertheless be understood as non-exhaustive and each AIFM must remain able to demonstrate to its home Member State's competent authority that it has delegated certain of its functions for any other objective reasons permitting a more efficient conduct of the management of its AIF(s).

The LPEA looks forward to reading ESMA's technical advice on the delegation to third country entities and to receive comfort that the current UCITS rules applied by each Member State's competent authority on the cooperation with foreign authorities shall not be strengthened. A common and practical position could be to consider as acceptable all countries whose relevant supervisory authority is a signatory to the IOSCO Multilateral Memorandum of Understanding concerning consultation and co-operation and the exchange of information.

The LPEA is also keen on strictly limiting the provisions of Article 20 to the delegation of functions, which are listed in Annex I of the AIFMD. The reference throughout Boxes 62 to 71 to both "functions" and "tasks" is not satisfactory. The function of risk management, for example, may indeed be insourced and performed by an AIFM, although not prohibiting some of the tasks that compose this function (e.g. ongoing analysis of the underlying investments and the risks they may represent for the AIF) to be outsourced. This should be permitted in order to avoid any excessive cost increases in the set-up and organisation of small-sized or opted-in AIFMs.

BOX 66 – 73 Delegation (cont'd) - not covered by LPEA

BOX 74 Appointment of Depositary - not covered by LPEA

BOX 75 – 77 Depositary functions – not covered by LPEA

Q25: How difficult would it be to comply with a requirement by which the general operating account and the subscription / redemption account would have to be opened at the depositary? Would that be feasible?

Q26: At what frequency is the reconciliation of cash flows performed in practice? Is there a distinction to be made depending on the type of assets in which the AIF invests?

Q27: Are there any practical problems with the requirement to refer to Article 18 of MiFID?

Q28: Does the advice present any particular difficulty regarding accounts opened at prime brokers?

Q29: Do you prefer option 1 or option 2 in Box 76? Please provide reasons for your view.

Q30/31: What would be the estimated costs related to the implementation of option 1 or option 2 of Box 76?/ Q31: What would be the estimated costs related to the implementation of cash mirroring as required under option 1 of Box 76?

Q33: Under current market practice, which kinds of financial instrument are held in custody (according to current interpretations of this notion) in the various Member States?

BOX 79 Depositary functions (cont'd) - not covered by LPEA

Q34: How easy is it in practice to differentiate the types of collateral defined in the Collateral Directive (title transfer / security transfer)?Is there a need for further clarification of option 2 in Box 79?

BOX 80-81 Depositary functions (cont'd) - not covered by LPEA

Q35: How do you see the delegation of safekeeping duties other than custody tasks operating in practice?

Q36: Could you elaborate on the differences notably in terms of control by the depositary when the assets are registered directly with an issuer or a registrar (i) in the name of the AIF directly, (ii) in the name of the depositary on behalf of the AIF and (iii) in the name of the depositary on behalf of group of unidentified clients?

Q37: To what extent would it be possible / desirable to require prime brokers to provide daily reports as requested under the current FSA rules?

Q38: What would be the estimated costs related to the implementation of option 1 or option 2 of Box 8? Please provide an estimate of the costs and benefits related to the requirement for the depositary to mirror all transactions in a position keeping record?

Q39: To what extent does / should the depositary look at underlying assets to verify ownership over the assets?

BOX 82-87 Depositary functions (cont'd) - not covered by LPEA

Q40: To what extent do you expect the advice on oversight will impact the depositary's relationship with funds, managers and their service providers? Is there a need for additional clarity in that regard?

Q41: Could potential conflicts of interest arise when the depositary is designated to issue shares of the AIF ?

Q42: As regards the requirement for the depositary to ensure the sale, issue, repurchase, redemption and cancellation of shares or units of the AIF is compliant with the applicable national law and the AIF rules and / or instruments of incorporation, what is the current practice with respect to the reconciliation of subscription orders with subscription proceeds?

