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European Securities and Markets Authority
103, rue de Grenelle
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13 September 2011

Our ref: 21541

Dear Sirs

Response to consultation paper on ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive (the "Consultation Paper")

Mayer Brown welcomes the opportunity to submit comments on the Consultation Paper.

Mayer Brown is a leading global law firm with offices in major cities across the Americas, Asia and Europe. We have an established practice advising on the structuring, marketing, regulation and operation of public and private investment funds including limited partnerships, authorised and unauthorised unit trusts, and closed-ended and open-ended investment companies with a wide range of investment styles and objectives, including private equity, infrastructure, real estate, mezzanine and venture funds.

Our comments have been prepared with the input of our personnel in a number of European jurisdictions. We do not give a comprehensive response but focus only on particular aspects of the Consultation Paper.

We hope you will find our contribution of assistance.

Yours faithfully

Mayer Brown International LLP

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Response to consultation paper on ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive

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III. ARTICLE 3 EXEMPTIONS

III.I. IDENTIFICATION OF THE PORTFOLIO OF AIF UNDER MANAGEMENT BY A PARTICULAR AIFM AND CALCULATION OF THE VALUE OF ASSETS 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?

Whether or not the production of net asset value prices within 12 months for underlying AIFs causes any difficulties for AIFMs largely depends on the applicable valuation methods. We would expect that this would be suitable for most funds but some flexibility must be available.

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

We think that a single date will not generate any practical benefits or synergies. We think that each AIFM should calculate its assets under management at least annually as provided for in Box 1 paragraph 2. Each AIFM should specify the commencement of its own interval for calculation of the threshold. A single date for all AIFMs could, in extreme scenarios, have disruptive effects on the market. The beginning or end of a financial year of the relevant AIFM will probably not be a useful date since this will, in the majority of cases, correspond to the calendar year.

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?

We consider that using the annual net asset value calculation is an appropriate measure for many types of AIF (see Q1 above).

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?

Bridge investments made by an AIF in anticipation of a syndication of significant parts of the investment should not necessitate a recalculation of the threshold even if the holding of the bridge investment would exceed the three month period mentioned in Box 1 paragraph 5(b).

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

We do not agree that AIFs which are exempt under the Article 61 of the Directive should be included when calculating the threshold.

III.II. INFLUENCE OF LEVERAGE ON THE ASSETS UNDER MANAGEMENT

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?

We agree that there should be a common definition and treatment of leverage in the AIFMD (see Section III.II paragraph 30 of the consultation paper). However we do not agree that the application of the Gross Method for calculating exposures set out in Box 95 would be appropriate. In fact, we strongly feel that exposure as defined for purposes of determining leverage in Boxes 93 through 99 (Leverage = Exposure divided by net asset value) should not be treated as equal to assets under management. The Gross Method aims at expressing the increase of exposure by the application of leverage. Conceptually the increase of exposure is reflected by the increased threshold in Article 3 paragraph 2(b) (Euro 500 million) of the Directive for leveraged AIFs as opposed to Article 3 paragraph 2(a) (Euro 100 million) of the Directive for unleveraged AIFs.

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?

We consider that valid foreign exchange and interest hedging positions should be excluded.

On a related matter, but not directly in response to this Q7, we would urge ESMA to advise the Commission that there should be a clarification in relation to Article 3, paragraph 2 of the AIFMD to the effect that positions which are deemed to be hedging arrangements in the meaning of Box 96 paragraph 1(b) should not be regarded as leverage and should not trigger the application of the threshold of Euro 500 million provided under Article 3 paragraph 2(b) of the AIFMD.

We also believe it would be appropriate to implement a *de minimis* threshold for off-setting arrangements as defined in Box 94.

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?

As set out in our response to Q6 use of the Gross Method is not appropriate for calculating AUM for these purposes. Subject to that, we believe that clear and accurate results would be achieved in accordance with Article 19 of the AIFMD.

IV. GENERAL OPERATING CONDITIONS

IV.IX. POSSIBLE IMPLEMENTING MEASURES ON DELEGATION

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

On balance, we take the view that Option 1 is preferable to Option 2. The drawback with Option 2 is that even though the list of objective reasons is not exhaustive, an AIFM may feel reluctant to base a justification on a factor other than the four listed, which is unduly limiting.

V. DEPOSITARIES

V.III. DEPOSITARY FUNCTIONS

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?

We consider that there is a distinction to be made depending on the type of assets in which the AIF invests – and by extension the type of AIF. AIFs investing in private equity, real estate and other illiquid assets are likely to have more infrequent cash flows which would justify reconciliations at longer intervals. Another factor (which is usually correlated with the type of assets in which an AIF invests) is the frequency with which the AIF is open for subscriptions and redemptions.

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

We consider that the depositary should be able to delegate its record-keeping and verification obligations to a third party if the terms of its appointment so permit. The depositary would remain responsible under Article 21(8)(b).

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 a group of unidentified clients?

Situation (i) leaves open the possibility that the assets could be transferred without reference to the depositary.

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?

The experience with UCITS funds may be an instructive parallel. However this is not to say that the parallel is useful in relation to AIFs generally.

V.IV. THE DEPOSITARY'S LIABILITY REGIME

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?

We consider local legislation (and local law and regulation generally) to be necessarily external.

