

European Securities and Markets Authority
103, rue de Grenelle
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France

20 March 2012

Dear Sirs

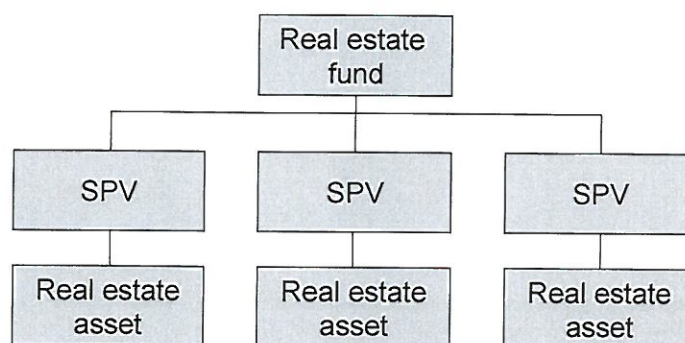
Response: Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM

Chatham Financial¹ is the largest advisor to end users of interest rate and currency OTC derivatives. Our European clients span multiple sectors, including real estate funds, public real estate companies (such as REITs), non-financial corporations and micro-finance funds. Our clients invest and operate in the real economy, and utilise OTC derivatives to reduce risk rather than to speculate or invest.

Chatham Financial is an active participant in the derivatives public policy debate in the US and Europe. As such, we welcome the opportunity to respond to ESMA's discussion paper on key concepts of the Alternative Investment Fund Managers Directive and types of AIFM (the **Discussion Paper**).

Proposed criteria to identify an AIF

Our response focuses on the proposals in the Discussion Paper for criteria to identify an AIF, which are of concern to our clients operating in the real estate field. Most real estate funds acquire and hold real estate assets via special purpose vehicles (**SPVs**), per the indicative structure set out below:



These SPVs are typically used to provide a non-recourse structure which ultimately protects fund investors' interests by ring-fencing liabilities attributable to specific real estate assets.

In our view, the clear legislative intention (and, accordingly, the correct interpretation) of the Alternative Investment Fund Managers Directive (the **AIFMD**) is that SPVs of real estate funds fall outside the definition of an AIF. It is therefore crucial to ensure that ESMA develops criteria for identifying an AIF which are consistent with this position, and do not inadvertently indicate that real estate SPVs are within scope.

¹ <http://www.chathamfinancial.com/>

Collective investment

We agree that, in the absence of any clear definition of “collective investment undertaking” in EU law, ESMA should take a purposive approach to interpreting this term. In our view, the “collective investment undertaking” concept is not intended to capture all undertakings involved in collective investment activity. Rather, it is inherently and specifically aimed at capturing investment funds. This is sewn into the terminology used throughout the AIFMD (including in its title): it is aimed at “funds” and “fund managers”. We therefore support ESMA’s position that *“a collective investment undertaking should have the purpose of generating a return for its investors through the sale of its investments”*.

ESMA goes on to contrast a collective investment undertaking with *“an entity acting for its own account and whose purpose is to manage... assets with a view to generating value during the life of the undertaking”*. We agree, in principle, with this distinction. However, we assume it is not intended to be exhaustive. For example, an entity should not be deemed to have the purpose of collective investment simply because it does not act for its own account.

A real estate SPV established with the sole or main purpose of acquiring, holding or administering (directly or indirectly) fund assets (e.g. for reasons of non-recourse) does not act for its own account. Nor, however, is its purpose one of collective investment. The AIF is the vehicle that investors expect to generate returns: the SPV simply exists to facilitate the transactions that give rise to those returns and should not therefore be considered to be a “collective investment undertaking” or AIF.

Number of investors

We have noted that real estate SPVs should not constitute AIFs because they are not collective investment undertakings, and this is so whether the SPV has one investor (as shown in the indicative structure above) or a number of investors. However, we further consider that single investor real estate SPVs do not meet the requirement for an AIF to raise capital from “a number of investors”.

We note in this context that ESMA has distinguished ‘true’ single investor funds from those where a single investor represents a number of underlying beneficial owners (e.g. nominee arrangements or master-feeder structures). Whilst we agree that this ‘look through’ to underlying beneficial owners may in certain structures be desirable for anti-avoidance reasons, it should not apply to single investor SPVs. It is not necessary because these SPVs do not offer an avoidance route: they are (vis-à-vis the AIF) investees, rather than investors.

Other relevant provisions of the AIFMD

We consider that the views set out above are supported by specific instances where the wording of the AIFMD distinguishes between AIFs and certain SPVs. For example, Article 26(2)(b) provides that the portfolio company disclosure requirements do not apply to investments made by AIFs in *“special purpose vehicles with the purpose of purchasing, holding or administering real estate”*. Recital (78) (amongst others) also refers to leverage at the level of *“financial and/or legal structures involving third parties controlled by the relevant AIF where those structures are specifically set up to directly or indirectly create leverage at the level of the AIF”*. We read these provisions as supporting the view that, not only do SPVs not constitute AIFs when treated on a stand-alone basis, but also that they do not form part of the wider AIF for the purposes of whose investments they are established.

Policy objectives of the AIFMD

We also consider our views to be consistent with the policy objectives of the AIFMD, which is expressly intended to govern the activities of AIFMs in their management of AIFs. Where a real estate SPV has been established to facilitate investment by an AIF, that AIF will have an AIFM to which AIFMD requirements may apply. Accordingly, no regulatory gap is introduced if we do not treat the SPV itself as an AIF (or part of an AIF).

Where opportunities for regulatory arbitrage using SPVs were identified during the development of the AIFMD, these have been expressly addressed in the text. For example, we have referred above to the inclusion in the concept of "leverage" of leverage at the level of *"financial and/or legal structures involving third parties controlled by the relevant AIF where those structures are specifically set up to directly or indirectly create leverage at the level of the AIF"*. We do not therefore consider that any avoidance route is offered if real estate SPVs are deemed to fall outside of the definition of AIF. Indeed, where AIFMD requirements apply in respect of each AIF managed by an AIFM (for example, the requirements to produce annual reports or ensure a depositary is appointed), it hard to see what additional benefit would be achieved by requiring compliance with these obligations in respect of each SPV used in a real estate AIF's holding structure. It cannot have been the draftsman's intention to require, for example, a depositary to be appointed for each SPV in the indicative structure shown above.

For the reasons set out above, we consider that real estate SPVs that are established with the sole or main purpose of acquiring, holding or administering (directly or indirectly) fund assets do not constitute AIF. We would therefore ask ESMA to be mindful of this in its further work on determining the criteria to identify an AIF and to ensure any technical standards in this area are consistent with the views set out above.

If you would like to discuss this response, please contact Luke Zubrod at lzubrod@chathamfinancial.com.

Yours faithfully,



Mark Battistoni
Managing Director, Chatham Financial Europe