Q43: Regarding the requirement set out in §2 of Box 83 corresponding to Article 21 (9) (a) and the assumption that the requirement may extend beyond the sales of units or shares by the AIF or the AIFM, how could industry practitioners meet that obligation?

Q44: With regards to the depositary's duties related to the carrying out of the AIFM's instructions, do you consider the scope of the duties set out in paragraph 1 of Box 85 to be appropriate? Please provide reasons for your view.

Q45: Do you prefer option 1 or option 2 in Box 86? Please give reasons for your view.

BOX 88 Depositary Due Diligence - not covered by LPEA

BOX 89 Depositary Segregation - not covered by LPEA

Q46: What alternative or additional measures to segregation could be put in place to ensure the assets are 'insolvency-proof' when the effects of segregation requirements which would be imposed pursuant to this advice are not recognised in a specific market? What specific safeguards do depositaries currently put in place when holding assets in jurisdictions that do not recognise effects of segregation?

In which countries would this be the case? Please specify the estimated percentage of assets in custody that could be concerned.

BOX 90-92 Depositary Liability Regime - not covered by LPEA

Q47: What are the estimated costs and consequences related to the liability regime as set out in the proposed advice? What could be the implications of the depositary's liability regime with regard to prudential regulation, in particular capital charges?

Q48: Please provide a typology of events which could be qualified as a loss in accordance with the suggested definition in Box 90.

Q49: Do you see any difficulty with the suggestion to consider as an external event the fact that local legislation may not recognise the effects of the segregation requirements imposed by the AIFMD?

Q50: Are there other events which should specifically be defined/presumed as 'external'?

Q51: What type of event would be difficult to qualify as either 'internal' or 'external' with regard to the proposed advice? How could the 'external event beyond reasonable control' be further clarified to address those concerns?

Q52: To what extent do you believe the transfer of liability will / could be implemented in practice? Why? Do you intend to make use of that provision? What are the main difficulties that you foresee? Would it make a difference when the sub-custodian is inside the depositary's group or outside its group?

Q53: Is the framework set out in the draft advice considered workable for non-bank depositaries which would be appointed for funds investing mainly in private equity or physical real estate assets in line with the exemption provided for in Article 21? Why? What amendments should be made?

Q54: Is there a need for further tailoring of the requirements set out in the draft advice to take into account the different types of AIF? What amendments should be made?

BOX 93-99 Calculation of Leverage - not covered by LPEA

Q55: ESMA has set out a list of methods by which an AIF may increase its exposure. Are there any additional methods which should be included?

Q56: ESMA has aimed to set out a robust framework for the calculation of exposure while allowing flexibility to take account of the wide variety of AIFs. Should any additional specificity be included within the Advanced Method to assist in its application?

Q57: Is further clarification needed in relation to the treatment of contingent liabilities or credit-based instruments?

Q58: Do you agree that when an AIFM calculates the exposure according to the gross method as described in Box 95, cash and cashequivalent positions which provide a return at the risk-free rate and are held in the base currency of the AIF should be excluded?

Q59: Which of the three options in Box 99 do you prefer? Please provide reasons for your view.

Q60: Notwithstanding the wording of recital 78 of the Directive, do you consider that leverage at the level of a third party financial or legal structure controlled by the AIF should always be included in the calculation of the leverage of the AIF?

BOX 100 Limits of Leverage and other Restrictions - not covered by LPEA

Q61: Do you agree with ESMA's advice on the circumstances and criteria to guide competent authorities in undertaking an assessment of the extent to which they should impose limits to the leverage than an AIFM may employ or other restrictions on the management of AIF to ensure the stability and integrity of the financial system? If not, what additional circumstances and criteria should be considered and what should be the timing of such measures? Please provide reasons for your view.

Q62: What additional factors should be taken into account in determining the timing of measures to limit leverage or others restrictions on the management of AIF before these are employed by competent authorities?

