dutch fund and asset

MANAGEMENT ASSOCIATION

DUFAS[1] reply to ESMA's consultation on it's draft Technical Advice on AIFM Implementing Measures

DUFAS welcomes the opportunity to reply to ESMA's Consultation Paper on ESMA's Draft Technical Advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive.[2] In addition to answering the questions raised in the Consultation Paper, DUFAS would like to submit a number of general remarks.

General Remarks

Consistency with the existing EU frameworks

DUFAS highly appreciates the approach adopted by ESMA to ensure the greatest possible convergence with the current UCITS and MiFID standards in implementing the AIFMD rules. Many AIFM also manage UCITS funds or provide MiFID services. They will be authorized not only as AIFM but also as UCITS Management Companies and as MiFID firms. For these managers, a consequent alignment of the relevant EU regimes is crucial and very welcome. This being said, DUFAS welcomes that adequate adjustments and differentiation must be made to take the difference between the UCITS funds and AIFs managed into account.

Limits of ESMA's mandate

DUFAS considers that ESMA should not go beyond the mandate initially received. ESMA has received mandate to advice the European Commission about implementing measures to the AIFMD. However, some of the proposals in the draft technical advice go beyond what the AIFMD itself requires. DUFAS believes that ESMA should respect the initial requirements and not further tighten them, as for example in Box 19.

Implementing measures for AIF for professional investors

DUFAS would like to remind ESMA that the AIFMD has been drafted to regulate all non-UCITS funds and to provide a European passport for marketing to professional investors. The benchmark of regulation was aiming at regulation for funds for professional investors. The AIFMD leaves it to national legislators and regulators in the Member States to prepare stricter provisions for funds for retail investors at national level.

DUFAS considers that this approach should also be followed in the preparation of the Level 2 measures. The measures should be drafted to provide a minimum regulation for non-UCITS for professional investors. Any stricter provisions to regulate funds for retail investors should be left to the discretion of the Member States.

Against this background, a number of provisions in the ESMA draft technical advice, in particular regarding Transparency, seem too strict and should be redrafted.

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1 DUFAS is the representative association of the Dutch investment management industry and a member organization of EFAMA, the representative association of the European investment management industry. For more information please visit www.dufas.nl

2 ESMA/2011/209, July 2011

Inclusion of explanatory text into boxes
DUFAS welcomes the very helpful, detailed and precise information provided in the explanatory text throughout the Consultation Paper.

However, DUFAS feels that the text in the Boxes in some instances is lacking clarity and the relevant information is provided in the explanatory text only. This is for example the case for provisions which should be applicable to specific asset classes only. The limitation itself or the asset classes concerned are only mentioned in the explanatory text. Another example is the indication in the explanatory text of a proportional application of certain requirements which again is not reflected in the boxes.

In some places in the explanatory text criteria are mentioned to further clarify certain text. In instances where these criteria should only be seen as examples for the purpose of clarification, and not be exhaustive, they should not be included in the text box.

In order to avoid confusion or diverging interpretation in the future, DUFAS strongly suggests including the relevant explanatory text into the Boxes.

Principle based approach
DUFAS understands that due to the fact that the AIFMD will be covering a very diversified universe of products, it might be difficult to clearly define exact rules for all possible circumstances. In particular, it will be very difficult to define rules taking into account all kinds of assets AIF may invest in and the very different legal nature of AIF to be set up (open-end /closed end, contractual or corporate type).

DUFAS would therefore suggest keeping the rules principle based where possible and allowing for a proportionate and differentiated application. A rule based approach can be taken, but should then be either generic enough to cater to all possible situations or should be clearly signposted in the box for a defined type of AIFM or AIF or assets.

Proportionality and differentiation
In several parts of the Consultation Paper ESMA underlines that requirements should be applied proportionally to the size of the AIFM, the amount and type of assets it manages and the complexity of its activity. DUFAS welcomes the application of the proportionality principle in these instances. However, in various parts of ESMA's draft technical advice, proportionality and appropriate differentiation of requirements have not yet been included.

DUFAS invites ESMA to reflect include the proportionality principle and provide for an appropriate differentiation of requirements throughout the entire set of implementing measures, and in particular regarding the General Operating Conditions and Transparency. For example many organisational requirements or the provisions relating to risk management should only be applied in a proportionate manner. Another example are the reporting obligations in Box 109 which is currently imposing a uniform set of strict reporting duties upon all AIF instead of differentiating in accordance with size or type of AIF.

Types of AIF
Throughout the Consultation, ESMA draws distinctions and suggests differentiations based on types of AIF. DUFAS understands that ESMA is currently preparing proposals for definitions of types of AIF. DUFAS remains at ESMA's disposal and offers its expertise to help in the elaboration of such definitions. DUFAS urges ESMA to organize a consultation on any draft proposals of definitions of types of AIF.

Costs and benefits analysis
DUFAS welcomes the efforts already shown by ESMA in order to assess the costs and benefits of possible solutions for implementation of AIFMD. DUFAS encourages ESMA to take an even more rigorous stance in this respect and especially to disclose the reasons for preferring implementing options which incur more costs for AIFM or managed AIF than other possible approaches to Level 2 regulation, for example regarding the reporting obligations proposed in Box 109.

Box 1 Calculation of the total value of assets under management
Para. 3
DUFAS welcomes the suggested text of Box 1 Para. 3 allowing for an exclusion of investments by AIFs in other AIFs under management from the calculation of the total value of assets under management. DUFAS also welcomes the exclusion from the calculation of investments by one compartment within and AIF in another compartment of that AIF. DUFAS shares ESMA's reasoning that these investments should be excluded because on a look-through basis there is only one set of underlying assets.

With regard to leverage, DUFAS considers that it should not be necessary to look through to the underlying funds when calculating leverage in the investing AIF provided this does not create any contingent liability at the level of the investing AIF, and DUFAS understands that the reference to Box 95 achieves this. However, it would ideally be confirmed explicitly in the text of Box 1.

Para. 4
DUFAS understands that the obligation to monitor the value of total assets under management does not require a "full" valuation of these assets. For instance, where the value of the assets is not calculated on a frequent basis, AIFMs should be allowed to use estimations of the value of the assets in the portfolio instead of proceeding with a "full and proper" valuation and a calculation of the NAV.

Para. 5a
ESMA's draft technical advice provides that the AIFM should notify the competent authority without delay when the total value of assets under management exceeds the threshold to state whether the situation is considered to be of a temporary nature.

DUFAS considers that the requirement "without delay", which means immediately, will be difficult to respect in practice. The delay granted to notify the competent authority could be one month where the net asset values (NAVs) of all the AIFs considered are calculated on a monthly basis and longer if the NAVs of the AIFs considered are calculated on a less frequent basis.

Furthermore, the requirement to notify the competent authority of any situation where the total value of assets exceeds the threshold whether it is considered to be temporary will result in a number of notifications which are unnecessary because the situation is temporary. DUFAS suggests that a notification should only be required if the situation is considered to be of permanent nature (or at least of a certain duration).

Para. 5b
DUFAS suggests that the temporary nature of the situation should be assessed over a period longer than 3 months - depending on the frequency of the NAV calculation, i.e. a period of at least 6 months or even at least 12 months as some NAVs are calculated on a monthly basis or sometimes at an even lower frequency.

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?
DUFAS does not foresee any difficulty with the requirement that the net asset value prices for underlying AIFs must be produced within 12 months of the threshold calculation.

We suggest flexibility in the start-up phase of AIFMs, where the threshold calculation could be extended to up to 18 months.

Q2: Do you think there is merit in ESMA specifying a single date, for example 31 December 2011 for the calculation of the threshold?
DUFAS does not believe that there is merit in ESMA specifying a single date for the calculation of the threshold.

The determination of the date for the calculation of the threshold should remain at the discretion of the AIFM which should be able to use the date most appropriate to them. This date will be determined by the reporting dates of the AIF the AIFM manages. For each AIF, the value of the assets in will usually be the subject of an annual, external audit report and this will generally determine the preferred date of the AIFM with regard to this specific AIF. Furthermore, AIFM may manage several AIFs located in various jurisdictions with potentially different accounting periods. The AIFM should be able to decide which date is the most appropriate to calculate the threshold taking into account the features of the AIFs under management. Allowing the AIFMs this discretion will also allow them to choose the date that involves as few intermediary NAV calculations as possible, considering the closing dates of the AIF they manage.

Furthermore specifying a single date for the entire industry would lead to a significant concentration of workload at one point in the year, which would lead to increased operational costs.

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.
DUFAS does not consider that using the annual net asset value calculation is an appropriate

measure for all types of AIF.

The AIFMD will cover a very broad universe of AIF and a differentiated solution needs to be found to achieve a satisfactory result. The differences between AIFs covered, for example differences due to assets classes into which the funds are invested and differences due to the open-ended and closed-ended nature of the AIFs, should be reflected in the solution found. Taking these differences into account, different methods of calculating assets under management should be implemented.

DUFAS considers that currently, differentiated systems are applied as in each Member State the value of the assets follow the methodology set by relevant domestically recognized accountancy standards. DUFAS suggests that for the time being, this solution should be maintained and setting the appropriate measure for each AIF should be left to national regulators.

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 re-calculation of the threshold?

DUFAS believes it is important that monitoring should not overly prescriptive, particularly for funds (such as closed ended funds) which do not calculate regular NAVs. An increase in AUM due to market exposure should not generally require a recalculation unless there is evidence that this is an established trend – since this is likely to be temporary in nature. On the other hand an increasing level of subscriptions over redemptions would clearly be indicative of a permanent increase in AUM.

As example, we would like to point to the situation of a closed end fund which invests in predetermined and defined assets, constituted for a pre-determined period with no redemption possibilities before the end date after which the investment is sold and paid out to the investors. For these funds only at one point in time this calculation should be made and could be used by the AIFM in calculating whether or not the assets under management are below or above the threshold. For these funds a re-calculation of the assets under management in view of the threshold seems not necessary. Examples of funds where this methodology could be applicable are certain real estate funds or funds investing in ships, where the assets are individually identified and disclosed in advance to investors.

However, for the avoidance of doubt, this does not exempt the AIFM to continue monitoring the "total assets under management" in respect of such other AIFs which it manages but only provides for the ability of the AIFM to set a fixed "asset under management value" in respect of certain closed-ended AIFs at a certain point in time.

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

DUFAS does not agree that AIFs which are exempt under Article 61 of the AIFMD should be included when calculating the threshold. An AIFM managing "exempt AIFs" will not be subject to the AIFMD requirements. In respect of AIFM managing only "exempt AIFs", the "assets under management" test is not applicable. An AIFM managing only "exempt AIFs" could exceed the applicable thresholds under article 3 of the AIFMD and nonetheless remain exempted from the AIFMD requirements.

There is no explanation why "exempt AIFs'" assets under management should be treated differently depending on whether the relevant AIFM is only managing "exempt AIFs" or managing a mix of "exempt AIFs" and "non-exempt AIFs".

Box 2, Calculation of Leverage

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?
DUFAS does not agree that AIFMs should include the gross exposure in the calculation of value of assets under management when the gross exposure is higher than the AIF's net asset value.

DUFAS believes that the approach taken in the context of the calculation of the value of assets under management in view of the determination of the threshold should be consistent with the approach in Part VI of the Consultation Paper. The approach taken in Part VI allows for various options and thus provides the very welcome differentiation to accommodate the broad range of AIFs covered by the AIFMD.

DUFAS calls for a consistent approach throughout the Level 2 measures of the AIFMD.

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?
DUFAS calls for a consistent approach throughout the Level 2 measures of the AIFMD. DUFAS considers that valid foreign exchange and interest rate hedging positions should be excluded.

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?
DUFAS considers that the proposed requirements for calculating the total value of assets under management are clear.

DUFAS suggests amendments to clarify further the text in Box 1:

Para. 3
The words 'as manages the investing AIF' should be inserted after the words 'the same externally appointed AIFM' in Line 1 for clarification.

With regard to leverage, it should not be necessary to look through to the underlying funds when calculating leverage in the investing AIF provided this does not create any contingent liability at the level of the investing AIF, and DUFAS understands that the reference to Box 95 achieves this. However, it would ideally be confirmed explicitly in the text of Box 1.

Para. 5
ESMA's draft technical advice provides that the AIFM should notify the competent authority without delay when the total value of assets under management exceeds the threshold to state whether the situation is considered to be of a temporary nature.

DUFAS considers that the requirement "without delay", which means immediately, will be difficult to respect in practice. DUFAS suggests that the delay granted to notify the competent authority could be of one month where the net asset values (NAVs) of all the AIFs considered are calculated on a monthly basis and longer if the NAVs of the AIFs considered are calculated on a less frequent basis.

Furthermore, the requirement to notify the competent authority of any situation where the total value of assets exceeds the threshold whether it is considered to be temporary will result in a number of notifications which are unnecessary because the situation is temporary. DUFAS suggests that a notification should only be required if the situation is considered to be of permanent nature (or at least of a certain duration).

Box 3, Information to be provided as part of registration

Para. 2
DUFAS considers that it the requirements for information to be provided to competent authorities as part of the registration process should be harmonised at EU Level. This is necessary to ensure an equal treatment of AIFMs wherever they are domiciled and also because otherwise pan-European AIFMs might face different requirements from one country to another and it would not be easy to manage.

In order to achieve a harmonisation at European level, the information required for the description of the investment policy should be determined in an exhaustive manner in Box 3. DUFAS therefore suggests deleting the words "at least" from Box 3 Para. 2.

Para. 4
DUFAS considers that the provision of updated information on a quarterly basis is too frequent and will be too burdensome for authorities and AIFM. DUFAS suggests that the provision of updated information should be made annually. Furthermore, providing the information required in Box 3 in addition to the information required in Box 109 is likely to lead to duplications and poses an unduly burden on both the regulators who will need to process the information received and on the AIFM providing the information.

Para. 5
DUFAS considers that it the requirements for frequency of information to be provided to competent authorities should be harmonised at EU Level. Again, this is necessary to ensure an equal treatment of AIFMs wherever they are domiciled and also because otherwise pan-European AIFMs might face different requirements from one country to another and it would not be easy to manage. Therefore, competent authorities should not have the possibility to request information on a more frequent basis than determined in Box 3 Para. 4. Box 3 Para. 5 should be deleted.

Box 4, Procedures

Para. 1
DUFAS considers that AIFMs which are opting into the Directive should be subject to the same procedure as AIFM falling under the scope of the Directive.

Para. 2
DUFAS agrees that there should only be the requirement to submit information not previously provided for registration purposes and, in case there has been a material change to that information, to update it.

Box 5, AIFMs falling below the threshold
No comment.

IV. General Operating Conditions

General Comments

Internally Managed AIF
DUFAS understands that ESMA's proposed Draft Technical Advice regarding possible implementing measures on Additional Own Funds and Professional Indemnity Insurance has been prepared for externally managed AIFs.

Unfortunately, for internally managed AIF, the proposed Draft Technical Advice is not appropriate and leaves a number of practical questions open:

- First it is unclear how the additional own funds should be raised. DUFAS understands that these funds are taken out of the investments by the investors.
- It is also unclear whether these additional own funds will be considered as part of the AIF's assets to be invested (subject to Article 9 para. 8 of the AIFMD) or whether they need to be segregated from the other assets of the AIF. In the latter case, the investors of the internally managed AIF will only receive the performance of their subscribed amount net of the own-funds' performance which will be withheld.
- Another example is the case of closed-ended self managed AIFs whose assets are fully invested in accordance with their investment policy. It is unclear how such vehicles should raise their additional own funds or solve cases of adjustments during the life of the AIF.

DUFAS understands that part of these issues arise from the Level 1 text of the AIFMD and cannot be solved by Implementing Measures. A possible solution would for example be to amend Article 9 para. 6 of the AIFMD to allow internally managed AIF not to provide any additional amount of own funds if they benefit from a guarantee covering 100% of the additional amount of own funds.

However, as far as possible, DUFAS urges ESMA to seek a solution to the open questions through the implementing measures.

Introduction of a Cap for additional own funds
ESMA's current advice does not provide for a cap on the additional own funds. DUFAS would strongly suggest to include a cap for additional own funds into the requirements reflecting the cap of Euro 10 Million already provided for in the directive regarding own funds. This would be in line with the intention of the Level 1 text not to pose an undue infinite burden on AIFM.

Combination of additional own funds and PII
DUFAS would welcome if ESMA could explicitly specify that an AIFM may not only chose between additional own funds and professional indemnity insurance but may also use a combination of both.

Box 6, Potential risks arising from professional negligence to be covered by additional own funds or professional indemnity insurance

Terminology
DUFAS would appreciate if ESMA could include the definitions of page 29 of the consultation into the text of Box 6 in order to avoid future diverging interpretation and implementation.

Combination of additional own funds and PII
DUFAS would welcome if ESMA could explicitly specify that AIFM may use a combination of additional own funds and professional indemnity insurance.

Delegation Context
DUFAS understands that ESMA, through the provisions in Box 6 and the definitions on page 29 seeks to provide coverage for potential risks of all relevant persons, including persons who are providing services under a delegation arrangement.

Firstly, DUFAS would appreciate if the definition on page 29 could be included into the text of the Box in order to ensure that it becomes part of the Level 2 provisions.

Furthermore, DUFAS considers that the coverage of such losses through additional own funds or an indemnity insurance constitutes a very strict and extreme measure. An indemnity insurance that covers the risks of relevant persons is very difficult to implement. The AIFM normally doesn't know all the risks of the delegate as the delegate is not legally obliged to inform the AIF about all its risks. The AIFM should only be required to have appropriate cover where the loss arises due to negligence of the AIFM in appointing and supervising the delegate.

