MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

May 16, 2011

Via ESMA Website:

European Securities and Markets Authority
11-13 avenue de Friedland - 75008
Paris
France

Re: Managed Funds Association Response to Discussion Paper on Implementing Measures under Article 3 of the AIFMD

Dear Sirs:

Managed Funds Association ("MFA")[1] welcomes the opportunity to respond to the European Securities and Markets Authority's ("ESMA") discussion paper on policy orientations on possible implementing measures under Article 3 of the Alternative Investment Fund Managers Directive (the "Discussion Paper"). Throughout the drafting process on the Alternative Investment Fund Managers Directive (the "AIFMD"), MFA engaged with EU policy makers in a thoughtful, constructive manner on a number of important issues, most notably the ability of third country managers and funds to market to EU investors. We welcome the opportunity to work with ESMA as it responds to the European Commission's (the "Commission") provisional request for technical advice as the Commission works to implement the provisions of the AIFMD.

Calculation of assets under management

We believe that the calculation of assets under management should be based on an alternative investment fund manager's ("AIFM") net assets under management, which best reflects investor capital that is at risk, and not based on gross assets. Net assets, as calculated on an alternative investment fund's ("AIF") balance sheet and audited annually, are easily verifiable. Gross assets would be difficult for regulators to define and would be confusing for AIFMs to calculate, which could lead to significant uncertainty for market participants. We further believe that calculation of assets under

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

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management should exclude certain assets that may be invested in an AIF alongside investors' assets, such as the AIFM's own funds.

We also encourage ESMA to consider advising the Commission to calculate assets under management for non-EU AIFM that are regulated in their home jurisdiction by including only those assets of: (1) EU-based AIFs; (2) assets of non-EU based AIFs that are beneficially owned by EU investors; and (3) assets managed out of a place of business in the EU (for example, by an EU sub-manager of a non-EU AIFM). We believe that these three categories should be the primary focus of EU regulators and, therefore, should be the relevant factor in determining whether an AIFM should be within the scope of the full regulatory framework created by the AIFMD.

MFA recognizes and supports the need for regulators to have appropriate oversight over market participants, including private fund managers. It is important, however, to ensure that the regulation of private fund managers is accomplished in a way that is consistent with the G-20 commitment to international coordination. We believe that the approach described above would effectively achieve the G20 goal of regulating private fund managers in a manner that avoids inconsistent or unnecessary overlapping regulation, both of which impede flows of capital. We note that the United States has taken a similar approach with respect to registration of foreign private fund advisers under the Dodd-Frank Wall Street Reform and Consumer Protection Act[2] and the proposed rules by the U.S. SEC to implement that Act.[3]

Leverage

The AIFMD and the Discussion Paper define leverage as "any method by which the AIFM increases the exposure of an AIF it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means." Neither the AIFMD nor the Discussion Paper defines the term "exposure" or how AIFM should calculate the exposures of their AIFs. The implementing directive for undertakings for collective investment in transferable securities ("UCITS") provides alternative methods that managers may use for determining the global exposure of their UCITS funds.[4] Specifically, the implementing directive permits managers of UCITS

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[2] Sections 402 and 403 of the Dodd-Frank Act.

[3] *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, SEC Release No. IA-3111 (November 19, 2010), available at http://sec.gov/rules/proposed/2010/ia-3111.pdf.

[4] Article 41(3) of the UCITS implementing directive (Commission Directive 2010/43/EU) provides that UCITS managers may calculate the global exposure of their UCITS funds:

> by using the commitment approach, the value at risk approach or other advanced risk measurement methodologies as may be appropriate. For the purposes of this provision, 'value at risk' shall mean a measure of the maximum expected loss at a given confidence level over a specific time period.

funds to calculate their global exposure by any appropriate advanced risk measurement methodology. We encourage ESMA to recommend that the Commission implement a similar approach for AIFMs to calculate the exposure of the AIFs they manage.

The definition of leverage has significant implications beyond the issue of determining which AIFM will be required to be authorized under the AIFMD. It will be relevant to a wide range of regulatory considerations, including regulation of over-the-counter derivatives and systemic risk monitoring and regulation. It is important for regulators to develop a definition or definitions of leverage that will provide the most useful information to regulators and other market participants by accounting for factors such as the source and type of funding creating the leverage and the types of assets being leveraged.

With respect to AIFs, such leverage is generally obtained from large financial counterparties, including global banks and broker-dealers, that conduct substantial due diligence and engage in ongoing risk monitoring. AIF borrowings are done almost exclusively on a secured basis (*i.e.,* secured by each AIF's overall assets or specifically posted collateral), which limits the amount of leverage that any AIF may obtain. This collateral posting by AIFs reduces the credit exposure of counterparty financial institutions and makes AIFs substantially less likely to contribute to systemic risk by causing the failure of a systemically important institution, such as a major bank. Given the limited leverage and the collateral posted by AIFs, any losses that AIFs incur are almost exclusively borne by their investors, not the general financial system. The "leverage" profile of a AIF is thus very different than that of other types of financial institutions, for example banks or principal dealers.