BOX 101-106 Transparency

Q63: Do you agree with the approach in relation to the format and content of the financial statements and the annual report? Will this cause issues for particular GAAPs?

We generally agree with the approach in relation to the format and content of the financial statements and the annual report (Option 1).

We support ESMA in its belief to present “material changes” in relation to the information listed in Article 23 of the Directive as a separate part of the annual report or referred to the medium in which or where such information is available, and not being disclosed as a part of audited financial statements, at least when such a disclosure is required by the accounting standard or rules adopted by the AIF.

We do not believe that the suggested approach will cause issues for Luxembourg in general and LuxGAAP as applicable for regulated Private Equity type vehicles (such as SIF, SICAR). This is mainly because financial captions as required by Level 2 measures are already consistent with LuxGAAP to a large extent and leave room for tailoring to specific situations by referring to the IASB framework.

Even though, ESMA suggests presentation of financial statements in compliance with either accounting standards or with the rules adopted by AIF, the pre-eminence is generally given to accounting standards over “contractual” accounting rules. This is because AIF should also comply with applicable legislations which in turn, often, define the GAAP.

As a general point, we note that a choice of IFRS over other GAAPs will generally result in more extensive disclosures, preparation of cash flow statement and a requirement to consolidate underlying controlled portfolio companies. In this respect, we fully support ESMA advise to explicitly exempt AIFs from consolidation requirement where specified in AIF accounting rules and where permitted under national law..

We believe that suggested approach may cause issues for AIF, which prepare their financial statements in accordance with the accounting rules laid down in AIF documents, i.e. do not follow any specific GAAPs.

In respect of report on activities, we also do not believe that the suggested approach will cause issues for Luxembourg GAAP in general and LuxGAAP as applicable for regulated Private Equity type vehicles for the reasons disclosed above. Even though, there is no comparative requirement for unregulated Luxembourg PE vehicles to present a report of activities under LuxGAAP, we do not believe that the suggested approach will cause issues for such types of vehicles.

We note that explanatory text makes it clear that any proprietary/confidential information should not be disclosed and we fully support this.

Q64: In general, do you agree with the approach presented by ESMA in relation to remuneration? Will this cause issues for any particular types of AIF and how much cost is it likely to add to the annual report process?

In general we do not disagree with the approach presented by ESMA in relation to remuneration and welcome flexibility allowed to choose whether the total remuneration is disclosed at the level of the AIFM or the level of the AIF. Practically, we believe that remuneration disclosure can only be made meaningfully at the level of the AIFM, as it requires collection of information from various locations / jurisdictions and is often of a highly sensitive nature. If presented as part of the financial statements of AIF, remuneration disclosure will have to be audited, which in turn may be impractical and likely to be extremely costly or even impossible, as the source of information is likely to be outside the scope of the auditors work (be situated in multiple jurisdiction, legal structures, etc).

We believe that implementation process will likely require establishing or enhancing remuneration policies and may result in exposing proprietary or confidential information (especially for smaller AIFM), breakdown of which might be subject to interpretation. We also note that AIFM managers typically manage multiple funds and their variable compensation is linked to various factors, which are not necessary linked to the performance of a specific fund.

We understand that ESMA suggests to use some implementation guidance in CEBS Guidelines on Remuneration Policies and Practices in relation to the identification of senior management and members of staff of the AIFM whose actions have a material impact on the risk profile of the AIF, nevertheless, detailed remuneration disclosure of such staff may result in undesired transparency of private equity funds managers and therefore allow for comparability (with potential bias) and end up in fierce competition for resources. In addition, the detailed breakdown of remuneration per key staff will result in considerably greater information than is currently required for quoted companies.

We note that in most private equity closed-ended AIFs, carried interest can only be recorded at the end of the life of the AIF, i.e. when investments are realised. Nevertheless, some GAAPs or accounting rules of AIF may allow recording carried interest during the life time of the fund based on unrealised result. This dichotomy will most likely continue to exist and potentially result in inconsistencies of presentation related to carried interest part of the remuneration disclosure.

