

VGF¹ comments on the discussion paper on ESMA's policy orientation on possible implementing measures under Article 3 of the Alternative Investment Funds Managers Directive (ESMA/2011/121)

¹ VGF Verband Geschlossene Fonds e.V. (Association of Non-Tradeable Closed-End Funds) represents the interests of providers of non-tradeable closed-end funds (NTCEFs) in Germany. Through its 59 members, the association represents some EUR 165 billion (portfolio of assets under management), managed in around 3.300 funds. Related to the total market in Germany with a fund volume of some EUR 198 billion, the association therefore represents about 80 % of the NTCEF market. Further information is available at: www.vgf-online.de.

Part 1: Thresholds – calculation and oscillation

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

Question 1: Do you agree with the proposed approach in relation to the procedure to identify the AIFs under management?

Managers of non-tradeable closed-end funds (NTCEF) will generally find it workable to identify the AIFs under their management in the proposed manner, the reason being that most NCEFs are managed by the same manager continuously throughout their maturity period. This is established right from the start and often forms part of the business model of the fund. The fact that funds are subject to only a minor degree of fluctuation makes it perfectly possible to assign a specific fund to a specific manager.

Question 2: Do you agree that where available, the gross asset value for AIFs using leverage or net asset value for AIFs not using leverage should be used to calculate the total value of assets under management? Should ESMA consider the extent to which AIFs which produce gross and net asset values apply different valuation methodologies to the underlying assets?

We would point out that the studies of the other ESMA taskforces comprehensively addressing the calculation methods for leverage, assets and fund shares must, without fail, be given due consideration. The different methodologies ought ideally to harmonise with each other.

Question 3: Do you consider that where gross and net asset values are not calculated regularly the AIFM can include portfolio valuations, taking into account the type of underlying asset?

Thus far, NTCEFs in Germany do not regularly determine the value of the asset concerned. The valuation period, intended to be at least once annually, for NTCEFs falling within the scope of the AIFM Directive will not become relevant until implementation of that Directive. The treatment of funds with managers not subject to the Directive has not yet been clearly defined. Whether or not portfolio valuation is appropriate for these funds is debatable. Strictly speaking, the classic form of NTCEF does not have a portfolio because none of the different

investments form a majority. Instead, a NTCEF generally invests in a specific, pre-determined investment object (e.g. a ship, an airplane, a real estate). If several investment objects are to be managed in one fund, there will usually be some close relationship as to type among them (e.g. several buildings in one industrial estate, several ships in the same fleet, several airplanes of the same type and use). Even though this may technically be regarded as a 'portfolio', it is quite clear that the intended meaning is different from that understood by ESMA. The bottom line is that whatever form a NTCEF portfolio valuation may take, it will either not be applicable at all or will yield the same outcome as an asset valuation. This is because no analysis so far undertaken has revealed any distinction between asset value and portfolio value.

Question 4: Can you suggest alternative approaches which could be used for AIFs which do not produce regular gross and net asset value calculations e.g. real estate, private equity? Can you provide information on best practice in relation to the calculation of the total value of the assets under management of AIFs in the sector in which you operate?

As already noted in Answer 3, the findings of the other taskforces concerned should be taken into consideration. Also, the advice given by ESMA to the Commission should allow sufficient leeway to accommodate current national valuation rules, some of which, with specific reference to asset valuation, have been accumulating over decades. As we have already indicated in our contribution to ESMA's Call For Evidence, numerous methodologies can be applied in order to arrive at a valuation of physical asset investments. Some of these are enshrined in law or have gained acceptance as an industry standard. The level 2 measures specified in the AIFM Directive should pay heed to these standards and be aligned with them.

Question 6: Do you agree that gross asset value, when available, is an appropriate measure of the leverage generated by the AIF?

This answer is also subject to the findings of the other taskforces.

Determination of the value of the assets under management by an AIF for a given calendar year

Question 9: Do you support the proposal for AIFs to calculate the total value of assets under management at least annually?

Annual calculation of the asset value seems feasible because of the statutory duty to render annual financial accounts.

Question 10: Please provide your views on the impact of requiring the calculation of the total value of assets under management or monitoring it on a quarterly basis.

The requirement to make quarterly calculations of the value of assets under management de facto renders quarterly valuation mandatory. Any shortening of the period between value calculations to less than one year would have a severely negative impact on funds not falling within the scope of the Directive. This is because, in all probability, NTCEFs covered by the Directive will only need to determine the value of the asset and fund shares annually. Under the policy orientation set out here, the value of funds not covered by the Directive would have to be calculated quarterly.

We take this opportunity again of making absolutely clear that NTCEFs invest in physical assets. Their value cannot be determined by purely computational methods and certainly cannot be taken from an index, which makes them different from investments in financial instruments. This means that a desk-top valuation is generally not possible. Instead, the object must be appraised and valued *in situ*. This constitutes a clear difference from most other funds addressed by the Directive. The level 2 measures must reflect this difference from investments in financial instruments and accordingly must treat it differently. Also, a quarterly valuation requirement would disadvantage the very funds currently exempted from the Directive's scope for reasons of proportionality. The likely costs for these small fund managers would be enormous. We also question whether there would be any benefit for the investor, who will derive no gain from this. Finally, the data will only be gathered in order to prove that individual managers are (and will continue to be) covered by the Directive's exemptions. This outcome seems to be untenable.

We would also like to comment on the fear that different approaches could give rise to an 'unlevel playing field' with regard to other AIFs. Indeed the AIFM Directive creates a general

legal framework for all fund managers. But it must not be allowed to choke the variety of available products, which in itself leads to increased competition, through inappropriate equal treatment. However, this sort of impoverishment of variety is to be feared, because the cost increases ensuing from frequent appraisal and valuation would significantly lower the appeal of the investment model.

If differentiation between open and closed-end funds seems inappropriate, we suggest referring to the distinction made by the AIFM Directive itself. Art. 21 (7) (a) and (b) of the Directive distinguishes towards the depository rules between investments in financial instruments and investments in physical assets.

Question 11: Can you suggest any alternative procedure for the calculation of the total value of assets under management throughout the period that would provide an accurate picture of the total assets under management?

We advocate a procedure which places greater emphasis on the personal responsibility of the manager. Because of liability issues surrounding unauthorised business dealings, a fund manager operating just within the threshold values will already be keenly aware of whether or not he is exceeding a threshold value. On the other hand however, a manager who clearly operates – and will continue to do so for a foreseeable period - below the threshold value, should not be forced to make costly valuations. Start-ups and smaller companies will be particularly affected by this.

There is here a contradiction as regards the significance of this issue which we would like to illustrate with an example. A start-up entrepreneur managing an individual property fund with a low fund volume would have to value the property four times in its very first year of business.

In our view, the manager benefiting from the Directive's exemptions should be explicitly made aware of the legal consequences brought into effect if his business grows to a size necessitating authorisation under the Directive. It does not seem appropriate to require separate evidence of valuation at fixed intervals. Instead of an approach based on a fixed rate of frequency, it would be much more appropriate to create a circumstance-driven duty to furnish evidence.

Our example runs as follows. If the start-up entrepreneur's managed fund volume grows significantly to the point where it must assume the threshold values will be reached, it should, for this very reason, inform the competent authority of the new volume of the managed fund post-increase.

It is obvious that ESMA already adopts a similar circumstance-driven policy with regard to mandatory notification of national competent authorities in cases where the pre-conditions for the exemptions can no longer be met (compare page 15 of the discussion paper, bullet points 1 and 2). Reference should be made to this. At all events, the frequency of duty to provide evidence of valuation should be not more than annual.

Part 2: Registration procedures

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

Question 16: Do you agree with the proposal to require information on the value of assets under management of AIFs? Please provide information on any potential cost impact.

Since providers of and the market for NTCEFs are extremely diverse, it is not possible to attempt an accurate cost forecast. Taken as a whole, the approach chosen by ESMA seems to be workable even for smaller companies.

At this point, we wish to point out that NTCEFs cannot provide updated documentation showing investment opportunities for the public. Because of the very nature of NTCEFs, once they are closed they are no longer available to other investors and consequently there is no ongoing updating of the offering document or any other related documentation.

Question 17: Do you agree with the minimum information which must be provided in relation to the AIF's investment strategy? Do you consider that the information requirement would be sufficient or can you suggest additions or amendments to the proposal?

We regard the named categories as sufficient for meeting the purpose of the Directive.

Question 18: Do you agree that the information referred to in Article 3(3) (d) should be provided at least annually?

This is another instance where we feel it is necessary to place greater emphasis on the principle of personal responsibility of the fund manager. The fact is that, during their maturity period, NTCEFs are only rarely subject to changes in the investment categories, the markets and outside financing, so we regard it as pointless to keep supplying the competent authority with the same data each year. Even if this seems feasible for a particular fund seen in isolation, it is obvious that a majority of managed funds will incur extra costs and yet this will not bring the authority any recognisable advantage in terms of more information. Hence our recommendation, here too, of a circumstance-driven approach designed to generate a duty to notify the supervisory authority only where changes have impacted on the named categories.

Notification to national competent authorities for AIFMs that no longer comply with the exemptions granted in Article 3(2)

Question 21: Do you have any alternative suggestions?

We think that, in principle, the approach is tenable because – as we have already stated – it focuses on the personal responsibility of the manager. Once again, however, there remains the problem of management and how often the value of the managed assets is to be calculated. As we pointed out at the outset, a mandatory duty to calculate the assets under management each quarter would have the effect of creating a quarterly valuation requirement for fund managers outside the scope of the Directive (see Answer 10). As a consequence, this criticism is also, for the same reasons, levelled at the approach to Art. 3(2) suggested here.

Opt-in procedure

Question 22: Do you agree that all AIFMs which are obliged to be authorised, or which choose to be authorised under the opt-in procedure, should be subject to the same authorisation procedure under Article 7?

In our view, there is no reason for the competent authority to treat an opt-in authorisation any differently from a standard application for authorisation.

Question 23: Do you agree that AIFMs previously registered under Article 3(2) of the AIFMD should submit all documents required under Article 7?

No, see Answers 24 and 25.

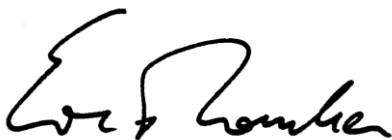
Question 24: Alternatively, should AIFMs only be required to submit information not previously provided for registration purposes and to update information previously provided?

We prefer this alternative for the reasons given below (Answer 25).

Question 25: Please provide justification for your preferred choice between the two alternatives set out under questions 23 and 24.

In our view it should be enough to supply the competent authority with the missing documents for a 'full' AIFM authorisation as an update, provided the information in the original documents is still valid. As already stated, much of the information pertaining to NTCEFs in particular (e.g. information on both investment object and investment strategies) remains unchanged during the maturity period. Repeated disclosure of the same information would seem to cause additional expense without additional benefit, neither for the applicant nor for the competent authority.

Brussels, 16th May 2011



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VGF Verband Geschlossene Fonds e.V.:

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