

Response to

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

For the most part, the AIFM directive is well suited to serve its purpose. In some respect, however, the broad contentual scope of the directive might lead to an overregulation of Europe's alternative investment industry. For this reason, current level II process seems to be a crucial in elaborating a fair regulatory framework for Europe's alternative investment industry

In this respect, the Austrian Alternative Investment Associations (VAI) has been seeking to offer recommendations, of how the directive could be implemented in a responsible yet balanced way.

Our institution represents national and international alternative investment houses totaling more than € 75 bn in assets under management and with a current exposure of more than 7,5 € bn to the Austrian alternative investment market. In addition, the Austrian Alternative Investment Associations represents Austria's thriving closed-end funds industry, which currently has € 1,2 bn of assets under management. Members of the association are already either monitored by Austria's national financial market authority (FMA) or respective authority in their country of origin.

We are delighted of having the opportunity to present our recommendations with regards to ESMA's technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive on the following pages. Recommendations are limited to those questions that seem to be most relevant for our member institutions from today's perspective. Some questions were not answered due to a lack of technical know-how in the specific context required.

III.I. Identification of the portfolio of AIF under management by a particular AIFM and calculation of the value of assets under management

Question 1

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?

Answer 1

We think that calculating the net asset value within a twelve month period seems reasonable. This also counts for to startups.

Question 2

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

Answer 2

In our view, it does not seem functionally adequate to set a specific date.

Question 3

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.

Answer 3

We do not think that using an annual net asset value calculation is appropriate for all types of AIF. Instead we recommend to either use the difference between acquisition costs and AFA or alternatively the discounted cash flow.

Question 5

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

Answer 5

Yes, we agree that these particular AIF should be included in the calculation.

III.II. Influences of leverage on the assets under management

Question 6

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?

Answer 6

No, we do not agree. In our view, ESMA's advice should remain consistent and hence only provide for a valuation standard.

Question 7

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?

Answer 7

We think that hedging positions should not be considered in the calculation of the total value of assets under management.

Question 8

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?

Answer 8

Proposed requirements are not clear at all.

Due to the large variety of distinctive AIF, we do not believe that the exclusive use of the NAV is sufficient.

III.III. Content of the obligation to register with national competent authorities and suitable mechanisms for gathering information

Box 3

Note

There seems to be a discrepancy in the ESMA advice on the updates of the information provided to the competent authorities according to article 3(3)(d) AIFMD. In para 4. of Box 3, it is stated that such updated information should be provided on a quarterly basis, whereas item 37 of the Explanatory Text states that such notifications shall at least be provided on an annual basis.

We propose to have a risk-driven approach: Updates shall be required in case material changes to the risk profile of the managed AIF occur; otherwise a reporting on an annual basis should be sufficient for an accurate regulatory supervision of the respective AIFM.

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

Box 6

Note

According to article 9(7) AIFMD, liabilities arising from professional negligence have to be covered by additional own funds or professional indemnity insurance. According to Box 6, para 2.(a), ESMA considers to include risks in relation to fraud to the potential liability risks from professional negligence.

With the AIFMD, the European legislator attempts to constrain fraud in the financial sector. Principally, this goal has been reached in particular fields of the AIFMD through appropriate regulations and control mechanisms. However, a complete elimination of fraudulent behavior is not possible – with or without the directive. For this reason, no additional insurance policy should be called for. Such insurance would, due to expectably high insurance premiums, only result in higher prices for investors.

In this respect, the focus should also be put on insurance policies with complex calculation schemes and potentially high insurance payments. In order to provide AIFM access to such insurance policies, an obligation to contract for insurance companies would most likely have to be implemented.

Furthermore, in our opinion, to include fraudulent behavior into the category of risks from professional negligence seems to be in contradiction to the wording of the AIFMD. The AIFMD explicitly refers to the term “negligence” and it is obviously not intended to include criminal acts requiring at least intentional or willful actions. Therefore, fraudulent behavior does not comply with the term professional negligence, and should therefore not be considered a liability risk arising from professional negligence as stipulated under article 9(7) AIFMD.

Question 9

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?

Answer 9

According to article 19(10) AIFMD, an appointed external valuer is liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer’s negligence or intentional failure to accurately perform its tasks. Therefore, we do not consider the inclusion of the valuation performed by an appointed external valuer under para 2(b)(iv) of Box 6 as practicable. In particular, risks resulting from third party failures should not impact on the capital requirements of AIFMs. Furthermore, the external valuer’s insurance has to cover all activities performed for the AIFM.