We also note that the overall definition, nature and extent of remuneration leaves room for interpretation, as it doesn't give clear guidance to the exact type of remuneration which may fall in scope. For instance, it could be interpreted that consulting fee provided by AIFM in relation to AIF overall structure or target portfolio investments can be considered as remuneration fee, however we do not believe, this should be the case.

To conclude, we support the general approach to increase transparency on remuneration and suggested definition of Senior Management and members of staff of the AIFM whose actions have a material impact on the risk profile of the AIF ("Senior Management").

We believe however that Senior Management remuneration should be presented as a single category, on an aggregated basis in the annual accounts of AIFM outside financial statements (i.e. in report on activities) in the meaningful but not prescribed manner. Likewise, we believe that presentation of detailed breakdowns of remuneration fee as part of audited financial statements will be difficult to implement, costly and potentially lead to undesired/excessive transparency and inconsistencies against the backdrop of data protection principles as well as disclosure requirements for quoted companies.

b) Transparency - VIII.II Disclosures to investors

Provide investors regularly with a minimum level of information on special arrangements, liquidity risks, and leverage and risk profile.

BOX 107-108 Disclosure to Investors

Q65: Does ESMA's proposed approach in relation to the disclosure of 1) new arrangements for managing liquidity 2) and the risk profile impose additional liability obligations on the AIFM?

We believe that question is principally aimed at hedge funds, and other funds which have liquidity needs driven by investor demands for redemptions. Private equity and venture capital funds, which do not permit routine redemptions, do not have the same issues and should therefore be scoped out from this requirement. Consequently, we do not comment on this.

We note however that only permanent borrowings will be considered as special arrangement for the purpose of managing illiquid assets and we support this view.

Q66: Do you agree with ESMA's proposed definition of special arrangements? What would this not capture?

We believe that this question is principally aimed at hedge funds, and other funds which have liquidity needs and use special arrangements as a tool for managing liquidity. Private equity and venture capital funds, which do not permit routine redemptions, do not have the same issues and should therefore be scoped out from this requirement. Consequently, we do not comment on this.

Q67: Which option for periodic disclosure of risk profile under Box 107 do you support? Please provide reasons for your view.

We support the Option 1, related to the Box 107 as the Option 2 appears to be too prescriptive. Option 1, in turn, recognises the diversity of AIF, various risk profiles and related extent of disclosure requirements. Private Equity AIF present low systematic risk and therefore should not be exposed to the same level of requirements as for example hedge funds.

We believe that disclosures related to results of stress tests are not relevant or appropriate for private equity types AIF which make mid to long term investments in illiquid assets.

Q68: Do you think ESMA should be more specific on the how the risk management system should be disclosed to investors? If yes, please provide suggestions.

We do not think that ESMA should be more specific.

BOX 109-110 Reporting to Authorities

Q69: Do you agree with the proposed frequency of disclosure? If not, please, provide alternative suggestions.

We do not object the proposed frequency of disclosure (quarterly) as most of private equity funds compile quarterly reports for its investors. Nevertheless, existing investor reporting for PE funds is not necessarily done in a prescribed format and certainly not in the required timeframe. We refer to the discussion in Question 71. We also note that the proposed frequency of disclosure is not required in Luxembourg for PE AIF so far and may therefore result in additional costs to produce quarterly reports, as it will involve implementation of systems and processes which might be costly especially for smaller managers. It may therefore create distortion in competition while the value of the reporting remains to be demonstrated for PE close-ended funds / funds of PE funds. We refer to the discussion in Question 70.

In that respect, options 2 and 3 are certainly less burdensome and seem to be more appropriate, as they consider and differentiate reporting requirements according to funds size and type.

It is not clear, whether the quarterly reporting has to be performed on a consolidated basis (i.e. for all AIF) or on a single AIF basis.