This being said, DUFAS expects that the delegate has his own indemnity insurance. DUFAS suggests that Box 6 should be amended and risks of the delegate should be excluded if the delegate holds an own sufficient indemnity insurance. A double coverage of the risks through an insurance at the level of the AIFM and the delegate should be avoided.

Box 6 para. 2a, Risks related to fraud
DUFAS is surprised by the proposed implementing measures providing that the potential liability risks to be covered should include the risks in relation to fraud. Risks in relation to

fraud are not mentioned in Article 9 AIFMD. Indemnity insurances normally only cover negligent behaviour and not fraud, which are acts of criminal offence committed deliberately and not negligently. Entitlements of third persons that refer to fraud are not part of an indemnity insurance. The scope of potential liabilities of an AIFM should therefore be restricted to risks arising from negligence, not risks arising from deliberate misbehaviour of employees of the AIFM or third parties. DUFAS therefore suggests that para. 2a be deleted.

Box 6 para. 2c, Risks related to mechanical failures
Para 2c of Box 6 concerns risks related to mechanical failures. The current draft technical advice suggests that the additional own funds or the professional indemnity insurance should also cover risks related to such mechanical failures. Current practice of the insurance industry however is, that losses resulting from mechanical failures are excluded from insurance coverage, unless the loss is a result of an intervention or manipulation of (staff of) the AIFM. Box 6 para. 2c should be modified accordingly.

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 valuer. Do you consider this as feasible and practicable?
DUFAS considers that ESMA's proposal that the AIFM should be liable for valuations performed by an appointed external valuer, according to the general principle that the AIFM is responsible for the valuation. DUFAS considers it as feasible, but as very far going rule. It is difficult to see how the risk referred to (i.e., the risk that an appointed external valuer improperly values assets or calculates units / share prices) could be covered in the manner contemplated by the draft rules - either by additional own funds or insurance.

Again, DUFAS would suggest that due allowance should be made for adequate capital backing or insurance coverage provided by the external valuer. There is no necessity to require a double layer of safeguards for the same liability risk.

Box 7 Qualitative Requirements (based on Annex X Directive Part 3 2006/48/EC)
DUFAS appreciates the suggestions presented in Box 7 and especially, support the notion of establishing a historical loss database at the AIFM level which could be helpful for demonstrating that the AIFMD capital requirements do not match with a company's individual potential for liability risk.

However, we do not believe it is useful to have a separate operational risk function next to the general risk management function, as is required by i.a. the UCITS and MiFID directives. The AIFMD does not include a specific obligation for AIFMs to measure, manage or mitigate *operational risk* (the concept of risk management applies to all risks and does not specify individual risk types which must be managed). A separate operational risk management function should be limited to an obligation to implement risk management facilities which reflect the size and internal organisation of the AIFM, and the nature, scale and complexity of its activities.

Box 8, Quantitative Requirements

Introduction of a Cap for additional own funds
ESMA's current advice does not provide for a cap on the additional own funds. DUFAS Members would suggest to include a cap for additional own funds into the requirements reflecting the cap already included in the directive regarding the own funds to avoid overly burdensome requirements for AIFM.

Preference for Option 1
Of the 2 options presented in Box 8, DUFAS prefers Option 1. DUFAS understands and welcomes the logic of determining the additional own funds requirement for liability risk in relation to the value of the portfolios of AIF managed by the AIFM. Furthermore, Option 1 has the clear advantage of simplicity.

Option 2 on the other hand is based on a combination of assets under management and relevant income. However, there is no logical link between the liability risk and the income of an AIFM. Option 2 also seems more complicated, leaves a very wide room for interpretation and brings the risk of an unlevel application by different competent authorities. "Relevant income" will be difficult to interpret and to determine in practice. Furthermore, the "relevant income" should only refer to the income derived from the activity as AIFM. In practice, AIFM very often also act as UCITS management and provide services as MiFID firms. To determine their relevant income attributable to the activity as AIFM will be very difficult and cumbersome in practice. Therefore, Option 2 seems very cumbersome.

Lowering quantitative requirements
For both options, DUFAS considers that the quantitative requirements for the additional own funds should be lowered significantly.

Q10: Please note that the term 'relevant income' used in Box 8 includes performance fees received. Do you consider this as feasible and practicable?
DUFAS does not consider that the term "relevant income" used in Box 8 should include performance fees received. There is no direct connection between increasing performance fees and increasing risks. Including performance fees received as part of relevant income may mean that the own funds maintained by AIFM will change materially from year to year (depending on whether performance benchmarks are exceeded) even though the risk in the funds may have remained constant.

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')?
DUFAS considers that the term "relevant income" should not include the sums of commission and fees payable in relation to collective portfolio management activities. The requirements of the AIFMD and its implementing measures should only require an AIFM to hold additional own funds against any risks which arise from business associated with its activity as AIFM. Capital requirements regarding other activities should be dealt with outside of the

AIFMD.

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.
No comment.

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?
DUFAS does not see any practical need to allow for the "Advanced Measurement Approach" as an optional framework. Within the AIFMD, there is no specific obligation placed on an AIFM to manage operational risk. It therefore seems unnecessary to include reference to the standards required of firms (banks) which have a legislative obligation to measure, manage and mitigate operational risk. The standards of operational risk management which are adopted by the AIFM should reflect the risk to which it is exposed, and AIFMs should be provided with sufficient flexibility to implement a risk management solution which is appropriate to the nature, scale and complexity of the AIFM.

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?
DUFAS welcomes that the competent authority may lower the requirements for the additional own funds. This power should be given to the competent authority independently whether ESMA presents Option 1 or Option 2 to the Commission.
DUFAS suggest that, in line with article 9 (6) of Level 1, a reduction of 50% of the additional funds should be possible if the AIFM benefits from a guarantee of the same amount given by a credit institution or an insurance undertaking.
DUFAS furthermore believes that the minimum historical observation period of 5 years is too long and should be reduced, for example to 3 years. Requiring a minimum observation period of 5 years would prevent AIFM with a shorter track record for a very long time from being able to apply for reduction of capital requirements.
Further, DUFAS would welcome if ESMA could include guidelines on the use of historical data in case of AIFM restructurings (for example in case of mergers or transformation). In cases of mergers, the historical loss data collected prior to the merger should in principle still be used for the purpose of assessing the individual ponential for liability risks.

Box 9, Professional Indemnity Insurance

Para. 1d
We do not understand what is meant by this.

Para. 1e
DUFAS suggests that the first sentence should stop after the words "ongoing supervision". Where an insurance company is licensed and under prudential supervision it should not be

the task/responsibility of the AIFM to assess the ability of the insurance company to pay claims. As the insurance company is regulated there should be the assumption that it is able to pay claims and in practice the AIFM will not be able to verify if this is the case, but the supervisor will.

Para. 1f
DUFAS sees no need to provide for a different solution regarding insurance coverage from “affiliated entities”. If insurance coverage is obtained from a separate legal entity (regulated insurance company) within a financial group, this “affiliated” insurance company has to fulfill all (prudential) rules that every “independent” insurance company also has to fulfill. There should therefore be no restrictions with regard to “affiliated” insurance companies.

Para. 4
DUFAS considers that the frequency of the review should be harmonised at a European level. The review should be conducted once a year and thus “at least” should be deleted from Box 9 Para. 4.

Further it should be reviewed in the event of any “material” change and not in the event of every change.

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 AIFs 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.
DUFAS does not see the reason why the number of investors should have any influence on the amount to be covered by the insurance. If a loss occurs, the amount of the loss is independent of the number of investors in the fund. Furthermore, one loss leads to one event/claim in the insurance policy independently of the number of investors in the fund.

Box 10, Duty to act in the best interests of the AIF or the investors of the AIF and the integrity of the market

Para. 1
DUFAS agrees with this adaptation of the UCITS standards as proposed by ESMA. However, DUFAS would like to point out that while UCITS Management Companies and AIFM are subject to these obligations, other market players are not. DUFAS invites the Commission to include these requirements into a horizontal legislation to establish a level-playing-field.

Box 11, Due Diligence requirements

Para. 4 and 5
The explanatory text regarding Box 11 Para. 4 and 5 explains that the additional due diligence requirements with which AIFMs must comply only apply when AIFM invest the AIFs assets in specific types of asses such as real estate or partnership interests.

In relation to Para. 15 of the explanatory text also mentions that the evidence of the significant investment opportunities shall be maintained with regard to specific assets and for a five year period. DUFAS suggest that only evidence regarding significant investments, not investment opportunities should be kept. Furthermore, it should be specified that this requirement only be applies as of the entry into force of the implementing measures of the AIFMD.

DUFAS sees a strong need to include explicit clarifications in this regard into the text of the Box 11 both under Para. 4 and under Para. 5. Should such clarification not be explicitly included, there is a very strong risk of diverging interpretation by the different competent authorities.

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?
DUFAS Members agree that the term "business plan" was rather confusing and too limited to cover all cases. They suggested the term "investment proposal".

Box 12, Reporting Obligations in respect of execution of subscription and redemption orders
DUFAS understands that where the subscription or redemption orders are processed by a third party, for example a third party distributor, and not the AIFM, the reporting obligations shall lay with the third party and not with the AIFM. In this case it should not be the AIFM's obligation to provide the investor with the essential information concerning the execution of that order and, upon request, with information about the status of the order. It should rather be the respective third party's obligation to comply with these reporting requirements.

Box 13, Selection and appointment of counterparties and prime brokers

Para. 1
DUFAS considers the requirements in Box 13 Para. 1 too far going and suggest that the text be modified:

The range of services to be considered in the framework of selection and appointment of counterparties should not be the full range of services but instead be limited to the services the AIFM would like to mandate the counterparty for. For example, if a broker is only used for brokerage services, any research services it might also propose should not need to be considered.

DUFAS also considers that it should be sufficient that counterparties and prime brokers are subject to authorisation and supervision in their jurisdiction. The requirement of ongoing supervision in any jurisdiction in which the counterparty is active would be too burdensome and restrictive.

Para. 2
DUFAS suggests modifying Box 13 Para. 2 by including the words “be able to” before “demonstrate the reasons for such a choice”.

Para. 3
DUFAS suggests modifying Box 13 Para. 3 to “counterparty of an AIFM or AIF” as in practice such contracts are made in the name of the AIF or the AIFM.

Box 14, Execution of decisions to deal on behalf of the managed AIF
DUFAS welcomes the clarification in Explanatory Text 21 that Box 14 paragraph 1 shall apply to all AIF while paragraphs 2-5 only apply to those types of AIF which acquire or sell financial instruments or other assets for which best execution is relevant. However, DUFAS strongly urges ESMA to include this clarification directly into the text of Box 14 to avoid diverging or contradictory future interpretations.

DUFAS understands that best execution requirements need and can be applicable to transactions in financial instruments (as defined in annex I of MiFID). However, ESMA suggests in Box 14 to make these requirements also made applicable to investments in other types of assets. DUFAS believes that this is not appropriate as the further requirements are tailored to transactions in financial instruments and not to other asset types like e.g. real estate, private equity, ships etc. DUFAS therefore suggests that the words “or other assets” are after “financial instruments” should be deleted.

Furthermore, DUFAS would welcome a clarification for cases of delegation of portfolio management. In case of delegation of portfolio management by the AIFM, the obligations under Box 14 should be fulfilled by the portfolio manager. In this case, and notwithstanding the obligations under Box 63-72, the AIFM should not be required to fulfill the obligations under Box 14.

Box 15, Placing orders to deal on behalf of AIFs with other entities for execution
DUFAS welcomes the clarification in Explanatory Text 24 that Box 15 paragraph 1 shall apply to all AIF while paragraphs 2-5 only apply to those types of AIF which acquire or sell financial instruments or other assets for which best execution is relevant. However, DUFAS strongly urges ESMA to include this clarification directly into the text of Box 15 to avoid diverging or contradictory future interpretations.

DUFAS understands that best execution requirements need and can be applicable to transactions in financial instruments (as defined in annex I of MiFID). However, ESMA suggests in Box 15 to make these requirements also made applicable to investments in other types of assets. DUFAS believes that this is not appropriate as the further requirements are tailored to transactions in financial instruments and not to other asset types like e.g. real estate, private equity, ships etc. DUFAS therefore suggests that the words “or other assets” are after “financial instruments” should be deleted.

Furthermore, DUFAS would welcome a clarification for cases of delegation of portfolio management. In case of delegation of portfolio management by the AIFM, the obligations under Box 15 should be fulfilled by the portfolio manager. In this case, and notwithstanding the obligations under Box 63-72, the AIFM should not be required to fulfill the obligations under Box 15.

Box 16, Handling of orders – general principles
DUFAS welcomes the clarification in Explanatory Text 25 that Box 16 does not apply where the investment in assets is made after extensive negotiations on the terms of the agreement. Again, DUFAS strongly urges ESMA to include this clarification directly into the text of Box 16 to avoid diverging or contradictory future interpretations.

Box 17, Aggregation and allocation of trading order
DUFAS welcomes the clarification in Explanatory Text 27 that Box 11 does not apply where the investment in assets is made after extensive negotiations on the terms of the agreement. Again, DUFAS strongly urges ESMA to include this clarification directly into the text of Box 16 to avoid diverging or contradictory future interpretations.

Box 18, Inducements
DUFAS agrees that the MiFID inducements rules should apply here as well.

We would however suggest the inclusion in the explanatory text of wording similar to Recital 39[3] of the MiFID Level 2 Directive, to clarify that payment of marketing fees/commissions can be regarded as enhancing the quality of the service. We suggest adding the following text:

> *"For the purposes of the provisions of this Directive concerning inducements, the payment by an AIFM of a commission in connection with marketing, in circumstances where compliance with the AIFM's duty to act in the best interest of the AIF is not impaired, should be considered as designed to enhance the quality of the collective portfolio management service."*

Most importantly, however, it is not necessary to consider third-party distribution payments as inducements in the sense of Para. 1 (b) in order to ensure investor protection. Fees and commissions received by intermediaries as remuneration for the distribution service are already regulated, subject to the conditions of Art. 26 (1) (b) of the MiFID Level 2 Directive and to disclosure to investors at the point of sale. There is no need to require the justification of the same payments in relation to collective portfolio management. The AIFM does, however, retain responsibility for managing conflicts of interest related to third-party distribution (covered under Section IV.III).

We also consider that it is disproportionate to seek to restrict the payment/receipt of inducements as the Directive is aimed at AIFs marketed to professional investors, and it should be sufficient to rely upon the disclosure requirement in Para. 1 (b) (i). Article 43 of the Level 1 text permits Member States to allow marketing to retail investors on their territory, and in such cases stricter requirements could be imposed; Level 2 provisions should consequently be limited to the professional client market.

[3] 'For the purposes of the provisions of this Directive concerning inducements, the receipt by an investment firm of a commission in connection with investment advice or general recommendations, in circumstances where the advice or recommendations are not biased as a result of the receipt of commission, should be considered as designed to enhance the quality of the investment advice to the client. '

Furthermore, contrary to ESMA's statements in Para. 30, we understand that the upcoming PRIPs initiative will not cover marketing fees paid for third-party distribution except within the MiFID Review (and IMD review for insurance products), therefore any necessary measure regarding direct sales would have to be included in the respective sectoral Directives (UCITS, AIFMD).

DUFAS strongly disagrees with ESMA's suggestion in Para. 32 of the Explanatory Text that details should be disclosed in the annual report. Firstly, there is no mandate in Level 1 for ESMA to advise the Commission on this issue. Secondly, our members believe that disclosure in the annual report would be neither meaningful nor feasible: the disclosure would span a range of different arrangements and it would be extremely onerous to quantify and to consolidate all the information. Additionally, the disclosure in the annual report is at fund level, so to apportion commissions across different funds, and to consolidate commissions/fees payable in respect of different transactions, would not result in meaningful information for investors.

If such disclosure was deemed necessary, it should take place ex-ante, in line with MiFID requirements. For this purpose, AIFM should be able to avail themselves of any appropriate durable medium, such as the AIFM's website. Disclosure of inducements in relation to third-party distribution should in any case not be necessary in the AIF annual report, as it is already the duty of distributors under MiFID to provide final investors with details of inducements they have received.

Box 19, Fair treatment by an AIFM

Q17: Do you agree with Option 1 or Option 2 in Box 19? Please provide reasons for your view.
DUFAS prefers Option 1 in Box 19. They considered that Option 1 provided more legal certainty because it was perceived as giving clearer guidelines and leaving less room for diverging national interpretations. DUFAS believes that fair treatment can be ensured by requiring AIFMs to disclose the existence and nature of preferential treatment as already required in the Level 1 text. The Level 1 text is sufficient; no further detailed provisions are required at Level 2.

Box 20, Types of conflicts of interest between the various actors as referred to in Article 14(1)
DUFAS welcomes ESMA's approach to align conflict of interest provisions for AIFM and in particular the fact that the proposals to a large extent aligned with the established standards of MiFID and UCITS Directive.

DUFAS considers that the requirement for the identification of conflicts of interest, that the AIFM should take into account the situation of the relevant person, is very wide given the definition of relevant person on page 29. As currently drafted, this could suggest that the AIFM would need to take into account all types of conflicts of interest along the entire delegation chain and even internally to relevant persons. However, for various reasons, such as confidentiality and data protection, the relevant persons will not be allowed or willing to disclose the information to the AIFM which the AIFM will need to identify all conflicts of interest. DUFAS would therefore welcome a modification of Box 20.

Furthermore, DUFAS would appreciate clarifications regarding the term "client", as there is no definition of "client" in the AIFMD. In order to avoid any misunderstanding, we suggest replacing "client" by the following wording: "any other contractual party".

