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European Securities and Markets Authority
103 Rue de Grenelle
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23 March 2012

Re: ESMA's Discussion Paper on Key Concepts of the Alternative Investment Fund Managers Directive and Types of AIFM

Dear Sir/Madam,

UBS would like to thank ESMA for the opportunity to comment on the Discussion Paper on Key concepts of the Alternative Investment Fund Managers Directive and Types of AIFM. Please find attached our response to the Paper.

We would be happy to discuss with you, in further detail, any comments you may have. Please do not hesitate to contact Gabriele Holstein on +41 44 234 4486.

Yours sincerely,
UBS AG

A handwritten signature in black ink, appearing to read "T. Bischof".

Dr. Thomas Bischof
Head of Legislative &
Regulatory Initiatives

A handwritten signature in black ink, appearing to read "G. Holstein".

Dr. Gabriele C. Holstein
Head of Public Policy EMEA
Group Governmental Affairs

UBS Response to ESMA's Discussion Paper on Key Concepts of the Alternative Investment Fund Managers Directive and Types of AIFM

INTRODUCTION

UBS would like to thank ESMA for the opportunity to comment on the discussion paper on Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM (the "Paper"). Please find below our response to the overall content, as well as the specific questions set out in the Paper.

UBS AG provides comprehensive wealth management solutions to the wealthiest individuals, families and family offices globally. As such we have provided our views on the family office vehicle exemption provided by recital 7 of the Alternative Investment Fund Managers Directive ("AIFMD").

UBS Global Asset Management operates and provides a range of investment products investing in varied asset classes such as real estate, infrastructure, hedge funds and other alternative asset classes. These investment products are provided to institutional clients and are managed either through its existing investment management businesses or through management company subsidiaries. As such we have provided our views to the remaining questions.

Summary of UBS views on the family office exemption

Wealthy individuals and their families have a number of choices as where to reside and where to locate their family offices. In order to attract non-EU based and retain EU-based family offices, it is important that the EU establishes an attractive regulatory environment for wealthy families.

We therefore advocate for ESMA to clarify the family office exemption set forth in recital 7 of the AIFMD. There is a lack of legal definition at EU level of what constitutes a "family office" as well as "family office vehicle" and Member States may have different interpretations. We believe that a clear definition is

required in order to ensure a consistent application of the AIFMD across Member States.

We would welcome confirmation from ESMA that any type of family office vehicle and the respective manager will benefit from the family office exemption set forth in recital 7 of the AIFMD. It should be acknowledged that the interests of a family office, be it a single or multi family office, are aligned with the interest of each family as opposed to commercial investment advisory / management business and family-run investment advisory / management businesses. We would also stress the fact that a multi family office is distinctly different from a financial intermediary who acts in his own commercial interest. Extended family members such as in-laws and their structures should be considered to be included in the scope of family members / family entities.

Please find below our response to the specific questions set out in the Paper.

III DEFINITION OF AIFM

According to ESMA, an entity performing either portfolio management or a risk management function is considered to be managing an AIF according to Art 4 (1) AIFMD. Such an entity must seek authorisation as an AIFM. ESMA recognises that although these functions may be delegated, the AIFM's liability will not be affected by the fact that it has delegated the portfolio management and/or risk management functions to a third party. ESMA also highlights that these functions may not be delegated to such an extent that the AIFM becomes, in essence, a "letter-box" entity.

IV. DEFINITION OF AIF

ESMA is seeking to produce guidance on criteria which may be extracted from the definition of AIFs which may be relevant when determining whether or not an entity falls within the definition of AIF and, therefore, the entity managing it is within or outside the scope of the AIFMD.

1. Types of AIF

ESMA states that it is not possible to define the types of AIFM without considering the types of AIF for which they act and, in particular, the different asset classes which are managed within these AIFs.

2. Vehicles which are not AIFMs or AIFs or are exempted from the AIFMD

Art 2(3) of the Directive describes a series of entities that fall outside of its scope, whereas Art 3 provides for certain exemptions applying to entities which do not fall under Article 2(3) and that, therefore, would otherwise be within the scope of the Directive, if they were not exempted.

Holding companies are considered not to be AIFMs and are defined as companies with shareholdings in one or more other companies, the commercial purpose of which is to carry out a business strategy strategies through subsidiaries, associated companies or participations in order to contribute to their long-term value, and which is either a company: (i) operating on its own account and whose shares are admitted to trading on a regulated market in the EU; or (ii) not established for the main purpose of generating returns for its investors by means of divestment of its subsidiaries or associated companies, as evidenced in its annual report or other official documents. ESMA considers, however, that the explicit exclusion of holding companies should not be used as a means to circumvent the provisions of the Directive.

Pursuant to Art 2(3) the AIFMD does not apply to:

- (i) Holding Companies.
- (ii) Institutions for occupational retirement provision
- (iii) Employee participation or savings schemes;
- (iv) Supranational institutions and national central banks;
- (v) National, regional and local governments and bodies or institutions which manage funds supporting
- (vi) Social security and pension systems
- (vii) Securitisation special purpose entities.
- (viii) Family office vehicles
- (ix) Insurance contracts and

(x) Joint ventures.

Recital 7 of the AIFMD clarifies that *investment undertakings*, such as *family office vehicles* which invest the private wealth of investors without raising external capital, should not be considered to be AIFs. Furthermore Recital 8 of the AIFMD states that *insurance contracts* and *joint ventures*, should not be considered AIFs.

Q1: Do you see merit in clarifying further the notion of family office vehicles? If yes, please clarify what you believe the notion of 'investing the private wealth of investors without raising external capital' should cover.

Yes, we believe there is a merit in clarifying further the notion of family office vehicles. The term is multifaceted and there is a lack of legal definition at EU level of what constitutes a "family office" as well as "family office vehicle" and Member States may have different interpretation. We believe that a clear definition is required in order to ensure a consistent application of the AIFMD across Member States. We would draw ESMA's attention to the fact that the term family in the context of family office activities led to controversial discussions in the US prior to the release of the U.S. Securities and Exchange Commission' Final Rule 202(a)(11)(G)-1, SEC Release Number IA-3220, (June 22, 2011)).

In our view *family offices* are best described as entities established by very wealthy families in order to manage their private wealth plan for their families' financial future and provide other ancillary services to family members. As the activities of family offices are aligned with family members' interests, there are no investor protection issues. Family offices do not market their services.

It is important to note that family offices are either set up as single family offices providing services only to members of a single family or as multi family offices serving a very limited number of wealthy families. In most cases multi family offices start as a single family office and over time open their services to a very

limited number of other wealthy families. The scope of family members served by family offices may extend to in-laws and their structures. We would stress the fact that a multi family office as described above is distinctly different from a financial intermediary who acts in his own commercial interest.

A *family office vehicle* is best described as a vehicle where the family office is at the origin of the vehicle, gives the initial impetus, organizes the creation of the vehicle, determines and controls the policy of its activities and benefits from its creation. Entities rendering such activities are sometimes called “promoters” or “initiators”.

We would advocate and welcome confirmation from ESMA that all family office vehicles, regardless if from a single or multi family office, and the respective manager will benefit from the family office exemption set forth in recital 7 of the AIFMD. It should be acknowledged that the interests of a single / multi family office are aligned with the interest of each family as opposed to commercial investment advisory / management business. Extended family members such as in-laws and their structures should be considered to be included in the scope of family members / family entities. Current and former key employees of the family office and family entities used for estate planning and charitable purposes, on behalf of the family, should explicitly be considered to be part of the family office set-up.

We furthermore advocate that the wording in Recital 7 of the AIFMD ‘investing the private wealth of investors without raising external capital’ is clarified to allow the following two activities:

- (i) “Repackaging” where the family office, without increasing the family office AuM, wraps family assets which have already been managed by the family office into a fund structure and provides management services to such a fund.
- (ii) “Internal capital raising” where the family office sources additional family capital, i.e. capital which was not serviced/managed by the family office prior to

the capital sourcing activities, and bundles the capital into an existing or to be launched family office fund.

Q2: Do you see merit in clarifying the terms ‘insurance contracts’ and ‘joint ventures’? If yes, please provide suggestions.

Yes, we see merit in clarifying the terms “joint ventures”. Similar to the term family offices, there is a lack of legal definition at the EU level which might lead to inconsistencies in the national implementation of the Directive. In particular, we believe the distinction between a joint venture and an AIF is not clear cut. Clarification is also required where joint ventures are realized by using fund and/or holding company structures. We would advocate defining a set of criteria to determine what constitutes a joint ventures.

For defining the criteria we would emphasize the fact that a joint venture is controlled by the community of venturers. Each venturer has a certain level of influence on the definition, implementation and accomplishment of the purpose of the joint venture which goes beyond the mere obligation of a fund investor to contribute capital and to participate in the profits and losses of a fund. Depending on the purpose of the joint venture, range and contribution process of each venturer is typically defined jointly by the venturers as opposed to the capital raising process for a fund which includes sourcing of capital from investors outside the sphere of the fund promoter. Strictly speaking there is therefore no capital raising in a joint venture.

Q3: Do you see merit in elaborating further on the characteristics of holding companies, based on the definition provided by Article 4(1)(o) of the AIFMD? If yes, please provide suggestions.

Yes, we see merit in elaborating further on the characteristics of holding companies.

Holding companies are distinctively different to funds. The latter are typically investment vehicles with the main purpose to generate returns based on a diversified investment portfolio and as such have a defined investment policy. The investor has certainty under which circumstances and at what point of time his capital contribution will be reimbursed by the fund out of the funds assets (open-ended fund: at redemption, closed-ended fund: at fund liquidation). The fund vehicle is therefore designed in a way to be able to manage the investor's capital for a limited period of time and to pay back the investors contribution (plus income and capital gain / loss) out of the assets held by the fund.

Holding companies typically pursue other objectives such as efficient tax and business management of various companies under one roof and do not predominantly serve as investment instrument. Compared to open-ended funds holding companies do not provide for redemption mechanisms and compared to closed ended funds holding companies typically do not have a limited life time already agreed upon in the articles of incorporation of the holding company.

We would specifically welcome clarification on the 'commercial purpose' test set forth in Art. 4(1)(o) AIFMD which, in our view, is likely to cause uncertainties in various cases. For example in the case of (co-)investment structures entered into with a view to subsequent flotation or disposal. We also believe that the classification of multiple shareholder acquisition vehicles is unclear.

Q4: Do you see merit in clarifying further the notion of any of the other exclusions and exemptions mentioned above in this section? If yes, please explain which other exclusions and exemptions should be further clarified and provide suggestions.

We have no comments to provide.

4. Proposed criteria to identify an AIF

According to Art 4(1) (a) AIFMD AIF are *collective investment undertaking*, including investment compartments thereof, which *raise capital* from a *number of investors*, with a view to investing it in accordance with a *defined investment* policy for the benefit of those investors". ESMA elaborates on the individual criteria as set out below.

Raise capital: According to ESMA it should not be considered as AIFs where capital raising and the investment are primarily undertaken for non-commercial purposes and are not intended to deliver an investment return or profit. Capital raising for the purpose of the AIFMD definition is considered to involve some kind of communication by way of business between the entity seeking capital and the prospective investors, which results in the transfer of investors' cash or other assets to the AIF. This activity might take place only once (as in the case of the initial subscription to a closed-end fund) or on an ongoing basis (as with certain open-ended funds). The absence of capital raising is, however, not considered conclusive evidence that an entity is not an AIF.

Collective investment: According to ESMA a collective investment undertaking should have the purpose of generating a return for its investors through the sale of its investments as opposed to an entity acting for its own account and whose purpose is to manage the underlying assets with a view to generating value during the life of the undertaking.

Number of investors: Where the AIF's rules or instruments of incorporation do not restrict the sale of units / shares to a single investor, the AIF is considered to

be raising capital from a number of investors. However, where a single investor represents a number of underlying beneficial owners (e.g. in the case of nominee arrangements or feeder / fund of funds investments) the fund falls within the definition of AIF.

Defined investment policy: ESMA lists indicative criteria to be taken into account in determining whether or not an entity has a defined investment policy. Criteria include a contractual relationship between the entity and the investor binding the entity to follow the investment policy and that the investment policy is set out in a document which becomes part of or is incorporated in the constitutional documents of the entity, contains a series of investment guidelines, is clearly set out and disclosed to investors.

Ownership of underlying assets: ESMA states that investors in AIFs are generally not the registered holders of the underlying assets and do not individually directly own the underlying assets, but rather their ownership of the assets is represented by shares/units in the AIF. Some Member States draw a distinction between beneficial and legal ownership, such that the beneficial owner enjoys the benefits of ownership with legal title held by another person (for example, a trust or a nominee company). In cases of beneficial ownership, investors usually have beneficial entitlement to profits or income arising from their investment in the assets held by the AIF.

Control of Underlying Assets: ESMA states that the AIFM or internally-managed AIF must have responsibility for the management of the AIF's assets. Investors have day-to-day no discretion or control over these assets.

Q5: Do you agree with the orientations set out above on the content of the criteria extracted from the definition of AIF?

While we broadly agree with the orientations on the content of the criteria extracted from the definition of AIF, we have a number of comments to offer.

Collective investment: With reference to such term ESMA suggests that an AIF should have the *purpose of generating a return* for its investors *through the sale of its investments* as opposed to an entity acting for its own account and whose purpose is to manage the underlying assets with a view to generating value during the life of the undertaking.

We would bring to ESMA's attention that a number of investment strategies aim at generating returns by keeping their underlying investment instruments in the portfolio while generating income from renting, leasing, exploitation, e.g. real estate, shipping, timber. We would furthermore advocate that the purpose of investment is left to the fund statutes. In our view the intention of the AIFMD text is merely that the AIF has a defined investment policy. We would be concerned if ESMA would restrict the purpose of an AIF to generating a return as AIF may be used for other purposes.

Number of investors: We agree that single investor funds should not qualify as AIFs and that the decisive criterion for assessing the collective nature of an investment must be the content of the AIF's rules or instruments of incorporation, not the actual number of investors at a specific point of time. However, we believe that the fact that the fund's constitutional documents do not restrict the sale of fund units/shares to a single investor should not automatically be considered as raising capital from a number of investors.

Defined investment policy: In general we agree to the criteria set forth by ESMA. However in practice there may remain some uncertainty as to the distinction to other forms of investment vehicles such as holding companies, joint ventures.

In regards to raising capital we refer to our response to Q7.

Q6: Do you have any alternative/additional suggestions on the content of these criteria?

We refer to our comments in Q5.

Q7: Do you agree with the details provided above on the notion of raising capital? If not, please provide explanations and an alternative solution.

While we broadly agree with the details provided on the notion of raising capital, we do not believe that the raising of capital should be commingled with the investment purpose of a fund (fund's capital invested in order to generate returns/profit). We refer to our response to Q5 that the purpose of investment should be defined in the vehicle's constitutional documents such as the instruments of incorporation and prospectus but should not be prescribed by the regulator.

We would emphasize our view that capital raising should be understood as any type of capital sourcing from outside the circle of the vehicle's promoters/initiators/managers in order to increase the capital base of the investment vehicle.

Q8: Do you consider that any co-investment of the manager should be taken into account when determining whether or not an entity raises capital from a number of investors?

Referring to our response in Q7, it is our view that co-investments of the manager should be treated like a promoter/initiator contribution and as such not be classified as capital raised from a number of investors. Based on his particular knowledge of the fund, the manager does not require any type of investor protection when investing into the fund managed by himself.

Q9: Do you agree with the analysis on the ownership of the underlying assets in an AIF? Do other ownership structures exist in your jurisdiction?

Yes, we agree.

Q10: Do you agree with the analysis on the absence of any investor discretion or control of the underlying assets in an AIF? If not, please explain why?

We agree with the analysis that the AIFM or the internally managed AIF must have responsibility for the management of the assets and that there should be an absence of investor discretion or control of the underlying assets in the AIF.

5. Proposed criteria to determine the application of the AIFMD to certain types of AIF

ESMA outlines that depending the nature, scope and complexity of the AIFM and the AIF it manages, some articles of the AIFMD will be applied differently acknowledging the principle of proportionality.

Such articles of the AIFMD and their application depends on whether the AIF is:

- (i) open or closed-ended – Article 16 and Article 19(3);
- (ii) significant in size – Article 13;
- (iii) leveraged / employs substantial leverage– Article 16, 24(4);
- (iv) internally or externally-managed – Article 9; or
- (v) contracts with a prime broker – Article 14.

An open-ended fund is generally considered to be one which provides redemption facilities to investors, while a closed-ended fund does not provide such a right. ESMA specifies that open-ended funds are those funds the units/shares of which may be, at the holder's request, *repurchased or redeemed without any limitation*, directly or indirectly, out of the assets of these undertakings *at least annually*.

Q11. Do you agree with the proposed definition of open-ended funds in paragraph 41? In particular, do you agree that funds offering the ability to repurchase or redeem their units at less than an annual frequency should be considered as closed-ended?

We believe that the proposed definition is too strict.

Paragraph 41 states that units / shares must be repurchased or redeemed “without any limitation”. We would draw ESMA’s attention to the fact that many funds, including UCITS, may limit redemption rights in certain instances. Typically this is done to protect the interest of the remaining shareholders. We would query whether funds which limit redemption rights for a short period of time would no longer qualify as open-ended funds. We would be concerned if this is the case. The frequency of subscriptions / redemptions criterion should, in our opinion, be viewed in conjunction with other criteria such as the investment process to apply the definition in a more flexible manner.

Last but not least, we would welcome clarification of the term 'indirectly' in paragraph 41.

Q12: Do you see merit in clarifying further the other concepts mentioned in paragraph 37 above? If so, please provide suggestions.

In our view the concept of “Leveraged / employs substantial leverage” requires further clarification. This is important given that every AIF will need to assess whether or not it is substantially leveraged and thus falls under the additional reporting duties under Article 24 (4).

VI TREATMENT OF UCITS MANAGEMENT COMPANIES

The AIFMD provides that an AIFM may act as a management company for UCITS provided the AIFM is authorised in accordance with UCITS Directive for that activity. The UCITS Directive currently permits UCITS management companies to

manage non-UCITS collective investment schemes. After the entry into force of the AIFMD, a UCITS management company which manages AIFs and which is appointed as the AIFM for the purposes of the AIFMD will no longer be subject to the UCITS Directive for that activity and will instead be required to obtain an additional authorisation under the AIFMD.

It will also be possible for a UCITS management company to provide services, including investment management services, to AIFs but not to be the appointed AIFM. It will be possible for a single entity to hold both a UCITS and AIFMD authorisation.

Both the AIFMD and the UCITS Directive allow firms to be additionally authorised to provide discretionary portfolio management, including investment advice and safe-keeping and administration of units in collective investment undertakings.

The AIFMD additionally allows AIFMs to be authorised to provide receipt and transmission of orders. ESMA is of the view that AIFMs which are also UCITS management companies should be able to carry out this additional activity under their AIFMD authorisation, provided conflicts of interest are taken into account.

Q13: Do you agree with the above analysis? If not, please provide explanations.

Yes, we agree with the analysis. We welcome the fact that both the AIFMD and the UCITS Directive allow firms to be additionally authorised to provide discretionary portfolio management, including investment advice and safe-keeping and administration of units in collective investment undertakings.

VII TREATMENT OF MIFID FIRMS AND CREDIT INSTITUTIONS

Art 6(8) AIFMD states that investment firms authorised under MiFID and credit institutions authorised under the Banking Consolidation Directive are not required to obtain authorisation under the AIFMD to provide investment services such as individual portfolio management to AIFs. This allows MiFID firms and credit institutions to continue to provide services to AIFs under delegation arrangements, subject to the rules set out under Art 20 AIFMD and relevant Level 2 measures.

Article 6 (2) states that no external AIFM can engage in activities other than those referred to in Annex I of the AIFMD and the additional management of UCITS. By way of derogation, Article 6(4) permits an AIFM to provide portfolio management services to clients including AIFs where it is not the appointed AIFM. The AIFM may also provide non-core services to clients i.e. investment advice, safekeeping and administration and receipt and transmission of orders.

According to ESMA a firm which is authorised under 'MiFID' or the Banking Consolidation Directive cannot be the appointed AIFM for an AIF nor obtain authorisation under the AIFMD. *The AIFMD allows dual authorisation only in the case of AIFMs and UCITS management companies.* However, according to Article 6(8) AIFMD, MiFID firms and credit institutions may provide investment services such as individual portfolio management in respect of AIFs. In this respect, the thresholds in Article 3(2) are not relevant since in any case the entity concerned – be it a MiFID firm or a credit institution – would not be considered as an AIFM under the Directive.

Q14: Do you agree with the above analysis? If not, please provide explanations.

We do not agree with ESMA's interpretation of the directive that a firm which is authorised under MiFID cannot be appointed as an AIFM nor obtain authorisation under the AIFMD.

Recital 9 states that “investment firms authorised under Directive 2004/39/EC (i.e. MiFID firms) should not be required to obtain an authorisation under this Directive in order to provide investment services such as individual portfolio management in respect of AIFs”. Article 6(8) restates this. We believe that this suggests that firms authorised under MiFID are in effect exempt from obtaining authorisation (...“shall not be required”) for the purposes of carrying on investment services (...“in order to provide”).

There appears to be no prohibition under the AIFMD that firms authorised under MiFID or the Banking Consolidation Directive cannot be the appointed AIFM for an AIF nor obtain authorisation under the AIFMD. We presume that ESMA has arrived at this position from its interpretation of Recital 20, where an external AIFM has been appointed to manage an AIF, that AIFM should not be deemed to be providing the investment services of portfolio management under MiFID, but, rather, collective portfolio management under the AIFMD.

Such an interpretation is likely to have a significant impact on UK and EU asset management firms which are currently authorised under MiFID (and are passporting certain investment services and activities) and which act as a general partner and/or manager of a number of funds that are likely to qualify as AIFs. These firms will have to either (i) terminate their MiFID authorisation, which for many is simply not possible; or (ii) re-structure existing funds in order to retire the existing general partner/manager and appoint an AIFM.

In the case of (ii) above, there is a risk that funds, and more particularly investors, could suffer a tax liability if underlying fund assets held by the existing general partner / manager are transferred to the AIFM. Additionally, the retirement or appointment of a general partner/manager and the appointment of an AIFM will, in most cases, be subject to investor consent which, on the one hand, puts a considerable administrative burden on the fund and, on the other, may put the fund at an increased risk of receiving investor redemption requests.

We urge ESMA to re-consider its interpretation of Recital 9 and to apply a pragmatic approach to the treatment of MiFID firms.