Q70: What costs do you expect completion of the reporting template to incur, both initially and on an ongoing basis? Please provide a detailed analysis of cost and other implications for different sizes and types of fund.

We are not in the position to provide with a detailed cost analysis. The associative costs will depend on existing organisational and IT structures, i.e. ability of existing IT systems to produce required reports, grade of automatisation and required man power, complexity and variety of AIF managed by AIFM. These costs are likely to be relatively high during the implementation stage and decrease with the time.

Q71: Do you agree with the proposed reporting deadline i.e. information to be provided to the competent authorities one month after the end of the reporting period?

We believe that the deadline of providing the reporting (no later than month) is unrealistic for private equity types of AIF in light of their typical reporting deadlines to investors. We recommend to extend this period to at least three months (which in the case of funds of funds may even be too short).

Q72: Does ESMA's proposed advice in relation to the assessment of whether leverage is employed on a substantial basis provide sufficient clarity to AIFMs to enable them to prepare such an assessment?

We believe that ESMA's proposed advice provide sufficient clarity to AIFMs to enable them to prepare such an assessment.

We agree with ESMA approach in a way, it doesn't specifically quantify threshold at which leverage would be considered to be employed on a substantial basis. We believe that option 2 (Box 110) is the most appropriate and it takes into account the need to avoid excessive burden.

We believe however that proposed advice fails to consider that some AIF, such as private equity AIF do not employ leverage at fund level, present a low systemic risk and should be therefore scoped out of this requirement.

AIFM of such AIF will have to conduct this assessment, supplemented by a re-assessment at each reporting date and report the results to the relevant authorities. This may be burdensome with related costs clearly outweighing benefits.

We therefore suggest to considering an option where private equity funds can be either scoped out of this requirement in instances of absence of leverage at fund level or AIFM would be given an opportunity to simply inform their competent authority the reasons which lead AIFM to believe that its AIF are unleveraged and subsequently, no further assessment will take place.
We also recommend that investors/shareholders loans and so called "bridging loans", which are short term borrowings to bridge funding calls are explicitly excluded from the definition of leverage.

Annex 1 – Appreciation of methods to determine AUM for closed ended AIFs

Method	Pro	Con
a) **Net Asset Value (NAV)**	Determination (at least on an annual basis) in line with industry practice. Reflects also effects of unrealized value fluctuations (write ups/write downs/write offs) as well as divestments.	Limited comparability depending on nature of AIFs (RE vs. PE vs. VC) as underlying methods for fair value determination are a) different due to the nature of the assets and b) depend on GAAP applied, examples : • Venture capital – at cost for extended period of time • PE – performance and benchmark driven (e.g. EBITDA multiples) Fair value of individual portfolio lines potentially subject to significant appreciation/depreciation (especially in venture capital).
b) **Commitments**	Easy to determine at any moment. Stable over time as commitments typically only vary through distinct closings.	Significantly overstates AUM at least for closed ended AIFs due to one or more of the following phenomena: • Committed capital is only called down over a significant period of time (2-5 years); • Committed capital may end up not being entirely called; • Effectively called capital is only ever 80-90 % invested in portfolio assets, the remainder being represented by operating cost of the AIF; • Neither disposals nor complete write offs of portfolio assets are taken into account.
c) **Net Acquisition Cost (NAC):** Acquisition cost (equity plus debt, if applicable) deployed for acquisition of a given portfolio asset less acquisition cost of divestments, the latter including total write offs)	Relatively simple to determine as systematically tracked by the AIFM. Close(est) to the « truth » particularly for closed ended AIFs/ commitment based AIFs Determination not subject to value interpretation.	AUM may never reach level of investment potential (i.e. 80-90 % of commitments) of an AIF, particularly if investment and divestment phase overlap (i.e. short holding periods as seen at times with PE funds). However, generally not an issue for PE/VC funds as average holding period often in the 3-7 year range, i.e. investment and divestment phase are somewhat following onto each other.