Box 21, Conflicts of interest policy
The requirements in the ESMA proposal in Box 21 regarding conflicts of interest policy include activities carried out by delegates, sub-delegates, external valuers and counter- parties.

DUFAS understands that these requirements only apply regarding conflicts of interest between the AIFM itself and these entities. The AIFM should not be required to have regard to the internal conflicts of interest policies of any of these entities. Furthermore, the AIFM should not be required to have to look through to entities with which its delegates, sub-delegates, external valuers and counter-parties have relationships. This would be impossible because of business secrecy and confidentiality. There is also no similar requirement in the MiFID or UCITS Directives. DUFAS would appreciate if the text in Box 21 could be modified to more clearly reflect this.

Conflicts between the AIFM and those entities with whom it has a direct relationship would in any case be identified and managed under the AIFM's own conflicts policy. Therefore, DUFAS suggests to delete the words 'with reference to…counterparty' in 2(a).

Box 22, Independence in conflicts management

Para. 2b
DUFAS does not see the need for a separate supervision of the relevant persons.

Box 23, Record keeping of activities giving rise to detrimental conflicts of interest and way of disclosure of conflicts of interest

Para. 2
DUFAS understands that the AIFM is only required to disclose actual (and not potential) conflicts of interest. This obligation should be aligned with the MiFID regime which places the focus on those conflicts of interest which cannot be managed. This would also allow to disclose only meaningful information and not to overload investors and regulators with information.

Para. 3
In case of indirect distribution or of trading of parts of the AIF on a secondary market (for example listed AIF), an AIFM has no direct contact with the investors. The AIFM therefore cannot ensure that the conditions in Box 23 Para 3 are met. DUFAS urges ESMA to modify the requirements of Box 23 Para. 3.

Box 24, Strategies for the exercise of voting rights
No comment.

General Remarks on Investment in Securitisation Positions
DUFAS understands that ESMA's proposed advice regarding requirements for investment in securitisation positions aim at a level playing field with the requirements under the CRD framework. While the requirements broadly go into the same direction, some important differences remain and the proposed advice should ideally be modified to create the envisaged level playing field.

For example, requiring AIFMs to verify that the originator, sponsor or original lender retains a net economic interest retained of at least 5% would go beyond the requirements in the CRD. This would create an unlevel playing field. DUFAS fears that the proposed draft implementing measures will place a high burden on an AIFM investing in securitisation positions. The requirements to monitor the retention of the 5% interest by the originator, to take corrective action if the 5% limit is breached and to perform due diligence on the originator's credit granting procedures seem excessively burdensome. It is also questionable whether they can at all be complied with in practice. As a result it can unfortunately be expected that most AIFM will refrain from investments in securitisation positions.

Furthermore, the term "tradable securities and other financial instruments based on repackaged loans" used by ESMA displays some important differences compared to the CRD wording as it lacks any reference to tranching and appears to limit the relevant securitisation underlying to loans. In our view, such modification of terms will lead to an unlevel playing field. DUFAS suggests aligning the requirements more closely with the CRD.

Box 27, Assessment, monitoring and review of the risk management policy
Para 2
DUFAS believes that this paragraph should be aligned with the wording of Art. 39 (2) of the UCITS Implementing Directive 2010/43/EU as follows:

> *"AIFM shall notify the competent authorities of their home Member State of any material changes to the risk management process."*

The proposed text appears too detailed, and not in line with a principle-based approach.

Box 28, Measurement and management of risk
Paragraphs 3 (b) and 3 (c) –We suggest further alignment with the UCITS Implementing Directive 2010/43/EU as follows:
(a) "conduct, where appropriate, periodic back-tests in order to review the validity of risk measurement arrangements which include model-based forecasts and estimates;
(b) conduct, where appropriate, periodic stress tests and scenario analyses, on the basis of reliable and up-to-date information (…)"

The addition to the text is required by the need to reflect differentiation of standards depending on the type of AIF, its investment strategy and portfolio assets.

Para 1 (a)
DUFAS considers that the requirements are much more extensive than those in the UCITS Directive, and the wording "*including those sources of risk the AIFM incurs on behalf of the AIF*" should be deleted.

Box 29, Risk limits

DUFAS has some general comments on this box, which we believe should be reflected in the drafting:

- Limits are different from procedures, and in some cases (for example for operational risks in Para. 2 (e)), it is not possible to set specific limits.
- Limits would not be set in some cases at AIF level, but at the level of the AIFM.

Para 2

Contrary to Box 26, there is no reference in this Box to relevance or materiality. Our members consider that it should be added in Para. 2 as follows:

"The qualitative and quantitative risk limits for each AIF shall, at least, cover the following risks <u>where relevant:</u>"

Box 30, Functional and hierarchical separation of risk management function

DUFAS would welcome more clarity regarding how the risk management function shall be functionally and hierarchically separated from the operating units, including the portfolio management function.

In this context, we suggest clarifying the meaning of the term 'operating units'. In our view, only the portfolio management function can be considered an operating unit which shall not be responsible for risk management tasks such as identifying, measuring, managing and monitoring of the relevant risks of AIF. On the other hand, the separation requirement should certainly not pertain to units engaged in investment compliance, monitoring of risk limits, fund accounting, fund reporting and comparable tasks. Furthermore, the legal and compliance department and the units for marketing and distribution are not operating units which shall be functionally and hierarchically separated from the risk management function.

Para 1 (c)

The requirement that "*Those engaged in the performance of the risk function are compensated in accordance with the achievement of the objectives linked to that function, <u>independent</u> of the performance of the other conflicting business areas*" is unrealistic, since performance of the other business areas will determine the total amount of money available for compensation. The wording "*<u>not directly linked to</u>*" would be more appropriate than "*independent*".

Para 1 (e)

ESMA requires separation to be ensured up to the governing body of the AIFM, whereas DUFAS believes that it should be sufficient to ensure such separation up to senior management level. Such provision is unlikely to be met by many AIFMs and it will be difficult for small self-managed funds to meet it.

Para 3

Concerning the provision of safeguards for independent performance of the risk management function in case of identified material conflicts of interest, DUFAS strongly disagrees with ESMA's proposal to document such safeguards in the risk management policy. Such safeguards should rather be implemented within the general management process of conflicts of interests and documented in the conflicts of interest policy of the AIFM. Otherwise, there could be a double obligation for monitoring of conflicts of interest.

The provisions in Para. 1 (a) are unlikely to be met by many AIFMS, particularly by small and medium-sized ones. It is therefore very important that the requirements in Para. 3 be applied proportionately and appropriately.

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?
No additional safeguards are required. Please see our comments above.

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?
Please see our comments above.

Box 31, Liquidity Management definitions
In Box 31 ESMA uses the term ‘class’ of unit/share. For regulated funds in some jurisdictions, this term has a specific meaning and the rights of a ‘class’ of unit/share must have the same rights to participate in the property of a scheme as other classes in the same scheme. This would imply that if certain assets were illiquid, all classes (and therefore all investors) would have the same rights to participate in those assets, which may not be the case for some “special arrangements”. We therefore recommend using wording such as ‘type’ of unit or share, which does not have a special meaning in Member States.
ESMA should clarify that special arrangements must not be automatically implemented, but that their use is at the discretion of the AIFM, as long as such arrangements are foreseen by fund rules.

Paragraph 9 of explanatory text
We recommend that the words “such as gates” be deleted from the last line. Firstly, “gates” is not a defined term, although the IOSCO consultation report “Principles on Suspension of Redemptions in Collective Investment Schemes” (issued March 2011) defines them on page 15 as a constraint in redemption amounts to a specific proportion on any one day. Secondly, Para. 8 and 9 imply that a special arrangement applies to specific assets, not to the entire fund and all investors. Gates, on the contrary, do not relate to certain assets but rather all assets and are not bespoke as they would apply to all investors where their redemption orders exceed the gate limit. It might be helpful for ESMA to clarify further what “special arrangements” are: in Para. 9 on page 58, for example, special arrangements are equated to side letters[4].

[4] *“By special arrangement (so-called ‘side-letter’), the AIFM grants an investor redemption rights that are preferential in terms from the general redemption rights given to other investors.”*

Box 32, Liquidity management policies and procedures
DUFAS believes it is important that Para. 1 of Box 32 should include a reference to appropriateness and proportionality, rather than the concept simply being reflected in the explanatory text in Para. 12 ("*These general requirements should be capable of calibration in an appropriate and proportionate manner which duly reflects the specific characteristics of the AIF including legal structure and national legislation*").

Para 3(b)
In some cases (for example for retail funds) the actual investor base may be unknown to the AIFM, and therefore the monitoring of the liquidity profile should be based on the type of investors targeted by the AIF.

Para 3(c)
Where an AIF invests in an AIF whose AIFM is subject to the Directive, it should not be necessary for the investing fund's AIFM to '*monitor the approach adopted by the managers of those other collective investment undertakings ('CIU') to the management of liquidity, including through conducting periodic reviews, to monitor changes to the redemption provisions of the underlying CIU in which the AIF invests.*' The obligation for the underlying AIF to meet Article 16 and also the liquidity-related transparency requirements in Articles 23 make the need to monitor such managers' approaches to liquidity unnecessary. Rather, there should be a requirement to review disclosures received in accordance with Article 23 and their impact upon the AIFM's obligations under Article 16. There should therefore be a distinction in the requirements in Para. 3 (c) for investment in AIFs subject to the Directive vs. the requirements for investment in other CIUs. Furthermore, in the last sentence the word "*actively*" should be deleted, as it is unclear and undefined. The exemption at the end of this paragraph should also be extended to CIUs traded on an MFT.

Para 3(d)
We recommend that '*where applicable and available*' be added the end of line 6 as some data may not be available. For example, post-trade transparency obligations can vary by type of instrument and some information may not be publicly available.
It would also be helpful if the text of the advice also recognized that the impact of exceptional liquidity conditions which have not been encountered before may difficult or impossible to predict. Where that is the case, assessment as to impact can only be on a best effort basis.

Para 3(e)
All the information to be disclosed to meet the requirements of Article 23 is important. We question the requirement for '*sufficient prominence*' as this might suggest that some information should be given more prominence than other matters to be disclosed. We think the intention of the Directive is that all matters be should be given the same degree of prominence and therefore recommend deletion of '*sufficient prominence*'. Regarding the requirement to disclose redemption policies in '*sufficient detail',* DUFAS believes that they should be disclosed in general terms, and further details made available upon request.
Furthermore, it should be noted that Para. 3 (e) is not relevant to closed-ended funds.

Para 3(f)
DUFAS recommends that '*will*' be replaced by '*may*' in line 3, to reflect the fact that the AIFM may have available a number of tools which it can use in a type of circumstance. For example, it may have a choice of deferring redemption, borrowing or carrying out an in specie redemption. It should be sufficient that an AIFM's systems and procedures set out the tools it may use in each type of circumstance.

Para 3(h)
DUFAS considers that the requirement in Para. 3(h) to update the liquidity management and procedures for "*any changes or new arrangements*" is overly burdensome and should be modified to foresee an update for "*any material changes or new arrangements*".

Paragraph 15 of explanatory text
The requirement that "*AIFMs are required to consider not only their obligations to investors, but also their obligations to counterparties, creditors and other third parties*" seems excessively broad and unclear, as it covers unspecified "third parties".

Paragraph 18 of explanatory text
Please see also our comments above regarding '*sufficient prominence*' in Para. 3 (e).

Paragraph 25 of explanatory text
Regarding the requirement to disclose redemption policies including escalation measures, DUFAS believes that redemption policies should be disclosed in general terms, and further details made available upon request. The principles underpinning the policies and procedures may be disclosed, but not the practical details of the implementation of those principles.
Please see also our comments above regarding '*sufficient detail*' in Para. 3 (e).

Box 33, Liquidity management limits and stress tests

Para 1
We suggest that the penultimate line be modified as follows: '*where the limits are exceeded or likely to be exceeded AIFMs shall determine what course of action, if any, is required.*' The addition of '*if any*' makes clear that the AIFM may determine that no action is required (as stated in paragraph 26 of the related explanatory text).

Para 2 (c) requires that market risks have to be covered when the AIFM conducts a stress test to assess the liquidity risk. Different types of risks should be assessed separately. Market risks should not be included in the assessment of liquidity risks, otherwise no clear result can be obtained regarding the liquidity of the AIF.

Para 2 (d) requires the AIFM to: "*account for valuation sensitivities under stressed conditions*".
In our opinion the text is too vague, as it does not clarify either under which valuation conditions it is relevant, or how it has to be assessed and reported:

- There is no differentiation with regard to marking-to-market and marking-to-model
  With marking-to-market stressed conditions pose liquidity risk (no trades at all or all market participants wanting to sell), whereas with marking-to-model the valuation model may be unable to cope with stress conditions because of extreme or unobservable inputs.

- "*account for*": Does this mean that valuation sensitivities for certain explicit stress scenarios have to be assessed? If so, global or specific scenarios?

Para 3
DUFAS considers that the requirement should be to act in the best interests of the AIF (not of investors) taking into account the redemption policy of the AIF. Investors' interests may differ and it may not be possible to reconcile them.

Paragraph 28 of explanatory text
The reference to the "*impact of anticipated AIF performance relative to peers*" should be deleted, as it is impossible to predict the future performance of an AIF relative to its peers.

Paragraph 29 of explanatory text
This paragraph should also be amended to take into account the comments made in relation to Box 33, paragraph 3.

Box 34, Alignment of investment strategy, liquidity profile and redemptions policy

Para 1 (a)
As already stated in reference to Para. 3 of Box 33, individual investors' interests may differ. The investment strategy, liquidity profile and redemption policy should be considered aligned when investors have the ability to redeem their investments in accordance with the AIF's redemption policy and its obligations. Para. (a) should therefore be deleted.

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?
DUFAS considers that gates and side pockets should be considered as normal liquidity management tools (and not used only in exceptional circumstances when the liquidity management process has failed), provided that investors are aware of their possible use by the AIFM.

If investors wish to have exposure to potentially illiquid investments and understand that there may be circumstances in which deferral of redemptions may be necessary, it would not be in the interests of those investors to restrict the AIF's ability to invest because liquidity requirements do not allow for deferred redemptions. Professional investors may make a conscious choice to invest in less liquid assets with the expectation of a higher return in the longer term, and their investment choices should not be limited.

Furthermore, both gates and side pockets should be available for the protection of investors, and do not necessarily indicate a failure of the AIFM's liquidity management process.

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 ar-

rangements 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?
Please see our comments above.

Q22: Do you agree with ESMA's proposed advice in relation to the alignment of investment strategy, liquidity profile and redemption policy?
EFAMA broadly agrees with ESMA's proposed advice, with the above-mentioned exceptions.

Box 35, Requirements for retained interest
DUFAS considers that AIFMs will in practice not be able to verify that the originator, sponsor or original lender retains a net economic interest retained of at least 5%. AIFMs can only check in the documentation of the securitisation product that the originator sponsor or original lender pledges to fulfil this retention requirement throughout the life of the product. Furthermore, the requirements in Box 35 go beyond what is required under the CRD and create an unlevel playing field with other market participants.

Therefore, DUFAS considers the requirements in Box 35 too burdensome. They are likely to lead to the situation where AIFM will refrain from investments in securitisation positions.

Box 36, Requirements for sponsors and originator credit institutions
DUFAS considers that AIFMs will in practice not be able to ensure that the sponsors or originators fulfil the requirements mentioned in Box 36. Again, the requirements in Box 36 go beyond what is required under the CRD and create an unlevel playing field with other market participants.

Therefore, DUFAS sees the requirements in Box 36 as too burdensome and fears that they will only lead to the situation where AIFM will refrain from investments in securitisation positions.

Box 37, Requirements for transparency and disclosure of retention
No comment.

Box 38, Requirements for risk and liquidity management
DUFAS understands that Box 38 reflects the general principles of risk management and therefore, should be deleted or at least tied in with the proposed implementing measures for risk management in section IV.IV of the consultation paper.

Box 39, Requirements for monitoring procedures
DUFAS would suggest modifying the last sentence as "Issuer name and credit quality" are no categories of securitisation tranches as implied by ESMA. If at all, these details should be deemed relevant information in relation to securitisation tranches and listed in the text above.

Box 40, Requirements for stress tests
DUFAS suggest linking the provisions in Box 40 to the general requirements for risk mea-

surement and stress testing proposed in Box 28 in order to ensure a consistent approach to the AIF risk management.

Box 41, Requirements for formal policies, procedures and reporting
No comment.

Box 42, Introduction of new underlying exposures to existing securitisations
DUFAS welcome that ESMA suggest grandfathering provisions for investment in securitisation provisions. ESMA's current proposal, however, only concerns securitisation positions issued before 1 January 2011.

In addition thereto, it would however be necessary to provide grandfathering provisions for investments in positions between 1 January 2011 and the entry into force of the implementing measures of the AIFMD. Without such grandfathering provisions, a highly uncertain situation exists for investments currently effected. These investments are likely not to fulfil the requirements which will eventually be applicable but are uncertain today. DUFAS considers that it would not be in the best interest of investors to require AIF invested in such non-compliant securitisation positions to immediately dispose of their holdings at the entry into force of the implementing measures of the AIFMD. DUFAS suggests that a transitional period should be granted to AIFM for dispositions of investments held by AIF at the entry into force of the new rules.

Box 43, Investments by UCITS
No comment.

Box 44, General requirements on procedures and organisation
No comment.

Box 45, Resources
No comment.

Box 46, Electronic data processing
No comment.

Box 47, Accounting procedures

Para. 2
DUFAS suggests inserting a reference to the proportionality principle (nature, scale and complexity of the business) into Box 47 Para. 2.

Box 48, Control by senior management and supervisory function
No comment.

Box 49, Permanent compliance function

Para. 3
DUFAS appreciates that it is not required to establish an independent compliance function if

this would be disproportionate for the AIFM. This clarification is however only reflected in the Explanatory Text Para. 15. DUFAS would suggest that it should be included into the text of the Box to avoid future diverging interpretation by competent authorities.

Box 50, Permanent internal audit function
DUFAS would appreciate if ESMA could include an option to outsource the permanent internal audit function into the text of Box 50.

Box 51, Personal transactions
No comment.

Box 52, Recording of portfolio transactions
No comment.

Box 53, Recording of subscription and redemption orders
DUFAS understands that the record requirement for direct orders are based on the existing UCITS framewok. However, it should be understood that these requirements are only applicable to the direct distribution of the AIF and that different solutions regarding the recording of orders must be permitted in case of indirect distribution or trading on a secondary market.

Box 54, Recordkeeping requirements
DUFAS understands that the recordkeeping requirement for direct orders are based on the existing UCITS framework. However, it should be understood that these requirements are only applicable to the direct distribution of the AIF and that different solutions regarding the recordkeeping of orders must be permitted in case of indirect distribution or trading on a secondary market.

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?
DUFAS does not consider that a requirement for complaints handling should be included for situations where an individual portfolio manager invests in an AIF on behalf of a retail client.

The relationship between AIF and the clients is covered by MiFID provisions which ensure the existence of adequate procedures for complaints handling. Therefore, it is not required to insert any requirement into the AIFMD Implementing measures.

Box 55, Policies and procedures for the valuation of the assets of the AIF

General Comments on the valuation chapter
DUFAS welcomes the possible implementing measures on valuation as proposed by EFAMA. They provide for a robust framework which can be adapted to the specific characteristics of the diverse types of assets in which AIF may invest.

DUFAS appreciates that ESMA clarified a number of important points in the explanatory text. DUFAS urges ESMA to include these important clarifications into the text of the boxes in order to mitigate the danger of future diverging interpretation. This concerns mainly:

- the point that the AIFM may appoint a number of different external valuers to one AIF in order to ensure the proper valuation of all assets.
- a third party which carries out the calculation of net asset value for an AIF is not considered to be an external valuer for as long as this entity does not provide valuations for individual assets but incorporates values which are obtained from the AIFM, pricing sources or the external valuer into the calculation process.
- a price provider is not considered to be an external valuer.

Comments on Box 55
DUFAS understands ESMA's proposal regarding policies and procedures for the valuation of the assets of the AIF require that for each AIF a policy and procedure exists.

DUFAS understands that it is not required that for each AIF a detailed written policy and procedure be prepared. Instead the AIFM may have a written policy and procedure at the level of the AIFM. The fund rules or instruments of incorporation of individual AIFs could refer to this company-wide policy while stipulating which particular valuation procedures and methodologies should apply to the assets held by the fund.

DUFAS considers that the Explanatory Text in paragraphs 10 and 24 are essential for the proper understanding of the valuation function and would appreciate if these texts could be included into Box 55 directly.

Box 56, Models used to value assets

Para. 1
DUFAS understands that the use of commonly accepted pricing tools such as "Bloomberg valuation tools" are not regarded as a model in the sense of this Box.

Para. 2
DUFAS understands that the person validating the model may be an internal or external person.

Box 57, Consistent application of the valuation methodologies

Para. 2
DUFAS considers the requirements overly burdensome that policies and procedures shall be applied across all AIF having the same AIFM and consistent over time and that valuation sources and rules shall remain consistent over time.

AIFM very often manage AIF incorporated in different jurisdictions which are subject to the local valuation rules and requirements. It will be difficult to create one set of policies and procedures which will comply with all of these requirements and then to apply them in a consistent manner across the entire product universe. Even if it was feasible to prepare such policies and procedures, it will not be in the interest of the investors that all funds managed by an AIFM be treated in a one size fits all approach.

DUFAS considers that Box 57 Para. 2 should be deleted. If it is not deleted, DUFAS asks ESMA to include a clarification into the text of Box 57 reflecting the idea raised in the explanatory text that the application of consistency should take into account the existence of different external valuers. It should be extended to also allow for different accounting standards and different pricing sources to be applied across different AIF's being managed.

Box 58, Periodic review of the appropriateness of the policies and procedures including the valuation methodologies

Box 59, Review of individual values

DUFAS considers that the requirements in Box 59 to Review of individual values are overly burdensome. In particular, if an external valuer has been appointed, the AIFM should be allowed to rely on the values provided by the valuer. This is also in line with the text of the Directive which is clear and does, in EFAMA's opinion, not require further interpretation.

Para. 1

DUFAS disagrees with the very strict and burdensome requirements posed on the AIFMD in Box 59 Para. 1. In case of an appointment of an external valuer, it should be sufficient that the AIFM ensure that there are procedures in place at the level of the external valuer for appropriate and fair valuation of the assets. The AIFM has to be able to rely on a delegate which meets the requirements of having sufficient resources, being of sufficiently good repute and being sufficiently experienced, without having to duplicate part of the work.

DUFAS suggests modifying the first sentence and deleting the second and third sentence of paragraph 1.

Para. 2 and 3

DUFAS considers that the requirements in Box 59 Para. 2 and 3 are too burdensome. If an external valuer has been appointed, the AIFM should be allowed to rely on the values provided by the valuer. Furthermore, the reference to "material risk" is too vague and will leave too much room for diverging interpretation by the different competent authorities.

DUFAS strongly suggests that Box 59 Para. 2 and 3 be deleted.

Box 60, Calculation of net asset value per unit or share

DUFAS welcomes ESMA's clarification in the Explanatory Text Para. 24 that a third party which calculates the NAV on the basis of values obtained from other sources shall not be considered external valuer.

DUFAS suggests an amendment of the Explanatory Text Para. 24. The difference between he valuer and an administrative agent calculating the NAV (without being the valuer) consists in the fact that the valuer determines the values. It is the essential feature of the valuers activity that the valuer determines the valuations. In other words, persons merely calculating the NAV without determining the valuation are not to be considered valuers.

In order to reflect this idea more clearly, DUFAS suggests amending para. 24 as follows:

"A third party which carries out the calculation of the net asset value for an AIF is not considered to be an external valuer for the purposes of Article 19 of the Directive, so long as this entity does not determine final valuations for individual assets (…)."

Furthermore, in order to avoid a different interpretation by competent authorities in the future, DUFAS suggests that this clarification should be included directly into the text of Box 60.

DUFAS also invites ESMA to reformulate the Explanatory Text paragraph 23 stating *'the AIFM is always responsible for ... where appropriate the appointment of an external valuer.'* DUFAS considers that this imposes a requirement going beyond the requirements in the Level 1 text and does not allow for sufficient flexibility. Article 19 (7) of the AIFM only states that the AIFM shall notify the appointment of an external valuer to the competent authorities. Article 19 does not state that the AIFM must appoint the valuer. The appointment could also be made by the governing body of an AIF that has appointed an external AIFM also to appoint an external valuer. DUFAS suggests that the Explanatory Text para. 23 should be amended accordingly.

Box 61, Professional guarantees
No comment.

Box 62, Frequency of valuation carried out by open-ended funds
No comment.

Box 63, Delegation
General Comments on chapter IV.IX
DUFAS welcomes that the ESMA proposals regarding implementing measures for the AIFMD are to a large extent aligned with the existing MiFID and UCITS requirements.

The proposed possible implementing measures regarding delegation, however, go beyond the existing requirements and DUFAS would appreciate if ESMA could review its proposals to achieve a better alignment. For example, the requirements with regard to the good repute of the delegate in Box 66 go beyond MiFID and UCITS requirements and seem overly prescriptive. Furthermore, the requirements in relation to conflicts of interest in a delegation framework are more detailed than under MiFID and UCITS and will be difficult to fulfill while complying with confidentiality obligations and data protection rules.

Comments on Box 63
DUFAS welcomes the proposals by ESMA in Box 63. The Explanatory Text Para. 9 and 11 are considered very important for the understanding of the proposals in Box 63, in particular the term of "critical and important functions". DUFAS urges ESMA to include the clarifications of Explanatory Text Para. 9 and 11 directly into Box 63.

On behalf of Dutch REITs we ask whether the situation in which several activities are performed by group companies qualifies as delegation and secondly how the obligation of article 20 (1)(c) of the Directive should be fulfilled. The group companies performing the activities are currently not authorised or registered for asset management.

In our view the obligation of article 20(1)(c) of the Directive should not apply to the activities performed intra-group because these activities should not qualify as delegation. We would like the level 2 texts to clarify this.
The entities are primarily put in place for corporate reasons. Consequently, the structures used by DREITs are not comparable to the situation in which e.g. part of the portfolio management is delegated to another asset manager (not being a group company) because of its expertise in specific financial instruments.

In our view the described structures (listed real estate companies with a corporate structure comprising (foreign) group companies) should not be subject to the delegation requirements nor should group companies be required to become authorised for asset management. A solution could be to introduce an appropriate definition of third parties, excluding such group companies.
We kindly request that ESMA takes the structure of DREITs and other (listed) real estate companies into account in its final advice since these legal structures cannot be compared to 'traditional' delegation by AIFM's investing in financial instruments.

Box 64, General principles
DUFAS welcomes that the proposed implementing measures in Box 64 regarding General Principles are based on the current UCITS and MiFID framework. However, DUFAS considers that the proposals as currently drafted much stricter than the UCITS and MiFID regimes and would suggest amendments.

Para. 1
ESMA’s proposal provides that in case of a delegation by the AIFM to third parties, the AIM should comply, in particular, with the conditions mentioned in Box 64.

DUFAS would appreciate if the conditions for delegation were harmonised on a European Level. Therefore, DUFAS suggests that the words “in particular” should be deleted from Box 64 Para. 1.

Furthermore, DUFAS considers that full compliance with all conditions at any time is not realistic. The relevant provisions in the MiFID framework take this into account. DUFAS asks ESMA to modify the wording of Box 64 Para. 1 in order to align it more closely with the MiFID framework. It should only require the AIFM to take necessary steps to ensure that the conditions are met.

Para. 1 f
DUFAS understands that the requirement in Box 64 para. 1f should be interpreted to mean that the AIFM shall make provisions to ensure continuity and quality of delegated tasks in cases of a termination of delegation. Our understanding is that the AIFM will have to ensure that only in case a termination of delegation is planned, the transfer of the delegated tasks to another third party or the insourcing of the function within the AIFM is properly managed to ensure continuity and quality of the delegated task.

Box 65, Objective Reasons
No comment.

Q24: Do you prefer Option 1 or Option 2 in Box 65? Please provide reasons for your view.
Options 1 and 2 could be combined. Option 2 could be combined with Option 1 as an indicative, non-exhaustive list of rationales to qualify as objective reasons for delegation of tasks under Option 1.

If this is not done, DUFAS prefers Option 1, because it provides a general rule which can be applied in a flexible manner to a multitude of different cases. Option 1 is also more consistent with the approach under the UCITS framework. Option 2 is too prescriptive and could possibly be interpreted by the competent authorities as an exhaustive, limitative list.

Box 66, Sufficient resources and experience and sufficiently good repute of the delegate

General Comments
DUFAS disagrees with the very detailed and burdensome requirements in Box 66. These requirements go far beyond what is required under the UCITS. DUFAS asks for a closer alignment between the approach taken under the AIFMD with the UCITS framework.

DUFAS also considers that in case of a delegation of tasks by the AIFM to one of the entities listed in Box 67, requirements under Box 66 para. 2-4 shall be deemed to be fulfilled. DUFAS asks ESMA to include this explicitly into the text of Box 66.

For all other cases of delegation, the requirements of Box 66 para. 2-4 should be modified. In particular the conditions in Box 66 para. 4 will be in practice difficult to assess as in some countries such negative records are not made public or at least not public until a final verdict. Furthermore, the requirement as currently drafted is not subject to the proportionality principle. However, it will not be practical for firms to carry out independent checks as to criminal records with regard to all employees of a delegate. Some DUFAS Members suggested that regarding the evaluation of a delegate's good repute in accordance with the proposed para. 4, AIFM should be allowed to rely upon a formal confirmation by the delegate concerning the absence of negative records relevant for the proper performance of the delegated tasks.

Box 67, Types of institution that should be considered to be authorised or registered for asset management and subject to supervision
A very large majority of DUFAS Members welcome the ESMA proposal in Box 67 regarding the types of institution that should be considered to be authorised and registered for asset management and subject to supervision.

Box 68, Circumstances under which a delegation would prevent the effective supervision of the AIFM, or the AIFM from acting, or the AIF from being managed, in the best interest of its investors
No comment.

Box 69, Sub-delegation – General principles
No comment.

Box 70, Type of evidence necessary for an AIFM to demonstrate its consent to sub-delegation
DUFAS agrees with the proposal in Box 70.

Box 71, Criteria to be taken into account when considering whether a delegation/ sub-delegation would result in a material conflict of interest with the AIFM or the investors of the AIF; and for ensuring that portfolio or risk management tasks haven been functionally and hierarchically separated from any other potentially conflicting tasks within the delegate/ sub-delegate; and that potential conflicts of interest are properly identified, managed, monitored an disclosed to the investors of the AIF
DUFAS welcomes the approach taken by ESMA regarding the proposals in Box 71. DUFAS appreciates in particular that ESMA applies the proportionality principle regarding the separation of functions.

Para. 1
DUFAS considers that the disclosure of conflicts of interest should be limited to existing and not merely potential conflicts of interest and to those that cannot be managed rather than all conflicts of interest. Otherwise, investors and regulators risk an overload of information.

Regarding the conflicts management processes required, DUFAS assumes that the conflicts management processes currently in place at UCITS Management Companies and MiFID firms should be sufficient.

Para. 2a
DUFAS understands that the requirement of independence in Box 71 Para. 2a refers to the independence between the portfolio management function and the risk management function. DUFAS encourages ESMA to modify the wording in Box 71 para. 2a to reflect this more clearly.

Box 72, Form and content of notification under Article 20(4)(b) of the AIFMD
No comment.

Box 73, Letter-box entity
DUFAS welcomes ESMA's proposal in Box 73 as it will provide a robust framework while giving the AIFM flexibility regarding their management structures.

Box 74, Particulars to be included in the written agreement evidencing the appointment of a single depositary and regulating the flow of information deemed necessary to allow the depositary to perform its functions pursuant to Article 21 (2) of the AIFMD.
DUFAS welcomes the approach suggested by ESMA consisting in defining the particulars to be included in the depositary agreement by reference to the corresponding requirements

under the existing UCITS legal framework, subject to a limited number of adaptations to take into account the specificities of AIF's (in particular, the fact that they are authorised to invest in a wider range of assets) and the additional requirements contained in the Level I AIFM Directive. DUFAS also welcomes the fact that the list of particulars contained in Box 74 is explicitly presented as non exhaustive. This will preserve the level of flexibility required to allow the parties to adapt the contents of the agreement to their particular needs (depending, for instance, on the type of AIF and its legal structure, the type of assets to be safe kept, the applicable law, ...).

Concerning the particulars to be included in the agreement, DUFAS would recommend the following clarifications:

- For the avoidance of any doubt, DUFAS recommends to amend item 2 in Box 74 so as to read "A description of the type of assets that will fall within the scope of the depositary's <u>safekeeping and oversight</u> functions (...)".
- The description of the type of assets under item 2 should also include a description of the geographic zones in which the AIF/AIFM plans to invest as this is an essential information to allow the depositary to fulfil its obligations (such as, for instance, the duty to properly assess and monitor relevant custody risks as defined in Box 80, item 1 (c)).
- DUFAS also considers that the list of particulars to be included in the agreement should also include an undertaking by the depositary to notify the AIFM when it becomes aware that the segregation of assets is not (or no longer) sufficient to ensure protection from insolvency of a sub-custodian in a specific jurisdiction (please also refer to our answer to question 46 below).
- DUFAS specifically supports item 11 relating to the provision of details of any third party appointed but considers that this undertaking needs to be extended to deal with further delegations so that the full custody chain is disclosed.
- Under item 12, the requirement to provide "<u>all</u> information (...)" is not sufficiently specific and should be replaced by a requirement to provide "*(Relevant) Information regarding the tasks and responsibilities in respect of obligations relating to anti-money laundering and combating the financing of terrorism*" (same wording as for items 8 and 13).

Although DUFAS considers that the list of particulars contained in Box 74 is appropriate (subject to the above required clarifications), one should recognize that the challenge for the AIFs/AIFMs and their depositaries will reside in the level of details required by some of the elements to be included in the contract (description of procedures ...). With this in mind, DUFAS strongly supports the confirmation by ESMA that there shall be no obligation to enter into a separate agreement for each AIF and that it will be possible to enter into framework agreements covering several AIF's managed by the same AIFM. This will significantly reduce the administrative burden (and associated costs) that the drafting, signature and regular maintenance/updating of these agreements represent for the parties without any negative impact on the level of investors' protection.

In the same line, the reference made by ESMA to the fact that the depositary agreement may be supplemented by a service level agreement (SLA) or a similar document is also very important in practice. Some of the particulars listed in Box 74 (for instance, the descriptions of procedures required under items 1, 6, 7, 9, 13 and 14) are indeed too detailed to fit appropriately in the depositary agreement itself. They are also inevitably subject to much more frequent changes than other elements of the agreement. In this context, DUFAS would strongly welcome a clarification by ESMA that the use of a SLA (or similar document) is not restricted to the description of the means and procedures referred to in Box 74, item 6 but can also be used for the description of other procedures and information listed in Box 74, as and when the parties to the agreement deem appropriate (a narrow interpretation of item 6 in Box 74 could indeed lead to a different conclusion, which, we assume, was probably not the aim of ESMA's draft advice and would considerably reduce the practical use of SLA's), thus allowing the AIFM and the depositary the ability to determine the need for a SLA and whether such descriptions and procedures should be included in the depositary agreement or SLA.

Finally, DUFAS fully agrees with the justifications given by ESMA for not providing a model agreement (page 142 of the Consultation Paper).

Depositary functions

Remarks regarding REITs and depositaries
The Consultation does not deal with the question which institutions can be appointed as a depositary besides banks and investment firms. Pursuant to the Directive, in the case of closed-end funds which invest in assets which cannot be held in custody (e.g. real estate), the depositary may also be an entity which carries out its depositary function as part of its professional business. Such entity must be subject to mandatory professional registration. In case of Dutch REITs the depositary will only perform the supervisory function and not the function of safe keeping of assets. Consequently, and again taking into account the characteristics of the Dutch REIT, it is important that Dutch REITs have flexibility and can e.g. also appoint a Dutch trust office, the valuer or use an accountant for the supervisory tasks.

We kindly request that certainty is provided about which entity may act as a depositary as referred to in article 21(2)(c) of the Directive, and this includes professionals like the auditor, the valuer of the real estate or a regulated trust office.

Box 75, Cash Monitoring – general information requirements
DUFAS broadly agrees with the general information requirements proposed by ESMA, subject to the following remarks:

- Second bullet point: it ought to be clarified that the obligation to inform the depositary prior to the opening of new cash accounts does not imply that the depositary has any influence in the choice of the counterparties where the accounts are opened. Indeed, this is purely an investment decision for which the AIFM is the only responsible.
- Third bullet point: this requirement to provide "… all information related to cash account …" is drafted in very broad terms and appears to be too extensive, given that the regulatory purpose (as described in paragraph 4 of explanatory text) is only to enable timely access by the depositary to the cash account. In line with the introductory paragraph in Box 75, the wording should therefore be amended to read as follows: "the depositary is provided with <u>the necessary (or relevant)</u> information related to the cash accounts opened at a third party entity, directly from those third parties in order for the depositary to have access to the information regarding the AIF's cash accounts <u>it needs to comply</u>

with its obligations and have a clear overview of all the AIF's cash flows".

Additionally, the last sentence in Box 75 following which "*where the depositary does not receive this information, the AIFM will have been deemed no to have satisfied the requirements of Article 21 of the Directive*" is problematic for several reasons:

1° it seems to impose an obligation of result on the AIFM even though there may be situations where the information could not be provided to the depositary for reasons beyond the AIFM's control;
2° the reference to "the requirements of Article 21 of the Directive" without any further specification is, in our opinion, much too broad.
3° the practical/legal implications of the AIFM's failure to ensure that the depositary receives all the information it needs are therefore unclear.

DUFAS therefore recommends withdrawing that last sentence in Box 75 as it creates a number of legal uncertainties without bringing any added value or clarification to the AIFM's information obligations already clearly described in Box 75. Alternatively, if ESMA believes that this sentence should be maintained, it should at least (1) clarify that the AIFM is not under an obligation of results but under an obligation of means to provide that information and (2) narrow the reference to "the requirements of Article 21 of the Directive" to a failure to meet the requirements of Article 21.7 of the Directive which specifically deals with the cash monitoring obligation. ESMA should also clarify the implications of the AIFM's failure to provide the depositary with the relevant information (which, in our opinion, should not lead to an automatic and unconditional discharge of the depositary's duty to perform its cash monitoring functions, although with persistent and unjustified failure ultimately this could be the result).

Box 76, Proper monitoring of all AIF's cash flows
DUFAS has a clear preference for option 2 (please also refer to our answers to questions 29 to 31 below).

DUFAS would also welcome further guidance from ESMA as to what should be understood with "*significant cash flows*" (Box 76, item 3). It would be helpful for REITs if it could be explained that this does not involve cash flows relating to service charges, maintenance, cleaning, wages, legal costs etc. The final advice should take the characteristics of DREITs and other (listed) real estate companies into account.

Box 77, Ensuring the AIF's cash is properly booked
DUFAS considers the requirement of Box 77 to be adequate and reasonable.

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?
First of all, DUFAS remarks that the Level 1 Directive explicitly retains the possibility that cash accounts (be they for general operating or subscription/redemption purposes) be opened with third parties. We therefore clearly question the compatibility with the Level 1 text of Level 2 measures which would impose that cash accounts be opened only with the depositary (we note in this context that ESMA recognises that this would consist in a "re-

strictive interpretation of the AIFMD text" – see Consultation Paper, cost-benefit analysis, p. 310-311).

It should also be noted that, in many cases, such requirement would not conform to the current market practice (e.g. for Real Estate funds) and it would be onerous to make the required changes to current practices and procedures with little perceived benefit accruing to investors. The same effect could be achieved by requiring the depositary to ensure that appropriate checks and controls are in place at the Transfer agent and that proper record-keeping and reconciliation procedures are established and working effectively.

Furthermore, it is clear that the requirement that subscriptions and redemption prices settle on a depositary account is likely to reinforce to a certain extent the integrity of the issuance and redemption of shares/units by easing up and making safer the depositary's monitoring of settlement process. However, it is equally clear that the advantages of such requirement would be offset by a number of significant disadvantages including, in particular, a damaging impact on distribution channels (as pointed out by ESMA, see Consultation Paper, p. 310) as well as potentially increased costs.

Finally, it should be noted that not all depositaries either have the regulatory or operational capability to operate such accounts. Even if operated within the depositary group, such accounts are often operated by another group entity. There are also cases where an AIFM has multiple funds with different depositaries. Such managers may have only one pooled subscription/redemption account covering a number of AIFs with a credit institution. It would be operationally complex if managers were to be required to open subscription/redemption accounts at each individual depositary.

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?

It is very difficult to provide a general answer to this question, given that the frequency of cash reconciliations may significantly vary from one fund to another, depending on a variety of factors.

In practice, open-ended AIFs trading on a daily basis will often be subject to a daily reconciliation of cash flows for subscriptions and redemptions, whereas for operating accounts reconciliation is in general performed on a monthly or quarterly (ex-post) basis. However, there is no general rule and the frequency of reconciliations may vary significantly from one AIF to another.

Furthermore, the frequency of the reconciliation usually does not essentially depend on the type of assets in which the AIF invests but will rather be influenced by the valuation frequency of the fund (reconciliation frequency should – at least – match the calculation frequency) and/or take into account the impact of cash collateral arrangements. It will also be dependent on the number and activity of cash accounts opened with entities other than the depositary.

Q27: Are there any practical problems with the requirement to refer to Article

18 of MiFID?
DUFAS does not anticipate any practical problem with this requirement.

Q28: Does the advice present any particular difficulty regarding accounts opened at prime brokers?
Provided option 2 in Box 76 is retained, DUFAS has not identified any particular difficulties regarding accounts opened at prime brokers. In practice, sufficient reporting is usually received from prime brokers to enable timely cash reconciliations to be reviewed by the depositary on a periodic basis.

It may, however, be worth mentioning in this context that the depositary will be relying on the prime broker or AIFM to provide sufficient documentation to demonstrate that it fulfils the requirement of Box 77, item 2 to "*ensure the AIF's cash is booked in one or more accounts opened at an entity referred to in Article 18(1) (a) to (c) of Directive 2006/73/EC or at a bank or credit institution of the non EU country in which the AIFM/AIF has been compelled to open a cash account in relation to an investment decision*" as the depositary will not have access to that information.

Q29: Do you prefer option 1 or option 2 in Box 76? Please provide reasons for your view.
DUFAS has a clear preference for option 2. The requirements described under option 1 and, in particular, the requirement to mirror the transactions into a position-keeping system would be very expensive to implement and would also be a pure duplication of the work already performed by fund administrators, without tangible added value in terms of investors' protection.

We also wish to draw the attention to the fact that the allusion made by ESMA (Consultation Paper, item 9 in Explanatory text on page 150) to a weekly verification by the depositary for funds performing reconciliations on a daily basis would not conform to market practice. For the sake of clarity, we therefore recommend to withdraw this example and to leave it to the depositary to decide on a case by case basis on the appropriate periodicity for the performance of its monitoring duties.

Q30: 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?
Given the very diverse nature of the funds covered by the AIFMD, it is nearly impossible to quantify these costs and, even if we were in a position to provide average figures, their reliability would be so unrepresentative that they might lead to wrong conclusions.

Nevertheless, it seems fairly safe to assume that Option 1 would lead to significantly higher costs than Option 2 as it would undoubtedly involve employing more people to perform the tasks, in particular mirroring the transactions of those cash accounts into a position keeping system and making periodic reconciliations between the cash accounts and the AIF's accounting records.

Box 78, Definition of financial instruments to be held in custody – Article 21 (8) (a)
DUFAS agrees with ESMA's proposed advice that the type of financial instruments that can be registered in a financial instruments account opened in the name of the AIF in the depositary's books, which should be included in the scope of the depositary custody duties as referred to in point (a) of Article 21.7, should be limited to transferable securities, units in collective investment undertakings and money market instruments, as set out in sub-paragraphs (1) to (3) of Annex I Section C of Directive 2004/39/EC.

DUFAS also agrees with the principle set out in item 2 of Box 78 on collateral and with the fact that any financial instrument that can be physically delivered to the depositary is to be considered as being "held in custody".

DUFAS also believes that ESMA has appropriately addressed the issue of instruments registered with an issuer or an agent of the issuer in Box 78 paragraph 3, which should not be regarded as being held "in custody". It is correct to limit this to instances where the financial instruments that are directly registered with the issuer or agent in the name of the AIF.

Q32: Do you prefer option 1 or option 2 in Box 78? Please provide reasons for your view.
DUFAS prefers Option 1. It is most in line with current practice. The custody status of an instrument cannot be linked to the possibility of its transfer via a settlement system subject to certain criteria (in particular, in view of the fact that in many non-EU markets adequate settlement systems do not exist due to the absence of a central depository) as contemplated under Option 2. Option 1 adequately reflects that the key criterion to determine whether a financial instrument is held in custody is the capacity for the depositary to instruct the transfer of those instruments or to act, claim, suit ... the property of those financial instruments. Option 2 is also less suitable for derivatives.

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?
No comment.

Box 79, Treatment of collateral – Article 21 (8) (a)
DUFAS considers that Option 3 is the most appropriate because it has the widest scope. Indeed, Option 3 makes it clear that, notwithstanding the type of financial collateral agreement, the collateral that is transferred out of the depositary's books falls outside of the scope of the custody obligations (as the collateral would no longer be under its 'control') and therefore should be considered to be part of the category 'other assets' (and, as such, subject to the safekeeping duties as set out in Box 81). In that context, we are not sure to understand the purpose of the distinction being made under option 2 between "title transfer financial collateral arrangement" and "security financial collateral arrangement".

It should also be noted that Directive 2002/47/EC on financial collateral arrangements will have to be amended so that an AIF and an AIFM fall within the scope of Article 1.2 as already is the case for UCITS and UCITS management companies.

Further, we note that the draft advice does not explicitly deal with collateral received by the depositary or any sub-custodian for the benefit of the AIF. We are of the view that any financial instruments received as collateral should be regarded as having been "entrusted to the depositary for safe-keeping" within the meaning of Art. 21(8) AIFMD.

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?

In practice it will not always be easy to differentiate between a "title transfer collateral arrangement" and a "security financial collateral arrangement". as the agreement setting out the collateral arrangement is often very complex and would require an indepth legal analysis to determine to which category the collateral arrangement belongs. However, as already mentioned in our comments to Box 79 we do not see the relevance of the distinction being made under option 2 between both types of collateral arrangements

Box 80, Safekeeping duties related to financial instruments that can be held in custody

DUFAS agrees with the general principles and the description of the safekeeping duties related to financial instruments that can be held in custody proposed by ESMA under Box 80.

For the sake of clarity, item 2 in Box 80 should be expanded to impose on the depositary the obligation to impose on its delegate that any further delegation will also be on the basis of the segregation requirements set out in Box 89.

Box 81, Safekeeping duties related to 'other assets' – Ownership verification and record keeping

DUFAS has a clear preference for Option 1 in Box 81, given that the benefits of a full mirroring exercise are questionable and that the costs of Option 2 would be very significant and would impose unwarranted additional costs on the depositary (and, therefore, on the AIF's investors) without commensurate benefits in terms of investors' protection. Option 1 is also closer to the current market practice.

Concerning the wording of Option 1, DUFAS recommends changing item 2 from "the relevant third party" to "a relevant third party" in order to allow the depositary to rely on documentary evidence provided by another third party than its delegate.

DUFAS agrees that it is beneficial to require documentary evidence upon every acquisition or sale of a significant asset and upon every significant corporate action. This requirement should however be proportionate and should be required only for assets which have a significant impact on the investment portfolio (e.g. ancillary assets in a real estate property would not be material in this regard). Furthermore, it is not common practice to renew legal real estate title or corporate certification on an annual basis, as such documentation is not always easily attainable and may require legal counsels to carry out further investigations. Instead, we would favour a risk-based approach to such documentation whereby the depositary would focus primarily on significant transactions and proceed with refreshes of existing documentation where appropriate.

Also regarding REITS, we prefer Option 1. In the case of REITs it is impossible that assets get lost. Consequently, a much more simple verification procedure should be possible, focussing on the procedures that are in place and taking a risk based approach to the documentation of the real estate titles. In our view, it is only beneficial to require documentary evidence upon the acquisition or sale of a significant asset and upon a significant corporate action. Insignificant assets such as fixtures and fittings in a property should not be included. We kindly request that ESMA allows for flexibility in the requirements regarding the verification of the ownership of the real estate, focussing on the procedures that are in place and taking a risk based approach to the documentation of the real estate titles.

In case of Dutch REITs with subsidiaries and real estate in multiple jurisdictions it is only possible to provide a reasonable verification of ownership. The depositary should be allowed to rely on confirmations from experts in other jurisdictions. Furthermore, the depositary should be allowed to only provide a reasonable verification as to the ownership of assets even if not all documents are still available (for instance a legal title search that has to go back many years is usually incomplete).

Q35: How do you see the delegation of safekeeping duties other than custody tasks operating in practice?
See comments on Box 81 above.

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?
There is no significant difference in terms of control when assets are registered in any of the formats outlined in the question. The key control is focused on the parties that can instruct the movement of the assets.

Q37: To what extent would it be possible / desirable to require prime brokers to provide daily reports as requested under the current FSA rules?
It is both possible and desirable that prime brokers provide daily reporting on the status of their client assets and client money. This information should be available online for depositaries to access as required. In practice, UK based prime brokers are currently obliged to provide this information and it would be beneficial to have this standard of reporting in place for all prime brokers contracted to provide prime broker services to AIFs.

Q38: What would be the estimated costs related to the implementation of option 1 or option 2 of Box 81? 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?
It is impossible to quantify these costs with precision given the very diverse nature of funds covered by the AIFMD.

However, as already mentioned above, it is safe to assume that the costs of Option 2 (full mirroring of all transactions) would be considerably higher than the costs of Option 1.

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

DUFAS believes that in order to fulfil its duty to verify the ownership of the assets of the AIF and to adequately protect the interests of AIF' investors, the depositary should be required to apply a "look-through approach" to the entire AIF's asset structure, i.e. that the depositary must look through any intermediary entity controlled (directly or indirectly) by the AIF which is interposed between the AIF and its target investments. This requirement is obviously of particular relevance for AIF's which are making substantial use of intermediary entities, such as AIF's investing in real estate through an SPV, private equity and other multi-layered structures such as fund of funds or master-feeder funds. This requirement should be applied with a sense of proportionality. In this context, depositaries should, for instance, be able to rely on accredited auditors with local expertise to satisfy themselves that the appropriate documentation is in place to demonstrate that the AIF or the AIFM acting on behalf of the AIF holds the ownership of those assets.

DUFAS recommends that confirmation of this requirement be given by Level 2 implementing measures in order to enhance the level playing field sought by the Level 1 text in relation to the scope of the depositary.

Box 82, Oversight duties – general requirements

DUFAS agrees with the general requirements regarding oversight duties described in Box 82 and welcomes the confirmation that the oversight duties of the depositary essentially consist in ex post controls and involves a verification of the appropriateness of the procedures and processes put in place by the AIF/AIFM rather than in a duplication of tasks or controls already performed by other entities.

Box 83

Clarifications of the depositary's oversight duties

Please refer to our answer to question 43 below.

Box 84, Clarifications of the depositary's oversight duties

DUFAS considers that Box 84 and its explanatory text are imposing more duties on the depositaries than foreseen by Art. 21.9(b) which requires that the depositary "(...) ensure that <u>the value of the units or shares of the AIFare calculated</u> in accordance with the applicable national law, the AIF rules of incorporation and the procedures laid down in Article 19 (...)". This does not require the depositary to directly oversee the valuation of assets. Similarly, it should not be the depositary's duty to check that an external valuer has been appointed as it is the responsibility of the AIFM and it goes beyond the requirements of the Level 1 text. Consequently, DUFAS recommends to delete items 1 and 5 in Box 84 and to amend items 2 and 3 as follows:

2. "The depositary should ensure that the policies and procedures <u>for the calculation and of the value of the units or shares of the AIF</u> are effectively implemented and periodically reviewed".
3. "valuation policy" should be replaced with "<u>policy for the calculation and of the value of the units or shares of the AIF</u>".

Box 85, Clarifications of the depositary's oversight duties
Please refer to our answer to question 44 below.

Box 86, Clarifications of the depositary's oversight duties
Please refer to our answer to question 45 below.

Box 87, Clarifications of the depositary's oversight duties
DUFAS considers that some of the requirements of Box 87, as they are currently worded, go beyond the Level 1 text or are not in line with the general oversight requirements as set out in Box 82:

- Concerning item 1, the depositary oversight duty should consist in ensuring that <u>appropriate procedures</u> are in place to ensure that the net income calculation is applied in accordance with the AIF rules, instruments of incorporation and applicable national law. The same applies to item 3.
- Concerning item 2, DUFAS holds the view that it is not the depositary's role to ensure that the reserves expressed by the auditors are effectively and appropriately followed up by the AIF or the AIFM.

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?
DUFAS welcomes the principle-based implementing measures proposed by ESMA with respect to oversight duties, which will be instrumental in achieving an appropriate harmonization of duties across all European Member States. By and large, the proposed advice on the depositary's oversight duties seems to achieve the right balance between flexibility, the harmonization objectives and the costs related to the implementation and ongoing monitoring duties.

In defining the precise contents and boundaries of the depositary control duties, ESMA should however take particular care to make sure that those duties remain proportional to the respective functions and duties of other service providers involved (such as transfer agents, fund administrators or auditors). In this context, please refer to our specific comments to Boxes 84 and 87 above.

If the right balance is achieved, DUFAS believes that the proposed advice will not materially impact the relationship between the depositary, the AIF/AIFM and the other service providers. To the contrary, it will enhance the cooperation and the flow of information among those entities, to the benefit of an increased investors' protection.

Q41: Could potential conflicts of interest arise when the depositary is designated to issue shares of the AIF?
There may indeed be situations where a conflict of interest could arise when the legal entity acting as depositary is also in charge of issuing the shares of the AIF, because of the depositary duty of oversight in relation to the subscription and redemption of shares. Such situations should be addressed by ensuring that there are adequate procedures in place to segregate both functionally and hierarchically the functions of depositary and transfer agents (Chi-

nese walls).

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?
No comment.

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?
DUFAS is of the opinion that, considering the set up of distribution networks in Europe, it would be practically impossible for the depositary to fulfill that obligation (we understand that this question actually refers to the sales of units of the AIF on a secondary market). Consequently, we believe that the oversight duty of the depositary should be limited to the verification of information stemming from the AIF's register. This is in line with ESMA's working assumption, which DUFAS strongly supports, that "the depositary is not required to make verifications along the distribution channel but rather to put the focus on the entity which centralizes the subscriptions (e.g. a transfer agent) and limit the verification to the information stemming from the AIF's register" (Consultation Paper, item 11, p. 151).

For the avoidance of doubt about the scope of depositary duties, DUFAS strongly recommends that this clarification be explicitly mentioned in Box 83.

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.
DUFAS considers that the scope of the duties as described in Box 85 is appropriate and in line with current market practice.

However, DUFAS recommends adapting the wording of item 1 in Box 85 as follows, in order to align it on the requirements of Article 21.9(c) of the AIFMD that explicitly refers to the applicable national law: "*Set up and implement appropriate procedures to verify the compliance of AIF/AIFM with **the** applicable **national** law and regulation (…)*".

Q45: Do you prefer option 1 or option 2 in Box 86? Please give reasons for your view.
DUFAS has a clear preference for Option 1. Indeed, we are of the opinion that the Level 1 requirement to ensure the settlement of transactions within the usual time limits is sufficiently clear and that there is no evidence that additional requirements would be necessary. We do not believe that the additional requirements proposed by ESMA under Option 2 would bring any significant clarification in this respect.

Box 88, Due diligence Requirements
DUFAS agrees with the due-diligence requirements as set out in Box 88.

We welcome the choice made by ESMA in favor of a principle based approach rather than a template and a list of due diligence tasks to perform. This will indeed give the depositary the required flexibility to adapt its due diligences to the specific circumstances of each delegation scenario and will also avoid a "tick-the-box" exercise which would be detrimental to the protection of the investors.

Box 89, Segregation obligation for third parties to which depositaries have delegated part or all of their safekeeping functions (based on Article 16 of Directive 2006/73/EC implementing the MiFID Directive)
DUFAS considers that the segregation requirements described in Box 89 appear to be adequate and reasonable.

However, DUFAS would welcome a clarification from ESMA concerning the practical implications of explanatory note (5) (page 176 of the Consultation Paper) that seeks to widen the scope of the segregation duty to assets in 'recordkeeping'. Article 21.11(d)(iii) AIFMD is referring to assets belonging to the depositary's clients for the safekeeping of which the depositary wants to appoint a third party. This paragraph stipulates that the depositary needs to ensure that its (clients) assets are properly segregated by the appointed third party. This requirement apparently implies that the depositary is part of the custody chain, hence excluding 'record keeping' assets (indeed, for record keeping assets, the third parties would not be appointed by the depositary, so it is hard to see how the level 1 text that specifically focuses on delegation by the depositary can be expanded through level 2 implementing measures to require the depositary to ensure segregation at a third party not appointed by it.

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 markets where the effects of the segregation requirements outlined in box 89 are not recognised, the typical issue is that there is no acceptance of the 'nominee' concept, whereby the account holder or legal owner is not necessarily the real or beneficial owner of the securities, but may be holding securities on behalf of its clients. As a result, those countries consider an intermediary in the chain of safekeeping as the real or beneficial owner, with adverse consequences in case of the intermediary's insolvency. The way depositaries today protect their client assets in those markets, is by opening single beneficiary accounts, very often at subcustodian and central securities depositary level.

Additionally, and depending on the specific circumstances of each country, DUFAS believes that there are indeed a number of alternative or additional measures that can potentially be taken by the depositary to mitigate the risks related to the insolvency of a sub-custodian in jurisdictions that do not recognize the effects of segregation:

- Disclosure to the AIF and AIFM so that this aspect of custody risk is properly taken into account in the investment decision

- Depositaries taking such measures as possible in the local jurisdictions to make the assets as "insolvency-proof" as possible based on local law advice
- Depositaries might undertake appropriate levels of ongoing monitoring to ensure that the relevant sub-custodian continues to comply with the criteria for selection set out in Box 88 – this may involve an enhanced level of credit monitoring or enhanced levels of reconciliations work or other measures to pick up any early warning signals of potential problems
- Crucially, foreign players can be a powerful voice to incentivize legislators, regulators, local market participants in a jurisdiction to improve their client asset protection regimes or processes.

As regards item 2 in Box 89, the depositary should be bound to notify the AIF/AIFM when it becomes aware that the segregation of assets is not (or no longer) sufficient to ensure protection from insolvency of a sub-custodian in a specific jurisdiction. In case no adequate notification has been made, the loss of assets as a result of such insolvency should not be considered an external event in accordance with Box 91.

In which countries would this be the case? Please specify the estimated percentage of assets in custody that could be concerned.
DUFAS is not in a position to provide a complete list of countries where the effects of segregation are not recognized.

DUFAS would strongly welcome if ESMA could set up and make publicly available a list of those countries, in order to facilitate adequate management of related insolvency risks by both the depositary and the AIFM.

Box 90, Definition of loss
DUFAS approves the principle-based approach set out in Box 90 rather than a typology or list of situations where the instruments would be considered lost (as a list is by definition limitative and, therefore, would most likely not encompass all situations) and believes that the criteria set out by ESMA to determine when a financial instrument is to be considered lost are appropriate (although, in practice, it should be recognized that the 'permanent' nature of a situation may sometimes be difficult to assess with certainty).

DUFAS also supports the explanatory notes 19 and 21 (pages 181 and 182 of the Consultation Paper) whereby it is primarily to the AIFM to determine whether the financial instruments are lost (or, ultimately to the relevant courts in case of dispute between the AIFM and the depositary). However, DUFAS holds the view that the depositary should be bound to cooperate in good faith to the establishement of the documented process set out in Box 90 item 2 and to share with the AIFM any document or evidence likely to facilitate the assessment of the loss. Additionally, in the case of an insolvency of the sub-custodian, we believe that is the duty of the depositary to monitor the proceedings and keep the AIFM informed so that the AIFM, in consultation with the depositary, can decide when a financial instrument is lost. The penultimate paragraph in Box 90 should be amended to reflect this.

Box 91
Definition of 'external event beyond the depositary's reasonable control, the

consequences of which were unavoidable despite all reasonable efforts to the contrary'

The definition of an external event and the consequential liability test may lead to differences of opinions among asset managers from different jurisdictions within the EU, because of different legal interpretation of domestic custody laws in member states. While the Level 1 Directive sought to provide a more unified approach to liability it, of course, did not alter basis provisions of national custody law. The liability test has to be read in conjunction with the requirements for "loss", "segregation" and "due diligence" in Boxes 88, 89 and 90 which together with proposed enhancements will constitute a robust regime for the holding of assets in custody which will limit the circumstances in which a loss will arise at all. This will then assist greatly in ensuring that any consequential increase in liability can be subject to an appropriate risk assessment and be accurately priced by custodians. While the debate on the liability standard has been vigorous and is not resolved, DUFAS does not want it to distract from the key concerns of the ESMA guidance which are aimed at preventing a loss from occurring in the first place.

DUFAS considers that, from an investor perspective, it would be reasonable for the depositary to be exonerated from liability provided it can prove that it fulfilled the segregation and due-diligence requirements as set down in the Directive. In our opinion, it should be clarified that the act or omission of the sub-custodian should be considered as an external event with respect to the depositary if it did not occur as a result of a wrongful act or omission of the depositary in respect to its duties in relation to the delegation of custody.

Box 92, Objective reasons for the depositary to contract a discharge

DUFAS is of the opinion that Option 2 is unacceptable and is incompatible with the Level 1 text (in particular Art. 21.13(c) AIFMD following which the written contract between the depositary and the AIF/AIFM must establish the objective reason to contract a discharge of the depositary's liabilities. Consequently, the fact that the written contract explicitly provides that the depositary can discharge its responsibility can never be in itself a sufficient objective reason to do so. The objective reason to contract a discharge should always be justified by reference to the best interest of the AIF's investors.

Therefore, we have a preference for Option 1 as it provides clarity from the outset as to the circumstances in which the depositary might contractually discharge itself from liability.

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?

No comment.

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

DUFAS strongly supports the principle based approach laid down in Box 90 and does not believe that it would be helpful to provide a typology of events which could be qualified as a loss. A list by its very nature is restrictive and it is impossible to properly capture all events which would qualify as a loss.

Q49: Do you see any difficulty with the suggestion to consider as an external event the fact that local legislation may not recognize the effects of the segregation requirements imposed by the AIFMD?
DUFAS recognizes that the application of the criteria set out in Box 91 to situations where the local legislation does not recognize the effects of the segregation will, in a number of cases, lead to the conclusion that this situation indeed constitutes an "external event beyond the reasonable control of the depositary". However, this will not always and automatically be the case.

As already mentioned in our answer to question 46, the depositary should be bound to notify the AIF/AIFM when it becomes aware that the segregation of assets is not (or no longer) sufficient to ensure protection from insolvency of a sub-custodian in a specific jurisdiction. In case no adequate modification has been made, the loss of assets as a result of such insolvency should not be considered an external event in accordance with Box 91.

Q50: Are there other events which should specifically be defined/presumed as "external"?
DUFAS disagrees with the fact that some types of events should be presumed *a priori* to be "external" to the depositary. This is not consistent with the principle-based approach chosen by ESMA.

Although some types of events (e.g. acts of God) are very likely to fulfill the criteria set out in Box 91, we believe that it always depends on the facts and circumstances of each individual case and that each event should first pass the test of the 3 criteria set out in Box 91 before it can be considered "external and beyond the reasonable control of the depositary".

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?
No comment.

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?
No comment.

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?
No comment.

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?

No comment.

Calculation of leverage

General comments
DUFAS would like to point out that under the current proposals the administrative burden of thousands of UCITS-like AIFs will increase substantially, although their risk characteristics are the same as UCITS', most of them are unsophisticated funds, and in many Member States they are regulated in the same way as UCITS. In their respect, the proposed advice is deemed excessively burdensome and disproportionate to their risk characteristics. These UCITS-like AIFs are currently applying the CESR Guidelines on risk measurement and the calculation of global exposure and counterparty risk for UCITS (CESR/10-788), and a change in calculation methodologies will cause high costs and duplication within the fund management company. We encourage ESMA to consider ways to simplify provisions for such AIFs.

DUFAS is concerned that the technical advice proposals place too much importance on leverage, and in particular gross leverage, as a useful statistic for regulators and investors. Gross leverage does not measure, and is poorly correlated with, the risk of a portfolio for investors, or the systemic risk that an AIF may pose.

Leverage is only one of many helpful measures of the risk of a portfolio. Taken alone – or with undue significance placed upon it – any one risk measure can be misleading and dangerous for regulators and investors. The quest for a unique measure for systemic risk (for regulators) and to help investors assess AIF risk is unlikely to succeed.
From the explanatory text we believe ESMA wants to use gross leverage to address three distinct issues: (1) Volatility, (2) Counterparty Risk and (3) Liquidity Risk.

We would suggest that gross leverage is a highly misleading proxy for these three important risks. Unfortunately this simple measure is too simple to achieve the aims set out for it by ESMA.

Market Risk / Volatility:
- The relationship between gross leverage and volatility is not intuitive.
- The volatility created by long leverage is determined by the volatility of the underlying asset. 10x leverage into a short dated US Treasury may create substantially lower levels of volatility than 1x leverage into emerging market shares. In this example quoting a gross leverage number alone would be highly misleading in judging the riskiness of a fund.
- The second key aspect is whether the leverage is part of a portfolio with negatively correlated assets (where certain trades expected to move in opposite direction from each other). For example, a portfolio that is long one oil stock and short another oil stock may have a leverage of 2x but would present substantially lower volatility than a 1x long oil stock position. Once again, quoting a gross leverage number would give the opposite information on volatility to investors and regulators.
- According to our members, funds with high levels of gross exposure tend to be invested in very low volatility asset classes, and be substantially hedged. In many instances the realised volatility of such strategies is low.

- Gross leverage appears to be at best no guide to volatility and can often be deeply misleading – as investment risk can often be negatively correlated with gross leverage.
- We would suggest that volatility, realised drawdown and VAR may be helpful in understanding volatility in a portfolio and the risk that the investor may lose capital due to market moves, or a failure of Alpha.

Counterparty Risk:
- We understand that certain regulators view hedging positions as contributing to counterparty risk, and therefore gross exposure would be a proxy for counterparty risk.
- We would suggest that (a) under-collateralized counterparty exposures and (b) collateral quality are more appropriate measures of this risk.
- Exchange-traded derivatives typically have frequently collateralized margin specifically to mitigate this risk; additionally, the exchange represents a central clearing counterparty, further mitigating systemic linkages between participants
- OTC derivatives typically use bi-lateral collateralization to mitigate this risk.
- In the event of a counterparty failure, the collateral serves to "make whole" the AIFM; if the collateral is either less than the exposure (under-collateralization) or is of insufficient quality to recover the lost value, counterparty risk has not been sufficiently mitigated.
- As a result, taking gross exposure as a proxy for counterparty risk is deeply misleading for both regulators and investors.

Liquidity Risk:
- A highly leveraged portfolio may find it more difficult to liquidate its positions when faced with redemptions.
- As with the volatility example below, the nature of the underlying investment may be more important than the level of leverage in determining the portfolio's ability to respond to redemptions or a market shock. For example a lightly leveraged real estate portfolio will be far less liquid than a government debt AIF with high levels of gross leverage.
- Gross leverage is an unhelpful proxy for liquidity risk and perhaps exploring other measures (such as "cost of liquidation of X% of the fund over Y period") may be more valuable.

Given that gross leverage does not helpfully measure volatility, counterparty risk or liquidity risk, DUFAS does not consider that it is a helpful headline measure of the riskiness of an AIF – either from a systemic risk or investor risk perspective.
We would suggest that gross leverage should be de-emphasised and a more nuanced approach including VAR, volatility, drawdown, net counterparty risk, and liquidity measures should be adopted.
Regarding the commitment method, due to the restrictive definitions of netting and hedging our members do not believe this will be a very helpful measure – and in most cases it will result in a number close to the gross method number. Furthermore, it does not correspond to current investor understanding of the net leverage or net exposure of an AIF – which makes use of offsetting arrangements.
As a result, many AIFMs will opt to use the advanced method but many different calculation methodologies will be used, and therefore its usefulness to investors will be limited.

Box 93, General Provisions on Calculating the Exposure of an AIF

Introductory text Paragraph 9
We disagree with ESMA's expectation in paragraph 9 that the Commitment methodology will lead to a reduced administrative burden. On the contrary, DUFAS expects that the process of establishing which hedging and netting arrangements are acceptable will be very burdensome (please see also our comments on Box 96).

Introductory Text Paragraph 10
DUFAS strongly disagrees with ESMA's assessment of VAR. VAR is a helpful methodology in many market conditions. No single risk measure can explain portfolio risk, but VAR has the advantage of being a measure of expected outputs (i.e., the level of expected loss with a confidence interval), rather than a measure of inputs (i.e., gross leverage). Whilst VAR has its limitations, it is one of the more helpful measures of portfolio risk, when taken together with other appropriate portfolio analytics and attribution techniques. Please see also our comments on Box 97.

EFAMA considers that for structured AIFs a similar grandfathering clause should be foreseen as the one in ESMA's Guidelines to competent authorities and UCITS management companies on risk measurement and the calculation of global exposure for certain types of structured UCITS published on 14 April 2011 (ESMA/2011/112 – Guideline 1 – Para. 4).