Question 10

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

Answer 10

The remuneration policy of AIFM is regulated in other fields and also regularly subject to examination. For this reason, an AIFM's income should, in this context, not be under consideration (option 2). It is not comprehensible, why an AIFM's income (possible performance fees included) should result in higher equity capital requirements.

Question 11

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')?

Answer 11

In this regard, we recommend the application of a „net income approach“.

Question 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?

Answer 14

We think that a period of five years is sufficient.

IV.II. Possible Implementing Measures on General Principles

Question 17

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

Answer 17

We agree with option 2 of Box 19, because a strict definition of the term “fair treatment” may not cover all aspects of fairness and some issues – in which compliance with such term would have to be assessed – may remain uncovered. Regulators will need sufficient flexibility in this respect so that any challenge in this respect can be appropriately addressed.

IV.V. Possible Implementing Measures on Liquidity Management

Question 20

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?

Answer 20

Special arrangements such as gates or side-pockets should, in conjunction with corresponding UCITS IV- regulations and national investment funds laws, be applicable for AIFs. What is more, redemption suspensions should constitute a legitimate instrument in particular situations.

IV.VII. Possible Implementing Measures on Organisational Requirements

Question 23

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?

Answer 23

We do not consider a requirement for the handling of such complaints as necessary, as the individual portfolio manager is licensed under the MiFID Directive, and therefore directly responsible to his retail client. AIFMs should be treated equal to MiFID investment firms; so that a statutory determined complaints handling procedure shall only be required for complaints of retail clients. Since marketing to retail clients is not within the scope of the AIFMD, to impose a complaint handling procedure cannot be justified.

IV.IX. Possible Implementing Measures on Delegation

Question 24

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

Answer 24

Among VAI-members, this question has been disputed in a quite controversial manner. In conclusion, however, we opt for option 2.

We give preference to option 2 (see box 65), under the precondition that this bulleted list has only demonstrative character and that the four given points don't have to apply cumulatively. From our point of view, option 2 ensures a higher degree of flexibility for the manager.

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

Box 95

Note

With reference to Box 95: From our point of view, this explication contradicts the actual EU regulation of derivatives. In accordance with this regulation, the VAR has to be used for every derivative financial product that is not a simple derivative.

Question 55

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?

Answer 55

Essentially, a commitment approach seems to be the most suited method, because the AIFMD covers such a wide variety of different funds. The workload associated with this method seems adequate/tolerable for most AIFs.

However, since the commitment approach can only be applied in the case of non-complex derivatives, it has to be possible -- especially in the case of complex derivatives -- to use the VAR.

For this reason, it is of utmost importance that each AIFM is able to select the appropriate method for respective AIF-strategy. Moreover, each AIFM should inform the responsible national regulating authority about his method of choice and clarify the reasons for it.

Question 56

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?

Answer 56

See answer to question 55

Question 57

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

Answer 57

No further clarification required.

Question 58

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?

Answer 58

Yes, in this respect we agree with ESMA. Furthermore, we believe that when calculating the exposure, cash-and-cash-equivalent positions should not only be excluded in the base currency but also in all other currencies that a fund holds (e.g. dollar-positions of euro-quoted AIF; these positions have to be converted into the base currency in a total view of the AIF for the purpose of the exposure calculation.)

Question 59

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

Answer 59

We opt for option 3, because with this procedure it can be ruled out that contrary positions are converted twice.

Question 60

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?

Answer 60

See answer to question 59

VII. Possible Implementing Measures on Limits to Leverage or Other Restrictions on the Management of AIF

Question 61

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 circumstance s and criteria should be considered and what should be the timing of such measures? Pleas e provide reasons for your view.

Answer 61

Generally, regulatory authorities should only intervene, if without constraints to AIFM the market would be exposed to systemic risks. Systemic market risks especially emerge under the following conditions:

- a) An overall view of AIF indicates that market volatility has risen sharply.
- b) Market liquidity is generally constrained.
- c) Signs of market concentration are observable

It should be underscored that proposed leverage restrictions could have a negative impact on financial markets. Most relevant AIF pursue strategies that intend to supply the market with liquidity in times of crisis. Leverage restrictions imposed by respective regulatory authorities would prevent such strategies from being implemented. Put differently, such restrictions would ban an important source of liquidity from the market and thereby increase the overall market risk.