We believe that there are a variety of factors regulators should consider when determining whether leverage is used on a "substantial basis" and whether the use of leverage creates potential systemic risk concerns. Some of the factors that we encourage ESMA to consider in advising the Commission on the calculation of leverage, as well as the extent to which leverage should be regulated include:

- In considering leverage as a contributor to systemic risk, it is important to consider not only the aggregate amount of such leverage (inclusive of off-balance liabilities), but importantly the sources and terms of such leverage. Debt that is secured, for example, significantly mitigates systemic risk compared to debt that is unsecured. Similarly, short-term leverage (such as overnight borrowing) introduces greater risk than term borrowings, which more closely match the term of the asset and the financing which funds it. Finally, the degree of an investment fund's portfolio leverage

Member States shall require management companies to ensure that the method selected to measure global exposure is appropriate, taking into account the investment strategy pursued by the UCITS and the types and complexities of the financial derivative instruments used, and the proportion of the UCITS portfolio which comprises financial derivative instruments.

must be considered in the context of its asset mix, including the liquidity of those assets, the liquidity rights of fund investors, as well as the size and nature of the capital markets in which those assets are transacted.

- Off-balance sheet exposures should be considered as part of determining overall leverage. However, the market value or risk of loss must be considered from a risk exposure perspective, as opposed to simply looking at notional values. Additionally, the nature of the instruments in question and risk of loss must be considered. For example, a purchased option has substantially less risk than a sold option. Similarly, collateral arrangements, as well as offsetting positions across a portfolio (a hedge), must be taken into account.
- The ability of AIFMs to appropriately match the assets and liabilities of a fund (in light of the AIF's leverage, sources of leverage, and equity capital stability) should prevent or mitigate the extent to which an AIF is likely to become subject to a forced unwind and impact the broader securities market or financial system.

Systemic Risk Reporting

MFA supports regulators having information about AIF for purposes of systemic risk assessment, provided that sensitive, proprietary information is kept confidential by regulators. In this regard we would ask that ESMA advise the Commission to take appropriate steps to ensure that such confidentiality be maintained. Because a number of regulators around the world request information from fund managers, we encourage ESMA to consider an internationally coordinated approach to such reports. We also encourage regulators to consider the extent to which requesting information from the prime brokers, exchanges, swap data warehouses and other market participants and utilities used by AIFMs may be a more effective or efficient way to gather and analyze information.

As ESMA and the Commission both know, many regulators around the world are developing enhanced reports from private fund managers for regulatory oversight purposes and for the purpose of analyzing the financial system.[5] As part of our support of the regulatory needs underlying these reports and requests for information, we have worked in a constructive manner with regulators to help them develop reports that are well designed to provide necessary information in an effective and efficient way. As part of those efforts, our members have provided regulators with requested data in response to survey requests in the EU, the U.S. and Hong Kong. It is important to note that the scope and type of information that different regulators are requesting is not consistent and frequently does not reflect the ways in which managers currently keep information.

[5] For example, each of the U.K. Financial Services Authority, Hong Kong Securities and Futures Commission and U.S. Securities and Exchange Commission has a systemic risk report for private fund managers.

A coordinated approach would likely be more valuable to regulators, as coordinated reports are more likely to produce data that can be compared across jurisdictions and would eliminate double counting of managers of funds, which will be critical to assessing the state of the financial system in a globally integrated marketplace. A coordinated approach would also be important to global fund managers, which are required to expend significant resources responding to requests for data. We also encourage regulators to consider the extent to which requesting information from the prime brokers, exchanges, data warehouses, and other intermediaries or utilities used by AIFMs may be a more effective or efficient way to gather and analyze information. As such, we suggest that ESMA and the Commission coordinate with other regulators to ensure that, to the extent possible, surveys and reports that are designed to achieve similar regulatory purposes are comparable and coordinated among regulators, consistent with the G-20 mandate.

We further suggest that regulators provide respondents a sufficiently reasonable period of time to comply and that regulators take into account current recordkeeping systems and methodologies, so that the information provided to regulators is consistent and useful and not unduly burdensome for the firms to gather. In that regard, it is important for regulators to consider not only how frequently AIFMs should file reports, but also relevant periods within the report (for example, an annual report could request information be presented on a quarterly basis) and how much time following the end of a reporting period managers will have to complete a report (for example, 90-120 days following the end of the year for an annual report).

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Conclusion

MFA appreciates the opportunity to provide comments to ESMA in response to the Discussion Paper. MFA and its members are committed to working in a constructive manner with policy makers and regulators to achieve the shared goal of effective and efficient regulatory oversight over AIFMs.

If you have any questions regarding any of these comments, or if we can provide further information with respect to these or other issues in connection with Level 2 implementation of the AIFMD, please do not hesitate to contact Stuart J. Kaswell or me at (202) 730-2600.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO