Comments by

Union Asset Management Holding AG

(Interest representative register ID 35378765850-63)

on the Consultation Paper

ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive (ESMA/2011/209)

Date: 13 September 2011

A. Background and general remarks

On July 13, 2011 ESMA launched a consultation paper with a draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive 2011/61/EU.

The implementing provisions to the AIFMD are essential for ensuring the feasibility and competitiveness of the new EU framework for alternative investment funds. Therefore we welcome the opportunity to comment on ESMA's recommendation for implementing measures to the AIFMD.

We highly appreciate the approach adopted by ESMA to ensure the greatest possible convergence with the current UCITS and MiFID standards in implementing the AIFMD rules. We also manage UCITS funds and provide MiFID services and will be authorized not only as AIFM but also as UCITS Management Companies and as MiFID firms. Therefore, a consequent alignment of the relevant EU regimes is crucial and very welcome.

Furthermore we welcome that ESMA intends adequate adjustments and differentiations with regard to the difference between the UCITS and AIF. In this context we would propose to introduce the following definition of "UCITS-style" investment strategy:

> "The main objective of the investment policy is to generate long-term capital growth in addition to earning income. Therefore the AIF / AIFM invests in assets which may be either eligible or equivalent according to Directive 2009/65/EC and the Commission's implementing Directive 2007/16/EC and considers the risk spreading rules as well as the investment limits including the limits for leverage or such rules and limits which can be considered as equivalent to the aforementioned Directives. This definition includes individual modifications according to national law."

The draft definition starts with a general description of the objectives of the investment policy, reflecting the deliberation that the investment strategy of any fund should be laid down in the investment policy (or equivalent documents / fund rules) of this fund. It continues with a description of the eligible assets and roughly refers to the risk spreading rules and investment limits of Directive 2009/65/EC. The global exposure limit for derivatives (Art. 51 para. 3 Directive 2009/65/EC) is not addressed in detail, but we consider the reference to investment limits to be clear enough and open to potential amendments to Directive 2009/65/EC. This definition may be used as well for reasons of the transparency / reporting obligations (e.g. see our comment to Box 109 below) but as well in other cases, where the need for differentiation may occur.

While appreciating the efforts already done by ESMA in order to assess the costs and benefits of possible solutions for implementation of AIFMD, we encourage ESMA to take a more rigorous approach in this respect and especially to disclose the reasons for proposing implementing measures which incur more costs for AIFM or managed AIF than other possible approaches to Level 2 regulation.

B. Specific comments and answers

Part IV.I. Possible Implementing Measures on Additional Own Funds and Professional Indemnity Insurance

Box 6:

Para. 2 (a) requires an indemnity insurance that covers entitlements of third persons that result from deliberate negligence of duty (for example fraud). Risks in relation to fraud are not mentioned in Art. 9 AIFMD. Indemnity insurances normally only cover negligent behaviour. 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.

Para. 2 (b) requires that risks covered by additional own funds or professional indemnity insurance also cover misrepresentation and misleading statements made by relevant persons. Generally speaking an AIFM does not know the risks of delegates since delegates are not legally obliged to inform the AIF about these risks. However delegates should have their own indemnity insurance. Therefore we request that Box 6 should be amended. Risks of the delegate should be excluded if the delegate holds an own sufficient indemnity insurance.

Para. 2 (c) 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. However the current practice of the insurance industry is that losses resulting from mechanical failures are not covered unless the loss is a result of an intervention or manipulation of (staff of) the AIFM. Box 6 para. 2) (c) should be modified accordingly.

Box 8:

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

We do not see a correlation between performance fees earned and relevant risks taken by the AIFM. Therefore the definition of "relevant income for the purpose of calculating additional own funds" should not include performance fees.

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

We consider that the term "relevant income" should not include the sums of commission and fees payable in relation to collective portfolio management activities. The re-

quirements 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.

Q 14: 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?

We believe that the minimum historical observation period of 5 years is too long and should be reduced, approximately to 3 years.

Box 10:

We agree with this adaption of UCITS standards proposed by ESMA.

Box 12 – 17:

We agree with the approach proposed by ESMA in respect of the issues mentioned in Box 12, 13, 14, 15, 16 and 17 which is largely based on the prevailing standards of the UCITS directive. Moreover we welcome the approach suggested in Boxes 14 to 17 to exempt some AIF investments (e.g. investment in real estates) from the provisions on best execution and order handling.

Part IV.II. Possible Implementing Measures on General Principles

Box 18:

Application to intermediated sales of AIF

In principle we do not object to the inclusion of the MiFID / UCITS standards on inducements in the Level 2 measures to the AIFMD as it safeguards consistency in the EU financial market regulation. However we strongly reject the proposed extension of the inducement rules to all activities of collective portfolio management if this refers to indirect marketing, too.

First of all from the legal point of view we do not share ESMA's appraisal that distribution via intermediaries constitutes part of the fund management services as specified in Annex I to the AIFMD. External intermediaries who are not tied agents to the fund manager conduct their business in their own right and under their own responsibility. Their relations to the fund provider are based upon distribution agreements which set out the duties and obligations of both parties in order to ensure compliance with their respective legal framework (e.g. for UCITS managers compliance with the duty to provide intermediaries with KIID for their products).

Hence third-party distribution cannot be deemed part of the collective portfolio management activities and the term "marketing" in para 2 (b) of Annex I must be read as referring only to direct distribution by AIFM.

Also looking at the sense and point of the inducement provisions it appears unreasonable to assume that payments to third-party intermediaries would fall under paragraph 1 (b) of Box 18. Payments of distribution fees to remunerate the service of investment advice or distribution in general are not by nature "designed" to enhance the quality of the collective portfolio management. In fact the function of distribution fees is not clear-cut and allows a differentiated qualification. Nevertheless they may be considered as mostly extraneous to collective portfolio management and from the fund manager's perspective should be rather qualified as "proper fees which enable or are necessary for the provision of the relevant service" in the sense of para. 1 (c).

Most importantly, however, it is not necessary to consider third-party payments as inducements in the sense of para. 1 (b) in order to ensure sound protection of investors. Fees and commissions received by intermediaries as remuneration for the distribution service are already subject to the quality test and must be disclosed to investors at the point of sale. Consequently enough these standards apply to distributors under MiFID and thus are set in clear relation to the relevant distribution service which can be investment advice or non-advised sales. It appears entirely inconsistent to require a renewed justification of the same payments in terms of collective portfolio management. The fund managers' role concerning third-party distribution should be predominantly seen in managing the related conflicts of interest for which recommendations taking up UCITS and MiFID standards are also included in the consultation paper.

Finally it is erroneous to assume that the PRIPs initiative currently in the pipeline is aimed at covering marketing fees paid for third-party distribution by an inducement test from the asset management perspective. Until now the PRIPs agenda comprises extension of MiFID standards to intermediaries not yet subject to the EU framework as well as to direct distribution by fund managers. While the second case is irrelevant to the inducement problem the assessment of quality enhancement in the first case would take place from the intermediary's standpoint and thus is not comparable to the discussed suggestions for AIFMD implementation. Moreover the implementing provisions to UCITS IV cannot have accounted for the PRIPs initiative as at the time of their adoption PRIPs had not even entered the first phase of consultation. Even today it is difficult to claim that a clear-cut concept for regulating distribution of PRIPs at EU-level exists.

Hence we encourage ESMA to revise its position on the extent of application of the inducement rules to AIF distribution. We consider that in order to limit the inducement standards to direct distribution by AIFM no amendment of the text proposed in Box 18 would be necessarybut a clear stance as regards its interpretation is indispensible.

Means of inducement disclosure

In line with UCITS and MiFID requirements disclosure of inducements should take place ex-ante by adequate means of investor information and in accordance with Art. 23 para. 1 AIFMD. For this purpose AIFM should be able to avail themselves of any appropriate durable medium such as AIFM's website. We do not understand why the same information should be included in the annual report as suggested by ESMA in para. 32 of the explanatory text.

Should ESMA imply disclosure of ex-post monetary figures in terms of inducements, such figures cannot in many cases be attributed to specific funds as they are paid for services designed to enhance the quality of the collective portfolio management in general. In relation to third-party distribution aggregated information on inducements in the AIF's annual report is also not necessary as it is already the duty of distributors under MiFID to provide investors with details of fees and commissions incurred on their investments.

Part IV.III. Possible Implementing Measures on Conflicts of Interest

Box 23:

Paragraph 2 (a) - We suggest to delete the reference to Art. 14 para. 1 of AIFMD from the text in Box 23. It is not necessary to inform investors about all conflicts of interest identified. According to Art. 14 para. 2 of AIFMD the AIFM has to disclose only conflicts of interest which cannot be reasonably solved by organisational measures.

Part IV.IV. Possible Implementing Measures on Risk Management

General Comments on Boxes 25, 26, 27, 28 and 29:

We welcome ESMA´s general approach to refer to UCITS risk management provisions. In particular we support the proposed application of the principle-based approach regarding the classification which risks are relevant for given investment strategies, which risk measurement techniques should be employed and which specific construction of the portfolio stress tests should be applied.

We also welcome ESMA´s acknowledgment of proportionality in several parts of the explanatory text. Nevertheless proportionality should also be explicitly included in the relevant text boxes in this section.

Box 27:

Paragraph 2 – We suggest that this paragraph should be aligned with the wording of Art. 39 para. 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 therefore not in line with a principle-based approach.

Box 28:

Para. 1 (a) – In alignment with Art. 40 para. 1 (a) of the UCITS Implementing Directive 2010/43/EU the wording *"including those sources of risk the AIFM incurs on behalf of the AIF"* should be deleted.

Para. 3 (b) and 3 (c) – regarding stress tests and back tests we suggest further alignment with Art. 40 para. 2 (b) and (c) of the UCITS Implementing Directive 2010/43/EU as follows:

*"(b) conduct, **where appropriate**, periodic back-tests in order to review the validity of risk measurement arrangements which include model-based forecasts and estimates;"*

*"(c) conduct, **where appropriate**, periodic stress tests and scenario analyses, on the basis of reliable and up-to-date information (...)"*

The criteria for determining appropriateness should reflect differentiation of standards depending on the type of AIF, its investment strategy and portfolio assets.

Box 29:

Though we agree with ESMA´s intention to establish and implement quantitative and/or qualitative risk limits we encourage ESMA to take into consideration that with regard to certain risks (e.g. operational risks) only stipulation of qualitative risk limits is feasible. This should be reflected in the drafting.

Para. 2 – Contrary to Box 26 there is no reference in Box 29 to relevance or materiality. Therefore para. 2 should be amended as follows:

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

Box 30:

We would welcome more clarity to the question 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, measur-

ing, managing and monitoring of the relevant risks of AIF. On the other hand the separation requirement should not apply to units engaged in investment compliance, monitoring of risk limits, fund accounting, fund reporting and comparable tasks.

Para. 3 - Concerning provision of safeguards for independent performance of the risk management function in case of identified material conflicts of interest, we encourage ESMA to reconsider the proposal in para. 3 to document these safeguards in the risk management policy. Safeguards for independent performance of tasks should be implemented in 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.

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?

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 hierarchical independence in accordance with the proposed advice and in consideration of the safeguards listed?

No additional safeguards are required. Furthermore, we would like to point out that the obligation for implementing an independent risk management function should be proportionate to the nature, scale and complexity of the AIFM's business and the AIFs it manages. This should be clarified in the drafting.

Part IV.V. Possible Implementing Measures on Liquidity Management

Box 31:

In principle we agree with the proposed definition. However we would welcome a further clarification that legal measures for reducing or managing liquidity risks, where allowed under national law (e.g. special notice periods, partial redemptions), are not subject to "special arrangements".

Furthermore we consider that ESMA should also clarify that special arrangements must not be automatically implemented, but that their use is at the discretion of the AIFM.

Finally it is important to ensure a consistent use of the term "special arrangements", which is mentioned also in other passages of the Consultation paper (e.g. in para. 9 on page 58). Therefore ESMA should clarify on which legal basis such arrangements are imposed on the investors (e.g. side letter, fund rules).

Box 32:

Applying the principle of appropriateness and proportionality and a principle-based approach regarding the liquidity management procedures we consider that ESMA should include a reference to the explanatory text 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*") in the text of the box.

Para. 3 (b) - In some cases (e.g. for retail funds) the actual individual investor may be unknown to the AIFM. Therefore the monitoring of the liquidity profile should be based on the ***type of investors targeted*** by the AIF.

Para. 3(c) – If 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 Art. 16 and also the liquidity-related transparency requirements in Art. 23 safeguard that there is no need to monitor such managers' approaches to liquidity. Rather there could be a **requirement to review disclosures received** in accordance with Art. 23 and their impact upon the AIFM's obligations under Art. 16. There should be a distinction betwenn the requirements in para. 3 (c) for investments in AIFs authorized under the AIFMD and the requirements for investment in other CIUs.

Para. 3(d) – In our opinion "where applicable ***and available***" should be added at the end of line 6 as some of the data may not be available.

ESMA should also consider that the impact of exceptional liquidity conditions which have not been encountered before may be difficult or impossible to predict. In these cases assessment as to impact can only be on a best effort basis.

Para. 3(h) – In our opinion the requirement in para. 3 (h) to update the liquidity management and procedures for "*any changes or new arrangements*" is too burdensome for the industry without gathering import information for the investors' needs. The requirement should be modified to foresee an update for "*any **material** changes or new arrangements*".

Comments on explanatory text to Box 32:

Para. 15 – 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". Therefore we propose to delete the words "and other third parties".

Para. 25 – Regarding the requirement to disclose redemption policies including escalation measures, we believe that redemption policies should be disclosed in general terms Further details should be provided to the investor **upon request**. The principles

underpinning the policies and procedures may be disclosed, but not the practical details of the implementation of those principles.

Box 33:

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'* clarifies that the AIFM may determine that no action is required (see also paragraph 26 of the related explanatory text).

Paragraph 2 (c) – Concerning the proposed criteria for stress tests we propose the following supplement:

> ***c) where appropriate**, cover market risks any resulting impact, including on margin calls, on collateral requirements or credit lines;*

The criteria "where appropriate" should reflect differentiation of standards depending on the type of AIF, the given strategies and the eligible assets of the AIF.

Comments on explanatory text to Box 33:

Para. 28 – 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.

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?

The proposed connection between the use of "special arrangements" and the failure of the liquidity management process gives cause for concern. In our opinion "special arrangements" as defined in Box 30 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 and given that legal measures for reducing and managing liquidity risks are not subject to "special arrangements". The use of "special arrangements" itself does 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 arrangements to manage such liquidity risks. ESMA's advice in relation to the use of tools and arrangements in both normal and exceptional circumstances combines a principles based approach with disclosure. Will this approach cause difficulties in practice which could impact the fair treatment of investors?

We support the application of the principle-based approach regarding the liquidity management procedures. This reflects the specific characteristics of the different

types of AIF. We also agree with the proposal combining this principle-based approach with disclosure. Regarding the disclosure requirements in para. 3 (e) of Box 32 and explanatory text para. 18, in particular, ESMA's proposal is appropriate.

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

We agree with the proposed advice.

Part IV.VII. Possible Implementing Measures on Organisational Requirements

Box 44 – 52:

We support ESMA's suggestion to align the Level 2 measures to the AIFMD with the established EU rules for the asset management.

Box 53:

We understand that the record requirements 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 recording of orders must be permitted in case of indirect distribution.

Box 54:

Paragraph 1 - We suggest to add in Box 54 para. 1 "However competent authorities may, ***in exceptional circumstances***, require AIFMs to insure …". This addition would be in line with Art. 16 para. 1 of Directive 2010/43/EC.

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?

From our point of view separate requirements for complaints handling are not necessary, if an individual portfolio manager invests in an AIF on behalf of retail clients. The individual portfolio manager is already required to deal with customer complaints under MiFID.

Part IV.VIII. Possible Implementing Measures on Valuation

Box 55:

Para. 1 – In our opinion it is not appropriate to require written valuation policies and procedures being established for each and every single AIF. AIFM managing several AIFs should be allowed to introduce sound valuation processes for specific types of assets at the management company level. The fund rules or instruments of incorpora-

tion of individual AIFs could refer to this company-wide policy stipulating which particular valuation procedures and methodologies should apply to the assets held by the fund.

Therefore the wording in Box 55 para. 1 should be amended as follows:

> *"AIFM should ensure that, for each AIF it manages, written policies and procedures are established, maintained and reviewed which seek to ensure a sound, transparent and appropriately documented valuation process.* ***Such policies and procedures can be established at the level of AIFM provided that their respective applicability is clearly determined in the fund rules or instruments of incorporation of each managed AIF.*** *Without prejudice (...)."*

Comments on explanatory text to Box 55:

Para. 10 and 11 – We agree with ESMA´s understanding that an AIFM may have different external valuers and that a price provider is not considered to be an external valuer. As these clarifications are essential for the understanding of the valuation function and the proper differention from other functions of the AIFM they should be included in the text of the box.

Box 56, 57 and 58:

We agree with ESMA´s suggestions in the above mentioned boxes.

Comments on explanatory text to Box 60:

Para. 24 – Though we welcome ESMA´s view that a third party which calculates the NAV on the basis of values obtained from other sources shall not be considered an external valuer we are concerned about the requirement that this should not be the case if the external valuer also ***provides*** valuations for individual assets. It should be noted that the difference between an external valuer and an administrative agent calculating the NAV is that the external valuer ***determines*** the values in a legally binding manner.

This important difference should be stated in the text which should be amended 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 (...)."

Part IV.IX. Possible Implementing Measures on Valuation

Box 66:

Para. 4 - As regards the evaluation of a delegate's good repute in accordance with the proposed para. 4, AIFMs 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.

Moreover it should be clarified that in case the portfolio management is delegated the person who effectively conducts the business of the delegate is not the fund manager managing a fund but the management board of the delegate. While a member of the management board has to present a certificate of good conduct when he starts the business with an investment management company it would be excessive to require a certificate of good conduct from the fund manager.

Box 67 – 70:

We agree with the above mentioned Boxes without further comment.

Box 71:

Para. 2 (a) - With respect to para. 2 (a) it appears not reasonable to require the portfolio management function to abstain from any controlling tasks. It should be allowable and desirable for the portfolio manager to engage in some controlling activities e.g. by monitoring compliance with the legal and contractual investment limits. In line with the approach adopted by ESMA in Box 30 the independence from the risk management function is the crucial matter for the purpose of functional and hierarchical separation. The wording in para. 2 (a) should therefore be amended as follows:

*"Those engaged in portfolio management tasks are not engaged in the performance of potentially conflicting tasks such as **risk management** tasks;"*

Box 72, 73:

We have no objections to these recommendations.

Part V: Depositaries

Our comments on the depositary section focus on issues which are relevant for the depositary's relationship with a fund manager or for ensuring adequate protection of investors' interest.

Part V.I. Appointment of a depositary

Box 74:

We support ESMA's suggestions for elements to be included in the depositary contract in line with the current UCITS standards and share ESMA's view not to provide a model agreement which could be hardly expedient to the wide range of situations covered by the AIFMD.

Part V.III. Depositary functions

Box 75:

As regards the third bullet point the requirement to provide the depositary with "all information related to the cash accounts opened at a third party" appears too extensive. The regulatory purpose is not to deliver all information on the accounts, but to enable timely access to the accounts by the depositary according to para. 4 of the explanatory text. Therefore the wording should be amended by referring to "**the necessary information**" rather than "all information".

Box 78:

The definition of financial instruments to be held in custody is of key relevance for the question which instruments are subject to the extensive due diligence and separation duties to be performed in relation to sub-custody of assets and in particular, can benefit from the high liability standards introduced by the AIFMD.

Q32: Do you prefer option 1 or option 2 in Box 78? Please provide reasons for your view.

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

In our opinion both options presented by ESMA in Box 78 show significant shortcomings.

Option 2 is not acceptable from the asset managers' perspective. The custody status of an instrument cannot be linked to the possibility of its transfer via a settlement system subject to certain criteria. Fund managers often have no knowledge as to whether the invested assets are registered or held in a way eligible for settlement systems to be utilised. More importantly, however, adequate settlement systems do not exist in many non-EU markets due to the absence of a central depository. Hence, option 2 would lead to a situation where the most problematic situations relating to the sub-custody of assets in emerging economies would fall outside the custody duty of the depositary and not be affected by the strict restitution liability provided in Art. 21 para. 12, second subparagraph of AIFMD.

We also have major concerns with regard to option 1. We do not agree to differentiate the custody status of an asset upon the question whether it is registered or held in the sole name of the depositary, in the name of depositary and on behalf of AIF, or in the name of AIF/AIFM. In detail:

- Registration of assets in the sole name of the depositary does basically not occur – at least in the German market. However, this is the only situation in which the custody relationship shall be acknowledged according to ESMA's proposal.

- Assets are usually registered or held in an account in the name of the depositary and on behalf of AIF. Disclosure of acting in the name of AIF is generally deemed necessary for evidence reasons. Indeed ESMA itself suggests in Box 89 that when appointing a sub-custodian, the depositary must be satisfied that the available records and accounts allow at any time for distinguishing of assets safe-kept for the depositary on behalf of its clients from assets belonging to the depositary. Hence, according to ESMA's own recommendations, the depositary must identify assets as economic ownership of the fund in order to be able to delegate the custody task. It lacks any sense to conclude that such delegation of the depositary's custody task performed in compliance with the legal requirements deprives the assets entrusted to the sub-custodian of their custody status in relation to the depositary.

- Some jurisdictions stipulate that the AIFM has to register the fund assets directly with the fund or its manager, or to keep them in an account opened in the fund's name. The assumption of a custody relationship with the depositary should not be generally excluded in these cases, too.

In our opinion the evaluation of whether financial instruments held by a fund falls under the depositary's custody duty should not depend upon the formal criterion of registration, but must take into account the substantive power of disposal vested with the depositary in respect of the registered or account-held assets. It would appear incongruous to deny the existence of a custody relationship in situations in which the depositary remains exclusively entitled to conduct a transfer of ownership or interest regardless of having identified itself as acting on behalf of a fund in a register or account.

Therefore instead of option 1 and 2, we would like to suggest the following new wording for para. 3 in Box 78:

> ***"they are financial instruments with respect to which the depositary has the exclusive right of disposal/can effectuate the transfer of title or interest"*** *[the second option shall account for EU jurisdictions without separation of property and contractual law; a proper wording to be found]*

Should this approach be for whatever reason not acceptable for ESMA we would rather prefer option 1, provided that the custody of assets is not put into question by the sole disclosure of the commercial ownership by the fund (cf. supra). To this effect the

second sentence in the second last paragraph of Box 78 should be deleted without replacement.

In these terms the depositary should also be unequivocally required to register or keep in an account the fund assets in its own name whenever possible. Currently the decision whether to register in its own name or in the name of AIF/AIFM is left to the depositary's disposition in Box 81 para. 3 (a) and (b). This would inevitably lead to situations where assets of the same type might be deemed held or not held in custody depending on the details of the registration. The latter concept would create intolerable legal uncertainty for the AIF and its investors, and opens the door for manipulative operations by the depositary who could escape the strict due diligence and liability standards by mere formal modifications of registration or account holding of assets.

Box 81:

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?

As already stated in the last paragraph of our comments on Box 78 above, we deem it inacceptable to leave the decision on whether assets shall be registered in the depositary's name or in the name of AIF/AIFM to the depositary's disposition. Having regard to the significant consequences of such registration in terms of the corresponding legal duties under option 1 presented by ESMA in Box 78, we strongly believe that the depositary must be under the general obligation to register the fund assets in its own name.

In cases in which the particularities of registration should lead to the treatment of some investments as "other assets", we think that the verification of ownership by the depositary should include an assessment of potential insolvency risk of the registrar and its effects on the enforcement of the ownership rights by the fund. Such assessment should be performed along the lines of the due diligence requirements suggested in Box 88.

Box 89:

As explained in our comments on Box 78 above ESMA's views in respect of segregation in para. 1 (a), albeit compatible with the current market practice, do not fit into the definition of asset to be held in custody. In our view this implies the indisputable necessity for a proper adjustment of the latter.

Q46: What alternative or additional measure 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 recognized in a specific market? What specific safeguards do depositaries currently put in place when holding assets in jurisdictions that do not recognize effects of segregation? In which countries would this be the case? Please specify the estimated percentage of assets in custody that could be concerned.

Currently we are not aware of any jurisdictions which do not recognise the effects of asset segregation. However, should ESMA obtain knowledge of such circumstances, it would be very helpful to make these findings public in order to facilitate adequate management of related insolvency risks by both the depositary and AIFM.

As regards para. 2, second sentence, the depositary should be bound to notify the AIFM if the depository becomes aware that segregation of assets is not sufficient to ensure protection from insolvency of a sub-custodian in a specific jurisdiction. Such information should enable the AIFM to take appropriate measures in order to account for the enhanced custody risk in the risk management process. 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.

Part V.IV. The depositary's liability regime

Box 92:

We decisively reject option 2 presented by ESMA as it is blatantly incongruous with the provisions of AIFMD. According to Art. 21 para. 13 (c) AIFMD, the written contract between the depositary and the AIF/AIFM shall establish the objective reason to agree upon a discharge of the depositary's liabilities. Consequently the existence of a contractual discharge in itself can never be deemed a sufficient objective reason for this purpose and the interpretation proposed by ESMA in option 2 would result in inacceptable legal uncertainty for AIFM agreeing in discharging the depositary from its liabilities.

Part VI. Possible Implementing Measures on Methods for Calculation the Leverage of an AIF and the Methods for Calculating the Exposure of an AIF

Box 93:

From our point of view the proposed methods for calculating the exposure of an AIF are only relevant for AIF which use leverage according to Art. 4 para. 1(v) of the AIFMD. Therefore it should be clarified that these requirements do not apply for AIF which do not use leverage.

Moreover we disagree with ESMA's approach in para. 3 of Box 93 that the AIFM shall calculate the exposure with the Gross Method set out in Box 95 ***and*** the Commitment

Method set out in Box 96. In our view it should be sufficient that the AIFM calculates the exposure with ***either*** of these methods in order to avoid excessively high implementation costs.

Accordingly only the leverage calculated under the method chosen should be disclosed to investors.

Box 99:

Given the following understanding regarding exposures involving third party legal structures we prefer option 3.

We understand that leverage which is contained within legal structures involving third parties (for example interests in a real estate company) should not be included in the calculation of leverage (see also our answer to Question 60 below). This should be the case as long as the AIF is holding ordinary shares as an investment and the capital of the AIF that is at risk is limited to the market value of those shares.

Therefore we consider that in the aforementioned case interests of real estates or interests in companies are normally excluded when calculating leverage. From our point of view option 3 is therefore sufficiently clear.

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?

No. Alternatively, we suggest for considering the described methods in CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (Ref. CESR/10-788).

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

We consider that leverage at the level of a third party financial or legal structure controlled by the AIF should only be included in the leverage of the AIF as a result of guarantees provided by the AIF with a legally enforceable obligation. In any other case the leverage should not be included in the calculation of the leverage of the AIF.

Part VIII.I. Possible Implementing Measures on Annual Reporting

Box 101:

We understand 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 AIFMD in another context, too. In particular it is used with regard to relevant changes in the scope of the AIFM authorisation according to Art. 10. In this respect "material changes" refer to the conditions for manager authorisation and especially to the information provided in the authorisation process according to Art. 7. It appears inappropriate to apply in this context ESMA's definition of "material changes" which is focused on the consideration of operating circumstances for a specific fund.

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

Box 103:

Para. 4 - We suggest that the phrase "together with any potential or anticipated impact on the AIF and/or investors of the AIF" in para. 4 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 aware of the particular circumstances of each investor.

We welcome the last sentence of para. 4 and suggest clarifying that the medium by which the information is made available could be a website as foreseen in Box 23, point 3.

Box 104:

Explanatory Text para. 26 - As regards the content of the income and expenditure account we deem it inappropriate to present "unrealised gains on investments" as part of the income and expenditure account as foreseen in para. 7(a)(iii) of Box 104. This conflicts with the established reporting practice in several European countries and would impede the calculation of distributable income which is currently determined as the ordinary net income of a fund.

Box 106:

We support the fact that it is in the own discretion of 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.

Box 107:

Para. 4 - According to ESMA an AIFM shall disclose material changes to the liquidity management policies and procedures. In this case an AIFM shall immediately notify investors when they activate special arrangements. The term "immediately notify" is to extensive and should be changed to "shall periodically notify".

Q 67: Which option for periodic disclosure of risk profile under Box 107 do you support? Please provide reasons for your view.

We prefer option 1 for the periodic disclosure of the risk profile. Option 2 requires a disproportional extensive documentation of the risk profile including methods of risk measurements. This is not adequate for investor information.

Box 108:

We support 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. The term "material changes" should be subject to further clarification preferably with reference to Box 101 which takes the perspective of a reasonable investor for assessing the materiality of events.

Q 68: Do you think ESMA should be more specific on 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 we do not suggest ESMA to be more specific on how the risk management system should be disclosed to investors. Otherwise it would be more difficult to achieve a "one size fits all" disclosure requirement. We suggest 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.

Part VIII.III. Possible Implementing Measures on Reporting to competent authorities

Box 109:

Para. 1 - We are concerned about ESMA's recommendations for reporting obligations towards supervisory authorities.

In our opinion 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. Furthermore we strongly encourage ESMA to include distinctions between hedge funds and other types of funds (especially such funds which are managed on a "UCITS-style" base), between large funds with potential systemic implications and smaller funds.

Thus said reporting should be on an annual basis for all or at least certain AIF-types (e.g. UCITS-style AIF, real estate AIF).

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.

Union Investment would then face the challenge to prepare quarterly reports for hundreds of AIF. This task will produce 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. These significant costs shall be considered a continuing factor that drags down the fund performance for the detriment of AIF investors.

Apart from that the competent authorities would be overloaded with a number of figures to be analyzed.

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 our 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 funds with a "UCITS-style" investment strategy and to "Private Equity Funds" displaying a static risk profile which certainly does not justify more frequent reporting. Real estate funds have a risk profile similar to private equity investments. Therefore real estate funds should also be included in the "Other Fund" section.

For reasons of differentiation the following draft definition of "UCITS-style" investment strategy should be supplemented in the text:

> "The main objective of the investment policy is to generate long-term capital growth in addition to earning income. Therefore the AIF / AIFM invests in assets which may be either eligible or equivalent according to Directive 2009/65/EC and considers the risk spreading rules as well as the investment limits as provided in Directive 2009/65/EC including the limits for leverage or such rules and limits which can be considered as equivalent to Directive 2009/65/EC. This definition includes individual modifications according to national law."

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

It should be deemed appropriate to report the leverage on a substantial basis annually. The required information can only be disclosed with high (manual) effort.

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

We expect high intial costs to complete the reporting template. There will also be high costs on an ongoing basis.

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?

In our view 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 - We suggest that further clarity and/or objective criteria are included to assess whether leverage is employed on a substantial basis.

We also note 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".