DUFAS strongly disagrees with the proposal in Box 93 to require the calculation of the AIF exposure according to two or even three different methodologies (Para. 3 and, 9), as well as the disclosure of the level of leverage according to two methodologies (Para. 11). The calculation requirement is overly burdensome and the disclosure of multiple figures is bound to create confusion among investors.

We suggest that calculation of exposure according to a <u>single</u> methodology (at the choice of the AIFM) should be sufficient, and that a single leverage calculation should be disclosed to investors. We encourage ESMA to include in its advice the reasons for the necessity to perform multiple calculations (and to disclose multiple leverage figures).

The proposed methods for calculating the exposure of an AIF are only relevant for AIFs which use leverage according to Article 4 (1) (v) of the AIFM Directive. ESMA should therefore clarify that these requirements do not apply to other AIFs which do not use leverage.

If the use of VAR is allowed as we suggest, the formula for the calculation of leverage in Para. 2 shall require a modification.

Box 94, Exposure Related Definitions
The definitions of Netting and Hedging are highly restrictive and do not reflect current industry practice.
The language referring to "sole aim of offsetting" seems unhelpfully restrictive. Risk is managed at a portfolio level – therefore any single trade will play multiple roles in a portfolio.

Box 95, Gross Method of Calculating the Exposure of the AIF

Regarding the gross method, please see our general comments. Regarding the reference to the risk-free rate in Para. 1 (a), please see our reply to Q58.

As previously stated, DUFAS believes that the calculation of exposure according to a single methodology (at the choice of the AIFM) should be sufficient, but if regulators consider that the calculation of the gross method is absolutely necessary, then two calculations of the exposure should be performed for the Competent Authorities. We still maintain, however, that only one leverage calculation should be disclosed to investors, to avoid confusion.

For funds that (almost) entirely invest in futures the outcome of the gross or commitment methods do not provide an appropriate indication of the risk incurred. For futures it is common to use the margin to equity ratio. Margin to equity ratio is the total margin posted by the AIF divided by the total assets of the AIF. For AIFs investing in futures the margin to equity ratio is the main indicator. The amount of leverage can serve as a second warning sign regarding excessive positions.

Borrowing should be excluded from the gross method when that borrowing is reinvested – as the re-investment is already captured.

Para 25 (4) of the explanatory text
ESMA's proposal explicitly refers to the fact that, when calculating the exposure of a private equity fund, the leverage of a portfolio company should not be included in the calculation of the exposure of an AIF. However, it should be clarified that leverage in any holding company structure is also to be excluded.

Box 96, Commitment Method of Calculating the Exposure of an AIF
The Commitment method proposal seeks to generate a version of Net Exposure, but the definitions of an eligible hedge are so restrictive as to be unhelpful. This is not an accepted definition of Net Exposure.

In particular, the restriction that the "Hedging arrangements do not generate a return" would prohibit the majority of equity long/short strategies from using their short positions to net their long positions. Hence, gross exposure would be the same as Commitment exposure in an equity long short AIF – despite the fact that the beta might be close to zero.

This will encourage managers to create their own methodologies in the advanced method – which may not be good for investor transparency – and would unnecessarily tax regulatory resources reviewing methodologies for vanilla funds seeking to follow standard industry practice. These points are clearly made in Paragraph 38 of the Explanatory text.

As the current definition of the commitment method is cumbersome and unhelpful, we suggest that it should be modified and replaced with a Net Exposure calculation which permits offsets, reflecting industry standards.

According to Paragraph 4 (a), some netting between interest rate derivatives of different durations can be performed if a degree of their correlation is taken into account. Further clarification on this would be helpful in order to understand how this will apply in practice.

Box 97, Advanced Method of Calculating the Exposure of an AIF
The advanced method as foreseen by ESMA would allow for an amended/hybrid version of the commitment method exposure calculation, where alternative exposure methodologies can be substituted for the parts of the portfolio where the commitment method does not provide reasonable results. In this sense, it is helpful, but we fail to see how the advanced method will reduce complexity.

DUFAS disagrees with the requirement to calculate the advanced method besides the commitment method, instead of as an alternative to it.

Box 98, Methods of Increasing the Exposure of an AIF
No comment.

Box 99, Exposures involving third party legal structures
No comment.

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?
Yes, It should be helpful to add the method for the calculation of the exposure of Credit Default Swaps to box 97, e.g. as described in CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (CESR/10-788).

In many funds which have a benchmark portfolio the primary method used to increase the relative performance is benchmark deviation in the physical investments. ESMA/2011/209 gives little insight into this method of risk taking.

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 specificities be included within the Advanced Method to assist in its application?
ESMA rejects the use of VAR for all funds captured by the AIFMD, citing the exposure of the VAR method to the breakdown of correlations in stressed market conditions (Introductory Text to Box 93 - Paragraph 10).

DUFAS strongly disagrees and recommends that VAR be a permitted advanced monitoring method where appropriate for the particular AIF. The range of funds covered by the AIFMD is too diverse to permit the specification of the advanced method to usefully go beyond a statement of basic principles.

As mentioned above, we consider that for structured AIFs a similar grandfathering clause should be foreseen as the one in ESMA’s Guidelines to competent authorities and UCITS management companies on risk measurement and the calculation of global exposure for certain types of structured UCITS published on 14 April 2011 (ESMA/2011/112 – Guideline 1 – Para. 4).

Q57: Is further clarification needed in relation to the treatment of contingent

liabilities or credit-based instruments?
No.

Q58: Do you agree that when an AIFM calculates the exposure according to the gross method as described in Box 95, cash and cash-equivalent positions which provide a return at the risk-free rate and are held in the base currency of the AIF should be excluded?
DUFAS agrees that cash and cash equivalents should be excluded from the gross method calculation.
The use of yield to identify risk-free positions, however, is unwise, as:
(a) the comparison of the yield of positions with the yield of government bills of a defined maturity is a complex process not offered by many monitoring platforms currently in use;
(b) yields of bills, and therefore prices, are manipulated by governments, at times volatile and in the case of the Euro not consistent from government to government; and
(c) the yield criterion excludes a range of instruments (reverse repos, AAA rated liquidity funds) which offer higher yields, default risk reduced by collateral or diversification, and an absence of revaluation, thereby producing a conflict between the reporting standard and the best interests of investors. Consequently, the method of applying the "risk free" criterion is likely to render the reporting objective unachievable.

Q59: Which of the three options in Box 99 do you prefer? Please provide reasons for your view.
DUFAS prefers Option 1. They consider that the approach in options 1 and 2 is preferable to that in option 3, because:
Option 3 creates uncertainty. Limb 1 specifies that AIFMs shall not include in the calculation of leverage exposures any exposure contained within third party structures where the capital at risk is not greater than the market value of its holding in the relevant shares or units. Limb 2 states that leverage shall include exposures gained through guarantees and the giving of security in specified circumstances. It is unclear what would happen where there is exposure greater than the market value of the shares but it is not gained through guarantees or the giving of security in the specified circumstances. Also, it is unclear why the calculation of leverage exposure hinges on the market value of shares rather than amount paid for such shares.

Option 1 is preferred over option 2 as it is more logically sound. Exposure on the basis of a guarantee is not dependent on whether or not the guaranteed company is listed or unlisted or whether it is controlled by the guarantor. Whether or not an exposure is realised is dependent on the terms of the guarantee, not these other factors. It is not, however, appropriate to count exposure guarantees that are not legally enforceable. The provision that "guarantees" in respect of which there is no legally enforceable obligation but "an expectation" are to be counted in the leverage calculation is ambiguous and should be deleted.

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.

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.
Firstly, it is essential that regulators carefully consider the impact of any restrictions they may impose on leverage, weighing the systemic benefits against potential damage to investors. We suggest once again that an undue focus on gross leverage is unhelpful, given its imperfect link with risk. Regulators are encouraged to take a more effective approach.

Q62: What additional factors should be taken into account in determining the timing of measures to limit leverage or other restrictions on the management of AIF before these are employed by competent authorities?
We strongly believe that these powers are used only in extreme circumstances, with transparent and predictable criteria. DUFAS recommends that a mandatory first step should be for the regulator to enter into dialogue with the AIFM. Communication with the AIFM could avoid circumstances in which leverage caps were imposed through misunderstanding of an investment strategy or of the risk created by this investment strategy.

Forced deleveraging of an AIF will create material costs for investors (trading costs, and depressed asset prices); hence, the burden of proof should be set with this balance in mind. Strict confidentiality would also be required. If a regulator became concerned about long leverage in a certain sector, a public pronouncement of a leverage limit and forced deleveraging would likely cause a price collapse. This forced selling at "fire sale" prices would have a material detrimental impact on investors. AIFMs should therefore be allowed to reduce positions within a reasonable period of time and in a way that is consistent with the investors' best interests.

DUFAS also considers that regulators should consider the importance of maintaining a level playing field. If a single regulator imposes a leverage limit, then local AIFs would be forced to de-leverage, but funds in other Member States and funds outside the remit of the AIFMD would still be able to pursue their investment strategies. This would create a detrimental impact on the investors in the local AIF, while not achieving the aim of the concerned regulator.

Box 100, Principles specifying the circumstances under which competent authorities will exercise the powers to impose leverage limits or other restrictions on AIFM
No comment.

Q61: Do you agree with ESMA's advice on the circumstances and criteria to guide com-petent 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 integ-

rity 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.
No comment.

Q62: What additional factors should be taken into account in determining the timing of measures to limit leverage or other restrictions on the management of AIF before these are employed by competent authorities?
No comment.

Transparency Requirements
The transparency requirements should apply the proportionality principle as intended in the AIFMD. The suggested reporting obligations seem out of proportion for small AIFMs, and are going beyond what was first requested by the AIFMD. DUFAS is extremely concerned about especially two aspects of the transparency requirements.

Firstly, the reporting requirements to competent authorities. These are extremely onerous. We strongly believe that rather than quarterly reporting, reporting should be on an annual basis, with CAs having the right to request more frequent reports if appropriate.

Secondly DUFAS is concerned about how all the transparency requirements will be applied to third country funds which will need to comply with these requirements from 2013 if they are being marketed under private placement. There is no mention of this in this CP, nor in the recent paper issued by ESMA on third country funds. We believe it essential that the advice which ESMA delivers to the Commission in November addresses this issue and does so in a flexible and proportionate way. Such funds will generally be subject to similar but not identical requirements from their own regulator and for them to have to submit different reports to European regulators is disproportionate. Also:

- There should be a general statement to the effect that where a fund is subject to equivalent reporting requirements, then it should be sufficient to make the local reports available to EU regulators and investors.
- Where specific issues are not covered in the local report then it should be sufficient for the AIFM to prepare a supplement to cover the additional material.
- EU regulators should liaise closely with third country regulators to ensure that reporting requirements are dovetailed as far as possible. For instance under Dodd Frank private funds have to file a form PF with the SEC covering similar but not identical issues to Annex V. ESMA and the SEC should liaise insofar as possible to ensure that these are brought into line.

Box 101, Annual Report Definitions
DUFAS understands that the definition of "material change" shall represent a benchmark for triggering additional information duties not only in relation to the annual report, but also in terms of periodic disclosure to investors as suggested in Box 107 and 108. However, the term "material change" is used in the Level 1 Directive also in another context and in particular with regard to relevant changes in the scope of the AIFM authorisation according to Art. 10. In this respect, however, "material changes" refer to the conditions for manager authorisation and especially, to the information provided in the authorisation process ac-

cording to Art. 7. It would appear inappropriate to apply in this context the ESMA's definition of "material changes" which is focused on the consideration of operating circumstances for a specific fund.

Therefore, DUFAS would be grateful for clarification that the proposed definition of "material changes" is relevant only to specific transparency requirements and without prejudice to other AIFMD provisions containing references to material changes.

'Material change' is currently defined as meaning "changes in information if there is a substantial likelihood that a reasonable investor, becoming aware of such information, would reconsider its investment in the AIF, including for reasons that such information could impact an investor's ability to exercise its rights in relation to its investment, or otherwise prejudice the interests of one or more investors in the AIF."

DUFAS proposes that this is changed simply to say: "changes in information if there is a substantial likelihood that a reasonable investor, becoming aware of such information, would reconsider its investment in the AIF." The reason DUFAS recommends this change is that the concept of 'material' is well understood (e.g. IAS1) and is best left broad; listing specific items runs the risk of restricting the concept.

Box 102, General Principles for the Annual Report
The Level 1 Directive is unclear as to whether the requirement to produce (as distinct from "to make available") an annual report applies to the AIFM or the AIF. The ESMA Consultation Paper continues the ambiguity and we would recommend that it be resolved expressly by recognising that while, under level 1, Article 22, the AIFM is obliged to make available an annual report to investors in relation to the funds it manages, the preparation of several components of that report properly belong to the governing body of the AIF itself. Accordingly, we would submit that the AIFM may discharge itself of its obligations to make disclosures under Article 22, to the extent that disclosure obligations are met by the governing body of the AIF. DUFAS would recommend as well that, as under UCITS, where the governing body of the fund prepares the annual statements, the document containing them can be supplemented by the inclusion of an annual Investment Managers Report (a mechanic which is contemplated but not explored in Paragraph 25 on page 225 of the CP).

Para 1 and 2
DUFAS notes that the information to be disclosed in the annual report includes, as set out in Article 22 (c) and (d), a report of the activities of the financial year; and any material changes in information listed in Article 23 during the financial year covered by the report. Article 23 sets out a long list of items, many of which would not be referred to in financial statements under most countries' laws or accounting standards (although may be included in Directors'/Investment Managers' reports). Much of the information is of a nature which would not be apparent to the Fund Administrator preparing the financial statements or potentially to the team of people within the AIFM that monitor and review them. Some reorganisation may be required therefore to accommodate these requirements. Responsibility for identifying such changes, determining materiality, drafting the text to be disclosed and providing this for inclusion in the financial statements would need to be established. It is proposed that these disclosures are part of the annual report document but not part of the financial state-

ments. This avoids the need for an audit of the data, however, audit firms generally are required to review all information included in the annual report document to ensure it is consistent with the audited sections. Increased disclosures of this nature will inevitably increase the work required to prepare annual reports and for the audit, the size of the documents , with a corresponding increase in costs and further pressure on meeting regulatory deadlines for completion. In some cases, it may be that this type of information is included within Directors'/Investment Managers' reports; however, this is not always the case, and the information currently provided may not be the complete list as set out in Article 23.

Para 3
DUFAS agrees with the first sentence; however, DUFAS suggests the deletion of the second sentence as it is not the role of the AIFM to determine what level of information is appropriate for an investor. Investors in AIFs should be completing their own detailed due diligence, focused on the areas that are important for them. DUFAS also notes the ESMA stance on consolidation and agrees that it would be expensive and may not fulfil the purpose for which it is intended.

Para 4
The first sentence should be deleted ("All information provided in the annual report….shall be presented in a manner that provides materially relevant, reliable, comparable and clear information") as this is duplicative. The second sentence states that "the AIFM shall ensure that as far as reasonably possible that the annual report contains the information investors may need in relation to particular AIF structures." The AIFM will, in many circumstances, be restricted to a greater or lesser extent with regard to its ability to dictate the format of the annual report, as it will need to comply with relevant accounting rules. Additionally, EFAM reiterates the point made above that it is not for the AIFM to speculate as to what information an investor may require.

Box 103, Reporting Material Changes for the Annual Report
Para 3
DUFAS agrees with the first sentence. However, DUFAS suggests that the remainder of the paragraph is deleted; reason being that it is not the role of the AIFM to speculate as to what additional information may be relevant for an investor. Investors in AIFs should conduct their own due diligence and request additional information where required.

Para 4
DUFAS suggests that the phrase "together with any potential or anticipated impact on the AIF and/or investors of the AIF" should be removed. The AIFM will not be in a position to know what the potential or anticipated impact of any change will be for its investors, as it is not privy to the particular circumstances of each investor.

DUFAS welcomes the last sentence of paragraph 4 and suggests clarifying that the medium by which the information is made available could be a website as foreseen in Box 23, point 3.

Box 104, Primary Financial Statements required under Article 22(2) (a) and (b) of Directive 2011/61/EU
Generally, there is a significant amount of text related to the standard and form of the finan-

cial statements. By and large, however, this seems to retain the status quo by permitting the AIF to report under the accounting standards and rules of its country of establishment or as set out in the prospectus. DUFAS is therefore broadly supportive of the approach set out.

As regards the content of the income and expenditure account, DUFAS opposes the suggestion in Paragraph 7 (a) (iii) of Box 104 to present "unrealised gains on investments" as part of the income and expenditure account. This runs counter to the established reporting practice in many countries. DUFAS also notes that the UCITS regulations do not require this.

Box 105, Content and Format of the Report on Activities for the Financial Year
DUFAS welcomes the clarification of the second sentence of point 24 of the explanatory text as well as point 25. DUFAS suggests including these sentences in Box 105.

DUFAS also recommends clarifying that if the AIF discloses conflicts of interest in its management report (as usually required by national rules/laws), it would satisfy the obligations foreseen under Box 23 (Paragraph 2 and 3) as well as Paragraph 6 of Box 106.

Para 2
DUFAS recommends that the phrase "containing also a description of the principal risks and investment or economic uncertainties that the AIF may face" should be deleted, given that there will already be sufficient disclosures made in accordance with Article 23 of the Directive.

Para 3
DUFAS recommends that this paragraph be deleted. This is because Article 23 already requires the disclosure of investment strategies, objectives, and other features and also any material changes to those features. DUFAS also suggests that it is not appropriate to include a set of additional performance indicators as it is not the role of the AIFM/ Directors to speculate as to what additional information may be helpful to investors or to judge their own performance.

Box 105 would then read as follows:

"Box 105

Content and Format of the Report on Activities for the Financial Year

1. In accordance with Article 22(2) (c) of Directive 2011/61/EU AIFM shall, for each of the EU AIF it manages and for each AIF it markets in the Union or in a member state territory only, make available a report on the activities of the financial year, or, where applicable, the activities of the relevant financial period within the annual report ***(which may be in the form of the Directors or Investment Managers' Report),*** *which shall contain at least the following elements:*

a) *an overview of investment activities during the year or period, and an overview of the AIF's portfolio at year-end or period end;*
b) *an overview of AIF performance over the year or period;*

> *c) material changes in the information listed in Article 23 of the Directive not already presented in the financial statements.*
> ***d) conflicts of interest pursuant to Article 14 (2) of the Directive and***
> ***e) remuneration disclosure as required under Box 106 (when appropriate).***
>
> *2. The report shall include a fair and balanced review of the activities and performance of the AIF.* ***It should not disclose proprietary information on portfolio companies.***
>
> *3. The information provided in the report should be consistent with national rules where the AIF is established."*

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?
See responses above regarding each box.

Box 106, Content and Format of Remuneration Disclosure
No comment.

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?
DUFAS considers that the remuneration disclosures should be subject to similar exemptions as are available to firms under Directive 2006/48/EC, which effectively allows information which is immaterial, confidential or proprietary to not be disclosed. The implementation of similar exemptions would ensure a level playing field across all firms subject to remuneration disclosures, which was one of the original objectives of the G20 when remuneration proposals were first tabled.

In our opinion, the proportionality principle is a key point to define the general framework of the remuneration policies for AIFM. It implies that each management company has a great flexibility to set up all the components of its remuneration policy, in accordance with the general principles established for the sector. In this respect, we would like to highlight one of the strong differences between the asset management industry and other financial activities: by nature, a management company does not take any risks affecting its own balance sheet or its assets.

DUFAS supports the fact that it is for the AIFM to determine whether to provide the disclosures at the level of the AIF or the AIFM. This should provide sufficient flexibility for AIFMs to be able to implement a solution which reflects the nature, scale and complexity of the AIFM and consequently results in a proportionate application of the obligations.

DUFAS would like to draw ESMA's attention to the fact that when AIF are incorporated as a separate legal entity, those responsible for the financial statements of the AIF will be those in charge of the corporate governance of the AIF. They may differ from the management of the AIFM. In this case, there are likely not to have a direct access to the AIFM records and thus not to be in a position to take responsibility and ownership for such disclosures. Moreover, the auditor of the AIF may not have direct access to the books of the AIFM in order to audit such disclosure.

In the case of umbrella funds it is not clear whether the remuneration disclosures should be at sub-fund or umbrella level.

Box 107, Periodic Disclosure to Investors

General comments on disclosure to investors
As a general concern regarding disclosure to investors DUFAS draws ESMA's attention to the fact that many funds caught by the AIFMD are nationally regulated retail investment funds. The distribution model of these products typically means that the AIFM does not have direct contact with the end investors but only with the distributors. This fact should be taken into consideration when finalising the disclosure requirements. The use of websites as a way to provide disclosure should be facilitated as much as possible.

Percentage of assets subject to special arrangements
When a prospectus is drafted, it is difficult to determine the exact percentage of assets that will be subject to "special arrangements" (i.e. side pockets, gates, lockups) as this would not be known until the point at which these arrangements are effectively exercised by the manager of the fund. In short, the manager of the fund cannot know in advance the exact percentage of assets that it will need to side pocket, gate, or lock in. The fund manager can only rely on an anticipated or maximum level of assets disclosed in the prospectus/offering memorandum. Periodic reporting, however, could theoretically capture the level of assets subject to special arrangements at a snapshot in time.
The way in which "special arrangements" are used varies across the different fund types and sufficient flexibility should be included in the Level 2 text to allow for this flexibility and so as not to stifle innovation in this area.

Furthermore, DUFAS believes that funds with no periodical redemption rights should only be required to disclose information relating to Paragraphs 1, 2 and 3 in its first disclosure to investors and not be required to do so on a periodical basis.

Risk profile of the AIF
DUFAS strongly favours the use of Option 1 as this more easily accommodates a variety of different types of fund. The primary difference between Options 1 and 2 is that Option 2 is proscriptive in stating "measures" and "relevant stress tests", etc. must be disclosed; the definition (and hence relevance) of stress tests is subjective and varies from AIFM to AIFM; what is relevant also varies from asset class to asset class. Option 2 is therefore too prescriptive and not necessarily relevant for all alternative sectors. Option 1's "exposure to … the most relevant risks" covers the same ground, but leaves the AIFM free to present the most relevant measures. It also is the option which maintains a better degree of flexibility to permit compliance by non-EU AIFM of non-EU AIF.

With respect to REITs we also strongly favour option 1. They are already subject to strict transparency requirements because they are admitted to trading on a regulated market. Option I in box 107 provides the most flexibility for DREITs in disclosing the relevant information to the investors. Furthermore, due to the principle based nature of option I investors will receive useful information, contrary to the situation in which the content is prescribed (as in option 2) but does not match with the characteristics of the AIFM.

Risk management systems employed by the AIFM
DUFAS considers the required information in the second part of paragraph 10 to be onerous (as the description of the techniques, tools and arrangements may lead to very long disclosure, in particular for umbrella structures as tools and techniques may differ from one sub-fund to the other) and not necessarily of an immediate interest to all investors. We suggest therefore the second part of the paragraph to be amended as follows, i.e.: "*and the AIFMs shall make available to investors on request the techniques, tools and arrangements it employs to manage these risks*".

Box 108, Regular Disclosure to Investors
DUFAS is concerned that the technical advice proposals place too much importance on leverage, and in particular gross leverage, as a useful statistic for regulators and investors. Gross leverage does not measure, and is poorly correlated with, the risk of a portfolio for investors, or the systemic risk that an AIF may pose.

DUFAS supports in general the proposed approach requiring timely disclosure only in respect of "material changes" to the maximum leverage level and permitting inclusion of information on the actual total amount of leverage in the AIF annual report. DUFAS is however concerned that setting a maximum level of leverage that must be complied with at all times may be unhelpful for regulators and investors as it allows no flexibility for unusual market conditions. The lack of flexibility would lead to AIFMs setting arbitrarily high limits on gross leverage to avoid ever breaching it. This is not helpful for regulators in terms of assessing risk posed to markets or prospective investors in terms of assessing suitability.

DUFAS notes that in broad terms the content of Box 108 is in line with UCITS regulations which will facilitate the reporting for AIFMs who also manage UCITS. There is one exception, however, whereby the Directive refers to the disclosure of the total amount of leverage, whereas for UCITS reference is made to disclosure of the "leverage level", whereby the information may be based on the average level of the leverage effects observed (and followed) during a period. DUFAS suggests also to making reference to the possibility to calculate the total leverage on the basis of the average level of the leverage effects observed (and followed) during a period.

Q65: Does ESMA's proposed approach in relation to the disclosure of 1) new arrangements for managing liquidity and 2) the risk profile impose additional liability obligations on the AIFM?
Disclosure of new arrangements may impose additional liability (including, but not limited, to conflicts of interest, insider trading, fraud and breach of fiduciary duty) where certain investors are informed of certain special arrangements that do not concern them as in the case of liquidating SPVs or side pockets. Accordingly "investor" should be defined and intended for all purposes as "investor concerned by the special arrangement".

Q66: Do you agree with ESMA's proposed definition of special arrangements? What would this not capture?
Please refer to our comments on Box 31 above.

Q67: Which option for periodic disclosure of risk profile under Box 107 do you support? Please provide reasons for your view.
DUFAS strongly favors the use of Option 1 as this more easily accommodates a variety of different types of fund. The primary difference between Options 1 and 2 is that Option 2 is proscriptive in stating "measures" and "relevant stress tests", etc. must be disclosed; the definition (and hence relevance) of stress tests is subjective and varies from AIFM to AIFM; what is relevant also varies from asset class to asset class. Option 2 is therefore too prescriptive and not necessarily relevant for all alternative sectors. Option 1's "exposure to … the most relevant risks" covers the same ground, but leaves the AIFM free to present the most relevant measures. It also is the option which maintains a better degree of flexibility to permit compliance by non-EU AIFM of non-EU AIF.

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.
Given the wide variety of types and natures of AIF falling under the scope of the AIFMD DUFAS does not suggest ESMA to be more specific on how the risk management system should be disclosed to investors, as it would then be more difficult to achieve a "one size fits all" disclosure requirement. DUFAS suggests however that the disclosure of the risk management system be subject to the general principle of proportionality and this should take into account the different types of AIF.

Box 109, Format and Content of Reporting to Competent Authorities
DUFAS is very concerned about the suggested reporting requirements to competent authorities which are extremely onerous. Our members are concerned about the volume of information and potential costs, particularly if this is required quarterly.

DUFAS strongly recommends that rather than quarterly reporting, reporting should be on an annual basis for all or at least most AIFs. The reporting deadline should be in line with that required for the annual report.

The reporting requirements largely exceed what is necessary to assess and manage systemic risks. The requirements are too detailed and reporting is required too frequently for majority of funds. A distinction should be drawn between hedge funds and other kinds of funds, between large funds with potential systemic implications and smaller funds.

ESMA proposes quarterly reporting for all AIFs on the basis of the extensive template provided in Annex V. Information on particulars of risk and liquidity management may be even required in a more frequent cycle by the competent authority of the AIFM. Many asset managers would then face the challenge to prepare quarterly reports for several dozens, or even hundreds, of AIFs. This task will involve high operational costs on a permanent basis as it will not be possible to fully automate the computation of the reporting items according to the reporting template in Annex V. Such significant costs must be considered a continuing factor to drag down the fund performance to the detriment of AIF investors. Our members estimate that the cost of implementing a quarterly reporting would be at least from half a person to one person a year.

DUFAS is fully aware of the fact that reporting to authorities is considered one of the cornerstones of the Directive for detecting potential systemic risks. However, in defining the applicable requirements ESMA must pay due regard to the proportionality principle as a general guideline for its recommendations. Measures taken for identifying systemic risk must still be commensurate to the probability of materialization of such risks in certain vehicles. It is incontestable that the potential for systemic risk in funds applying speculative trading strategies and an unlimited level of leverage is much higher than in funds with a conservative approach to leverage and clear rules on portfolio composition.

As the layout and content of the ESMA reporting template derives from the IOSCO work on reporting for hedge funds, most of the information required would not be relevant for other alternative funds. Moreover, it is important to bear in mind that, given the broad definition of an AIF as per the Directive, a significant proportion of AIF's will not pursue alternative strategies at all but will be plain-vanilla funds investing only in long position over listed securities that had not opted for the UCITS status. Most of the disclosure require under the pro-forma are not relevant for these unleveraged funds. Imposing these onerous reporting requirements to types of funds when not relevant is not in line with the "proportionality" principle.

Hence, we believe that the reporting requirements should ensure a proper differentiation between the types of AIF having regard to the corresponding probability of systemic risk. In EFAMA's opinion, such differentiation could be performed according to the predominant investment strategy which shall be specified for each AIF as the first item in the reporting template.

ESMA itself has categorized the AIF investment strategies depending on the AIF type in the sample guidance for reporting included in the consultation paper. On the basis of these categories, the reporting duties should be attached first and foremost to AIFs following hedge fund strategies (column 1) and to funds of hedge funds (column 3). The remaining types of AIF should be granted significant reliefs in their reporting obligations towards authorities. This should pertain both to the "Other Funds" category which comprises UCITS-like long-only funds and to "Private Equity Funds" displaying a static risk profile which certainly does not justify more frequent reporting. Real estate funds the risk profile of which bears similarities with private equity investments should also be included in the "Other Fund" section.

DUFAS proposes to define the UCITS-like AIFs the following way: The AIF invests in assets which may be either eligible or equivalent according to the UCITS Directive and considers the risk spreading rules as well as the investment limits as provided in UCITS including the limits on leverage or such rules and limits which can be considered as equivalent to UCITS. This definition includes individual modifications according to national law.

DUFAS would indeed welcome a "decision tree" approach whereby the responses given to initial questions on the strategy, leverage and size would trigger a tailored report. DUFAS notes from Annex V that only section 1 is applicable to all AIFMs; Sections 2 and 3 only apply to an AIF 'which is of a material size'. Much will depend therefore on which AIFs fall in this category. We think it critical that these sections need only be completed for AIFs which are of such a size as to pose systemic risk. There is no point in competent authorities being overloaded with information – they will not be able to assess and utilize this volume of information effectively.

This approach would reconcile the legitimate concern of ESMA to establish the tools for an adequate supervision, the flexibility requested by the Commission and the efficiency objective of the industry. In EFAMA's view it is highly disproportionate to expect the same reporting quality from highly leveraged hedge funds and traditional real estate or long-only funds for the purpose of identifying systemic risk. This view appears to be backed by the new strategy of the EU Commission to exempt certain vehicles from the AIFMD scope of application and to submit them to a "lighter regulatory regime" precisely for the reason of their negligible relevance in systemic terms, see The Commission consultation on Venture Capital funds.

Detailed DUFAS comments on Annex 5

- Page 422, section 1 : under the proposed format, the funds that do not pursue an alternative strategy, which can be very numerous as mentioned above, will be mingled in an "other funds" category including as well infrastructure and commodity funds as well as an "other" category. DUFAS wonders whether it makes sense to mix funds with such different profiles.
- Page 423 and 424, individual exposures per categories of instruments: DUFAS believes that a category of cash and cash equivalent (for money market funds) should be added as well as a category "other assets" under point c) real assets (for assets such as art, wine,…).
- Page 423: DUFAS wonders why the G10 bonds are split per maturity and not the Non-G10 bonds (what is the purpose of this information?). DUFAS would also suggest considering the distinction between "investment grade" and "non-investment grade" similarly as for the corporate bonds, as DUFAS do not understand the relevance of the distinction between G-10 and Non G-10.
- Page 425: typical deal size: the type of information required should be clarified.
- Page 425, point 4, value of turnover: formula for calculating turnover should be defined to order to allow consistency in the reporting. Turnover on money market instruments and derivative is usually not a relevant information as it is a direct consequence of the roll forward of short term positions. DUFAS would then suggest to remove these from the reporting.
- Page 426, section 1, 4, c): DUFAS assumes that there is a typo and this should read other assets rather than other funds?
- Page 426, section 2, point 6: if the fund is distributed through intermediaries (for instance, retail funds, feeders, funds of funds…), this information will not necessarily be accessible and the AIFM might not be in a position to report.
- Page 427, section 2: AIFM should not be required to disclose "expected" return and risk profiles to regulators. Such disclosure would be pure conjecture.
- Page 427, section 3, point 9: the category "infrastructure fund" mentioned here is not included as a category per say under question 1. As this section focuses on typical "hedge fund" risks, all fund categories other than hedge funds (for instance the unleveraged funds

invested in listed securities as mentioned above) should be exempted from this section. Indeed, expected return cannot be assessed upfront for traditional funds taking long position on the markets as the return will largely derive from the beta.

- Page 429, section c) liquidity profile is not relevant for closed-end funds. They should be exempted from this reporting.
- Page 431, 18, i): if the fund is distributed through intermediaries (for instance, retail funds, funds sold through feeders, funds of funds, structures…), this information will not necessarily be accessible and the AIFM might not be in a position to report.
- Page 434: the category "other funds of funds" will mix up alternative and non-alternative strategies. Will this information be useful?

Q69: Do you agree with the proposed frequency of disclosure? If not, please provide alternative suggestions.
As discussed above regarding Box 109, DUFAS strongly recommends that rather than quarterly reporting, reporting should be on an annual basis for all or at least most AIFs and then the reporting deadline should be in line with that required for the annual report.

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.
According to EFAMA's evaluation, reporting upon the template proposed in Annex V would incur very high initial and ongoing costs. The high level of ongoing expenses must be assumed due to the suggestion to require quarterly reports for each and every AIF and the necessity to perform manual computation of certain reporting items.

Costs will vary significantly depending on the nature of strategies, the number of funds, their domicile and the number of different systems from which the information will have to be aggregated. Whilst difficult to precisely quantify within such short timeframe, costs seems disproportionate for the closed-end structures and small unleveraged funds invested in listed securities where the risks are limited as theses do not present systemic risks. DUFAS urges ESMA to consider proportionality principle as regards to the information to be reported and to carefully balance the cost to produce the information versus how this information will be used in order to identify systemic risks as these costs could damage the competiveness of the European AIF versus the rest of the world.

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?
DUFAS strongly recommends that rather than quarterly reporting, reporting should be on an annual basis for all or at least most AIFs and then the reporting deadline should be in line with that required for the annual report.

Box 110, Use of leverage on a "Substantial Basis"

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?

Para 1
The calculation should be done only according to one method, at the choice of the AIFM (see comments on Box 93).

Para 2, 4 and 5
The criteria set out in order to assess whether leverage is employed on a substantial basis are highly judgmental and subjective and could be interpreted very differently by competent authorities and AIFMs. We therefore wonder whether the proposed definition will lead to a consistent approach to leverage. This is particularly the case as the list is noted as being "non exhaustive".

Moreover, we believe that to perform the assessment required under the points d) to f), the AIFM would have to consider consolidated information on the markets and information about investees/counterparties that are not under its control or accessible to it but rather only to the regulators. These points create an obligation that is difficult to discharge effectively.

DUFAS therefore suggests that further clarity and/or objective criteria are included here and also that our previous comments are borne in mind in determining those criteria.

DUFAS also notes that it is extremely unlikely that an AIFM would knowingly pursue a strategy which, per item (e), "could contribute to the aggravation or downward spiral in the prices of financial instruments or other assets in a manner which threatens the viability of these prices".

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