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

Examples would be the acts and defaults of sub-custodians which are not associates of the depositary, acts and defaults of settlement and clearing systems and events of force majeure

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?

We consider that amendments should be made to recognise that the external events include the acts and defaults of unassociated sub-custodians.

VI. POSSIBLE IMPLEMENTING MEASURES ON METHODS FOR CALCULATING THE LEVERAGE OF AN AIF AND THE METHODS FOR CALCULATING THE EXPOSURE OF AN AIF

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

Subject to our comments below, Option 3 appears preferable to Option 1 and Option 2.

In particular the concept in Option 1 and Option 2 of guarantees encompassing "*an expectation that the AIF will contribute to the underlying structure even though there is no legally enforceable obligation*" appears to overstretch the notion of leverage.

The decision whether or not to inject (further) capital or to provide (further) security constitutes a business decision concomitant to virtually any investment. It is a decision of accepting additional business risks or alternatively, in an event of crisis, the potential failure of an investment. To qualify as leverage the mere expectation of such a business decision being potentially made at one point in the future would result in almost any investment to qualify as being leveraged. Moreover, business decisions of this kind are not generally detrimental to investor protection, provided the investment structure ensures limited liability of the AIF.

Accordingly, business decisions to inject capital or to provide security cannot, without more, be considered to automatically increase exposure. The equation of the liberty to make such business decisions with legally binding guarantees appears to be disproportionate. As explicitly stated in Recital 78 of the AIFM Directive, the focus should be on structures specifically set up to directly or indirectly create leverage at the level of the AIF, as opposed to commonplace business decisions.

The wide concept of leverage in Option 1 and Option 2 also undermines the distinction between leveraged and unleveraged AIFs made by the AIFM Directive, since, as a result of such a wide concept, almost no unleveraged AIFs would exist. In particular, the exemption in Article 3(2)(b) as well as the exception in Article 16(1) regarding liquidity management would almost never apply and the special provisions under Chapter 5 Section 1 applicable to AIFMs managing leveraged AIFs would be of general application.

Against this background, Option 1 in particular appears to be too wide, as it does not even contain a limitation to non-listed companies or issuers controlled by the AIFM within the scope of Article 26, as stipulated by Option 2.

Finally, Option 1 and Option 2 are not conducive to legal certainty, given the indeterminate legal concept of "expected contributions", making it doubtful whether effective implementation of Option 1 or Option 2 would be feasible in practice at all.

Although for these reasons Option 3 generally appears preferable to Option 1 and Option 2, a clear endorsement of Option 3 would nonetheless only be possible, once the wording of the second sentence of Option 3 has been clarified. The current wording appears to be grammatically incorrect, making it difficult to evaluate its full meaning.

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?

No. In particular any debt employed in the operation of a portfolio company should be excluded from the calculation of the leverage of the AIF, as such debt does not serve the primary purpose of creating leverage at the level of the AIF. This has been clearly recognized in Recital 78 of the AIFM Directive.

VIII. TRANSPARENCY REQUIREMENTS

VIII.II. POSSIBLE IMPLEMENTING MEASURES ON DISCLOSURE TO INVESTORS

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

We recommend that AIFM should be given sufficient latitude to create their own framework with respect to their risk management system under the supervision of competent authorities of their home Member State.

ADDITIONAL OBSERVATIONS IN RELATION TO ARTICLE 19

Since Article 19, paragraph 3, sentence 2 of the Directive requires that the assets of an AIF and the net asset value per unit or share are calculated at least once a year, the policies and procedures for the valuation of the assets of the AIFM (Box 55) and the inherent valuation methodology will need to be reasonably practical and cost-efficient in order to make an annual revaluation of the assets feasible. With regard to venture capital funds, we agree with the suggestion in paragraph 7. of Section III.I. of the consultation paper, pursuant to which venture capital funds should in principle be permitted to value their investments at cost.

We note that pursuant to Article 19, paragraph 3 of the Directive (other than for purposes of calculating the threshold under Article 3, paragraph 2 of the Directive), valuations may become necessary more frequently than every twelve months. AIF of the open-ended type will need to carry out valuations and calculations at a frequency "which is both appropriate to the assets held by the AIF and its issuance and redemption frequency". AIFs of the closed-ended type must carry on valuations and calculations in case of an increase or decrease of the capital by the relevant AIF.

We feel that it is necessary in this context to differentiate clearly between the valuation of assets and the calculation of the net asset value of the shares or units of the AIF (on the basis of valuation of the assets). "Appropriate" in the meaning of Article 19, paragraph 3, sentence 3 should mean that the calculation of the net asset value shall correspond to the issuance and redemption frequency of the AIF, while the value of the assets should merely be reviewed in order to eliminate a material risk of an inappropriate valuation (see Box 59 paragraph 2).

For funds of the closed-ended type it should be clarified that the draw-down of legally binding committed capital from investors is deemed not to be an increase of capital, given that the investors have no discretion to make a new investment decision based on the recalculation of the net asset value of the relevant AIF.

Similarly, a calculation of net asset value is not relevant for the process of distribution to investors of the proceeds of a disposal by a closed-ended fund, so it should not be deemed a decrease of capital for the purposes of Article 19, because the distribution in closed-ended type funds will be made on a pro rata basis of available cash rather than on the calculation of a net asset value of the fund.

Mayer Brown International LLP

13 September 2011